

Taxi rides on business trips are more expensive than on private trips

March 13 2017

Who has never experienced this situation: Arriving in another city, you are completely dependent on taxi drivers, who know their way around, to take you where you want to go. However, sometimes you may suspect that you are paying a higher taxi fare than locals. This suspicion is founded, as Matthias Sutter from the chair 'Economics: Design and Behavior' at the University of Cologne, has found out. Taxi drivers calculate a higher fare if they know that their passenger is from out of town and, in particular if the passenger indicates that he or she will be reimbursed for the costs. In these cases, the taxi fare rises by an average of 7 percent. In his current study on moral hazard, Sutter cooperated with his colleagues Loukas Balafoutas and Rudolf Kerschbamer from the University of Innsbruck. The results of their study 'Second-Degree Moral Hazard in a Real-World Credence Goods Market' appeared in *The Economic Journal* 127, February 2017.

Markets for so-called credence goods, like taxi rides, medical therapies or repair services, create strong incentives for the providers of these services to behave dishonestly. Since the customer usually cannot gauge the quality of the provided services, it is easier for the provider to cheat than with other goods. In these cases, the scientists speak of 'asymmetric information', which can lead to first- or second-degree moral hazard. First-degree moral hazard refers to the buyer paying too little attention because of the coverage of his or her costs by a third party (e.g. an insurance company or employer). Second-degree moral hazard refers to the behavior of providers who use the buyer's lack of knowledge to charge a higher price, thus exploiting that the buyer gets reimbursed

from a third party. This study focused on second-degree moral hazard.

Sutter asked his assistants to take 400 taxi rides in Athens. The passengers began all rides with the sentence: 'I would like to go to ... Do you know where that is? I'm not from Athens.' At the beginning of 200 rides, they moreover added: 'Can I have a receipt at the end? My employer will reimburse me.' This provided an opportunity for the driver to behave immorally, since the passenger did not know his or her way around and would most likely not protest a higher fare because the costs would be reimbursed.

The researchers wanted to find out if higher costs were actually being calculated and if the [taxi drivers](#) provided additional, unnecessary services. In 112 out of 400 rides (28 percent), the fare was too high (rising by 7 percent, on average). In order to be able to demand a higher fare, the drivers resorted to various tricks. Almost 77 percent asked for the payment of made-up services (rides to and from the airport, seaport and the like). In 14 cases, the taximeter was manipulated or the night rate was calculated instead of the day rate. In 5 percent of the cases, the fare was simply rounded up.

Out of the four assistants who conducted the experiment, two were male and two female, since the researchers from Cologne and Innsbruck were also interested in possible gender differences in the treatment of passengers. And indeed, they noted that women were charged a higher fare more often than men.

The research team did not, however, note a significant rise in detours - regardless of the passenger's gender. 'A higher calculation is more lucrative and raises the taxi driver's income without creating additional costs for gas or repairs through detours', says Sutter.

'The experiment shows that moral hazard has an economically relevant

and statistically significant positive effect on the probability and extent of overcharging', Sutter explains. 'This implies that second-degree [moral hazard](#) has a substantial impact on the provision of services in a market for credence goods.'

More information: Loukas Balafoutas et al, Second-Degree Moral Hazard In A Real-World Credence Goods Market, *The Economic Journal* (2017). [DOI: 10.1111/eoj.12260](https://doi.org/10.1111/eoj.12260)

Provided by University of Cologne

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