Room 1184
10 Causeway Street
Boston, Massachusetts 02222-1073
(617) 565-7240

UNITED STATES OF AMERICA V870013

FEDERAL TRADE COMMISSION

BOSTON REGIONAL OFFICE

COMMISSION AUTHORIZED

July 30, 1987

Mr. James T. McDavitt, Chairman
Cambridge License Commission
City of Cambridge
City Hall
Cambridge, Massachusetts 02139

Dear Chairman McDavitt:

We are pleased to respond to your invitation for comments on the Report of the Cambridge Taxicab Advisory Committee (the "Committee").[1] The Report contains 19 separate recommendations to the City Council, 52 recommendations to the License Commission, and 7 recommendations to other city agencies. We believe that many of the recommendations in the Report reflect an attempt to deal with problems in the taxi industry by establishing an expanded regulatory program of fixed fares and restricted entry. We suggest that instead of implementing additional regulations that may be costly to administer and difficult to enforce, the city reconsider the basic premise of its regulatory approach. Specifically, we suggest that you consider letting market forces determine both the number of cabs and the fares they will charge. This approach will help consumers far more than would incremental adjustments to the existing regulations.

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

We believe that the costs of Cambridge's current regulatory approach are substantial. As discussed below, we estimate that the regulations cost Cambridge taxicab consumers at least $1,500,000 annually. In addition to this monetary cost, consumers must suffer the long waiting times and poor service resulting from a shortage of cabs and a lack of competitive incentives. Drivers or others who would like to operate their own cabs are also harmed. They must pay the $60,000 price of a medallion -- if they can find one for sale. The costs of lost opportunity to drivers and of waiting time for consumers are not easily quantified, but we believe that they too are significant.

Interest of the Federal Trade Commission

The Federal Trade Commission has long been interested in this subject. In 1984, the Commission's Bureau of Economics released a report entitled An Economic Analysis of Taxicab Regulation.[2] 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 by making taxis more difficult to find, and impose a disproportionate burden on low-income people, including the elderly and handicapped, who are most dependent on public transportation. On the other hand, the report noted that other kinds of taxicab regulations, such as those relating to driver training and knowledge vehicle safety or liability insurance, may be justifiable as a means of protecting consumers against abuse.[3]

The Commission's staff has submitted comments concerning taxicab regulation to the city governments of Anchorage, Chicago, New York, San Francisco, Seattle and Washington, D.C., as well as to the Alaska and Colorado legislatures. Further, the Commission issued administrative complaints in 1984 against Minneapolis and

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2 See Bureau of Economics, Federal Trade Commission, An Economic Analysis of Taxicab Regulation (May 1984).

3 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 these restrictions cost consumers nearly $800 million annually in higher fares, and resulted in 38,000 fewer jobs nationwide in the taxi industry. H.C. Wainwright & Co., II Economic Regulatory Impediments to Private Sector Urban Transit at 85 (1984).

New Orleans, challenging entry restrictions and price restraints imposed by those cities.[4]

<u>Adverse Consequences of Current Regulations</u>

At present, the City of Cambridge closely regulates the taxicab industry through the License Commission. The number of medallions has been fixed at 248 since 1943, thereby restricting entry into the market. The City has also imposed a fixed fare structure that eliminates price competition. Additional rules and regulations govern vehicle safety and appearance, and the conduct of owners and drivers. This extensive system of regulation appears to have resulted in higher fares for consumers, poor service, and the concentration of medallion ownership in the hands of a few firms.

The most important of these problems is inflated consumer prices. The $60,000 value of taxicab medallions 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 stream of future profits that would allow the medallion owner to recoup the $60,000 investment. At a 10% rate of interest, a stream of profits of $6,000 annually would be necessary. When this figure is multiplied by the 248 medallions, the estimated annual consumer injury totals about $1.5 million.

While the 10% interest rate used above represents the cost of capital in the economy generally, most medallion purchasers cannot find a loan at such a low rate. According to the License Commission, a typical loan for a medallion purchase would require borrowing $52,000 at 24% interest for eight years. To make payments on such a loan, a new medallion owner must earn an additional $270 each week.[5] If all of the 248 medallions were recently purchased under such loan terms, this would amount to

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4 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.

5 Loans for shorter periods, even with lower interest rates, could involve higher weekly costs.

additional charges of nearly $3.5 million annually during the pay-off period of the loans.

These extra charges do not cover any of the real costs of providing service, nor are they a tax to maintain the streets or pay for regulations. They are simply a transfer of money from consumers to medallion owners that has been ordered by the City of Cambridge through its restriction on the number of taxicab medallions.

In addition to causing artificially high fares, the limited number of medallions and fixed fare structure restrict competition, resulting in poor service quality. Specifically, the License Commission has received complaints about shortages of cabs, long waiting times, and unanswered calls.

The Committee also is concerned about the accumulation of actual ownership or a large degree of control of a substantial proportion of the 248 medallions in the hands of a few companies, some of which also run radio dispatch services and provide loans for medallion purchases. Such industry concentration arguably would decrease competition for quality service and reduces the medallion owners' incentives to have a taxicab operating to the fullest extent possible for each medallion.[6] In addition, the License Commission has received complaints charging that the dispatch service companies favor those who have loan payments due to those same companies.

