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Ridesharing vs. Taxis: Rethinking Regulations to Allow for Innovation

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NEW TECHNOLOGY CAN DISRUPT ESTABLISHED

industries, vastly improving consumer welfare. It can also disrupt policy, vastly improving governance. The advent of ridesharing platforms like Uber and Lyft has prompted regulators everywhere to rethink their approach to the vehicle-for-hire industry. Taxi companies and drivers have called for a level playing field where they can compete on equal footing with ridesharing drivers. The evidence suggests that the best means to provide parity lies in extensive taxi deregulation.

In this policy brief, we provide a framework to help policymakers understand the harms of anticompetitive taxi regulations. We organize the discussion around regulations that act as barriers to entry, control prices, and mandate certain business practices. We briefly address the original rationale for taxi regulation—the belief that it was necessary to correct for ruinous competition or for market failures such as asymmetric information—and explain why this rationale is obsolete. We then discuss the unintended consequences of regulation, focusing on the tendency for regulations to benefit incumbent firms at the expense of consumers and would-be competitors. We conclude with a roadmap for regulatory reform that includes specific steps for reform as well as guiding principles for sound regulation.

CATEGORIES OF TAXI REGULATION

Our recent paper, “Rethinking Taxi Regulations: The Case for Fundamental Reform,” describes the excessively burdensome regulations that taxis face and the outdated rationale for regulation.¹ The paper includes a case study of Washington, DC—one of the least-regulated taxi markets in the country²—showing that even relatively light regulatory requirements

can increase the cost of starting a taxi company by approximately \$2,650.

Anticompetitive taxi regulations can be grouped into three categories: barriers to entry, price controls, and mandated business practices. These are explained in detail below.

Barriers to Entry

The most obvious barriers to entry are government-mandated restrictions on whether a company may offer goods or services, like the franchise requirement for taxi companies in Austin, Las Vegas, and Los Angeles.³ Limitations on the number of taxicabs allowed to offer service are another barrier to entry, such as the taxi medallion systems in Boston, Chicago, Miami, New York City, Philadelphia, and many other cities.⁴ Slightly less obvious barriers to entry include requirements that new entrants to the market pay large permit fees, use specific equipment, or comply with onerous regulatory procedures.

Barriers to entry harm consumer welfare by limiting the quantity of vehicles for hire and the number of firms competing to serve customers. Such anti-competitive regulations create monopoly-like power for the privileged companies. The corresponding restriction of supply means that prices may be higher or the quality of goods and services may be lower compared to a market characterized by entrepreneurial free entry.⁵

Price Controls

Price controls are stipulations on the maximum or minimum price or mandates on the exact price that a firm may charge customers. Conversely, price controls can be understood as limits on the amount that customers are allowed to pay for the service. Although it may not seem that customers would want to pay more, someone who is late for a job interview or about to go into labor might appreciate having the option to pay a premium for immediate service.

Prices are a frequently misunderstood but critical element of a market economy and the free enterprise

system. Prices inherently communicate to buyers and sellers the scarcity and relative value of a good or service—rising prices signal higher demand or lower supply to potential suppliers and consumers.⁶

In the short run, higher prices cause consumers to economize on their consumption of now-scarcer goods and services, meaning that these products are available for those who highly value them (such as those with an urgent need for a ride). Higher prices also encourage more suppliers to offer their services, eventually driving prices back down.

In the long run, price changes help keep industries competitive. If, for example, a market has only a few firms and prices rise, this will motivate new producers to enter the industry and to increase supply through more efficient production and innovation.⁷ As more firms enter, greater competition between companies leads to higher-quality products or lower prices.⁸

The dynamism of prices is therefore a powerful balancing force in a market economy. When price fluctuations are restricted, as in the case of mandated taxi and limousine fares, the result can be surpluses or shortages of service that lead to wasteful production or insufficient business investment.⁹

Mandated Business Practices

A mandated business practice is any way in which a regulation restricts producers' choices in how to provide goods and services. When regulations stipulate or restrict the means by which businesses may serve customers, the possibility of any innovation in that restricted area—and the associated potential for economic development—is lost.

