

## EC201: Principles of Macroeconomics, Fall 2021

Business Case: Why the Taxi Medallion Lenders Are Feeling Like Roadkill

Application: Quantity Controls

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In 2015, four loan companies filed a strongly worded lawsuit against the City of New York, accusing it of failing to protect the taxi industry's quantity-controlled status. The four companies, Melrose, Progressive, LOMTO, and Montauk, are among the largest lenders to purchasers of taxi medallions. They lend money to those who want to buy a medallion but don't have the sizable amount of cash required to do so, and to borrowers who pledge the medallions as collateral for their loans. That is, if the borrower can't repay the loan, the companies take ownership of the medallion to satisfy the debt by reselling it to someone else.

And for a long time, lending money to finance the purchase of medallions was a very good business—almost as good as printing money, some said. Over two decades, from 1990 to 2013, the value of a New York City taxi medallion rose 720%, making it a better investment than stocks, oil, or gold. As a result, loan companies saw very little downside risk to lending for taxi medallions. And they had steady business: as the price of a taxi medallion rose, buyers wanted to borrow more money. The lender Melrose, for example, lent a total of \$1.56 billion for 3,110 medallions.

But by 2015, these lending companies were deeply worried. The prices of a taxi medallion began to fall from a high of \$1.3 million in 2013 to as little as \$250,000 in 2016, *if* a buyer could be found. Monthly taxi pickups in New York City dropped from 14 million to 12 million over a two-year span from June 2013 to June 2015, while Uber ridership increased tenfold, to 3.5 million. And, meter revenue from taxicabs was down more than 9% from March 2014 to March 2015. As the four lenders stated in their lawsuit, arguing for more protection of taxicabs, “borrowers are falling behind in their loan payments and loans will soon fail.”

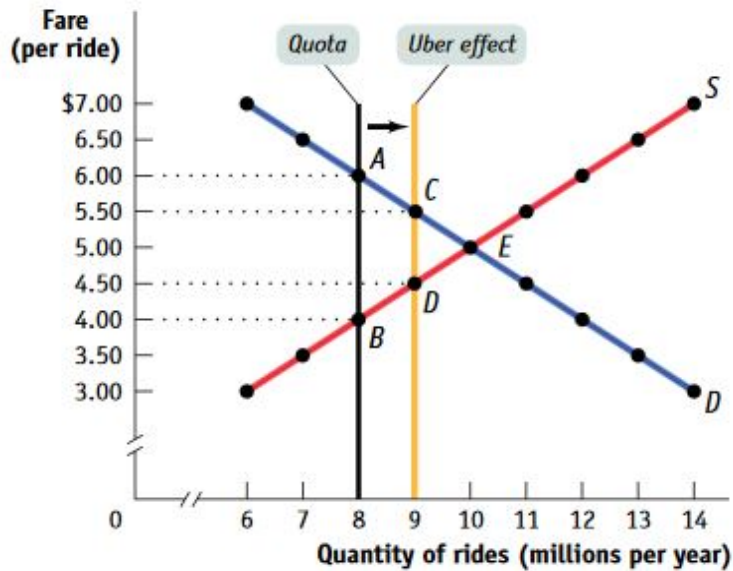
Soon afterward, the fight between the taxicab industry and Uber turned political as a bill was introduced in the New York City Council to limit the number of Uber vehicles on city streets. Uber responded with a \$3 million lobbying and advertising blitz. In the end, the bill didn’t pass—a victory for Uber. However, Uber is still restricted from picking up fares hailed from the street.

### QUESTIONS FOR THOUGHT

1. How did lenders benefit from the restriction on the number of New York City taxi medallions?
2. Use a graph to illustrate the effect of the entry of Uber on the incomes of taxicab drivers. Assume that Uber cars cannot pick up fares hailed from the street and that there are some people who prefer to hail cabs rather than use an app. How does your graph change if that restriction is lifted?
3. Why has the fight between Uber and the taxicab industry turned political?

#### Suggested answers:

1. Lenders benefit from the restriction on the number of taxi medallions because as the price of taxi medallions goes up, purchasers have to borrow more. Hence the demand for loans increases. In addition, loans are secured by the medallions that were purchased using the lent funds. If the borrower is unable to pay, she has to surrender the medallion to the loan company. Hence those loans are worth more as the prices of medallions climb. So since fewer medallions lead to higher medallion prices, the lenders clearly benefit from the restriction on the number of medallions.
2. To devise your graph, take Figure 4-8 as it is, then add to it a vertical line at 9 million rides, and arrows showing a horizontal shift from the vertical line at 8 million to the line at 9 million. Label the upper point on the 9 million line graph as C (at \$5.50 fare) and the lower point as D (at \$4.50 fare). Draw in the dotted lines from the vertical axis to points C and D. Label the shift “Uber Effect” with a balloon.



The entry of Uber into the taxicab market will increase the number of rides offered. As shown here, the entry of Uber shifts the vertical line indicating the quota right-ward. As a result, the quota rent going to the owner of a medallion falls. Here we have shifted the quota line from 8 million rides pre-Uber to 9 million rides post-Uber, and the quota rent falls from  $6 - 4 = \$2$  to  $5.50 - 4.50 = \$1$ . The \$1 represents the quota rent that medallion holders still receive because some people still prefer to hail taxicabs rather than use Uber cars, and the number of taxicabs is still restricted. However, if the rules are changed and Uber cars are also allowed to pick up fares hailed from the street, the market will move to equilibrium E because the quantity control will have been completely eliminated. As a result, the quota rent will disappear.

- It is predictable that the fight between Uber and the taxicab industry turned political because restrictions on how many cars can sell rides in New York City are creations of the city government. The taxi industry would like to maintain the quota so it can maintain the quota rents, while Uber would like to circumvent the quota so it can operate.