1st

Student Essay Contest
UNDERGRADUATE

UBER AND THE CASE FOR PERMISSIONLESS INNOVATION

by Heather Lynn Bone

"Many people want government to protect the consumer: A much more urgent problem is to protect the consumer from the government" –Friedman, n.d.

Though Milton Friedman was not alive to witness the rise of Uber, the controversy surrounding the ridesharing service serves as a living testimony to the phenomenon he described.

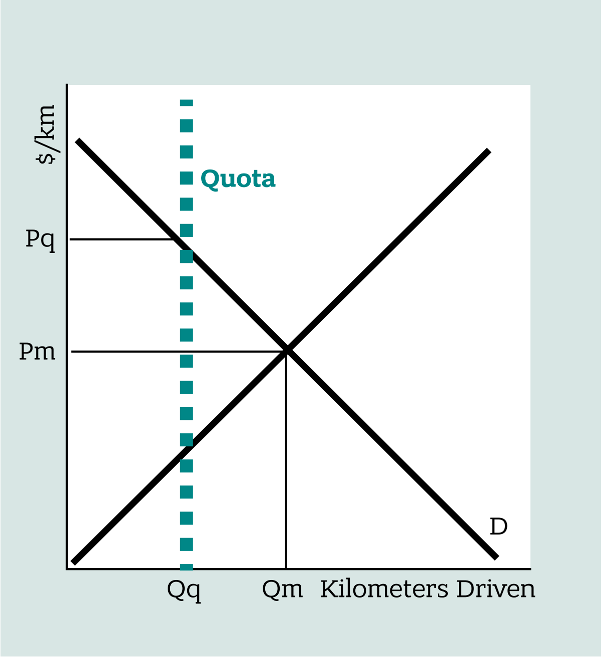
The premise of Uber is simple: Individuals sign up to be a partner with Uber, using their existing car to drive individuals to their destination, coordinating the entire exchange through a mobile app. The rise of Uber is an example of what is known as the sharing economy, that is, the marketplace formed through the sharing of otherwise underused resources.

Uber has been an extremely popular service. In fact, the app is installed on 21 percent of all Android devices in the United States (Marciano, 2016, August 21). Yet many people have severe reservations with Uber. A recent poll by Angus Reid found that while the vast majority of Canadians want to see its continued existence, 63 percent believe that Uber should be regulated in a manner analogous to the taxi industry (Angus Reid Institute, 2016).

Applying current regulations to ride sharing will benefit incumbent businesses, with consumers bearing the costs. To understand why, we must consider the current regulatory framework. Most municipal governments in Canada use licensing to regulate the taxi industry. For example, the Municipality of Waterloo issues licenses for taxi brokers, owners, and drivers, all of which are mandatory for operation (Regional Municipality of Waterloo, 2016).

The result of this approach to policy can be seen through an application of economic theory. Since municipal governments limit the number of licenses they issue, they implicitly impose a quota on the number of taxi rides available to consumers. As figure 1 shows, the consequences are obvious. Through licensing, governments set fares directly and quantity indirectly. If the government sets the fares sufficiently high as to guarantee no service shortage, consumers are left paying more money for taxi rides in what amounts to a transfer from consumers to taxi drivers. By definition, municipal governments are supporting the existence of a taxi cartel.