Mandated business practices can anchor companies into increasingly inefficient production technologies or lock in archaic business models.¹⁰ Stagnant companies then waste resources or offer lower-quality goods and services than could otherwise be possible. At the same time, such regulations make companies ripe for disruption by competitors that can offer a substitute product, as in the case of taxicabs facing competition from ridesharing platforms within the vehicle-for-hire industry.¹¹

Policymakers should pass legislation that sets an ambitious goal of eliminating regulations that are anticompetitive, raise substantial barriers to entry, privilege incumbent businesses, or discriminate against certain business models.

PRIOR RATIONALE FOR REGULATION

Most taxi regulations emerged from the era surrounding the Great Depression, when a prevalent—and misinformed—policy mindset emphasized the importance of government protection against “ruinous competition,” which motivated policymakers to control prices and restrict supply.¹²

Some researchers have justified regulators’ intervention in the taxi industry by citing potential problems of monopoly power, asymmetric information, and externalities.¹³ “Asymmetric information” is a form of market failure in which buyers cannot access relevant information regarding the quality of goods or services offered by sellers. The result is a reduction in trade because buyers cannot distinguish high-quality products from low-quality products. An “externality” is a side effect of production whose cost is borne by an external party, like traffic congestion or pollution.

However, a historical investigation by the Federal Trade Commission shows that such regulations were actually put into place to protect privileged companies from competition:

The discussions of the early 1930s emphasize that the motivation behind the regulations was “to drive many cut-throat cabs, operating without authority, from the streets” and to enable the organized cab fleets and transit companies to increase their profits. Restriction of entry was not motivated by a concern for congestion or pollution externalities.¹⁴

Because modern taxi regulations are in most cases the direct descendants of these anticompetitive laws, they warrant reconsideration.

CONSEQUENCES OF ANTICOMPETITIVE TAXI REGULATION

In the case of taxicabs, regulations that inhibit competition can contribute to

- Higher prices (in taxi markets where fares are not regulated),
- Poor service quality (rude drivers; old, dirty, or unsafe cabs; long waits; and no-shows),
- Areas without service,
- Decreased public safety (lack of service leading potential passengers to drive while intoxicated or leaving them unable to escape a dangerous situation),
- Inefficient use of existing resources, and
- Failure to innovate or create new services that customers would find valuable.

Public officials should also bear in mind the specter of unintended consequences that often hangs over regulatory intervention. This can occur even if regulators attempt to analyze the effects their actions will have. This is because the dynamism of human interactions and the alertness of entrepreneurial individuals to regulatory flaws can lead to completely unforeseen business models. In the end, the resulting “government failure”¹⁵ can be worse than the “market failure” it ostensibly corrects. As the economist Richard Coffman wrote,

It is not sensible to advocate [for] government regulation simply because an unregulated industry fails to operate as a perfectly competitive industry should. Regulation may also operate imperfectly,

and perhaps create an even larger welfare loss than would have been suffered in the absence of regulation.¹⁶

A good example of unintended consequences is the mandate that all taxicabs must have a uniform paint scheme. Mandating a uniform paint scheme is akin to requiring every candy bar to be sold in an identical wrapper. Since customers would not know what kind of candy bar they had bought until opening it, candy bar producers would lose the incentive to produce high-quality products, creating a race to the bottom in quality.¹⁷ Inhibiting differentiation actually *increases* the asymmetric information problem, just as Nobel laureate George Akerlof predicted.¹⁸

Regulatory Capture

Policymakers should also keep in mind the potential for regulatory capture¹⁹—the counterintuitive result that regulations often end up serving the interests of the regulated companies. Regulatory capture does not necessarily involve malicious decisions made by corrupt officials. Often it can simply be the result of the disproportionate interaction regulators have with the regulated industries, while consumers and the public can accidentally become passed-over constituencies.

Importantly, regulatory capture should be understood as a potential, sometimes unintentional, cost of the decision to regulate. Companies or special interest groups cannot co-opt governmental authority if regulatory intervention does not occur in the first place.

NEW TECHNOLOGY OFFERS NEW OPPORTUNITY

Modern technological innovations, like the Internet and smartphones, allow better communication between buyers and sellers and better identification of the quality of goods and services.²⁰ These changes have radically reduced the degree of asymmetric information in most markets, including transportation services. This means ridesharing is not only disrupting the taxi industry, but it is also diminishing

the economic rationale for taxi regulation.²¹ As a result, policymakers should question the need to maintain existing regulatory structures.

REGULATORY REFORM

We propose a three-step process that should guide regulatory reform in general but is especially relevant to the taxi industry, given the breadth and depth of the regulatory restrictions it faces.

