

# Of Taxi Cabs and Special Interest Groups

A study conducted by Armstrong Atlantic State University students in

Economics 4450: Public Choice

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October 2009

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## **I. Introduction**

Imagine for a moment that Bill Gates is pleading to Congress to have it stop Linux, MAC, and Unix from supplying their product because Microsoft is unable to cover its costs. He would be saying: My competitors have to stop because “there are so many [operating systems] that nobody can make a living anymore”. Imagine Bill Gates uttering these words. Would anyone feel an ounce of sympathy for Bill? We do not think so.

The above quote is from Larry Greene (SMN, 9-23-09), the president of the Savannah Taxi Owners Association (STOA), in which we substituted the words “operating systems” for “cabs.” This statement is made to defend the proposed ordinance limiting the number of taxi licenses in Savannah. The argument for the ordinance is faulty, at best. The fundamentals of supply and demand do not support the claim that with fewer suppliers, fares will fall. The opposite, in fact, holds true as we shall demonstrate below.

The true aim of the ordinance is to reduce competition and increase long-term profits of large-scale taxi cab operators, greater profits than what the market would normally allow. With fewer suppliers in a given market, market share is increased for the remaining suppliers, which makes it easier for the taxi cab cartel to lobby city hall for higher fares in the future. Indeed, STOA is lobbying for a government-enabled small scale cartel, a local OPEC, if you will, on taxi cab services in Savannah.

STOA’s claim that “nobody can make a living anymore” is effectively an admission that they are running inefficient businesses. Solutions to that problem include re-tooling the business or asking for aid from the government. STOA seems to be opting for the latter approach. They are arguing that they need an ordinance to artificially prop up their business with what is effectively a tax on consumers by eliminating competitors.

In the sections that follow, we outline the basic economic theory that is relevant to the situation at hand. A brief review of the City of Savannah’s regulations governing taxi cab operation follows. We end with brief discussion of the ordinance and the problems it is supposedly meant to address.

## **II. Underlying Economic Theory**

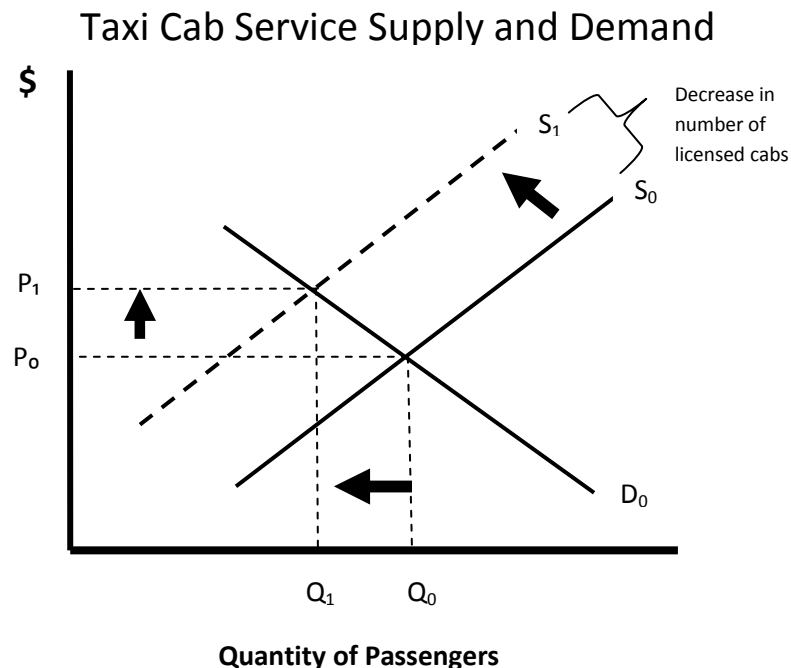
The quote from the President of the Savannah Taxi Owners Association suggests that large scale taxi cab companies face higher average costs per ride than smaller independent, part-time, and/or weekend cab drivers. This is likely due to higher overhead costs associated with maintaining a large fleet of vehicles, employee compensation, dispatching costs, insurance, etc. The claim of the large cab company operators is that they are not securing a sufficiently large volume of passengers to cover their costs, and therefore “no one can make a living anymore.” The small-scale operators are obviously covering their costs or they would not be able to stay in business.

The Savannah Taxi Owners Association (STOA) wants to limit the number of cabs on the street in order to increase market share for large operators; with less competition for passengers they would be able to cover their higher overhead costs, and presumably “can charge less per trip.” By asking the city to regulate the number of cabs, STOA is asking the city to limit their competition. If there truly are too many cabs on the streets of Savannah, it would be unprofitable to operate and the market will force companies to downsize or go out of business. The essential problem for the large operators is that they are operating inefficiently, and therefore should scale back their operations or change their business strategy. However, the clear preference of the large scale operators is that the city regulate their competition of out existence, rather than they right-size their own business.

