
Seattle Taxis: Deregulation Hits a Pothole

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ALL TOO OFTEN, we talk vaguely about regulating or deregulating “the market” for some good or service, while forgetting that most sizable markets are not uniform entities: they consist of a collection of submarkets, often quite different from one another. Policies that work well for competitive parts of the market may work badly in the noncompetitive pockets, and vice versa. Regulation itself may represent a mix of “public-interest” and self-interest effects and motives, so the effects of deregulation may also be mixed. In general, deregulation as well as regulation may have unexpected side effects. The case of taxicab deregulation in Seattle shows why regulatory reformers should keep this complexity in mind—and what can happen when they do not.

Taxis came to be regulated in Seattle in much the same way as in other U.S. cities. First the powerful transit union correctly perceived taxis as a threat to buses and trolleys and called for a halt to the “ruinous competition” of cabs. The city, which itself had an economic stake in the matter as owner of the transit system, responded in 1930 with a tough ordinance that fixed uniform taxi fares and restricted the number of taxis to one for every 2,500 residents (a number apparently pulled from the air but that

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lasted for about forty years). Subsequently, King County, in which Seattle is located, established very similar price and entry controls, as did the Port Authority that operates the Seattle-Tacoma (Sea-Tac) airport. Later, the port moved to an exclusive franchise arrangement.

This regime was ended in 1979 when all three jurisdictions—the county and port in May, and the city in June—adopted similar rules allowing open entry and permitting individual taxi firms to change fares as often as every three months by simply filing new rates. It was a sweeping act of deregulation intended to reduce fares, increase jobs in the industry, and eliminate the administrative burden of taxi regulation. All this it has done. But it has produced some adverse consequences as well, and these have led to a partial reregulation and to some public demand for further regulation. It is a case where more careful analysis of the market at the beginning might have avoided subsequent difficulties.

How the Reformers Won

Taxicab deregulation in the Seattle area resulted from a somewhat unique confluence of ideological and practical factors: an activist, consumer-oriented regulatory reform movement within city government; a forceful, pro-competitive member of the city council; a series of requests for fare hikes, brought on by rapidly

increasing gasoline prices, that made continued regulation a burden on the city council; and a poorly organized taxicab industry.

On the ideological side, the most important factor was Councilman Randy Revelle's personal commitment to decontrol (and his success in persuading the Port Authority and King County to go along). He was backed up by economists from the city's Department of Licensing and Consumer Affairs, which had responsibility for taxi regulation, and from the Federal Trade Commission's Seattle office. These economists agreed on the need for a market solution to the taxi problem, including at least an end to entry and minimum-fare regulation. (Some of them wanted to retain maximum-fare regulation.)

On the practical side, the most important factor was probably the city council's growing experience with the inherent economic and political difficulties of setting rates. In the several years before 1979, owners' costs were rising rapidly, and the council, which had to approve or deny all requests for rate changes, was swamped with work. It grew unhappy with the quality and quantity of the financial and operating data that taxi operators supplied to support their requests, while the operators complained about the hassle of compiling it. Rate hearings became long and bitter. In the end the council, not sure what rates would be economically or politically "right," held off on allowing increases—and moved toward decontrol.

Whatever the relative importance of different factors in bringing about deregulation—interviews with council members and staff suggest that the council's dissatisfaction was second in importance only to Revelle's persistence—it is beyond question that the impetus for reform came mainly from within the city council. There was never an organized consumer movement for deregulation. The taxi industry spent several hundred dollars per cab fighting the idea, but failed nonetheless.

What Happened under Deregulation

Elementary economic analysis predicts that the combination of price and entry restrictions should lead to higher fares, lower taxi usage in general but more intensive use of each cab, slower responses to customer calls for service, and positive license (or medallion) values.

