

Cab ride to the future

Uber and Lyft show how tech innovation and deregulation benefit society

By Jim Epstein

Not so long ago, economists pointed to government interference in the cab industry as a parable for the folly of artificial supply constraints. Take the New York City taxi mess, which began in 1937 with the passage of the infamous Haas Act.

The law, which was widely imitated by other cities, fixed the supply of taxis at 16,900 (the total has since dropped to 13,437) by issuing exclusive operating licenses called medallions that can be bought and sold on a secondary market. New York's medallions initially sold for \$10 apiece; today they run about \$1.15 million.

Medallions drive up fares, limit service and diminish profits. In New York, cabbies can still buy their own medallions — if they can scrounge up a \$200,000 down payment and commit to an annual mortgage

payment of about \$28,000. Alternatively, drivers can rent medallions — which means forking over about \$115 per shift.

Milwaukee's recently deposed cab system was similar to New York's.

In 1992, Milwaukee stopped issuing new taxi permits, capping them at 354. (The total eventually dropped to 321.) With the supply of cabs constrained, the value of these licenses climbed to about \$150,000 apiece. Brothers Mike and Joe Sanfelippo — Joe is a Republican state representative from West Allis — control 162 cab licenses, or more than half the total.

This system has done a poor job of serving the riding public by making it nearly impossible to catch a cab in downtown Milwaukee during certain hours.

There's just one licensed taxi in Brew City for every 1,850 residents. (New York City has about three times that per capita.) But the Sanfelippos and other permit owners lobbied against boosting the cap because, understandably, they didn't want to see their assets diluted.

Licensing caps have also made it difficult for drivers to get out from under the control of cab companies. That's why, in 2011, three Milwaukee cabbies teamed up with the libertarian public interest law firm the Institute

for Justice and sued Milwaukee to lift the permit cap. In April 2013, Milwaukee County Circuit Court Judge Jane Carroll ruled that the law violated the state constitution, and in November the Milwaukee Common Council voted to meet the court partway and amend the law by adding 100 new permits.

Enter Uber and Lyft, two Silicon Valley-based software companies that in just four years have remade the taxi business in cities across Europe and the United States. This is no small feat, because this seemingly impregnable industry hadn't substantially altered its operating practices since the first cabs appeared on the streets of Victorian London.

But the bigger story about Uber and Lyft is about much more than just cabs.

“Software is eating the world,” venture capitalist and Netscape cofounder Marc Andreessen memorably quipped in a 2011 *Wall Street Journal* op-ed. The cab business itself isn't significant to the overall economy. (Federal data show only one of every 431 working Americans drives a cab or a limo.) But the upending of this industry provides a

perfect case study for what happens when software transforms consumer markets, a trend that's been supercharged by the global proliferation of smartphones.



The upending of the cab industry provides a perfect case study for what happens when software transforms consumer markets.



Within two years, according to the digital research firm eMarketer, a third of the earth's population will be carrying these powerful, pocket-sized computers, making it seductively simple to integrate software into our everyday lives. Use of software is replacing timeworn

practices — such as flagging down a cab by walking into the street and waving a hand in the air.

The curious thing is that Uber and Lyft have more in common with eBay than with a traditional taxi or limo company. Uber and Lyft don't own any cars. Their businesses are rooted in the versatile online platforms they developed to connect passengers with drivers (who are independent contractors). This has significantly reduced the transaction costs associated with taking a cab.

To order a car through one of these services, a customer first opens a smartphone app, which automatically detects the pickup location using the built-in GPS. A simple tap of the screen books a nearby driver. Then an estimated arrival time appears on the screen, and the customer can watch on a tiny map as the vehicle approaches.

After the ride is finished, a charge automatically hits the passenger's credit card or PayPal account, which Uber and Lyft keep on file, without haggling or tipping. Fares fluctuate based on the supply of cars in the pickup neighborhood. Known as “surge pricing,” this controversial feature occasionally

results in outlandish fares, but it also entices drivers to underserved areas.

The very same week the Milwaukee Common

Council agreed to boost the cap on cab permits, drivers for these two companies rolled into town and began making a mockery of the city's regulatory system.

