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An Uber problem with Chinese characteristics: Beijing and the market for taxis

Summary

Strikes by taxi drivers against disruptive taxi apps such as Uber have become a common occurrence around the world in recent months, including last week across a number of major cities in China. However in China, striking taxi drivers were not protesting against but for a freer market. Their main target was not Uber – as in other countries - but the government, which has for years managed the taxi market by capping fares at below market price and restricting licenses. Uber and other taxi apps have allowed market forces to flourish and to set a price that is in line with demand. In most markets, this is a problem for the taxi industry which has a vested interest in high prices. In China, it is a problem for the government, who see maintaining low prices as one of their main claims to legitimacy. The rise of taxi technology provides a valuable insight into the wider question of Chinese reforms and the route to a "mixed" economy proclaimed last year in the Chinese Communist Party's 2013 Third Plenum vision for Chinese growth.

Last week, strikes by taxi drivers continued throughout half a dozen major Chinese cities, against low pay, long hours, and competition from private cars using taxi-hailing apps. Uber is the smallest player in China, which is dominated by home grown apps Kuaidi Dache (快的打车, or 'Quick Taxi'), backed by Alibaba, and Tencent's Didi Dache (嘀嘀打车, 'Honk Taxi'). All three apps allow mobile users to hail and pay for taxi rides from registered drivers, who may or may not have a taxi license. The Ministry of Transport in Beijing responded on 8 January by implementing a nationwide ban on private drivers without taxi licenses from using the apps.

Whilst media commentators have painted these strikes as being of a kind with the anti-Uber riots which have swept through other markets in the last 12 months, the Chinese case is distinct. Firstly, private drivers in China charge more than public ones, which means their role has been to 'overcut' rather than undercut public taxis. This only works well because the Chinese taxi market works so badly. Secondly, taxi drivers in China do not want more protection for their market, but less. Finally, the Chinese Government has reacted in this instance not by banning the apps but by forbidding their use by private drivers, suppressing not the technology but one of its effects on the market. Why draw the line there?

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What makes China different is that it is not the taxi industry that is rigging the market, but the Government. The Chinese version of the Uber problem is a case study in the limits of Beijing's power to exercise political control over a market being reshaped by booming demand and technological change. The reasons behind this highlights three problems for the CCP in taking forward promised market reforms. The first is the potentially painful political cost the CCP faces in giving markets a freer rein in the economy, as it pledged to do in the 2013 Third Plenum. The second is the political pressures that will be brought to bear on the system by the light that new information technology is shining on informal or 'black' markets that have operated in China for a long time. Finally, the comparatively modest response of regulators in this case (many others have banned Uber outright) suggests the rise of a new set of elite vested interests in China - the private Chinese tech MNCs - that are potentially transforming the State's relationship with the private sector.

Beijing doesn't do 'Surge Pricing'

Anyone who has taken a taxi in Beijing in the last few years will have noticed how increasingly difficult this task has become. The same applies in other major cities. Why is this? The answer, quite simply, is because the CCP has taken a quantity rationing approach to regulating the taxi market: maintaining low prices, but restricting the number of licenses.

Taxi fares in China are capped by the government. Despite the average per capita income in Beijing quadrupling over the last decade (from RMB 1300 in 2004 to RMB 5800 in 2014) the official taxi rate has only risen by 30%. The motivation for this price cap is political. Inflation in China has always been close to the Party's political nerve. The Tiananmen protests in 1989 were sparked partly by high cooking oil prices and the state has always shied away from unpopular price rises. When Unilever announced in 2011 that it wanted to raise the price of its detergents, the NDRC ordered it to reverse its plans and to pay a fine of RMB 2 million. Supply of licenses is restricted at a central and municipal level in an attempt to combat congestion and pollution.

