FEDERAL TRADE COMMISSION

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AUTHORIZED

July 31, 1987

Ms. Jane Noland
Seattle City Council
1100 Municipal Building
600 4th Avenue
Seattle, Washington 98104

Dear Councilmember Noland:

We are pleased to respond to your invitation for comments on a proposed taxicab ordinance for the City of Seattle.[1] The ordinance would fix cab fares, impose restrictions on the entry of new taxis into the market, tighten taxicab safety and appearance standards, and require drivers to complete a training program.[2] Our comments focus primarily on the price and entry control features of the proposed ordinance. We believe that these features would result in higher prices and a decreased supply of taxi services and would therefore harm consumers. For this reason, we recommend against their adoption.

The FTC's Seattle Regional Office has been interested in taxicab regulation since 1978, when we submitted comments in support of deregulating Seattle taxicabs. The Commission's staff has also submitted comments concerning taxi regulation to the city governments of Anchorage, Chicago, New York, San Francisco, and Washington, D.C., as well as to the Alaska and Colorado legislatures. Further, the Commission issued administrative

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

2 Currently, Seattle and King County, in which Seattle is located, have taxi ordinances that are different from each other. King County mandates a required taxi fare system, while Seattle imposes only maximum fare levels. The proposed Seattle ordinance is similar to one recently adopted by the King County Council.

complaints in 1984 against Minneapolis and New Orleans, challenging entry restrictions and price restraints imposed by those cities.[3]

In 1984, the Commission's Bureau of Economics released a report entitled An Economic Analysis of Taxicab Regulation.[4] Based on a careful study of regulatory systems in cities throughout the country, the authors found, among other things, that there is no persuasive economic rationale for restricting the total number of taxicabs. The study found that such restrictions waste resources, harm consumers, and impose a disproportionate burden on low-income people, including the elderly and handicapped. On the other hand, the report noted that other kinds of taxicab regulations, such as those relating to vehicle safety or liability insurance, may be justifiable in order to protect consumers.[5]

A. The Benefits of Deregulation

Seattle residents and visitors have been enjoying the benefits of taxi deregulation since 1979. We estimate that between 1979 and 1981, over 200 new jobs for taxi drivers were created.[6] Waiting times have dropped because of the greater number of taxis on the streets. Fares have risen more slowly

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[3] 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' amendment of its City Code to permit more competition among taxicabs.

[4] See Bureau of Economics, Federal Trade Commission, An Economic Analysis of Taxicab Regulation (1984).

[5] Another 1984 study, commissioned by the U.S. Department of Transportation, confirms the principal conclusions of our Bureau of Economics 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. UMTA, U.S. Dept. of Transportation, Regulatory Impediments to Private Sector Urban Transit 25 (1984).

[6] This is based on the number of new taxis that entered the market. See Zerbe, Seattle Taxis: Deregulation Hits a Pothole, Regulation, Nov.-Dec. 1983, at 43, 44. (copy attached)

than transit prices generally. Taxi fares for radio-dispatched cabs in Seattle in 1981 were about 15% lower than we estimate they would have been had regulation continued.[7]

Evidence from 1967-1979, a period when taxis were regulated in Seattle, suggests that price regulation increases cab fares by about 11%.[8] Higher fares harm all consumers, but disproportionately injure those who are most dependent on taxi transportation: the poor, the handicapped, and the elderly. Those consumers spend a larger portion of their incomes on transportation than other segments of the population.[9] To some extent, the special burden of these groups may be lessened by the ordinance provision, Section 1(c), under which schedules for discount fares for senior citizens, the handicapped and youth may be filed. This provision, however, will not help other low-income customers.

There are two taxi markets in Seattle. The first, representing about two-thirds of the total taxi market,[10] is for radio-dispatched cabs and is dominated by taxi fleets. In this market, customers can easily call different taxi companies and thus shop for cabs through price comparisons. Fares and entry are effectively controlled through competitive market forces. Deregulation reduced the fares for radio-dispatched cabs by about 15%, as compared with what fares would have been had they remained regulated.[11]

The second market is for taxis at cab stands and for cruising cabs, such as at the airport, the bus depot, or the ferry terminal. Here the "first-in-first-out" taxi line systems make shopping for price more difficult. As a result, this market is less competitive. A significant percentage of the independent taxicabs serving Seattle operate in this market and, if left unregulated, will tend to charge higher fares than those prevailing in the radio-dispatched market. If problems exist in

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7 Id. at 45.