"All of a sudden on a weekend in downtown Milwaukee there were hundred of cars to choose from if you want to get home from the bars," says Anthony Sanders, who was the lead attorney for the Institute for Justice in the Milwaukee lawsuit. "The drivers were more confused than anyone because for the longest time you could barely get a job driving, let alone own your own vehicle," he says. "It was just marvelous to watch it all play out."

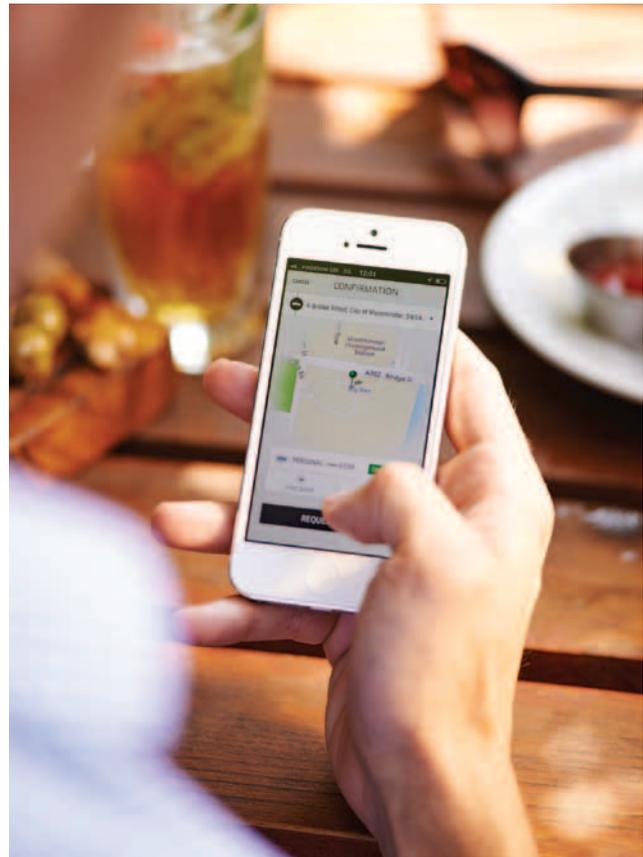
Milwaukee's taxi regime unraveled at an astonishing pace. Ald. Robert Bauman, who sponsored the legislation that boosted the number of permits by 100, came out with a new bill lifting the cap altogether and legalizing services like Uber and Lyft. Bauman's bill was a model of laissez-faire governance, mandating that drivers submit to regular vehicle inspections but little more. The legislation sailed through the council, and in August, Mayor Tom Barrett added his signature.

Uber and Lyft transformed the city's taxi laws by throwing a wrench in the political sausage factory. The city's 1992 cap came into existence in the first place because permit holders, with much to gain, hired the law firm of Adelman, Adelman & Murray to lobby the council to impose a cap.

The bill passed the council without getting much attention because future drivers and the general public — those most hurt by the cap — weren't clued in, so they didn't know to object.

Uber and Lyft clued them in.

The companies won supporters by getting Milwaukeeans hooked on their service before wading into a political battle, which forced City Hall to play catch up. The Common Council could no longer bend to the demands of the taxi cartel because that might anger their constituents.



In Milwaukee and other cities, the battle has moved

to the courts. Cabbies in Seattle, Boston and Houston have filed suit against Uber for trampling on their territory. In February, a group of operators sued the city of Chicago, claiming that by tolerating these new companies, the local government has devalued their medallions, which have an estimated worth of \$2.38 billion.

In August, a group of cab companies owned by

the Sanfelippos sued the city of Milwaukee for both monetary damages and to invalidate the new taxi ordinance, on the grounds that their 162 permits, which as of February the plaintiffs said were worth somewhere between \$16 million and \$24 million, will lose nearly all their value when the cap is lifted.

Red Christensen, director of the Milwaukee Chapter of the Wisconsin Association of Cab Owners, says that most of the remaining 159 permits are owned by independent cabbies, who've been deprived of their nest eggs by the lifting of the cap. "They're hard-working guys — I know one driver who's 75 years old and spent \$95,000 on his permit," says Christensen. "What's it worth now? Nothing."

The great taxi upheaval has certainly had collateral damage — and not just in Milwaukee. A *Washington Post* story about the Chicago taxi market told of 40 young Ghanaian men, mostly in their 20s, who purchased their medallions for around \$350,000 each. Then Uber and Lyft came to town, and the medallion market collapsed. When Chicago held an auction for 50 new medallions, nobody showed up.

