



UNITED STATES OF AMERICA  
FEDERAL TRADE COMMISSION  
BOSTON REGIONAL OFFICE

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Ms. Margaret Lynch  
Hearing Examiner  
Department of Public Utilities  
Transportation Division  
100 Cambridge Street  
Boston, Massachusetts

**COMMISSION AUTHORIZED**

Re: D.P.U. 88-203

Dear Ms. Lynch:

The staff of the Federal Trade Commission is pleased to submit comments concerning the issuance of additional taxicab medallions in the City of Boston, over and above the current level of 1,525.<sup>1</sup> This level was established by law in 1934, and has remained unchanged since then.<sup>2</sup> We believe that the authorization of additional medallions and the associated increase in taxi service would benefit consumers.

Virtually all major factors affecting the demand for taxi services in Boston have grown tremendously since the current number of medallions was set in 1934. This growth includes increases in the number of employees and hotel guests and in the volume of office space. At the same time, a precipitous overall decline in taxi services has inconvenienced consumers with many groups reporting lengthy delays and "no show" cabs. These conditions point to the need for expanded taxi service and suggest that restricting the number of cabs harms Boston consumers. As a result of the restrictions on the number of cabs, consumers suffer from lower service levels than would be the case under open entry, and they appear to pay higher prices. As to the market value of medallions, we estimate that, as a result of the restrictions on the number of taxicabs, Boston's consumers may pay an estimated \$14.5 million per year in excess of the

<sup>1</sup> These comments are the views of the staff of the Boston Regional Office and the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or of any individual Commissioner.

<sup>2</sup> We understand that an individual, Robert K.M. Lynch, has appealed the decision of the Hackney Carriage Unit of the Boston Police Department denying his request for a hackney license on the grounds that there are no medallions available for issuance. Pursuant to Mr. Lynch's appeal, the Transportation Division of the Department of Public Utilities ("DPU") has been holding hearings to determine whether or not to authorize the issuance of additional medallions.

costs of the service they receive each year. In the comments that follow, we explain why we believe consumers would be well served by an increase in the number of medallions authorized and best served by completely unrestricted entry of additional cabs into the Boston taxicab market.

## 1. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair competition and unfair acts and practices.<sup>3</sup> The staff 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 providing countervailing benefits to consumers. As part of this effort, the staff has submitted comments on taxicab regulation to the city governments of Cambridge, MA; Anchorage, AK; Chicago, IL; New York, NY; San Francisco, CA; and the District of Columbia.

In 1984, the Commission released an extensive report by its Bureau of Economics, based on a review of taxicab regulation in cities throughout the country, entitled "An Economic Analysis of Taxicab Regulation" ("Taxicab Regulation" or "the Report") (copy attached). A principal conclusion of this Report is that no persuasive economic rationale exists for regulations that restrict the total number of taxicabs.<sup>4</sup>

We will first address some likely effects of taxicab entry restrictions in Boston. Subsequent sections will discuss the potential benefits of increasing the number of medallions and the arguments typically raised against such increases.

## 2. Boston's Need for More Taxicabs

Currently, Boston has 1,525 taxicabs medallions, the same number initially issued in 1934. However, Boston has experienced dramatic demographic changes since 1934, most notably significant increases in employment, office space, and tourist and convention trade. These changes suggest that consumers would gain significantly from an increase in the number of cabs permitted to operate in the city.

A 1987 study conducted by the Hackney Division of the Boston Police Department ("Hackney Study") found that although the

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<sup>3</sup> See 15 U.S.C. §41 et seq.

<sup>4</sup> The Report supports, in principle, other kinds of taxicab regulations dealing with vehicle safety and liability insurance.

resident population in Boston had decreased since 1934, during the work week the total population was more than twice the resident population. Further, other relevant indicators -- employees, hotel rooms, and office space -- had increased significantly since 1934 and were expected to continue to grow in the years to come.<sup>5</sup> The following figures from the Hackney Study reflect these increases:

	<u>1935</u>	<u>1985</u>	<u>\$+/-</u>
Office Space (sq. ft.)	22,610,000	50,590,558	+123%
Employees	355,346 (1930)	594,000	+ 67%
Hotel Rooms	3,049	12,288	+303%
Population	781,188	601,095*	- 23%
Taxi Medallions	1,525	1,525	0%

\*This figure doubles during the work week.