Figure 1: The Costs of Taxi Licensing



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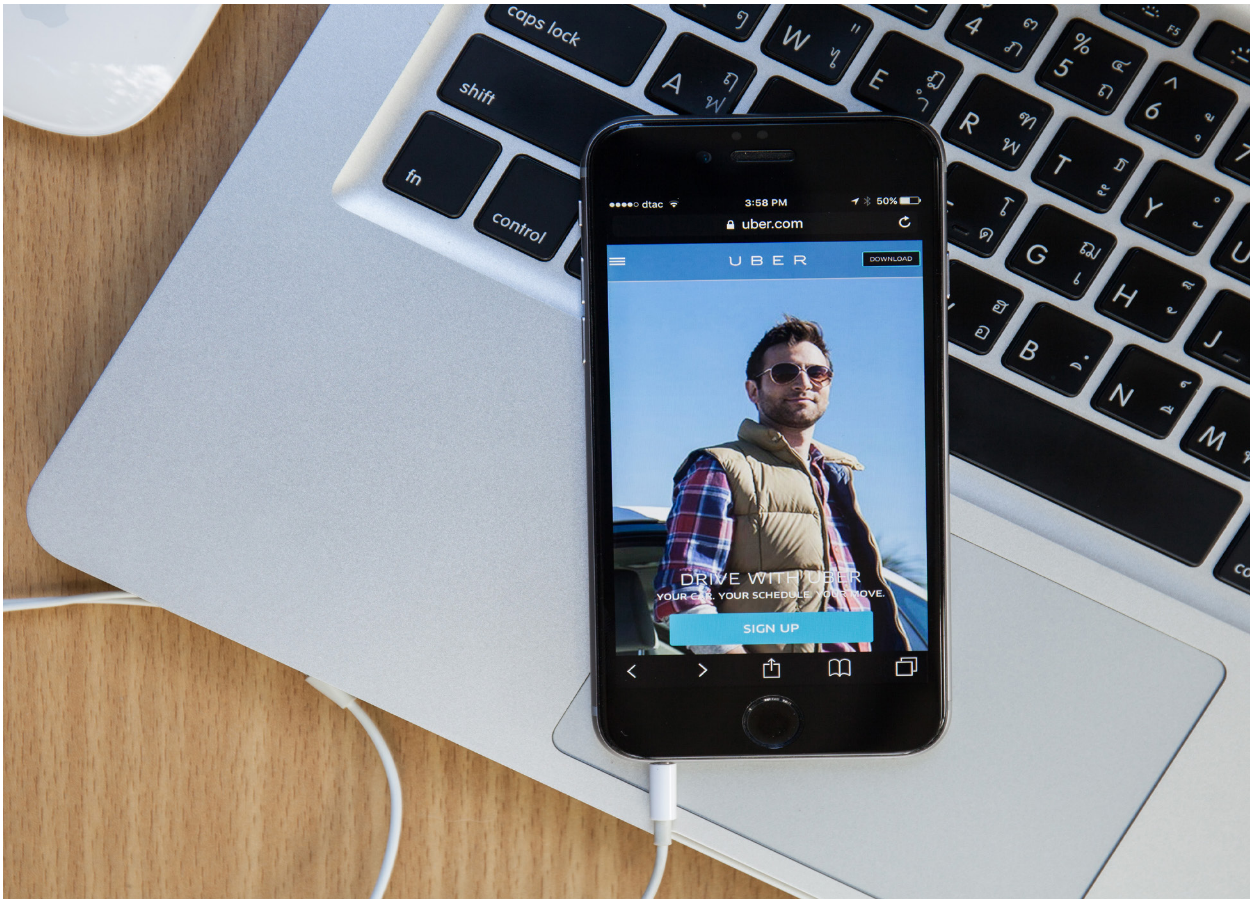

If we examine a market in which Uber is already operating (without licensing), it can be shown that subjecting Uber drivers to the same regulatory scheme as taxis without expanding the number of licenses available would leave the cost of taxi services unchanged, while destroying the cheaper ridesharing option. In effect, this policy eliminates Uber from the market entirely. The winners of this scheme would be taxi drivers, as the price of rides would be higher in the absence of competition.

Meanwhile, consumers are the clear losers of this policy. To see why, consider the City of Toronto, where the average trip taken in a taxi is 10 kilometers, with an associated cost of $25.00 per ride (Cook, 2014). With Uber's funding formula, a trip of this distance would cost $13.10 (Uberestimate.com, n.d.). Collectively, therefore, Uber's 17,000 daily passengers in the city save over $200,000 by using the service (Rider, 2015, September 9). Of course, that's assuming that the passengers would even consider taking a cab in the place of Uber. If they don't, consumers lose from not purchasing a service that they otherwise would have, had it been an option for them.

Some opponents of ridesharing argue that they do not wish to regulate Uber out of existence. Instead, they simply want ridesharing to be subject to more stringent safety regulations, such as requirements for more extensive criminal background checks

than the ones Uber currently uses, or a high level of insurance coverage. While these regulations may not be strong enough to push Uber out of the market, they are not without negative effects.

