UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

BUREAU OF COMPETITION

February 22, 1988

Mr. Michael L. Subin, President
Montgomery County Council
100 Maryland Avenue
Rockville, Maryland 20850

Dear Mr. Subin:

The staff of the Federal Trade Commission[1] is pleased to respond to an invitation from the Montgomery County Council's legislative staff to comment on Bill 54-87, the proposed new taxicab law for Montgomery County, and the six proposed amendments to the bill. The invitation requested us to provide oral testimony at the public hearing on the legislation, and we will be glad to testify. This written statement summarizes the essence of our testimony. We hope it will be useful to you and the other members of the Council as you consider the proposed law.

Bill 54-87 would abolish existing taxicab fares and require the County Executive to set new fares by regulation. It would link the number of taxi licenses authorized to the County's population and distribute the licenses available under this scheme by lottery among the eligible applicants. While this program would greatly expand the supply of licenses and thereby benefit consumers, we suggest that the County adopt proposed Amendments Nos. 1 and 5, which would let market forces determine both the number of cabs and the fares charged. This approach is likely to help consumers more than would the adjustments to the existing regulations proposed in Bill 54-87. Freer entry into the taxicab market and unregulated fares is likely to benefit Montgomery County residents and visitors by increasing the number of taxicabs, thus reducing waiting times for taxis, creating employment opportunities, and lowering fares.

---

1 This letter represents the views of the Federal Trade Commission's Bureaus of Competition, Consumer Protection, and Economics, and not necessarily those of the Commission itself or any individual Commissioner. The Commission has, however, with Commissioner Bailey dissenting, voted to authorize submission of these comments.

We believe the costs of Montgomery County's current regulatory scheme are substantial. We estimate that the regulations cost taxicab consumers at least $1,152,000 annually in excessive fares. In addition to this cost, consumers may suffer long waiting times resulting from the shortage of cabs. Qualified drivers desiring entry into the market may also be harmed. A new driver would have to purchase a medallion from a current holder, if he could find one willing to sell, at a price informally estimated to be about $30,000. The costs of waiting time to passengers and of lost opportunity to potential drivers are not easily quantified, but we believe that they, too, are significant.

The Federal Trade Commission's Experience With Taxicab Deregulation

The staff of the Federal Trade Commission, with the approval of the Commission, upon request by federal, state, and local governmental bodies, analyzes regulatory proposals to identify provisions that may impede competition or increase costs without countervailing benefits to consumers. The staff has submitted comments on taxicab regulation to the city governments of New York, Seattle, San Francisco, Cambridge, Massachusetts, and the District of Columbia, as well as to the Alaska and Colorado state legislatures. In addition, the Commission issued administrative complaints in 1984 against Minneapolis and New Orleans, challenging entry restrictions and price restraints imposed by those cities.[2]

In 1984, two economists in the Commission's staff completed a study of taxicab regulation.[3] Based on an analysis of taxicab regulation in cities throughout the country, the authors concluded that restrictions on the number of taxicabs, prohibitions on fare competition, and restrictions on shared ride or jitney service harm consumers and impose a disproportionate burden on low income people, including the elderly and

---

2 The complaints stated that the Commission had reason to believe that each city, acting in concert with local cab companies, had violated the antitrust laws by restricting entry into taxicab markets and by adopting uniform fares. The complaints were withdrawn following Louisiana's enactment of a law expressly permitting its cities to regulate taxicabs in an anticompetitive manner exempt from the antitrust laws, and Minneapolis's amendment of its City Code to permit more competition among taxicabs.