Step 1

First, policymakers should pass legislation that sets an ambitious goal of eliminating regulations that are anticompetitive, raise substantial barriers to entry, privilege incumbent businesses, or discriminate against certain business models.

Step 2

Second, policymakers should establish an independent commission charged with examining the jurisdiction's regulations.²² The commission's first task should be to identify the barriers to entry associated with regulation (fees, exams, required training, educational requirements, forms to be filled out, technologies to be acquired, and any other conditions that must be met). The commission should not be dominated by members of the taxi or ridesharing industry,²³ should include consumer representatives, and should include third-party experts, such as academics, who have no financial stake in the industry being regulated. Furthermore, the commission should be guided by a set of guidelines for evaluating regulations. These are summarized in table 1. It is critical that policymakers start from a blank slate and define the nature of the problem that a proposed policy aims to address. The long history of anticompetitive taxi regulations and the dubious circumstances under which they were initially created suggest that extensive changes to these rules are appropriate. It is also important that policymakers identify multiple options to address any perceived problems and

remember that deregulation can expand competition and ensure that entrepreneurs face a strong incentive to innovate to solve market imperfections.

Policymakers should take care to avoid creating rules that could soon be obsolete, or worse, which might preclude market-enhancing innovations. In the same way, extensive—or complete—deregulation is worth explicitly considering to allow entrepreneurs the room to more accurately address specific customer needs, especially in niche markets that serve poor, elderly, or disabled persons. Policymakers should define both the benefits and the costs of regulation; protection of incumbent firms should not count as a benefit, given that these protections come at the expense of consumers, taxpayers, and would-be competitors. Whenever possible, policymakers should develop objective measures of benefits and costs. But when that is not possible, they should acknowledge subjective assessments.

Step 3

Finally, the independent commission should be charged with setting a comprehensive path toward creating an open and level regulatory environment with as few restrictions on entry, price, and business models as possible.

CONCLUSION

For decades the taxi industry has been a literal textbook example²⁴ of the perils of overregulation. The results argue that broad and total deregulation is warranted, especially given the ability of modern technologies to solve the asymmetric information problem. Importantly, any regulations that do remain must focus on the desired outcomes—rather than mandate the particular means to achieve those outcomes—to allow entrepreneurs the room to innovate and find the best and least costly solutions.

Deregulation can offer unforeseen benefits.²⁵ The limit on taxi licenses and restrictions on pricing and business practices have been at least partially responsible for a lack of taxi service in impoverished

neighborhoods—exactly the areas of cities that might need taxi service the most. The advent of ridesharing services, however, has resulted in an increase in the amount of transportation services offered to poorer neighborhoods.²⁶ In the same way, several ridesharing firms have emerged to provide specialty services in niche markets for elderly persons or for women and children.²⁷ In short, increased competition (coupled with ridesharing platform firms' improved safety features for drivers and passengers) has spontaneously led to the exact outcome that taxi regulators had previously tried to accomplish by government mandate.

NOTES

1. Michael D. Farren, Christopher Koopman, and Matthew D. Mitchell, "Rethinking Taxi Regulations: The Case for Fundamental Reform" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2016).
2. Bruce Schaller, "Entry Controls in Taxi Regulation: Implications of US and Canadian Experience for Taxi Regulation and Deregulation," *Transport Policy* 14, no. 6 (2007): 495–97.
3. Franchise requirements are strict governmental controls on the entry of new firms. They generally grant a monopolistic privilege to existing companies to protect them from competition. *Ibid.*, 495–96.
4. *Ibid.*
5. Farren, Koopman, and Mitchell, "Rethinking Taxi Regulations," 7–11; Matthew D. Mitchell, *The Pathology of Privilege: The Economic Consequences of Government Favoritism*, 2nd ed. (Arlington, VA: Mercatus Center at George Mason University, 2015).
6. Donald J. Boudreaux, "Information and Prices," in *The Concise Encyclopedia of Economics*, ed. David R. Henderson, 2nd ed. (Indianapolis: Library of Economics and Liberty, 2008).
7. It should be noted that the only difference between the "short run" and the "long run" is the speed of adaptation, which could be measured in years or minutes, depending on the market in question.
8. A side benefit of competition—or primary benefit, depending on one's perspective—is the more efficient use of the limited resources in society, leading to increases in human welfare.
9. Farren, Koopman, and Mitchell, "Rethinking Taxi Regulations," 8, 11.
10. *Ibid.*, 9.
11. Such disruption is not always legally possible. It requires some "gray area" in the law that permits some companies to serve customers' needs without adopting these mandated practices. Alternately, it requires that the service provider and customers engage in what scholars have called "systematic civil disobedience," "technological disobedience," or "evasive entrepreneurship" to protest regulatory interference in mutually beneficial transactions. Charles Murray, "Regulation Run Amok—And How to Fight Back," *Wall Street Journal*, May 11, 2015; Adam Thierer, "Innovation Arbitrage, Technological Civil

