Economics Internal Assessment 1

Candidate Name	Koh Hui Hui Elizabeth
Candidate Number	
Commentary Number	1
Title of Extract	Fare cuts by Uber, Grab will hurt sector: Taxi body
Source of Extract	Straits Times (Singapore)
Date the extract was published	24th April, 2016
Date the commentary was written	27th June, 2016
Word Count	746
Section of syllabus the commentary relates to	✓ Section 1: Microeconomics ○ Section 2: Macroeconomics ○ Section 3: International Economics ○ Section 4: Development Economics

<u>Article 1</u>

Fare cuts by Uber, Grab will hurt sector: Taxi body

The National Taxi Association (NTA) has criticised the recent price cuts by Grab and Uber, saying they not only hit their drivers' earnings but, if left unchecked, could also hurt the taxi industry and, ultimately, commuters.

"It's an unhealthy and unsustainable business strategy," said NTA executive adviser Ang Hin Kee.

On April 14, Uber cut fares for its UberX private chauffeur service by an average of 15 per cent. Four days later, Grab slashed its GrabCar prices by up to 14 per cent, with minimum fares falling from $8 to $4.

<u>Concerns over private-hire car firms driving up COE premiums</u>

Cab firms, which had fares comparable to those of UberX and GrabCar before, are now under pressure, Mr Ang told The Sunday Times. But a "price war" would mean both private-hire car drivers and cabbies having to do more trips and driving longer to earn the same amount.

"We don't want to go down this road," he said.

Mr Ang, who is also an MP for Ang Mo Kio GRC, pointed out how both app companies were still taking their 20 per cent cut from their drivers, despite having shaved fares.

The worry is that if private-hire car firms end up dominating the market, they can then start raising prices, and charge a premium.

"The new players will (first) offer a lot of goodies... But when they have the market share later on, they could exercise the right to earn profits," said Mr Ang. "What checks and balances do we have to ensure that both commuters and drivers are not taken advantage of?"

Earlier this month, the Government said that by the first half of next year, Uber and GrabCar drivers must be licensed and undergo background and medical checks, and also have to register their cars.

Mr Ang said that while the taxi industry welcomes competition, the playing field is not level, given that cab operators must factor in "compliance costs". These include the bulk of cabbies having to meet certain standards set by the Land Transport Authority, such as covering 250km each day and being on the road during peak hours. Fleets also have to be serviced regularly.

"Cab firms hire teams of people to manage this, and these costs are passed down to the taxi drivers through their rentals," said Mr Ang.

While these yardsticks benefit the public, he believes similar standards should be imposed on the private-hire car business. Alternatively, have these requirements lifted from taxi firms, he suggested.

Head of Grab Singapore Lim Kell Jay said the fare cuts have led to a "tremendous growth" in passenger demand. This means drivers are getting more bookings over the same length of time, and bringing home "comparative incomes". He added that its part-timers and full-timers make a gross average of $30 an hour.

Asked about its drivers' earnings after the fare cuts, Uber said it would share details later.

Some private-hire car drivers told The Sunday Times that their earnings have been hit by around 20 per cent since the price cuts.

Dr Walter Theseira, an economist at SIM University, said traditional cab operators have a key advantage - they are the only ones allowed to get flagdowns. Still, they face a tough battle. He said: "App companies are willing to lose some money now to gain market share, but the incumbents wouldn't want to do this after being profitable for so long."

1

[1] LIM, A. (2016). Fare cuts by Uber, Grab will hurt sector: Taxi body. [online] The Straits Times. Available at: http://www.straitstimes.com/singapore/fare-cuts-by-uber-grab-will-hurt-sector-taxi-body [Accessed 25 May 2016].

Commentary 1

The article illustrates the situation in the Singapore cab market due to the arrival of new competitors in the market such as Uber and Grab. (For the purposes of this article, “Cab” refers to the general taxi service while “Taxi” refers the conventional Taxi models)

Uber and Grab (U&G) are mobile platforms that allow private individuals who drive cars offer their cab services to the public for a price set by the company. Customers book their ride via a mobile app and are offered incentives for asking their friends to join, promotions offered are rather frequent. U&G are substitute goods for conventional taxis because they are offering consumers an almost identical service.

Cross (price) elasticity of demand is a concept that draws the connection between demands for different goods. When applied can help business in their production, pricing and marketing decisions. Calculated by the formula

$$XED = \frac{\%change\ in\ quantity\ demanded\ for\ product\ A}{\%change\ in\ price\ for\ product\ B}$$

Substitute goods have a positive XED value and substitutes that are strongly related have a value higher than 1. The XED value for the cab market can be said to be more than 1 because the price cuts have resulted in “tremendous growth in passenger demand” for Grab.

For a long time, the cab industry has been “monopolised” by the conventional taxi firms, allowing them to comfortably obtain their profit margin. The fare cuts by U&G have caused quantity demanded for their services to increase (law of demand), causing a decrease in demand for conventional taxis, leaving the cab firms unhappy with the situation being thrown at them.