By capping prices and restricting supply, the government has rationed taxi services. While taxi drivers can make a living, they face high and rising costs but are unable to pass those costs onto customers. Taxi drivers are self-employed, and rent

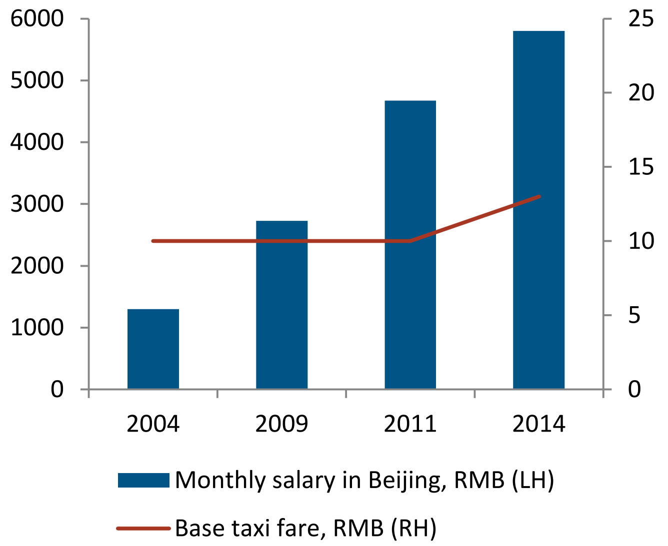

Fig 1: Household income and taxi fares in Beijing, 2004-2014
Source: Beijing Municipal Bureau

their cars and licenses from taxi companies. These companies often have a monopoly over the cities in which they operate, and are able to charge taxi drivers up to RMB 9000 per month (€1250) in rent. This high rent squeezes the drivers: in Beijing, a taxi driver will often turn down a potential customer because the fare will hardly cover the costs of fuel. The recent fall in the global price of oil has only brought limited relief. At the same time as cutting the domestic retail price for fuel, the government has raised oil consumption taxes as a buffer to the falling profitability of the state owned oil companies. They have also withdrawn fuel subsidies that were paid to taxi drivers when the oil price was high.

Another consequence of restricting the supply of public taxis in the face of growing demand has been the growth of an informal market, where 'black cars' (黑车) operate, charging customers much more than the standard public rate. The black taxi market has been able to benefit from the arrival of taxi hailing apps, which allow them to advertise their services more effectively. Public drivers are not permitted to raise their official fares, but benefited from the growing usage of the apps because of the cash incentives offered through the apps. At one point last year, as part of the turf war between Kuadi and Didi, public taxi drivers were receiving as much as RMB 100 as an additional 'reward' for every customer they picked up, five times the average fare. Eventually the Chinese authorities moved to cap the cash incentives apps were paying to drivers. However, the damage had already been done: public taxi drivers had had a glimpse of how much the market might be willing to pay for their services in the absence of government intervention.

An Uber crisis with Chinese characteristics

Resentment bubbled over in the New Year, when taxi drivers went on strike across half a dozen Chinese cities. The Government moved quickly to appease them with a ban on private hires from using the apps, and pledging to reform the taxi industry by curbing the influence of the taxi company monopolies. The speed with which the CCP responded is in itself revealing. Taxi drivers are a practical channel for popular discontent, repeating and amplifying grumbles on issues such as social inequality, healthcare and housing. For this reason, the government sees strikes by taxi drivers as more of a threat than those by factory workers. A similar strike by taxi drivers in 2011 met with rapid government acquiescence in the form of agreement to pay temporary fuel subsidies and a very modest increase to fares. This time, the State seems to feel that they only have limited room for manoeuvre.

Instead of tackling the real gripe of prices, the Government has chosen to ban private drivers and pledged to tackle taxi company monopolies. To justify the app ban for private hires the government cites concern that private drivers do not come with a guarantee of safety. Uber's argument in other markets has always been that they follow a vetting process, and that user ratings provide another form of safety guarantee. The concept that users can allocate authority and trust through a voting system rather than abiding by the judgment of a central authority is not one that has much traction in the Chinese political system. The popular TV show 'China Girl', the Chinese equivalent of Pop Idol, was banned in 2012 allegedly for the popularity of its vote by text campaign.