Plaintiffs, including the Sanfelippos and the Chicago cabbies who got together to sue the city in February, will be hard-pressed to prove in court that their city-issued medallions and permits were protectable property, and that a change in policy that strips away their monopoly privileges qualifies as a "taking" by the government.

Madison is still wrestling with what to do about Uber and Lyft.

The capital city never instituted a permitting cap, but it still managed to create a taxi cartel by imposing

rules that make it difficult for new firms to enter the market. Operators are required to provide service 24 hours a day and seven days a week, and they must service the entire 77-square-mile city.

These rules are self-defeating because erecting barriers to entry shrinks the size of the overall market, which only reduces coverage. A few years ago, when a taxi upstart called El Barrunto saw an opportunity to focus its services on Madison's underserved south

side, the city intervened on the grounds that the firm was violating the universal coverage rule.

Lyft and Uber showed up in Madison in March of 2014 without asking permission, leaving City Hall scrambling to respond. The Madison police

department ran a series of sting operations, hitting Uber and Lyft drivers with steep fines, which the companies shrugged off. (Both companies reimbursed their drivers.) Two bills are before the council that would regulate the two companies, which city leaders have dubbed transportation network companies, or TNCs.

Twenty-seven-year-old Ald. Scott Resnick, who's vice president of a Madison software firm, has crafted a bill that would legalize Uber and Lyft. Resnick believes the city need to embrace innovation in the industry and is calling on the community to resist a "blanket approach of saying 'no' to TNCs."

His bill is more meddlesome than Milwaukee's ordinance, but it would free these companies from many of the nonsensical rules that govern traditional taxis. One of its worst provisions is a requirement that TNCs open physical offices in Madison that stay open during business hours — a rule that Uber and

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Lyft might be able to comply with, but that would make it more difficult for other firms to break into the market down the road.

Resnick's bill also severely limits surge pricing, undermining the mechanism that encourages comprehensive service — the very issue that Madison's political class is so concerned with. The promise of earning big fares entices drivers to gravitate toward areas of the city with unmet demand, which is a fairer and more effective method of expanding coverage than imposing laws.

In drawing up his own bill, Mayor Paul Soglin consulted only with the traditional taxi industry — and it shows. Among other things, his proposal requires TNC drivers to submit to vehicle inspections every 10,000 miles, which is extremely frequent by industry standards, and it applies the 24/7 rule because, according to a press release, otherwise “some operators will cherry-pick prime time days and hours.”

By the same logic, shouldn't the city also require restaurants to stay open 24 hours to stop them from cherry-picking the lunchtime crowd?

Even if Soglin's draft ordinance is adopted, it seems inevitable that the rules will change to allow Lyft and Uber to thrive in Madison and elsewhere. Why?

Support for Uber and Lyft transcends political affiliation. “Republicans and Democrats are fighting over who loves Uber more,” *The Verge* website noted recently. The Republican Party posted a pro-Uber petition on its website, which *Politico* interpreted as an effort “to help sell the GOP's free-market, lower-regulation message to a younger generation of voters.”

Just as the petition went up, Uber announced that it had hired David Plouffe, Obama's former campaign manager, as its senior vice president of policy and strategy. Chalk it up to Uber's massive war chest and

growing interest in playing the Washington game. In June, the company raised \$1.2 billion in a financing round that valued the firm at \$18.2 billion.

And if Madison can't pass its own TNC-friendly taxi bill, the Legislature may step in. There are already rumblings of state action to supersede hostile local ordinances.

But the rise of Uber and Lyft is also more than a paradigm for the salutary effect of technology forcing change on outdated governmental operations. These two firms foreshadow a much larger technological shift that may be as significant as the invention of the Model T.



Uber and Lyft offer a better way of *ordering* cars, by replacing dispatchers and street hails with smartphones. Meanwhile, Silicon Valley is already perfecting a better way to *drive* those same cars, by replacing humans with computers.

As software devours the analog world all around us, politicians stuck on nonsensical regulatory measures will be left at the curb. ■

Jim Epstein, who lives in Brooklyn, is a staff writer for Reason magazine. He has worked at New York City's PBS affiliate and has written for The Daily Beast, The New York Daily News, Barron's and other publications.