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A FRESH LOOK AT REGULATION

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Regulation often is used in markets that don't have all the ideal qualities of the "perfect competition" model found in economics textbooks. Still, we shouldn't take regulations as untouchable necessary evils. A fresh look at existing regulatory schemes can bring to light feasible tweaks that will make them better at improving market outcomes. Taxicab market regulation offers an interesting case study.

The economic literature indicates that regulation may be a necessary feature of taxicab markets--at least in big, dense cities in which street hailing is the predominant mode of operation. In an unregulated market, a taxi user who is quoted a fare slightly above the market price may well agree to pay it just to avoid having to wait longer for another taxicab that may or may not be cheaper. On the other hand, an individual taxi driver cannot effectively communicate to the market that he is offering a lower fare. Geographic dispersion may thus dampen the competitive forces of the market. Higher prices and higher profitability bring more taxis into the market. The process continues until the market is saturated with taxicabs and price comparison is feasible. Thus, the market ends up with an inefficiently high number of taxis.

Regulation has been proposed to achieve

more efficient outcomes. Regulatory authorities set the number of taxicab licenses or medallions (entry regulation) and the fares that taxicabs can charge to users (price regulation).

A potential problem with price and entry regulations, though, is that they may lag behind changing economic conditions, such as population growth or an increase in economic activity. Inadequate regulation benefits existing taxicab license holders, who may lobby regulators to keep the status quo. Historical evidence seems to support this view. The number of taxicab medallions in New York City, for example, remained unchanged for over sixty years (60!) at 11,787 until a court order added 400 medallions in 1996.

Radical changes in the institutional organization of taxicab markets, such as outright elimination of the medallion system, may not be politically feasible in many instances. However, economists often can find ways to work within existing regulatory frames and focus on viable changes that improve market efficiency and increase benefits to consumers.

Generally, each U.S. city regulates the taxicabs operating within its city limits. In Western Europe, on the other hand, taxicab markets tend to be regulated by broader regulatory bodies that

encompass several adjacent cities in a metropolitan area: taxicabs licensed to operate in a metropolitan area may pick up and drop passengers in any of the cities that belong to it.

Regulation at the city level creates a specific problem: in order to make entry regulations effective, picking up customers on the streets of a city must be restricted to taxicabs licensed by that city only. These “exclusive cruising” regulations would not have major economic effects in self-contained cities. However, they create inefficiency in metropolitan areas formed by more than one city: a taxicab driving a passenger to a destination beyond the city limits must return empty to the

city of origin.

Recent analysis of taxicab traffic data between the cities of Boston and Cambridge (Massachusetts) provides evidence that exclusive cruising regulations have a significant impact on the way taxicab markets operate: in most instances, taxicabs licensed in one city go to the other city only when occupied, and return to their city of origin without passengers.

Merging the taxicab markets of two closely related adjacent cities can improve market efficiency, increasing taxicab availability and reducing idle taxicab time. Taxicab regulators in the U.S. could do worse than considering the creation of metropolitan taxicab markets.

*1For more information, see: Daniel Flores-Guri, “Local Exclusive Cruising Regulation and Efficiency in Taxicab Markets.” Forthcoming in *The Journal of Transport Economics and Policy*, v. 39, May 2005.*

Daniel Flores has been invited to Paris to participate in a RoundTable of European Ministers of Transport and OECD regarding taxi (de-)regulation.