8 Id.

9 A 1980 U.S. Department of Transportation study of the Seattle taxi market concluded that financially disadvantaged consumers make up 25% of total taxicab ridership in Seattle. UMTA, U.S. Dept. of Transportation, Taxi Regulatory Revision in Seattle 102 (1980).

10 Id.

11 Zerbe, A New Trip for Seattle Taxis, Public Policy Notes, Institute for Public Policy, University of Washington (1982).

the Seattle taxicab industry, they appear to lie in this second, smaller market. Nonetheless, the proposed ordinance is aimed at both markets and would harm all taxi consumers.

B. Problems the Proposed Ordinance Seeks to Address

The proposed ordinance now before the Seattle City Council is in some respects similar to the ordinance recently adopted in King County. That ordinance was developed from the recommendations of the King County Taxi Task Force. In 1986 hearings before the Task Force, four perceived problems associated with a deregulated market were mentioned: (1) an excessive number of taxicabs; (2) unduly large fare discrepancies among cabs; (3) insufficient income for drivers and owners; and (4) the poor appearance and safety conditions of taxis.[12] We will briefly examine each of these concerns and consider whether they would be effectively addressed by the proposed fare and entry restrictions.

1. Number of Taxicabs

A surplus of taxis may be created when existing fares rise high enough to attract many new taxis. The number of cabs can then be reduced in three ways: (1) by imposing entry restrictions, as in the proposed ordinance; (2) by raising license costs; or (3) by lowering taxi fares. The proposed Seattle ordinance imposes entry restrictions based on population. Under Section 4, the licenses issued may not normally exceed one for every 750 people in the city.

We believe that the better solution lies in allowing unregulated fares (up to a maximum fare) and open entry. This approach is likely to lead to a decline in taxi fares, which is likely to lead in turn to some taxis leaving the market.[13] This is the only remedy that would benefit consumers; it would lead to the lower fares mentioned above. It is also the most self-enforcing of the remedies. A freely competitive market will determine the appropriate number of taxis desired by consumers through continual adjustments of fares. When there are more taxis at the existing fare than consumers can effectively use,

12 There seemed to be general agreement that the existing number of taxis was larger than needed, although there appeared to be less of a consensus regarding the seriousness, or even the existence, of the other three problems.

13 The King County Task Force heard testimony to the effect that if fares are not increased, the number of cabs operating will decline. This is a natural occurrence and does not call for re-regulation.

competition will drive down fares and some taxi owners will find their capital is better invested elsewhere. Conversely, when the number of taxis is insufficient, fares will be bid to higher levels, thus attracting new cabs.

2. Fare Discrepancies

Total deregulation of taxicabs in Seattle and King County did lead to fare discrepancies, and to some very high fares, mainly at the airport and among independent taxis operating at cab stands. A first-in-first-out taxi line and lack of consumer information made this segment of the market less competitive. These high fares, but especially the fare discrepancies, led to many consumer complaints. Seattle solved this problem by establishing a ceiling on fares, set so as to eliminate the extreme fares, while still permitting lower fares brought about by competition. Fare discrepancies are, apparently, no longer a problem in Seattle.[14]

3. Welfare of Drivers and Owners

Nothing in the proposed ordinance will improve the welfare of taxi drivers who do not own their cabs. Their wages, whether in the form of an hourly wage or the more usual distribution of revenue remaining after payment of expenses, are governed by the supply and demand for taxi drivers. Entry restrictions on the number of cabs will, over time, reduce the demand for drivers, but will not increase their wages. Since the supply of drivers is quite large at the existing wage level (i.e., is elastic), a decrease in demand for drivers will probably leave their wages unchanged, although fewer drivers will be employed. Each regulated cab will be busier and earn more. However, owners may raise the rental fee of the cab so that the driver's compensation remains at the competitive level.

There is no doubt that existing owners will benefit from the proposed ordinance.[15] Current taxicab licenses have no marketable value because there is open entry into the Seattle market. With entry restrictions imposed, the taxicab owner's license will

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14 Staff of the Seattle Regional Office of the Federal Trade Commission contacted agencies that register consumer taxi complaints in 1980, 1982, 1986 and 1987 to determine the type and number of complaints received.