The major problem of this approach is that it fails to recognize that in the interest of maximizing their profits, businesses have an incentive to satisfy the desires of their customers, including their desire for safety. Without the pressure of government regulation, Uber has created new, innovative ways to improve the safety of its service. For example, after every ride, users rate their driver and their driver rates them, and this information is made available to users every time they make a request. In addition, there is a strong case to be made that the safety of ridesharing will only improve after Uber is legalized. After all, it is impossible for insurance companies to create new, innovative packages when the service they are insuring is itself illegal.

The desire to regulate ridesharing also assumes a high degree of government competence at determining appropriate minimum standards to implement. There are many times, however, that governments have gotten this wrong in the past. For example, California's Department of Motor Vehicles introduced regulations for autonomous vehicles that would require a licensed driver to be behind the wheel at all times. This was done in the name of safety, the argument being that a licensed driver could need to intervene if something went wrong. However, Google argues that this rule would actually make the technology less safe, citing the inability of humans to monitor the technology for long periods of time (Vekshin, 2016). Indeed, it is likely that by interfering in the market, governments will either place a ceiling on safety, stifling innovation, or they will unintentionally introduce legislation that makes the service less safe.

If the source of the problem is bad regulations, the solution is not to apply them more broadly.

Still, despite the costs of regulation to consumers, many people will assert that it is unjust for taxi drivers to be subject to burdensome regulations and Uber drivers to be subject to none. While these people have correctly diagnosed a problem, their prescription is dangerous. If the source of the problem is bad regulations, the solution is not to apply them more broadly, but to eliminate them entirely. The best example of this comes from New Zealand, which implemented sweeping reforms to its taxi industry in the 1980s.

Prior to 1989, the regulatory framework in New Zealand was similar to that of Canadian cities, with quantity, quality, and price controls in effect. Legislation was introduced to liberalize the industry, eliminating controls on the number of licenses and making them easier to obtain. Price controls were loosened, meaning that taxi companies could set their own fares,

subject to a government-imposed maximum (Gaunt, 1996). As a result, less than ten years after the reforms were introduced, the number of taxi companies in metropolitan areas had tripled, the number of taxi cabs had increased greatly, and there had been a real decline in fares. In addition, service quality also improved as a result of greater competition. Consumers experienced shorter wait times and wider geographic coverage (Morrison, 1996).

Given the obvious benefits to consumers of ridesharing, governments should eliminate unnecessary regulations to ensure that the service exists for many years to come.

New Zealand's approach to taxi deregulation was by no means perfect, nor was it free from red tape. Under the new laws, taxi cabs are required to be members of an approved taxi organization and to obtain a passenger service license (Gaunt, 1996). In fact, these laws have caused Uber some trouble. In particular, Uber has clashed with the government over both licensing requirements and the government-administered background check, arguing that the standards for their own background check are actually higher (RNZ, 2016, July 6). Still, New Zealand's approach to deregulating the taxi industry remains an improvement over the status quo in most Canadian cities, where the taxi business remains a government-protected industry.

Given the obvious benefits to consumers of ridesharing, governments should eliminate unnecessary regulations to ensure that the service exists for many years to come. Licensing requirements are the most obvious example of government overreach, but as seen in New Zealand, even well intentioned laws such as government administered background checks may be regressive. In addition, municipal governments should treat the backlash over Uber as a symptom of a broken regulatory system and deregulate the taxi industry. More specifically, as in New Zealand, the government should eliminate quantity controls and end the practice of government price setting. Only then will traditional taxis be able to compete with ridesharing companies like Uber.

A fundamental change in government's approach to regulation is needed if we wish to avoid refighting each and every battle whenever a new an disruptive service like Uber emerges.

This alone is not enough, however. The emergence of Uber and the sharing economy more generally makes the case for permissionless innovation, that is, the removal of regulations that limit the entry of new firms into the market. Governments should adopt an innovation-friendly approach to regulation and react only to safety concerns after they arise. The fact that it is impossible to predict what technologies will

exist in the future should make us approach regulation with caution. By enacting unnecessary regulation, we discourage the invention of new goods and services like Uber that improve consumer welfare.

A fundamental change in government's approach to regulation is needed if we wish to avoid re-fighting each and every battle whenever a new and disruptive service like Uber emerges.

Heather Bone is a graduate student at the University of Toronto. She recently graduated from the University of Waterloo where she majored in economics. Upon graduation, she hopes to work for a think tank and research labour economics.

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