3 Frankena and Pautler, An Economic Analysis of Taxicab Regulation, FTC Bureau of Economics, May, 1984 ("Taxicab Regulation").

handicapped, many of whom are more reliant on taxi service and expend a greater share of their income on taxi transportation than the general population. Another 1984 study, commissioned by the U.S. Department of Transportation, confirms the main conclusions of the FTC staff economists' report. The DOT study concluded that regulations restricting entry of new taxicabs and preventing discounting of fares cost consumers nearly $800 million annually in higher fares, and resulted in 38,000 fewer jobs nationwide in the taxi industry.[4]

The Benefits of Deregulation

The benefits of taxi deregulation are not theoretical -- they are real and immediate. For example, Seattle deregulated its taxis in 1979. One author estimates that between 1979 and 1983 over 200 new jobs for taxi drivers were created there[5] and that price regulation increased cab fares there by about 11-15 percent.[6] While data to measure the effects on waiting time are often not available, in San Diego the average waiting time in the radio-dispatched market declined 20 percent after deregulation, and the average waiting times at major cab stands became negligible. In Seattle, waiting times likewise decreased significantly, and no municipality where taxicab entry has been deregulated has reported an increase in waiting times.[7]

Virtually all cities that have changed to open entry have experienced an increase in the number of firms in the taxi industry and a decrease in the market shares of the largest firms. In some cities, entire new fleets have entered the radio-dispatched segment of the market. For example, in Oakland, two new fleets entered with 76 and 14 cabs, and in Sacramento, Portland, and Charlotte, new fleets entered with 27, 15, and 14 cabs, respectively. In Phoenix, new firms accounted for 20 percent of radio-dispatched trips. In most cities, the number of independent owner-operators also increased significantly.[8]

---

4 UMTA, U.S. Department of Transportation, Regulatory Impediments to Private Sector Urban Transit 85 (1984).

5 Zerbe, Seattle Taxis: Deregulation Hits a Pothole, Regulation 43, 44, Nov/Dec. 1983 (copy attached).

6 *Id.*

7 Taxicab Regulation, *supra* note 3, at 117.

8 *Id.*, at 115.

Will open entry diminish quality of service? The FTC staff economists concluded that quality did not deteriorate following the lifting of entry restrictions in other cities. Safety regulations, such as requirements for driver training and knowledge, vehicle safety, and liability insurance, may be justifiable as a means of protecting consumers against abuse. We note that the proposed Montgomery County law contains several such provisions.

A major benefit of deregulation is the ease with which a competitive market can make the continual adjustments needed to accommodate market changes over time. The problem with both Montgomery County's current approach and the reform proposed in Bill 54-87 is the extreme difficulty of determining administratively how many cabs are needed and what fares should be charged. Even if the number of taxicab licenses available under the proposed law's population-based formula and the level of fares set by the county were to simulate a competitive market initially, an administrative apparatus is unlikely to be able to respond to subsequent needs for change as quickly and easily as can free competition. Montgomery County's situation is complicated by the lack of comparable counties to serve as obvious models for regulation. As a report commissioned by the Montgomery County Department of Transportation points out, "It becomes apparent early in this study that there were few counties or other jurisdictions which were unquestionably similar demographically to Montgomery County."[9] Because of its singularity, the County cannot draw on others' experience to forecast taxi demand or to determine the level of fares appropriate to meet that demand without using sophisticated statistical techniques. Even with the use of such techniques, significant errors are likely to result. Under these circumstances, we believe that permitting market forces to determine the number of taxicabs and the fares charged is the best course of action.

Montgomery County's Particular Suitability for Deregulated Taxicab Service

Montgomery County is especially well suited to benefit from deregulation of fares and free entry into the taxicab industry because all Montgomery County taxicabs have radio-dispatch equipment and almost all taxicab service in the county is provided in response to telephoned requests. The radio-dispatched segment of the taxicab industry functions particularly

---

[9] Rys and Fischetti, A Comparison of Entry Regulation in the Taxicab Industry in Counties Demographically Similar to Montgomery County, Maryland, report prepared for the Department of Transportation, Montgomery County Government, at 1, 2.