The long term implication of the proposed ordinance is that some cab operators, 124 to be exact (a 44% reduction in the number of licenses), will lose their jobs as cab operators. The obvious matter of interest is which operators will lose their jobs. As a special interest group advancing the interests of large-scale taxi companies, it is clear that STOA would prefer that its membership retain those licenses while the part-time and weekend operators lose their licenses. This is the purpose of the grandfathering clause in the proposed ordinance. Existing cabs would be protected while attrition will reduce the number of cab operators. There is no doubt that the large majority of the licenses lost through attrition will be lost by part-time and weekend operators, while large-scale operators will be less affected by attrition. Thus, the grandfathering clause ultimately will contribute to increasing the market share of large-scale operators while competition from small independent cab operators diminishes through time.

We use several charts below to illustrate that basic supply and demand theory is at odds with STOA's claim that the regulation may result in lower fares charged per trip. Well, to be fair, there is one circumstance under which this claim can be true, but we will address that shortly.

In the supply and demand chart below, it is demonstrated that as the number of licensed cabs is reduced (to  $S_1$  from  $S_0$ ), the fare must increase (to  $P_1$  from  $P_0$ ), all else equal. Neither we, nor STOA, can repeal this basic law of supply and demand. As fares increase, the volume of passengers will decrease (to  $Q_1$  from  $Q_0$ ) – passengers will find other means of transportation, where feasible, such as the free CAT shuttle. If rising fares are deemed socially and politically unacceptable in Savannah, this may result in a call for further regulation that caps the price of a ride, as in the current city code. However, if regulation caps the price below the free-market determined price, a shortage will emerge in the market. The regulation must very carefully, almost miraculously, identify what the market-determined price of a taxi ride will be to avoid a shortage.



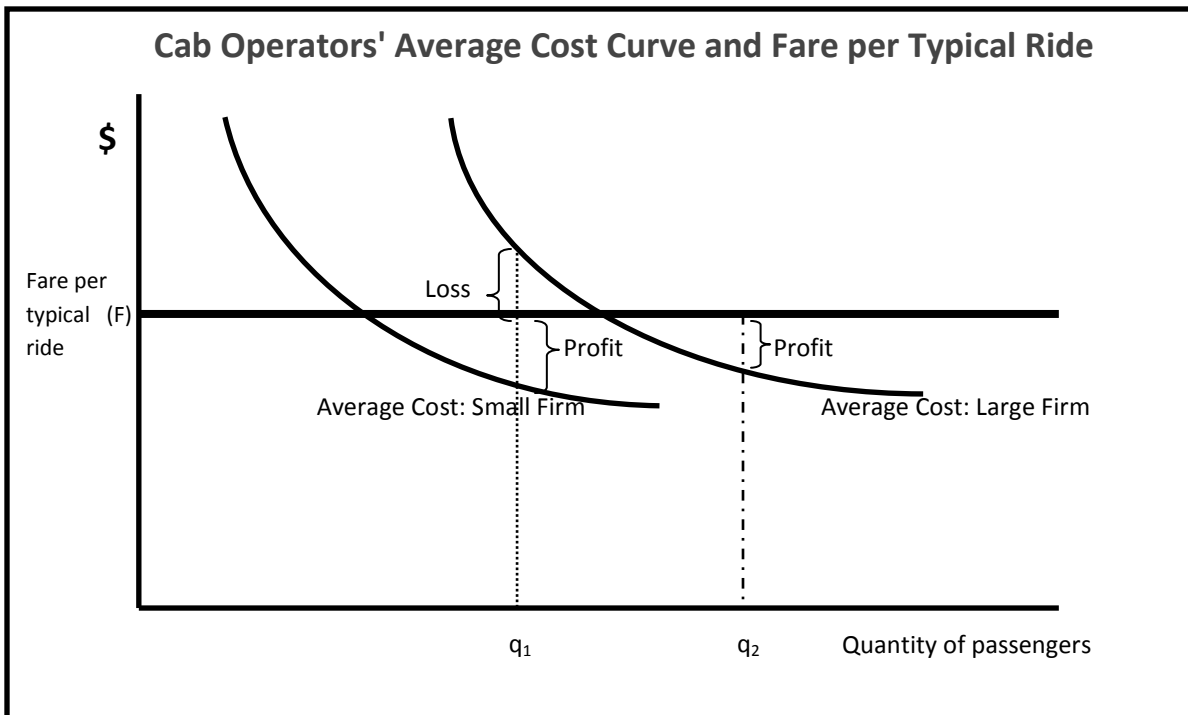
STOA suggests that by reducing the amount cabs on the street they would be able to reduce the fare faced by passengers. This is fundamentally inconsistent with the basic law of supply and demand as explained above. However, there is a case in which a reduction in supply could be consistent with lower

fares offered to passengers. What must happen is that the market share of inefficient large-scale operators increases (to the detriment of small-scale independent cab operators) so that the higher overhead costs are spread over more passenger trips. The easiest way to accomplish this is if regulation induces small operators to exit the market while simultaneously creating a barrier to entry into the market for taxi services in Savannah.

Adoption of an ordinance that ultimately increases the market share for large-scale operators would inhibit the attainment of the normally efficient outcome generated by markets unfettered by government intervention. The result is a reduction in output (to  $Q_1$ ) and an increase in price (to  $P_1$ ) as shown in the above diagram. Consumers pay a higher price for reduced output – this is clearly an economically inferior result as compared to a market-determined outcome.

