Discussion

FAIR AND EFFICIENT REGULATION OF THE SHARING ECONOMY

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Introduction

While sharing is not new, the Sharing Economy is still quite a new phenomenon. It can be understood as the following economic process: online platforms reduce the scale for viable hiring transactions, or participation in consumer hiring markets, and thereby reduce the extent to which assets are underutilised.[1]

Assets could be shared before the Sharing Economy emerged. Staying with friends or family was an alternative to hotels before the advent of Airbnb and its competitors. If you did not know anyone in the area though, or the people you knew were not well placed to offer you accommodation, that might not be an option. Equally, if you were going away and leaving your home empty, you might not know anyone who would like to use it instead at that time. That meant valuable assets went underused.

Sharing assets with strangers was also possible before the advent of the Sharing Economy. The scale of the market was limited by high transaction costs, such as the need to take payments, to screen those who might use the property, to insure against potential risks and, particularly, to market assets to those who might wish to hire them. Online platforms minimise some or all of those costs.

Users of these platforms are able to share labour, homes, cars, intellectual property and other assets. The upside for each side of the market is obvious: those who need an asset can enjoy greater availability and a lower quality-adjusted price; those who have an asset can enjoy a financial return on it that might otherwise go underutilised.

The Sharing Economy can be contentious, however. Sceptics such as Robert Reich (2015) describe a dystopia in which the desperate rent out their homes, making up for downward pressure on their real incomes, and in doing so displace employment in existing industries (which are not given a fair chance to compete), creating more downward pressure on real incomes overall. Even if those using these platforms can make a reasonable amount of money, they enjoy none of the benefits and security associated with conventional employment. The owners of the platforms are the only ones who benefit. Many policymakers also have more run-of-the-mill concerns: protecting consumers; maintaining a competitive market; collecting taxes.

Yet those inclined to favour free markets should generally be optimistic. Both sides of the market engage with the Sharing Economy voluntarily. It promises to unlock enormous value in underused assets and, unlike many other digital services, create substantial employment.

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Consumers no longer have to make large, lumpy purchases in order to access certain classes of asset. That lumpiness meant consumers often lost out because they either could not justify buying an asset they would value the ability to access but not enough to justify the cost of ownership, or had to buy an asset which was then left unused most of the time.

The efficiency of online platforms allows users to pay lower quality-adjusted prices, and providers to maintain healthy earnings. Uber drivers, for example, spend less time than conventional taxi drivers waiting for a fare. Research has found that, on average, the capacity utilisation rate for UberX drivers is 30 per cent higher than for taxi drivers in terms of time, and 50 per cent higher in terms of miles (Cramer and Krueger 2016). We can expect substantial welfare improvements overall.

The realisation of the potential of the Sharing Economy depends on its political legitimacy, though. Otherwise outright bans or draconian regulations might limit the ability of platforms to grow or develop over time.

This article will not attempt to set out a detailed blueprint for regulation of the Sharing Economy. The sector is too varied and changing too quickly for such a blueprint to be helpful. In particular, there is an ongoing transition from essentially peer-to-peer networks to specialisation, with some people owning the assets (either the platforms or businesses trading through them) and others renting them. Instead, the aim is to set out five conclusions about the sector – correctives to common misconceptions – which it is important for policymakers to understand.

1. It is not fair or efficient to subject all substitutes to the same rules.
2. Regulation needs to strike a balance between safety and social inclusion.
3. New markets are a better way to recreate workplace benefits than old rules.
4. The Sharing Economy will not increase inequality.
5. We should not assume the Sharing Economy will tend to monopoly.

It is not fair or efficient to subject all substitutes to the same rules

It is often alleged that competition between those offering services through Sharing Economy platforms and existing provision is not fair as the regulatory requirements are different. Those offering properties on Airbnb are not subject to all of the requirements applied to hotels, such as disability access. Uber drivers are not subject to the same kind of requirements for geographical knowledge as drivers of London black cabs.

It is normally regulatory best practice to avoid discriminating among competitors in a market. This both feels fair and should mean that resources are allocated efficiently to the most efficient sources of supply. This is often translated into calls for a 'level playing field'.

The objective for a regulator should not always be a level playing field, though, or at least not in the sense of identical rules. It might be that less regulation is needed in some cases than in others to achieve the same regulatory objectives. That represents a genuine technological improvement in efficiency which regulation should not try to offset or frustrate.