- Disobedience & Spontaneous Deregulation,” *Technology Liberation Front*, December 5, 2016; and David S. Lucas and Caleb S. Fuller, “Entrepreneurship: Productive, Unproductive, and Destructive—Relative to What?,” *Journal of Business Venturing Insights* 7 (2017): 45–49.
12. “Ruinous competition” appears to have been defined as any new competition that lowered the profits of established companies. Unsurprisingly, those established companies lobbied for barriers to entry and price controls that effectively gave them monopoly power. Customer welfare, entrepreneurial innovation, and economic growth in general suffered as a direct result. Mark W. Frankena and Paul A. Pautler, “An Economic Analysis of Taxicab Regulation” (Bureau of Economics Staff Report, Federal Trade Commission, Washington, DC, 1984).
 13. Chanoch Shreiber, “The Economic Reasons for Price and Entry Regulation of Taxicabs,” *Journal of Transport Economics and Policy* 9, no. 3 (1975): 268–79; Richard B. Coffman, “The Economic Reasons for Price and Entry Regulation of Taxicabs: A Comment,” *Journal of Transport Economics and Policy* 11, no. 3 (1977): 288–97; Chanoch Shreiber, “The Economic Reasons for Price and Entry Regulation of Taxicabs: A Rejoinder,” *Journal of Transport Economics and Policy* 11, no. 3 (1977): 298–304; David J. Williams, “The Economic Reasons for Price and Entry Regulation of Taxicabs: A Comment,” *Journal of Transport Economics and Policy* 14, no. 1 (1980): 105–12; Chanoch Shreiber, “The Economic Reasons for Price and Entry Regulation of Taxicabs: A Rejoinder,” *Journal of Transport Economics and Policy* 15, no. 1 (1981): 81–83.
 14. Frankena and Pautler, “An Economic Analysis of Taxicab Regulation,” 79.
 15. Gordon Tullock, Arthur Seldon, and Gordon L. Brady, *Government Failure: A Primer in Public Choice* (Washington, DC: Cato Institute, 2002).
 16. Coffman, “The Economic Reasons.”
 17. Christopher Koopman, Matthew D. Mitchell, and Adam Thierer, “The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change,” *Journal of Business, Entrepreneurship & the Law* 8, no. 2 (2015): 537.
 18. Akerlof analyzed the “market for lemons,” referring to used cars whose quality was unknown. Previous research published by the Mercatus Center offers additional information on the importance of feedback mechanisms and reputation effects that can solve the asymmetric information problem. George A. Akerlof, “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism,” *Quarterly Journal of Economics* 84, no. 3 (1970): 488–500; Adam Thierer et al., “How the Internet, the Sharing Economy, and Reputational Feedback Mechanisms Solve the ‘Lemons Problem’” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2015).
 19. Adam Thierer, “Regulatory Capture: What the Experts Have Found,” *Technology Liberation Front*, December 19, 2010.
 20. Thierer et al., “How the Internet,” 855–73.
 21. *Ibid.*, 873–77.
 22. The 1992 Regulatory Study Commission created by Mayor Goldsmith in Indianapolis offers a good example of how such a commission can develop better regulations. Stephen Goldsmith, “Regulation and the Urban Marketplace,” *Regulation* 17 (1994): 76.
 23. It is important for policymakers to recognize that past “regulatory advisory commissions” in many cities were dominated by the taxi industry, with the result that such commissions actually led to substantial regulatory capture. St. Petersburg, FL, in the late 1970s was one such example. Taxi special interests managed to convince city regulators to restrict the number of taxi licenses issued but also allow taxi companies to set their own fares, effectively creating perfect conditions for taxis to exercise their monopoly power. Department of Transportation, “Taxicab Regulation in US Cities, Volume 2: Case Studies,” October 1983).
 24. See Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* (Cambridge, MA: MIT Press, 1988); W. Kip Viscusi, Joseph Emmett Harrington, and John M. Vernon, *Economics of Regulation and Antitrust*, 4th ed. (Cambridge, MA: MIT Press, 2005), 583–86.
 25. Airline, railroad, and trucking deregulation have all been noted for reducing transport costs, lowering prices, and improving service—saving hundreds of billions of dollars each year. They have also produced unanticipated benefits, such as safety improvements and increases in capital investment. Fred L. Smith Jr. and Braden Cox, “Airline Deregulation,” in *The Concise Encyclopedia of Economics*, ed. Henderson, 2nd ed.; Thomas Gale Moore, “Trucking Deregulation,” in *The Concise Encyclopedia of Economics*, ed. Henderson, 1st ed. (Indianapolis: Library of Economics and Liberty, 1993); Steven Morrison and Clifford Winston, *The Economic Effects of Airline Deregulation* (Washington, DC: Brookings Institution, 1986); B. Kelly Eakin et al., “Railroad Performance under the Staggers Act,” *Regulation* 33, no. 4 (2010): 32; Jean-Paul Rodrigue, Claude Comtois, and Brian Slack, *The Geography of Transport Systems*, 4th ed. (New York: Routledge, 2017).
 26. Jared Meyer, “Uber-Positive: Ride-Share Firm Expands Transportation Options in Low-Income New York” (Issue Brief No. 38, Manhattan Institute, September 2015); Rosanna Smart et al., “Faster and Cheaper: How Ride-Sourcing Fills a Gap in Low-Income Los Angeles Neighborhoods” (BOTEC Analysis Corporation, July 2015); Carl Bialik et al., “Uber Is Serving New York’s Outer Boroughs More Than Taxis Are,” *FiveThirtyEight*, August 10, 2015; “Analyzing 1.1 Billion NYC Taxi and Uber Trips, with a Vengeance,” *Todd W. Schneider*, November 17, 2015.
 27. Tracey Lien, “Uber . . . for Women? Start-Ups Hope to Match Female Passengers with Female Drivers,” *Los Angeles Times*, July 16, 2016; “7 Services Expanding Mobility for Aging Americans,” Shared Use Mobility Center, February 3, 2016.