The increase in the demand for taxis created by this growth, coupled with the limit of 1,525 cabs, has led to increased waiting times and refusals of service.<sup>6</sup>

<sup>5</sup> For example, in 1987 Boston had 12,288 hotel rooms. An additional 3,500 hotel rooms are projected to be built by the year 2000. Hackney Study, p. 6. According to the Massachusetts Hotel/Motel Association, in 1987 Boston experienced the highest hotel occupancy rate of any major city in the country.

<sup>6</sup> The limit on the number of medallions interacts with fare regulation and other taxi rules to produce the level of service we observe in Boston. With cab numbers held below the free-entry level, fare regulation may give taxi drivers added incentives to refuse service to particular riders (e.g., those who are expected to be poor tippers or want rides to neighborhoods with low taxi demand) even if the regulated fares cover the cost of providing the service. Since taxi drivers will have a larger number of alternative customers to transport, they have an incentive to choose to serve those customers who provide the greatest expected profit. Conversely, if there were no entry constraint, taxis would have fewer alternatives per cab and a greater incentive to provide service to all customers for whom the fare exceeded the cost of providing the service.

Of course, taxis may never freely choose to serve those customers for whom the regulated fare is below the cost of providing the service. In such situations, allowing surcharges

The deterioration of Boston's taxi service was documented in the Hackney Study, which surveyed a number of groups most directly affected by the shortage of taxi service, including the elderly, retail and tourist associations, the convention trade, hospitals, and colleges and universities. Seventy percent of elderly respondents in the Hackney Study reported "extreme distress" at the length of the wait for a taxi sent by radio dispatch, which averaged 30 minutes.<sup>7</sup> Twenty-seven percent of the elderly had been refused service by a dispatcher or cab driver, and forty-four percent reported that after waiting 30 minutes or more, the cab they had requested failed to show up.<sup>8</sup>

Other groups experience problems as well. The Massachusetts Hotel/Motel Association reported that for most of the time hotels do not have cabs waiting and that hotel patrons experience delays in obtaining cabs. The two major trade show/convention centers (Bayside and World Trade Center) reported frequent and excessive delays, "no show" cabs, and inability to even get through to a cab company to request a cab. Retail groups, tourist attractions, colleges and universities, and hospitals also reported delays, "no shows," and general unavailability of taxi service.<sup>9</sup> Inadequate taxi service persists because additional cabs are not permitted to serve Boston.

The current market value of a Boston taxicab medallion, as high as \$95,000, is evidence of an inadequate supply of taxis.<sup>10</sup>

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may be the only means of improving the quantity of service. For a discussion of this issue, see Taxicab Regulation, pp. 83-97, esp. 94.

7 The elderly often depend on taxi transportation to get to and from medical appointments and treatments.

8 Hackney Study, p. 5 (copy attached). In part, service refusals to senior citizens may have been caused by the mandatory discounts required by the City. While the discounts stem from an admirable sentiment, they reduce the profitability of providing taxi service to this group of consumers. As a result, senior citizens may be experiencing diminished levels of service, albeit at "discount" fares. Direct subsidies from the City would be an alternative means of reducing senior citizens' cost of taxicab transportation and might result in less diminishment of service to this group. San Diego, for example, has successfully implemented such a program.

9 Hackney Study, pp. 8-11.

10 The medallions were originally issued for a \$50 fee.



Such a high price for medallions indicates that consumers pay more than the cost of the service that the taxi operators supply. To estimate the magnitude of payments over cost for current service, we calculate the annual stream of profits to taxi operators necessary to make the purchase of a \$95,000 medallion worthwhile. At a 10 percent interest rate,<sup>11</sup> an annual profit stream of \$9,500 would just repay the price of the medallion. That is, a medallion holder must charge consumers \$9,500 a year above the costs of services to amortize the cost of the medallion. The estimated annual payment over cost for Boston consumers is \$14.5 million ( $\$9,500 \times 1,525$  medallions).<sup>12</sup>

This regulation-induced payment over cost does not result in better service. The payment reflects a transfer of money from consumers to medallion holders as a result of the governmental restrictions on the number of taxicab medallions. The DPU could reduce this disparity by increasing the number of medallions available to taxicab drivers. Alternatively, the DPU could entirely eliminate these extra costs by eliminating restrictions on the number of medallions. Even if the city chose to maintain its present system of regulated fares, more medallions would allow new cabs to enter the market, and thereby reduce the revenue earned by each cab and the consumers' waiting time.<sup>13</sup>

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<sup>11</sup> The interest rate reflects either the rate at which the taxicab operator could borrow the money or the rate that he could earn on an investment of a comparable sum of money. An interest rate is a valid basis for comparison because the taxi cab owner could resell the medallion for cash and invest the cash. A 10 percent rate is not inconsistent with current long-term bond rates. The annual profit needed would rise if interest rates were higher or fall if they were lower.