Fares should be higher because restricted entry raises the market-clearing price and because, under uniform price controls, regulators will tend to set fares above market-clearing levels. In consequence, the license to operate a taxi, known as a "medallion," will carry a positive value: new entrants will be willing to pay to buy one. The medallion price should approach the present value of the stream of future fare income that an owner expects to receive, over and above the costs of operation, and that can be attributed to the artificial scarcity of cabs. (See "New York City Looks at Taxi Regulation," Perspectives, *Regulation*, September/October 1982.)

Deregulation would, of course, reverse the effects of regulation. Thus, it could be expected to attract more cabs into the market, which would lead to lower fares, higher industry employment, faster response times, and falling license values. All this did in fact occur.

- The number of city-licensed cabs rose by around 21 percent, from 421 just before deregulation to 511 by August 1981, and the number of taxi companies rose nearly 50 percent, from 57 to 85. The number of airport-licensed taxis increased from about 35 under the previous exclusive franchise to 263 by December 1979. (Currently there are about 208 such taxis, even though the license fee has risen substantially.) Thus employment in the industry clearly rose, a significant item to be added to deregulation's side of the ledger. Moreover, although the available data are scanty, it appears that response times are much faster under deregulation.

- The effect on fares is more difficult to assess, for two reasons: the period was one of rapid general inflation, and the city council, busy planning deregulation, had let rates fall to abnormally low real levels by 1978. Thus, from mid-1979 to April 1982, fares of radio-dispatched cabs (mainly fleets) increased about 6 percent in nominal terms, while fares of airport cabs increased by 25 percent and those of cabs not radio-dispatched (mainly independents) increased by about 30 percent. However, several comparisons suggest that deregulation helped keep fares down and, indeed, that fares fell in real terms.

The "average taxi trip" I used for purposes of comparison was 3.4 miles long and was weighted by type of taxi (airport, radio, other). After calculating the fare for such a trip for

COST OF AN AVERAGE TAXI TRIP IN SEATTLE, 1967-81

each of the years 1967-81, I compared the results with both the Bureau of Labor Statistics' index of private transportation costs for the Seattle-Everett SMSA* and the consumer price index (see table). First, I found that over the period from 1967 to mid-1979, fares for the average trip were 11 percent higher than the cost index for private transportation, whereas in the two-and-a-half years after mid-1979, they were about level with that index. These figures suggest that fares would have been about 11 percent higher had controls continued: a 3.4-mile trip would have cost \$5.55 in 1981 rather than \$5.00. Second, I found that fares averaged 99 percent of the national CPI in the twelve-and-a-half years before deregulation, compared with just 92 percent afterwards.** The decline in real fares for radio cabs has been especially dramatic: the largest firm has not hiked its rates since 1979.

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• License values also fell, as expected. In Seattle, the taxi license is attached to the vehicle itself, so that the sale price of a taxi will have a physical and a license-value component. I estimated license values (with assistance from Tim Feetham) by comparing bill-of-sale data for cab sales with "blue book" values for the cabs and radios. The difference is the value attributed to the license. In the twelve years before deregulation, licenses in Seattle fluctuated in value—depending on taxi costs, fares, the volume of business, and the probability of deregulation—from \$12,000 to about \$2,500. As deregulation approached, the value fell toward zero.

Taking a figure in the middle-to-low part of this range, \$5,000, we can estimate the total value of Seattle-area cab licenses at about \$2 million. This gives us another way to estimate the amount by which the regulated fares exceed-

Year	Taxi Fare for 3.4-Mile Trip		BLS Private Transportation Cost Index, Seattle- Everett (1967=100)	Ratio of Fare Index to Private Transportation Index	Ratio of Fare Index to CPI, All Items (national)
	In dollars	Indexed (1967=100)			
1967	1.91	1.00	1.00	1.00	1.00
1968	1.91	1.00	1.02	0.98	0.96
1969	2.50	1.30	1.03	1.26	1.18
1970	2.50	1.30	1.05	1.24	1.12
1971	2.50	1.30	1.07	1.21	1.07
1972	2.50	1.30	1.10	1.18	1.02
1973	2.50	1.30	1.14	1.14	0.94
1974	2.98	1.56	1.28	1.22	1.00
1975	2.98	1.56	1.40	1.11	0.97
1976	3.20	1.68	1.51	1.11	0.99
1977	3.20	1.68	1.63	1.03	0.90
1978	3.20	1.68	1.75	0.96	0.83
1979					
Jan.-June	3.20	1.68	2.04	0.82	0.73
July-Dec.	4.20	2.26	2.04	1.08	0.96
1980	4.40	2.30	2.37	0.97	0.89
1981	5.00	2.62	2.67	0.98	0.93