Table 1. Guidelines for Privilege-Free Regulatory Rulemaking	
START WITH A BLANK SLATE	Policymakers should approach their task using a fresh perspective, asking themselves: “If I were to design regulations today, what would they look like?”
DEFINE THE NATURE OF THE PROBLEM	Begin by identifying a systemic market failure that the regulation aims to address. This step requires the policymaker to clearly explain how the normal process of market competition is not working and assess the factual basis for this market failure. The desire to simply improve a product or service falls far short of justifying regulatory intervention.
IDENTIFY ALTERNATIVE SOLUTIONS	If a systemic market failure has been identified, the next step is to develop reasonable ways to address it. The list of options should include reducing existing regulations and doing nothing. These options are important to consider because the current set of public policies might be contributing to failure (e.g., through regulatory capture). Ultimately, there may be no need for regulatory intervention if other approaches resolve the problem more effectively than regulation (especially if there is an entrepreneurial incentive to solve the problem privately).
DEFINE THE EXPECTED COSTS OF EACH ALTERNATIVE	Every available option will require tradeoffs of some sort, and regulators must identify the expected costs—both monetary and nonmonetary—associated with each. Regulators should also explicitly recognize the potential for unintended consequences of regulation (such as regulatory capture) and attempt to include these difficult-to-quantify unknowns in their qualitative analyses.
DEFINE THE EXPECTED BENEFITS OF EACH ALTERNATIVE	The benefits of each alternative need to be identified, defined, and quantified as much as possible. Importantly, maintaining the profitability or continued existence of established firms should not be counted as a benefit of regulation. Such artificial protections of industry come at the expense of consumers, taxpayers, would-be competitors, and future economic growth.
COMPARE BENEFITS AND COSTS	Once the benefits and costs of each alternative have been identified, defined, and quantified, the tradeoffs of regulation can be systematically and transparently evaluated. In cases where the benefits and costs cannot be accurately quantified, the subjective nature of these tradeoffs should be explicitly acknowledged and discussed.

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