<sup>12</sup> In addition to this transfer from consumers to taxicab medallion owners, the entry restraints produce an additional "deadweight welfare loss" that is not captured in the medallion value. This "deadweight loss" represents the value of taxicab service that would be provided by operators who cannot now enter. Additionally, waiting time costs imposed on consumers by the restriction on cabs may not be fully reflected in the medallion value. Thus, the medallion value is a minimum estimate of the loss to consumers from taxi regulation. See Taxicab Regulation, pp. 105-111.

<sup>13</sup> Currently, fares are regulated in Boston. To realize consumer gains fully, open entry may have to be coupled with fare reform. See Taxicab Regulation, pp. 45-52. For example, fares that are set at inappropriate levels can cause regulatory problems of their own, but as these problems emerge, they can be addressed through changes in the fares. Fares that fail to cover the cost of service will result in service refusals, even if such

The main beneficiaries of Boston's medallion restrictions are the taxicab owners who sold or can sell<sup>14</sup> their medallions at a higher real price than originally paid.<sup>15</sup> Many of those who sold their medallions for a profit may no longer operate in the market. Current operators who paid the full \$95,000 earn only a competitive return on their investment.<sup>16</sup>

As noted above, all significant indicators except resident population have increased dramatically in Boston since the current medallion limit was set in 1934, and during the work week the total population is more than double the resident population due to the influx of commuters from outlying areas. Most of these indicators are projected to grow over the next few years, exacerbating any problems now caused by the shortage of taxicab services in Boston. The DPU could increase the welfare of Boston's taxi customers by lifting entry restrictions in their entirety. If open entry is not desirable or possible, the DPU could ameliorate some of the consumer costs by issuing a significant number of new medallions in order to increase taxicab service to the city.

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refusals are illegal. By contrast, fares that are set too high generate so much entry that the cabs suffer reduced productivity. In such circumstances, each cab services fewer riders per day without generating a reduction in waiting-time large enough to offset the increase in the cost per ride. This may become more apparent not only with open entry, but even in situations where the number of medallions is increased. If the number of cabs is found to be excessive, the City may then wish to consider a reduction in its fares.

14 Market transfers of medallions help to ensure that the medallions go to the lowest-cost providers. Prohibiting these transfers would not eliminate the regulation-induced payments and is likely to increase waste, serving to reduce service to consumers.

15 The real price is the price after taking inflation into account.

16 If Boston changed to a system of open entry or increased the number of medallions, the current operators who invested in medallions would lose their investment as the market price of medallions fell. If the City goes to a system of open or increased entry, it might wish to consider some form of compensation to existing medallion holders for losses from unanticipated changes in regulation. We would expect the value of the additional taxi services to consumers, which may be coupled with possible fare reductions and discounts, to exceed the losses suffered by current medallion holders.

3. The Benefits of Eliminating Restrictions on the Total Number of Taxicabs

The Bureau of Economics Report found that restrictions on the total number of taxicabs waste resources, harm consumers, and, when coupled with inappropriately high fares,<sup>17</sup> impose a disproportionate burden on low income people.<sup>18</sup> Such restrictions have the most significant negative effect on those consumers who depend most on cabs for transportation and the procurement of necessities: the handicapped, the poor, and the elderly. These groups spend a larger proportion of their incomes on taxi transportation than do other segments of the general population. A study in Seattle indicates that financially disadvantaged consumers make up twenty-five percent of total taxi ridership.

The conclusions of the Bureau of Economics Report are not unique. Another study, commissioned by the U.S. Department of Transportation, concluded that the combination of restraints on entry of new cabs and regulations preventing fare discounting cost consumers nearly \$800 million annually and the loss of 38,000 jobs in the taxi industry.<sup>19</sup> An increase in the number of medallions issued for the City of Boston, or complete removal of restrictions on the number of taxicabs, is likely to both benefit consumers and increase employment opportunities in Boston.

The benefits of easing taxi restrictions are not theoretical -- they are real and immediate. For example, Seattle eliminated

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<sup>17</sup> Even though fares are regulated in Boston, these fares may be high relative to those that would exist in a competitive taxicab market. More taxicabs may not only reduce waiting-time but may also provide incentives for greater price competition. Even if it is not desirable to reduce the level of the set fares, the current prohibition against fare discounting harms Boston's consumers. Coupling an increased supply of taxicabs with the liberty to engage in fare discounting would benefit all of Boston's consumers. We are aware that the Department of Public Utilities is not considering taxicab fare structures in this hearing. Coordination of fare and entry reform would, however, ensure the best possible outcome for consumers from regulatory reform.