well without regulation. Under free competition, customers who receive poor or expensive service can easily choose another dispatch service. Consumers can telephone and sample a number of dispatch services to find the fare and quality-of-service mix they prefer. Radio-dispatched cab companies can also benefit more than can other taxi firms from disseminating information about fares and services because their customers are apt to make purchase decisions based on the information provided. They may have an incentive, therefore, to advertise in the telephone yellow pages, local newspapers, and "shopper" papers, to post notices on community bulletin boards and to distribute fliers in apartment buildings. Further, because of the preponderance of radio-dispatched taxicabs in Montgomery County, the problems that have arisen in other cities at airports and train stations are unlikely to arise.[10] The Montgomery County Airpark relies exclusively on taxicabs requested by telephone, and the relatively few taxicab stands in Montgomery County are likely to be used by local residents and visitors familiar with the area and with alternative transportation. At present, however, consumers have little choice among taxicab services in Montgomery County, as the entry restrictions now in effect make the formation of new taxicab companies extremely difficult.

Proposed Amendment No. 1 would eliminate the cap on the number of taxicab licenses issued in Montgomery County. We therefore urge you to consider its benefits. Proposed Amendment No. 2 would phase out Bill 54-87's population-based cap on taxicab licenses after 1990; while this would be preferable to continuing to limit the number of licenses, it would merely postpone the benefits of competition, which Amendment No. 1 would make available immediately. Similarly, Amendment No. 3 would increase the number of new taxicab licenses to be made available in 1988 from 40 to 60. While 60 new licenses would be better for consumers than 40, this amendment would not permit the flexibility in response to demand that open entry would allow.

Given consumers' ability to prevent above-cost pricing by choosing among competing providers of taxicab services, the market will function best if taxicab operators are given complete freedom to vary fares in accordance with differences in the costs of providing service. For example, costs may vary with respect to particular areas or at particular times, and if operators are prevented from adjusting their prices in response, service

---

[10] When Seattle deregulated taxicab fares, no problems were reported in the market for radio-dispatched taxis; problems of overcharging arose only with where taxicabs were chosen from a cab line, at the airport and the train station, where price competition was difficult because customers are unlikely to refuse to take the first taxi waiting in line. Taxicab Regulation, at 129.

shortages are likely to develop. Moreover, a study of deregulation in Seattle indicates that variations in fares unrelated to the costs of providing service do not occur in deregulated, radio-dispatched taxicab markets. The only problems of this sort that did arise in Seattle occurred at the airport and Amtrak station cab stands; moreover, they occurred only before a fare ceiling was imposed. Fare variations unrelated to cost no longer appear to be a problem in Seattle.[11] In general, problems with fare deregulation have been confined to taxi service at major airports and intercity train stations. Although such experience suggests the desirability of fare ceilings in certain circumstances, Montgomery County, which has no major airports, seems unlikely to experience problems of this sort. When customers can choose among fares quoted over the telephone, fares that do not reflect the cost of service quickly become untenable. Permitting operators to change fares freely also would serve as an incentive to innovation and would allow adaptation to changing market conditions.

Proposed Amendment No. 5 would eliminate regulation of fares altogether. We therefore support its adoption. Amendment No. 6 would retain County regulation of fares but would permit development of a fare system designed to encourage ride-sharing. Although we believe this amendment would benefit the citizens of Montgomery County less than complete deregulation of fares, we consider it preferable to the existing fare provisions of the Montgomery County Code.[12] We expect, of course, that complete deregulation of fares, as proposed in Amendment No. 5, would result in discounted fares for ride-sharing that would reflect the lower per-person cost to the taxi operator. If the County Council decides against Amendment No. 5, however, we would recommend that Amendment No. 6 be strengthened so as to allow fare discounting on all taxicab services, not only on shared rides. While a strengthened Amendment No. 6 would offer no protection against shortages and refusals of service whenever regulated fares do not cover the costs of service demanded, and so is inferior to Amendment No. 5, we would expect its adoption to result in lower fares for consumers overall. Fare discounting, in addition to benefiting consumers, would prevent or reduce the possibility that too many cabs will be attracted into the market by artificially high regulated fares. Market-

---

11 The staff of the Seattle Regional Office of the Federal Trade Commission reached this conclusion after contacting the agencies that registered consumer complaints in 1980, 1982, 1986, and 1987 to determine the type and number of complaints received.