Note: Taxi fares are averages for the periods.

ed the market-clearing fares. The yearly flow of income corresponding to that lump sum is about \$200,000. Divided by the 3.5 million passenger miles that Seattle cabs drove per year, that amounts to a price premium of six cents per mile or about 5 percent. Indications are that the demand elasticity for taxi service is about -1; that is, a fare increase would result in a directly proportional reduction in passenger miles. This means that the reduction in passenger miles owing to regulation would also be about 5 percent.

In sum, the evidence from the transportation cost index, the consumer price index, and medallion values suggests that deregulation has lowered fares as expected. It is curious that, before deregulation, city officials believed fares were artificially high, but they apparently did not believe that licenses had significant market value—which is one reason why they were willing to deregulate. In fact, if license values had been zero, there would have been no point in

*This index includes the costs that are most germane to taxi operation, except for labor.

**The fare reduction under deregulation is somewhat less if one combines the transportation cost index with an index for labor costs in the service industries. The amount of the reduction depends on the relative weights given to the two indices: giving them equal weight yields an implied fare reduction of 1 or 2 percent, while assuming a smaller labor component yields a larger reduction (but in no case larger than 10 percent).

deregulation: fares would already have been at the competitive level.

The Split Taxi Market

For the major submarket of taxicab services, that of radio-dispatched cabs, deregulation fulfilled, and continues to fulfill, the intended goals of lower fares and better response time. This market, which included about 60 percent of the operating taxis in 1982, encompasses the major fleets. But deregulation has not been so successful in the other 40 percent of the market where cabs wait in a line for passengers. This market is made up mostly of independent operators. While the new entry and pricing freedoms did improve the availability of cabs here, they also produced a number of unexpected problems—and, as a result, widespread consumer complaints.

The troubles at the King Street railroad station were representative of, though a bit more extreme than, those at cab stands in the city. Before deregulation, Amtrak awarded the right to serve the railroad station to a single franchisee. It agreed to switch to open entry in 1979, mostly because of pressure from independent operators—who quickly took advantage of the new opportunity. Long taxi lines developed, taxis spilled out of the assigned areas, some drivers left their cabs (blocking access for Amtrak employees and passengers, as well as fellow cabbies), and some loitered in the station aggressively seeking passengers. Amtrak personnel attributed these problems almost entirely to the independent cabs. Independent drivers clashed with drivers of the lower-priced “major” cab fleets. On one occasion independents delayed a major from leaving the station with a passenger, on another they ripped off the station wall a direct-line telephone that passengers could use to call one of the majors. There were reports of physical intimidation, of drivers who lied about the availability of bus service, who were slovenly, vulgar, and rude—and so on. Amtrak officials and tourist-related businesses naturally began to worry that all this was making a bad impression on visitors to the city.

The Sea-Tac airport has had even worse problems in its cab lines, largely because it has mostly kept the system for assigning cabs it used in the days of uniform fares. Taxis are

called up into the loading area one by one, strictly according to their place in the line. It is a system that impedes price competition, because it puts drivers in a stronger position than customers. A cab that refuses, or is refused by, a customer goes not to the end of the line but to a holding area, so that it soon returns to the head of the line. Moreover, airport customers are unlikely to dicker with or refuse a cab that seems to be assigned to them, especially when they do not know local fares or know that legal fares may vary, or when they are on expense accounts and not much concerned about costs. Until changes were made in early 1981, taxis operating solely at the airport were able to set their fares as high as they wished so long as they could find enough customers to pay. In contrast, cabs that also picked up passengers away from the airport, in areas where there is more price competition, were more reluctant to raise their fares to the level profitable for airport taxis. As a result, fares were not only higher than before, but also varied substantially: a consumer might, for example, pay \$25 for a ride from the airport to downtown Seattle and only \$16 for the return trip. Interestingly, consumers have protested more about the fare *discrepancies* than about the *amount* of the fare, which suggests they would pay a premium to have uniform rates.