15 License owners might not benefit if the city initially sold the rights-to-serve to the highest bidder, or if the maximum fare were set so low that even with a reduced number of cabs, profits would not exist. Neither of these scenarios is envisioned by the proposed ordinance.

become a valuable asset.[16] Increasing the welfare of taxi owners in this manner, however, can only occur at the expense of consumers since the value of that license will lead to higher fares to consumers. Moreover, consumers will suffer increased waiting time as fewer cabs become available. Further, administration of the ordinance will itself be costly, and the welfare of taxi owners will therefore increase by an amount smaller than the harm done to consumers.[17] Finally, the ordinance will harm potential future entrants into the taxi market who are excluded by the entry restrictions. These potential entrants, being unknown, are without a voice in these proceedings, but the harm to them is nonetheless real.

4. Appearance and Safety of Taxicabs

We are aware of no evidence from the King County Taxi Task Force proceedings or otherwise showing that fare and entry restrictions will improve taxicab appearance or safety.[18] Safety can be controlled much more effectively and efficiently through direct regulation under other sections of the proposed ordinance. Similarly, to the extent that the city concludes that appearance of taxis is a concern, it should directly address that problem rather than enact price and entry controls.

C. Transfer of Licenses

Section 5 of the proposed ordinance prohibits the sale or transfer of taxi licenses. The section also states that there shall be no "medallion value" to a taxicab license. Nonetheless, medallions will acquire value if entry is constrained and fares are set above the competitive rate. When fares are above the competitive level and entry is restricted, the value represented by the excess profits becomes capitalized in the value of the

16 In New York City, for example, the selling price of a taxi medallion is in the range of $100,000. New York Times, June 4, 1986, at B2.

17 The gain to the owners will be less than the increase in revenues because they will bear some of the administrative costs. Consumer injury will arise from the higher prices charged plus the loss of taxi services to potential riders who are priced out of the market.

18 In the absence of price competition, owners might compete on the basis of appearance or safety. However, there is little reason to believe that any significant improvement would occur. See Frankena and Pautler, Taxicab Regulation: An Economic Analysis in 9 Research in Law and Economics 146, 147 (R. Zerbe ed. 1986).

medallion. License holders would then have a significant incentive to prevent the loss of a license. Since the value of the medallion can only be realized by operating the cab and not by selling the medallion, owners who would otherwise sell their licenses (perhaps to undertake other, better business ventures) will instead keep them to avoid losing the medallion value, and thereby prevent new, more efficient owners from acquiring licenses.

As harmful as a restricted entry policy is, such a policy is less objectionable when medallions are freely transferable than when such transfers are prohibited. Disallowing transfers will result in either inefficient ownership or in legal subterfuges seeking to transfer medallions.

D. Administrative Costs of the Ordinance

Section 7 of the proposed ordinance would allow the Director of Licenses and Consumer Affairs to require the installation of new taxi meters capable of storing information. The Director may also require licensees to file a considerable amount of largely unspecified financial information, and an annual report with a certificate of review by a certified public accountant. These requirements might be justified under certain conditions. However, in assessing their value, it should be realized that the requirements could impose both substantial costs on taxi owners (which they may pass on to consumers) and on the city as well. The proposed ordinance also leaves open a number of difficult specific questions that will arise if fares are set on the basis of costs. These questions include what rate is to be used in calculating the wage costs of owner-drivers and how this imputed wage rate is to be changed when necessary. Providing answers to these questions may be costly.

E. The Procedure for Fare Setting

The considerations for fare setting under Section 1 of the proposed ordinance are quite general. There are no guidelines ensuring that the level of fares will be competitive. There is instead a return to the same type of "public convenience and necessity" scheme of fare setting that existed before deregulation and that proved unsatisfactory then.

F. Conclusion

In summary, we believe the proposed Seattle ordinance addresses largely nonexistent problems, yet would impose substantial costs. Restricting the number of taxicabs or setting minimum fares can be expected to hurt rather than help consumers and competition. It will especially harm the disadvantaged groups that must rely most heavily on taxicab transportation, but for whom discount fares will not be available. We therefore urge the Council not to establish minimum taxi fares or to restrict entry in Seattle. We do not object, however, to narrowly-tailored regulations specifically designed to ensure quality and safety standards, such as mandatory driver training classes.

We have focused our comments on the portions of the proposed ordinance that appear to have an identifiable anticompetitive impact. We express no opinion on the remaining provisions of the ordinance. We hope that our comments will assist you in your deliberations, and we appreciate the opportunity to present our views.

Sincerely,

Richard O. Zerbe, Jr.

Richard O. Zerbe, Jr.
Economist

Attachment