<sup>18</sup> 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.

<sup>19</sup> UMTA, U.S. Department of Transportation, Regulatory Impediments to Private Sector Urban Transit 85 (1984).

limits on the number of taxis in 1979.<sup>20</sup> One author estimates that between 1979 and 1983, over 200 new jobs for taxi drivers were created in that city.<sup>21</sup> 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 open entry, and the average waiting times at major cab stands became negligible. In Seattle, waiting times likewise decreased significantly, and no municipality with open entry has reported an increase in waiting times.<sup>22</sup>

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 companies. In some cities, new fleets have entered the radio-dispatched segment of the market. For example, in Oakland, two new fleets entered with 76 and 14 cabs, respectively, 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.<sup>23</sup>

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<sup>20</sup> Recently, Seattle has abandoned its open entry policy by imposing a moratorium on the issuance of new licenses. However, this change did not reflect a dissatisfaction with open entry but rather a desire to facilitate discussions about the formation of a common regional taxicab system with the surrounding area of King County. The Regional Taxicab Commission has informed us that open entry is an option that is being considered for this common regulatory system.

<sup>21</sup> Zerbe, Seattle Taxis: Deregulation Hits a Pothole, Regulation 43, 44, Nov/Dec. 1983.

<sup>22</sup> Taxicab Regulation at 117.

<sup>23</sup> Taxicab Regulation at 115. In January 1987, Oakland abandoned open entry in favor of a closed system. According to city officials, the impetus for this change came from the taxicab industry. As the FTC staff report notes (p. 140), the industry was opposed to open entry from its inception. Oakland responded to the industry in the hope of improving the appearance of the cabs. Since Oakland's taxi market is largely radio-dispatched and consumers can therefore exercise greater selectivity, it is likely that competition will lead to the level of appearance for cabs desired by customers. However, as noted in Taxicab Regulation, p. 69, regulators have used taxi regulations to create a taxi system that would appeal to businessmen and tourists rather than to local users of taxi services. In the event that regulations to improve quality were truly needed, they





#### 4. Common Arguments Against Open Entry

Proponents of restricted entry typically argue that without restrictions there will be "too many" taxis. They argue that the quality of cabs, drivers, and service will decrease by allowing open entry. The available evidence, however, provides little support for these assertions.

The concept of open entry does not prevent regulations requiring reasonable levels of safety and quality of taxis and reasonable skill and knowledge of drivers.<sup>26</sup> Nor does open entry mean that service will decline. Over the years, many cities have reported that service has improved under open entry. In Jacksonville, Oakland, and San Diego, open entry led to an increase in fleet maintenance and a reduction in vehicle age as new fleets entered the market. In Milwaukee, San Diego, Santa Barbara, and Seattle taxi competition reduced the waiting time for a cab.

Waiting time is an important factor in determining the productivity of the taxicab industry. Therefore, a decline in the number of rides per cab does not necessarily indicate a decline in cab productivity. A ride with reduced waiting time has higher quality and is more valuable to the extent that taxi consumers value their time. Thus, even if the number of rides per cab declines, productivity would still be enhanced, as the rides become more valuable to consumers because they experience a reduced waiting period for the service to arrive. Moreover, as we have noted above, if an excessive number of cabs does develop, this supply can be reduced to the benefit of consumers through fare reductions. With an appropriate fare structure, open entry will not result in an excessive number of cabs.

#### 5. Conclusion

In sum, based on the economic evidence and experience throughout the country, the Department of Public Utilities may wish to consider the issuance of more taxicab medallions in Boston. Additional taxicabs, consistent with maintenance of safe and competent service, will benefit Boston residents and visitors by improving taxi service.

The Department of Public Utilities is considering authorizing the issuance of a specific number of new medallions, although that number has not yet been determined. We believe

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<sup>26</sup> If the minimum levels of quality and safety were set excessively high, they could act as de facto restrictions on entry. In considering any such regulations, we would suggest that Boston weigh the costs and benefits of such regulation, and issue only those regulations that provide net benefits.

the removal of all restrictions on the number of taxicabs would do most to enhance the welfare of Boston's taxicab operators. In the alternative, issuance of a significant number of new medallions would be very beneficial to consumers.

We appreciate the opportunity to comment on the issues raised by Mr. Lynch's appeal.

Sincerely yours,

*Phoebé D. Morse*

Phoebé D. Morse  
Regional Director