The Current Proposals Will Not Solve the Problems

In an attempt to address the problems caused by the current regulatory framework, the Committee proposes to make only incremental adjustments to the current system. For example, to alleviate the burden of high fares on the elderly, handicapped and low-income consumers, the Committee proposes to introduce special discounts for those riders and a system of group fares for trips to Logan Airport from certain Cambridge neighborhoods and trips from supermarkets and hospitals to Cambridge

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6 Medallion owners could reduce the number of cabs in service during the busiest times in order to persuade the Cambridge government that a fare increase is needed to raise the incentive for operating cabs. The effectiveness of such a reduction in operations depends on the number of medallions that participate. Concentrating medallion ownership in the hands of a few holders will facilitate coordination, or may give one large owner sufficient share to accomplish a reduction even without the other medallion owners.

residences. However, if drivers can identify discount consumers in advance, some may refuse such calls just as some now refuse to take calls for short trips. The License Commission knows from experience the difficulty of enforcing rules requiring that each call be answered. Moreover, to compensate for such discount fares, the Committee is proposing to increase the regular rates by 25%. Thus, the situation for the ordinary taxi rider will be exacerbated, and the underprivileged may also experience diminished levels of service, albeit at "discount" fares.

The Committee offers a number of proposals in response to complaints about poor service. It proposes a six-month period during which the License Commission will monitor responses to calls to determine whether there is "unmet" demand. The Committee further suggests that the License Commission "encourage" the operation of cabs to the fullest extent possible during the monitoring period. This proposal suffers, however, from the fact that it will simply induce an abnormally high level of taxicab operation for six months without addressing the level of operation after this period.

In addition, the Committee proposes that the City Counsel pass an ordinance requiring that the issuance of any additional medallions be predicated on consideration of one or more factors such as: increases in medallion prices, the number of complaints or unanswered calls or demographic statistics. The problem with both of these approaches is that it is extremely difficult, if not impossible, to determine administratively how may cabs are needed or what fares should be charged. Even if the City of Cambridge were to select the proper number of cabs and fare schedule to emulate a competitive market, it would be unable to make the continual changes needed to accommodate market changes over time.

To improve the utilization of existing cabs, the Committee proposes that the License Commission encourage all taxicabs to use a radio service. Radio services, in turn, would be regulated to ensure that each call is answered. Such regulations would, however, require detailed monitoring of both calls and responses. Even selecting sample calls and responses would make enforcement difficult and costly.

Lastly, in response to the domination of the taxicab market by a few companies that have large fleets, their own radio dispatch service, and internal financing for the purchase of medallions, the Committee appears to recommend extension of the License Commission's current policy that prohibits the owners of a large number of medallions from purchasing additional medallions. Further, the Committee proposes to regulate the dispatch services for fairness, the participating cabs for responsiveness to calls, and all parties for the division of profits between drivers and medallion owners. Such a regulatory approach will only increase the burden on the License Commission without solving the underlying problem of the concentration of medallion ownership. Such an approach is likely to be expensive as well as ineffective.

The Benefits of Deregulation

The problems of high fares, poor service, and industry concentration could all be effectively alleviated by open entry and renewed fare competition. The radio-dispatched segment of the industry, which represents most of Cambridge's taxicab demand, functions especially well without regulation.[7] It would be relatively easy for consumers to telephone and sample a number of dispatch services to find the fare and quality-of-service mix they prefer. With open entry and unregulated fares, therefore, new radio dispatch services would have an incentive to organize fleets with various fare and quality combinations responsive to different groups of consumers. Customers who received poor service, and drivers who felt they were being treated unfairly, could easily move to another dispatch service.

These benefits of deregulation are not mere hypotheses based on an untested theory. For example, Seattle deregulated its taxis in 1979. We estimate that between 1979 and 1983 over 200 new jobs for taxi drivers were created.[8] Waiting times have dropped because of the greater number of taxis on the streets.[9] Taxi fares in Seattle in 1983 were about 15% lower than we

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7 The Chairman of the License Commission, James McDavitt, estimates that approximately two thirds of taxicab service in Cambridge is provided by cabs that subscribe to a radio dispatch service.

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

9 Id. The only actual data we have on waiting times come from San Diego. Following deregulation there, the average waiting time for radio dispatched cabs declined 20% and the average waiting time at major cab stands became negligible. Bureau of Economics, supra note 2, at 117.

estimate they would have been under continued regulation.[10]

The domination of the taxicab market by a few firms is also mitigated by deregulation. Virtually all cities that have changed to open entry have also 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-dispatch trips. In San Diego, two small fleets expanded from 23 and 12 cabs to 106 and 38 cabs, respectively. In most cities, there was also a significant increase in the number of independent owner-operators.[11]

Conclusion

At this juncture, the City of Cambridge faces a crucial choice. It can, as the Advisory Committee suggests, enact detailed new regulations in an attempt to fix the problems caused by the City's restriction of entry and its imposition of fixed fares in the taxicab market. The City can raise fares to most riders, leaving others with the current fares as "discount fares," and attempt to monitor both taxicab service and the conduct of dispatch services. However, such monitoring may be difficult and costly to enforce and will not solve the underlying problem caused by a lack of competition in the Cambridge taxicab market. Alternatively, the City can choose to eliminate non-safety-related entry restrictions and allow fares to be discounted to all riders. If it chooses the latter course, Cambridge will join the growing number of cities that have recognized and obtained the benefits of competition in the taxicab market.

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10 Evidence from 1967-1979, a period when taxis were regulated in Seattle, suggests that price regulation increases cab fares there by about 11-15% Zerbe supra note 8, at 44.

11 Although some of these independents subscribed to radio-dispatching service (San Diego and Charlotte require that all firms have radio-dispatching), most focused on cab stands, including airport service. Bureau of Economics, supra note 2, at 115.