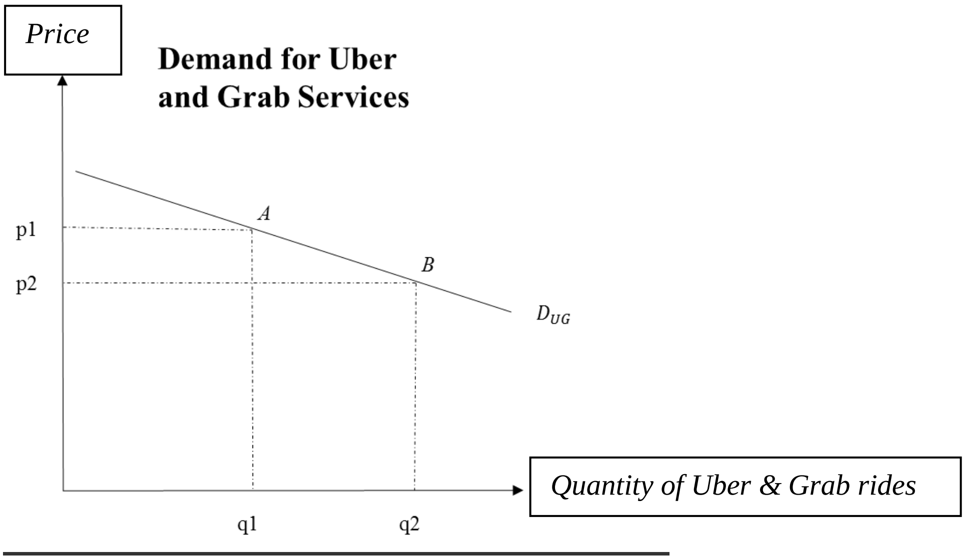

Figure 1: Price cuts by Uber and Grab

Cab service is used here as the example. The price cut by U&G is the vertical difference between P1 and P2. The effect of the price cut is shown as quantity demanded moves from Q1 to Q2, a large movement along demand since demand for cab services is very elastic.

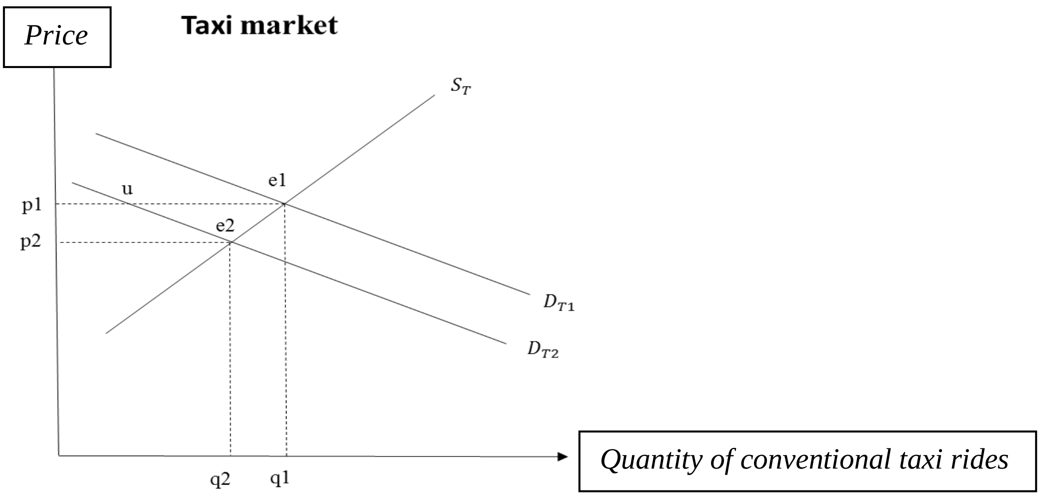

Figure 2: Decrease in demand for conventional Taxis

On the other hand, the demand curve for Taxi services will shift to the left. Causing the equilibrium price and quantity for the taxi market to decrease (E1 to E2).

However, despite the arrival of new competitors and a lower equilibrium price for the taxi market. The taxi firms choose to have their prices unchanged as they are fearful that this will end up in a price war. This is justified because a price cut by the Taxi industry will only put Taxi drivers at a further disadvantage from the prevailing rules and regulations that make “the playing field not level”

However, failing to reduce the price will also mean that consumers will continue to choose U&G over Taxis. There is going to be a surplus in supply (between *u* and e1), resulting in a downward pressure on price. Taxi industry’s revenue will continue decreasing once more people “convert” to using apps like U&G. Not reducing prices will hurt taxi firms further.

The fear by the National Taxi Association (NTA) is that one day U&G will start to dominate the market, and “hurt the taxi industry and, ultimately, consumers”. Though half of the statement holds true, the other half does not.

The more legitimate worry would be the income of taxi drivers and private car drivers, though in competition, both will suffer equally. The U&G drivers, though having a larger quantity demanded, have lower prices and therefore would have to make more trips in order to earn the same amount of money. Furthermore, U&G still take 20% from their drivers despite lowering prices, “having their earnings hit by about 20%” On the other hand, taxi drivers will earn less revenue as a result of the decreased demand for taxi services. As a result of the fare cuts, both cab drivers and U&G drivers will be inevitably hit by a decrease in earnings.

However, the fare cuts by U&G will benefit consumers in the short run and long run. In the short run, consumers get to benefit from the low prices offered by U&G as well as an oversupply of cab services, which implies that consumers will get cabs more easily. In the long run, since there is no more “monopoly” by the taxi firms, prices by both parties will be more competitive and therefore benefit the consumers. Competition also allows for improvements to be made to their services, and efficiency will increase. As a result, consumers will receive more value for money cab services.