To give an extreme example, the regulatory burdens for nuclear power plants and wind turbines are not equal. There is normally a much greater level of safety regulation for a nuclear plant. You could say that a nuclear plant is therefore at an unfair disadvantage. It is not able to compete on a level playing field with a wind turbine. That would only be the case (and this might be the reality) if the burden of safety regulation were excessive relative to the safety risks posed by the nuclear power plant. It is also possible that the wind turbine is still facing an unfair disadvantage if its lower level of

safety regulation is, despite being lower, still disproportionate (and the nuclear power plant's regulatory burden is proportionate). The question is not whether the rules are identical, but whether they are proportionate in each case.

It is therefore not regulatory best practice to have the same rules for all substitutes operating in the same market. Instead, regulators should set proportionate regulatory objectives and then accomplish them at lowest possible cost. This will sometimes mean that some activity is subject to a significantly lower burden, either because that activity is less subject to the kind of risks or external costs that lead to regulatory intervention, or because that activity is easier to regulate. Any resulting difference in costs will affect which kind of provision prevails in the market over time.

In the case of the Sharing Economy, we can expect that the need for certain categories of regulation is likely to be less. The rationale for many regulations is to correct for information asymmetries. In large cities, I might use a certain hotel, even more likely a certain taxi, only once. I might be able to rely on recommendations from friends, or in some cases a trusted brand, but the information I have in transacting with someone is still extremely limited. The ratings systems employed by platforms mean that information asymmetries are much less severe.[2] I can check ratings and possibly reviews beforehand (the personal brands of market participants); the platform can (and has ample incentive to) remove those who do not meet reasonable standards (defending its own brand); prices are advertised beforehand. Informational asymmetries are better addressed in the Sharing Economy and therefore some categories of regulation are less necessary.

Sharing Economy provision is also generally much more closely tracked. Transactions are logged and paid for electronically. Travel in Uber cars is tracked by the same app which uses that data to calculate the total charge for each trip. This makes it easier to enforce accountability if a provider mistreats a customer (or vice versa). It also makes it easier to ensure the correct taxes are paid. Airbnb collects some tourism taxes automatically in certain jurisdictions.

Finally, there is a multiplication in the number of alternatives. If a certain facility is not available in a flat I might rent for a night, it is not so significant if that feature is available in a hundred other properties I might rent instead. Existing regulations already exist to try to ensure that, for example, there is sufficient provision for disabled access across the housing stock. The sheer number of properties available means it is less urgent that each one has any particular feature.

It is, of course, also possible that some existing provision is simply subject to more regulation than it needs to be. For example, quantity regulation for taxis and private hire cars was widely seen to be a bad idea before the advent of Uber, and it remains a bad idea (OECD 2007). In other cases, additional competition thanks to the Sharing Economy could make regulations premised on inadequacies in competition in existing markets unnecessary.

Demonstrating that the same regulations do not apply to Sharing Economy providers as other provision does not, in itself, establish the case for additional regulation. Policymakers should first consider the possibility either that it might be better to deregulate established provision, or that regulation might be necessary for existing provision but not the Sharing Economy.

Regulation needs to strike a balance between safety and social inclusion

Policymakers are naturally keen to ensure that consumers are protected in these new markets. Platforms are aware that their growth is contingent on establishing trust on both sides of the transaction: the person offering the asset needs to trust it will not be misused (their car won't come

back with a nasty scratch); and the person hiring the asset needs to trust it will do what it says (the flat won't have bed bugs). The sides to a transaction need to trust that their counterparties are who they say they are. Debbie Wosskow (2014, p. 8) argued, in a report on the Sharing Economy for the UK government: 'Helping to build consumers' trust in online transactions in the sharing economy is critical for its future development.'

The threat to platforms is serious. We tend to overstate the frequency of newsworthy events (a cognitive bias known as the availability heuristic). Essentially, we judge the frequency of an event by how much we hear about it, which is likely to be inflated with newsworthy problems at novel platforms. Acquiring a reputation for allowing unsuitable participants into the network is a sure way for a platform to create a space for an alternative platform to define itself as safer. If the Sharing Economy as a whole is not trusted, then its growth will be diminished.

On the other hand, caution carries social costs. It will not always be obvious whether or not someone should be excluded. The aforementioned incentives might cause policymakers or platforms to err on the side of excluding someone. The risks if someone unsuitable is allowed into the network are obvious: another market participant on the other side of a transaction might lose out and the network's or regulator's reputation might suffer.

The risks arising from suitable applicants being excluded might be less newsworthy, but could be serious for those individuals. Consumers might lose access to the network. If the Sharing Economy comes to dominate entire markets, and particularly if platforms were to coordinate their ratings systems (in a manner similar to all the bars in a town having a single list of unwelcome problem customers), they might lose access to entire classes of services. Providers could lose their livelihoods.