As fares at the airport rose, they attracted new entrants and the taxi lines became much longer. But since each cab was making fewer trips, the drivers were no better off. Many of them refused short-haul customers because they had invested so much time getting their place in line. Also, cab operators say that tension among drivers increased, exacerbated by instances when customers chose a cab other than the first in line.

Finally, at the airport, as at the cab lines downtown, the quality of the ride deteriorated. Drivers were less knowledgeable, cabs dirtier. Some deterioration in quality results from open entry: new entrants are likely to know less about the area. And some is to be expected when prices drop in a deregulated market. As the airline case demonstrated, price and entry regulation leads to greater competition on the basis of quality. In cab lines, however, the deterioration in quality also occurs because there can be little competition on the basis of either quality or price.

The Response

The troubles in the cab lines—large increases in fares, substantial variation in fares among taxis, much longer taxi lines, refusals by drivers to carry passengers short distances, and minor violence—convinced area officials, hotels, and the tourist industry that this market was not suited to full-scale decontrol. The different jurisdictions responded in different ways.

Early on, the city council addressed the problem at cab stands by passing an ordinance requiring cabbies operating in the city to post their fares on the outside of the vehicles. It is unclear whether drivers would have done this anyway. In any event, rate-posting seems to have benefited customers by helping them shop around among taxis, though the evidence is anecdotal and difficult to quantify.

More recently, some members of the city council began to agitate for full reregulation of city cabs, and two hearings were held. The effort collapsed, however, when the city's lawyers noted that the U.S. Supreme Court's decision in *Community Communications Co. v. City of Boulder* (1982) "could expose the City to liability for antitrust violations for returning to taxi cab regulation." Pressure to reregulate thereupon shifted to the state level, where antitrust immunity operates more strongly.

Amtrak officials, having put up with the troubles at the station for over three years, decided in mid-1983 to re-franchise taxicabs. Meantime, some hotels had already moved on their own to reduce fare uncertainty for their guests: they have been guaranteeing fixed fares from the hotel to key locations, something they can do by using only the lower-priced radio-dispatched cabs (in a kind of informal franchising arrangement).

The Sea-Tac Port Authority, which has responsibility for regulating airport taxis, began considering some changes in late 1980. Among them were four suggested by the Seattle regional office of the Federal Trade Commission: develop a way of bringing the cheapest cab to the front of the line, make more information available to customers, limit entry to the cab companies that "bid" with the lowest fares, or regulate entry or fees. The port rejected the first option as too costly to implement, the second as having already failed in a limited experiment, and the third for reasons not stated (my guess

is the port feared a hostile reaction from the drivers).

To their almost immediate embarrassment, port officials decided on a version of the fourth option: they established maximum rates, setting them equal to the average of rates registered with King County. It did not take long for a group of enterprising cab owners to torpedo the plan by getting one driver, who did not expect to operate in King County, to file a rate of \$500 a "drop" and \$100 a mile within the county. These ludicrous numbers raised the average rate far above the level that prevailed even among the highest priced airport taxis.

Although the taxi drivers won round one, the port struck back within a month. In February 1981, it adopted a maximum-rate scheme based not on the average rate but on the median rate, which cannot be so easily manipulated. That put an effective lid on fares charged by cabs at the airport, and seems to have eliminated most of the obvious problems. The price differences between non-radio-dispatched cabs and radio-dispatched cabs have narrowed. Consumer complaints have also decreased: the city reported in 1982 that it had received only one complaint in the last half of 1981 as against twenty-three in the same period of 1980. Cab lines at the airport remain long, but the problem of short-haul customers has been solved by creating, at the drivers' suggestion, a special line to serve only customers going shorter distances. Finally, passengers have become more familiar with deregulation, which—coupled with rate-posting—has brought some competition to the taxistand market.