12 Bill 54-87 would repeal existing taxicab fares and require the County Executive to establish taxicab rates by regulation.

determined fares, of course, would address such problems automatically.

Regulation makes the cost of owning and driving a taxicab in Montgomery County higher than it would be if there were open entry. This is because the cost of taxicab licenses is passed on to passengers through higher fares. The high market value of taxicab licenses, informally estimated by observers in Montgomery County to be about $30,000,[13] indicates that entry has been restricted below the competitive level and that fares are higher than they would be if competition existed. One method of estimating the resulting injury to taxicab consumers is to calculate the annual stream of profits necessary to make the purchase of a $30,000 license worthwhile. At a 10 percent rate of interest, an annual stream of $3,000 would be necessary. This means that a license holder must charge consumers $3,000 a year more than competitive rates in order to amortize the cost of the license. When this figure is multiplied by the 384 licenses now issued, the estimated annual consumer injury totals more than $1,152,000. These regulation-induced profits are not necessary to cover any of the real costs of providing service, nor is there any evidence that monopoly profits actually foster regulatory compliance. This amount is, in effect, a transfer of money from consumers to license owners as a result of governmental restrictions on the number of taxicab licenses. The County could, in effect, transfer part of the future monopoly profits to itself by auctioning the new licenses rather than giving them away in a lottery. Deregulation of entry would eliminate this transfer.

The current Montgomery County taxicab law provides for waiver of the extra passenger surcharge for senior citizens. This provision is, in effect, a discount to senior citizens traveling together. While this provision stems from an admirable sentiment, we believe that deregulation of fares, combined with open entry for taxicabs, would serve senior citizens better than the current scheme or a similar one established by the County Executive under the proposed law. If drivers can identify discount customers in advance, some may refuse such calls, just as some may now refuse to take calls for short trips. Senior citizens, therefore, may experience diminished levels of service under the proposal, albeit at "discount" fares. Moreover, the discounts to senior citizens traveling together may not be lower than the fares that would result from unrestricted competition.

---

13 Preventing the market transfer of these licenses will not eliminate monopoly profits, though it will make the estimation of these profits more difficult. Market transfers of licenses help ensure that licenses should go to the lowest-cost providers. Prohibiting these transfers is likely to increase waste and may also serve to reduce service to consumers.

With open entry and unregulated fares, radio-dispatched taxicab services would have an incentive to offer various fare and quality combinations responsive to different groups of customers, including senior citizens. Taxicab companies might also begin to offer shared cabs or jitney cabs,[14] with lower fares than individual passenger cabs, to serve senior citizens' transportation needs. Where both fares and entry are administratively controlled, as in the proposed law, incentives to develop new transportation services are substantially reduced.[15]

Conclusion

We recommend that Montgomery County eliminate restrictions on fares and entry altogether by adopting Amendments Nos. 1 and 5. We believe that both lower fares and an increased availability of taxicabs will result from deregulation. Experience in other jurisdictions has shown that these benefits follow from increased competition in the taxicab market. Some regulations, carefully drawn to avoid restraining competition needlessly, may be appropriate to ensure vehicle safety, liability insurance, and driver training and knowledge. This policy would help ensure safe, economical taxicab service to the citizens of Montgomery County.

We hope these comments will help you in your deliberations and appreciate the opportunity to present our views.

Sincerely,

Barbara A. Clark, Acting

for Jeffrey I. Zuckerman
Director
Bureau of Competition

---

14 Jitney cabs are shared cabs that operate along a semi-fixed route. In some situations, jitneys may be more efficient than either conventional taxi or bus service.

15 If, after deregulation, Montgomery County wished to reduce the cost of taxicab transportation even further to its senior citizens, it might consider providing direct subsidies to them. The city of San Diego, for example, has successfully implemented such a program. In any case, all taxicab users in Montgomery County, not only the elderly, would benefit from the lower fares that deregulation would generate.