The ban on private drivers from using the apps has failed to appease public taxi drivers, who have continued to strike. What taxi drivers really want is for the government to stop intervening in the taxi market, and to allow prices to rise. The problem is that the government feels it cannot do this. Price occupies a totemic position within the Chinese political economy. As long as the CCP 'owns' taxi fares, allowing prices to rise is seen to be too politically costly.

Technological innovation has played an interesting role in exacerbating this particular problem for the CCP. The authorities have been deliberately stopped short of criticising innovation in implementing the ban. Public commentary in the People's Daily praises the positive, innovative benefits of taxi-hailing apps, which can "advance market reforms, smash the monopoly of vested interests, challenge conservativism and kick open the door of reform" ("推进市场化改革，冲破垄断利益，解开保守观念的自缚，踢好出行改革的临门一脚") whilst condemning their use by 'black' cars that threaten to "destabilise society" ("造成社会不稳定"). Rather than ban the use of apps outright – a move that has been used by city authorities from Delhi to Toronto – the Ministry of Transport explicitly condoned and even praised the use of the apps by licensed drivers.

This moderate response may have something to do with the significant stake that Alibaba and Tencent, two home-grown multinationals, have invested in the technology. The two have reportedly spent in excess of US$300 million in last year's turf war over customers. Alibaba's Kuaidi came out on top, ending the year with 55% market share and an estimated 200 million user accounts across 300 Chinese cities. The commercial logic was that promoting use of the taxi app would draw customers to other services offered by the internet giants, including lucrative mobile payment systems.

Whilst the state has a different relationship with this new breed of enterprise to the complete control it exerts over traditional SOEs, it still has an incentive to protect their interests. Alibaba, Baidu and Tencent have a combined value of more than US$500 billion. They have enjoyed rapid growth as a result of the constraints the Chinese Government has imposed on foreign internet companies, and have repaid this debt by submitting to government demands in areas such as censorship and monitoring of web content. It is perhaps no coincidence that following a raid on Uber's offices in Shanghai in November, official opposition to the company has died down somewhat after Baidu announced in December that it was taking an undisclosed stake in the San Francisco-based tech company.

The CCP is anticipating that these private companies will play an important role in driving the reform of the inefficient state sector and in projecting Chinese interests abroad. Premier Li Keqiang presided this month over the launch of Tencent's new online banking service, WeBank, which promises to challenge the incumbent state owned banks such as Bank of China. As long as these companies do what the CCP asks, they will continue to enjoy its patronage.

Markets, prices and politics

The landmark Third Plenum in November 2013 heralded a new chapter for China's pursuit of 'socialism with Chinese characteristics.' The official communique declared the CCP's pledge to let the hand of the market play a more ‘decisive’ role in the economy. Investors and observers have looked to this pledge to deliver far-reaching market driven reforms in everything from financial services to agriculture to the SOE sector.

The taxi case suggests why the CCP may find it difficult to meet some of these expectations. Technological innovation as embodied by Uber allows demand and price to interact. This is a problem for a government that has sought to maintain low prices whilst restricting supply. From taxis to healthcare and financial services, the Party finds itself caught in the same bind. The planned economy is struggling to meet the demands of a growing population, and the CCP is struggling to give way to the hand of the market, for fear it will undermine one of the Party’s fundamental claims to legitimacy: as the guarantor of cheap prices.

In the case of taxis, the most ‘free market’ of the CCP’s instincts has been to target the monopolistic control of taxi firms. In the announcement of the ban on private hires, the Ministry of Transport also declared its intention to tackle the abuse of power by taxi companies – in the words of the People’s Daily, to “smash the monopoly of vested interests” (“冲破垄断利益”). This approach neatly wraps the latest conflict into the broader NDRC-led antitrust campaign which has menaced foreign companies from Microsoft to Starbucks over the last 18 months.

However, the CCP is taking aim at monopoly for political reasons, as a scapegoat, rather than as part of a genuine attempt to find a market solution to the problem. When the debate moves to other areas such as energy, which will impact heavily on SOEs, and land reform, which will hit the balance sheet of beleaguered local governments, the political costs of giving in to the market will be even higher. To those hoping to hail a taxi in Beijing next year, you might want to consider taking the bus.

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