This might be seen as just. If someone cannot measure up to the standards required, why should the rest of the network put up with their misbehaviour? It seems less just if they are excluded from the network entirely and, as a result, unable to rebuild their reputations. Reputational social exclusion might become a material problem with some people outside these networks and unable to turn their lives around.

The role of policy should therefore not be seen as simply maximising the safety of these networks. It should instead be to allow and encourage platforms to best reconcile safety with inclusion. This is similar to the situation in financial services, where there is a generally accepted need to balance managing risk and maintaining access to finance (with policy requirements including access to credit ratings). The best way to achieve this is probably not to dull the informational value of rating systems. If someone needs to be excluded, they probably should be excluded. It is important that people can trust those systems. The best approach is probably to instead ensure that there are mechanisms for people to rebuild their reputations.

Platforms and policy need to strike a balance between protecting consumers and avoiding the creation of new forms of social exclusion. The priority should be to ensure that it is possible for participants to rehabilitate a bad reputation.

New markets are a better way to recreate workplace benefits than old rules

There have been claims that those offering services on Sharing Economy platforms should be treated as employees of the platform. This is particularly important in the United States, where employment status determines entitlement to expensive benefits such as private health insurance.

These concerns are less urgent in the UK. Participants in these markets seem to fit neatly into the self-employed category. There is still the question of whether we should be concerned at a large growth in self-employment. Self-employment has generally been seen as less secure than more formal employment.

We should not assume that this means worse conditions, though. First, self-employment has upsides, too, and many people with other commitments or simply a taste for greater flexibility prefer being able to choose their own hours. Second, the Sharing Economy will not always displace more formal provision (e.g. an Airbnb rental displacing a hotel stay). It may create new economic activity, or it may displace less formal provision (e.g. a flat advertised with a card in a local shop). Third, the Sharing Economy means more options for workers and therefore both reduces the likely hit to incomes if people do lose an existing job (they can do Sharing Economy work while looking for new permanent employment) and can improve their bargaining position (more demand for less-skilled labour will tend to improve the position of less-skilled workers).

Nevertheless, there are benefits associated with full-time work that the self-employed often do not enjoy as a matter of course occupational pensions; paid sick leave; paid holiday leave; maternity leave. A practical objective might be to see how those benefits could be offered to those working in the Sharing Economy (particularly those for whom it is their main employment). The platforms might be able to accomplish this by providing a facility for those using the apps to make contributions automatically from their earnings. As specialists in creating two-sided markets online, those platforms could extend their business by creating a framework in which financial services firms can compete to offer products to those using the platform. They might thereby recreate the benefits of conventional employment for those who are self-employed and using the platforms to sell services. These benefits might even be opted-in by default to encourage their use.

With innovation over time, the Sharing Economy can become a source of economic security. This is a better path forward than attempting to replicate older labour market rules, which might cost workers the flexibility that many of them value and frustrate platform growth. Better outcomes are more likely if the market is able to grow, meaning that the market is large enough to justify the investments that would realise its potential.

The sharing economy will not increase inequality

There have been concerns that the Sharing Economy might increase income or wealth inequality. Those concerned this might happen see that existing owners of assets will be able to increase the return on those assets by increasing their utilisation. They then see that fewer people will need to own assets, and draw the conclusion that wealth inequality might be exacerbated.

This seems mistaken. The benefits of the Sharing Economy will be particularly significant for those on low incomes. As providers of goods and services they will have new employment opportunities. Unlike in many digital markets where huge value is created but few people are employed in generating that value, many Sharing Economy services are labour intensive.

As consumers, they can hire assets they would not have access to otherwise, or simply save money. They are more likely to benefit from the reduced lumpiness in the purchases of assets (as a given asset will be a larger share of a lower income). There is some evidence that the Sharing Economy reaches consumers who might be missed by existing rental markets. For example, research has found that Uber reached low-income communities in Los Angeles poorly served by existing taxi

services and offered a more reliable service that arrived in half the time and cost less than half as much (Smart et al. 2015).

There will then be less need for people to commit their savings to investments in assets that do not generate a financial return. People first satisfy their needs to save for assets like homes and cars which they have a practical use for, and then save any remaining surplus in the form of financial assets. Those on modest incomes are therefore likely to hold less of their wealth in financial assets.