We illustrate STOA’s claim regarding a possible reduction in fares with the chart below. Due to higher overhead costs, the average cost curve for large-scale operators exceeds the average cost curve for small-scale operators. At a given fare (F) and volume of passengers ( $q_1$ ), the large-scale operators face losses while the small-scale operators can survive, and indeed, thrive with the profits they are earning at  $q_1$ . Thus, the small-scale operators cover their costs per ride while the large-scale companies operate at a loss. In order for the large-scale operators to “make a living” they would need to increase their share of the market, represented in the chart by an increase in the number of passengers from  $q_1$  to  $q_2$ . The proposed city ordinance would do this by strictly limiting entry of new competitors (through the cap on the number of licenses) and through attrition which is much more likely to affect small-scale license holders (independents, part-timers, week-enders) than large-scale license holders.

The large-scale companies are simply asking the city to enable the establishment of a cartel in the provision of taxi-cab services in Savannah. How does this happen? By means of an ordinance reducing competition and enhancing the concentration of market share in the hands of large-scale cab operators represented by STOA.



If the number of cabs licensed to operate is reduced and small-scale independent, part-time, and weekend cab operators are driven from the market, the large-scale operators could capture a larger volume of passengers and cover their higher cost per ride. However, not everyone can increase their market share at the same time, so a sorting mechanism (the grandfathering clause and its implications) must be established by the ordinance. The fundamental result of the ordinance is that small-scale, weekend, and part-time operators are displaced from the market. The increased market share that STOA is lobbying for on behalf of its membership would adversely affect the market share of small-scale, more efficient cab operators. This does not bode well for consumers of taxi cab services in the Savannah market, for the underlying upward pressure on fares induced by the regulation (as illustrated above in the supply and demand chart) will ultimately result, to be sure, in STOA clamoring for higher regulated fares in the now-cartelized market.

At the end of the day, the large-scale taxi cab operators are asking the city prop up their business by reducing their competition. There is no such thing as an entitlement to any portion of the marketplace whether it is a long high-fare route or a short low-fare route. Competition in the marketplace ultimately will squeeze out inefficient operators and yield the lowest possible price for consumers. It is normal and desirable to expect that firms in a competitive market will try to find ways to acquire, expand, or maintain market share. This type of competition is good for consumers. However, it is economically unproductive for the city to enact an ordinance desired by a special interest group that will limit the number of licensed taxis because, by reducing competition, market inefficiencies result that injuriously affect consumers.

### **III. Current City Regulation of Taxis**

The City of Savannah currently has 23 pages of code establishing basic requirements for taxi cab companies and drivers. The requirements for the companies include a taxicab regulatory permit which must be displayed in each vehicle in a conspicuous area. An insurance policy is required for the passengers, and separate insurance is mandated for each taxi-cab.

Requirements are also listed for individuals desiring to work as taxi cab drivers. A permit is required for each operator. The code outlines in explicit detail the application stages to be followed in acquiring a permit and the requirements for obtaining a permit. The basic thrust of the requirements is to enhance the safety of the service provided to passengers. For example, the requirements include:

- physician's certification of good health
- must be 18 years of age or older
- cannot have a D.U.I. or major traffic violations
- a current valid driver's license and test

The permitting requirements, including a trivial \$10 fee for a background check and a \$10 driver's permit fee, act as minimal barriers to entry into the market. The code establishes rate (fare) schedules, delineates clear and explicit guidelines governing driver conduct, and provides rules for matters related to the operation of safe taxis. The code also provides for the removal of unsafe vehicles and drivers.

The overall thrust of the code is to allow easy entry into the market, thereby enhancing competition, while presumably protecting the safety of passengers. The customer service problems

cited by advocates of the proposed ordinance are already addressed by the existing code. Enactment of laws and regulations will not necessarily result in adherence to the laws. However, enforcement of the laws will likely have the socially desired effect. We recommend enforcement of existing laws rather than the passage of new laws to address the alleged problems of cab driver appearance and behavior in Savannah.

#### **IV. Conclusion**

STOA wants to limit the number of cabs on the streets of Savannah in order to increase the market share of large-scale operators because with less competition for passengers they would be able to cover their higher overhead costs. If there truly are too many cabs in Savannah, it would be unprofitable to operate and the market will force companies to downsize or go out of business. STOA appears to prefer that the ordinance protects their members through grandfathering rather than allowing market forces to determine which operators get downsized. Market solutions apparently have no place in the heart of a special interest group.

In closing, the proposed statute to limit the number of taxi cab licenses is not the solution to any supposed problem that consumers or STOA are facing. Some drivers' slovenly appearance or unruly behavior can be controlled by better enforcement of the existing 23 pages of taxi cab regulations. As a special interest group, STOA is doing what, from a public choice perspective, it is expected to do – obtain favorable regulation that limits competition and increases market share for its members. All of this takes place at the expense of consumers, as usual.