The port's solution is not ideal from a purely economic viewpoint. The *maximum* rate has tended to become *the* rate (as the U.S. Supreme Court foresaw in the 1951 *Miefer-Stewart* case). Fares charged by taxis at the airport are 20 percent or more above the competitive price as judged by the fleet price in Seattle, and there still are large differences between the fare from the airport (now \$23) and the fare from the hotel to the airport (still \$16).

A Preferred Direction?

Partial reregulation has alleviated many of the problems that arose in the noncompetitive cab-line market. Those that remain could be addressed in a number of ways. The problem of

driver and cab quality can be handled in part by direct regulation, and Randy Revelle, now the county executive, recently introduced a bill that tries to do this. Of course, this approach to quality improvement has its own costs—in inspectors, paperwork, and so on. The problems of fares and long lines are more tricky, and the proposed solutions more numerous. They include setting flat rates to and from the airport and certain key points, establishing a zone rate system, imposing a city-wide maximum-fare schedule, allowing only radio cabs or cabs that agree to abide by radio cab rates into the market, and refashioning the separate ceiling that now exists for airport fares.

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It is the last of these options that I would like to take up here. The problems at the airport and similar locations have one basic cause. Because customers find it hard to shop efficiently for service, taxis can charge high fares. Consequently, a long line of cabs forms at the airport—thus driving up costs of operation, dissipating the monopoly profits, and retrospectively justifying the high level of fares. The Port Authority has the responsibility for improving the operation of this market, for the simple reason that it is the one that controls the bottleneck of congestion through which taxis compete; it serves its customers poorly if it does not provide for the best use of its taxi stands.

There are two maximum-fare schemes that would ease the bottleneck problems. First, of course, the Port Authority could simply lower the existing ceiling so as to reduce congestion by any desired amount, while still letting into the cab lines all cabs whose fares are not above that ceiling. Alternatively, it could invite taxis to “bid,” with the lowest fare schedules, for airport licenses. Of course, both schemes would require port officials to estimate the number of taxis needed to meet peak demand (the first implicitly, the second explicitly). This number,

the officials say, is relatively easy to determine and is probably about eighty cabs—far fewer than are currently working the airport and undoubtedly closer to the competitive number. In any case, the port could adjust the fare in the first scheme or the number of cabs in the second, in order to maintain any desired level of probability that a customer would find a cab available at slow periods. Fares would be lower on average than they are now, since cab owners would save in congestion costs what they lost in lower fares.

It is an interesting question whether such a plan would violate what might be called the spirit of competition or the spirit of deregulation. I would argue that it does not. An airport is no more obliged to give away its taxi bottleneck to all comers than a restaurant is obliged to open its hat-check room to competing hat-check concessionaires. Precisely because their businesses are competitive, restaurant owners strive to provide for their customers the most attractive overall package of services.

Conclusion

Deregulation in Seattle varied notably in its results among different types of taxis and different places. It worked well in the market in which direct price competition is possible (among radio cabs). But in markets where price competition is difficult (at the airport and at cab stands downtown), it led to fare discrepancies, higher fares, and other problems that were a major source of consumer dissatisfaction. In hurting some groups and helping others, its overall effect on economic welfare is indeterminate. Probably the most important benefit has been additional employment.

The lessons of Seattle taxicab deregulation are more complicated than the simple one that deregulation works or does not work. First, a change in regulation—from more to less, just as from less to more—can have unexpected side effects. Second, reformers should realize that, in some markets, even institutional structures that at first sight appear to restrict entry—such as Amtrak’s franchise operations—are compatible with a competitive (low-cost) solution. To view the choice of policies as a black-and-white dichotomy between regulation and deregulation is much too simple. ■