Financial assets are the most conducive to accumulating wealth over time. They also allow people to smooth their consumption over time (e.g. saving for retirement) and prepare for uncertain future financial demands (e.g. a desire to help children through university). If the Sharing Economy means that people do not need to save for assets in the same way, as they can hire those assets at a low cost (and save money, as they do not buy assets they then underutilise), then it will make it easier for people to save and invest in financial assets.

By contrast, those who already own assets might see higher returns individually, but are likely to see lower returns overall. If more use can be got out of a given asset (e.g. a car), then there will be less demand for capital to invest in those assets (people can invest in fewer cars). Less demand for capital is likely to mean lower returns over time and should therefore tend to favour those for whom capital income is a lower share of their existing income. Over time, this is also likely to reduce wealth inequality. It will be easier for those earning and saving now to catch up.

Sharing Economy platforms and other online platforms will also change the kind of businesses that can succeed in certain markets. In earlier advertising, it might have been possible to communicate only capital-intensive features like location and amenities (e.g. a swimming pool), whereas peer reviews might mean it is possible to attract customers based on friendly service and other features more accessible to small businesses.

The final element in this equation is those who set up the platforms themselves. These founders may become very rich indeed. There are very few of them, however, and the returns they enjoy are likely to be a small fraction of the overall consumer and producer surpluses that accrue to the many millions or billions who end up using the platforms. This would fit with the normal pattern, described by Nordhaus (2004, p. 1), whereby only a 'miniscule fraction' of the benefits of an innovation are captured by producers. Those consuming the new goods will get the overwhelming majority of the benefits (which, in this case, will include those offering services on the platforms, who are consuming the marketing and other services the platforms offer).

Increasing the utilisation of assets will particularly benefit those on modest incomes who benefit from their use, more than it benefits the wealthy. The Sharing Economy is likely to diminish income and wealth inequality.

We should not assume the sharing economy will tend to monopoly

Network effects, also known as demand-side economies of scale, occur where the value of a network to each individual user grows with the number of users. They occur in homogenous networks (e.g. a phone network) where users wish to contact their peers, and heterogeneous networks (e.g. a marketplace) where many traders sell to many customers. In either case, more customers either directly improve the customer experience or attract more merchants, indirectly improving the customer experience, which in turn attracts yet more customers.

This means that networks can struggle to get started, as they need to reach a certain critical mass in order to be viable. In theory, it also means that the Sharing Economy might be characterised by winner-takes-all or winner-takes-most markets in which a starting advantage is reinforced by network effects and becomes unassailable.

This is possible in theory and in other industries clearly true in practice. In the case of Sharing Economy platforms, however, it seems less likely. Users of these networks can often multi-home. They can have the apps for multiple platforms and use different platforms for different transactions. That means users are not forced to choose one, and multiple platforms can reach and maintain critical mass.

Users might prefer platforms other than the largest ones for several reasons: smaller platforms might have additional features, they might choose differently with respect to certain trade-offs, and they might be particularly popular with a niche community of which the user is a part. Users might also prefer smaller platforms because they are smaller (reverse network effects), low-quality assets might drive out higher-quality assets in larger networks, smaller networks might be less attractive than larger networks to malicious entrants, and some consumers might value smaller networks for their very exclusivity.

There are few other barriers to entry in these markets. Once the concept has been proved, the technology itself is within reach of a wide range of potential players. New entrants will often be those who enjoy a strong brand and consumer relationships from other businesses. For example, Apple used its strong brand and links with customers who own its phones and computers to establish Apple Music as a competitor to Spotify. BMW and Ford have both moved to establish car-sharing platforms to compete with Zipcar. If a platform establishes a profitable Sharing Economy business, the competition it is likely to face for that market is not necessarily going to be composed of naïve entrants with no resources of their own, but could include entrants from other sectors with their own strengths.

To the extent that market power accrues to Sharing Economy platforms, it is likely to be due to other barriers to entry. In particular, regulatory choices which limit the growth of the Sharing Economy might not deter existing platforms, who are already committed to the market, but instead might deter potential new entrants, who would be competing for a share of a smaller market (and know that they were therefore less likely to attain critical mass).

Notes

1. This definition and other analysis in this paper are based on research I wrote with Andrew Lilico for the European Parliamentary Research Service. Other definitions exist which would exclude some of the asset classes (e.g. labour) or platforms (e.g. Uber or Spotify) discussed here. The rationale for this definition is discussed in our research, along with alternative definitions. See Lilico and Sinclair (2016, pp. I-42–50).
2. A general decline in the prevalence of asymmetric information, of which the Sharing Economy is a part, is discussed in Tabarrok and Cowen (2015).

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