***Perspectives from FSF Scholars***
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# Eight Takeaways From the FTC's Sharing Economy Workshop

**by**

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## Introduction

The Federal Trade Commission (FTC) hosted a stimulating workshop regarding the "sharing economy" on Tuesday, June 9, 2015. The workshop offered a variety of perspectives from regulators, academics, and industry executives on the sharing economy's emerging and innovative business models.

Free State Foundation scholars submitted comments to the FTC in connection with its workshop. In these comments the FSF scholars credited the sharing economy with fostering innovation, creating value, and providing cost saving options for consumers. The FSF scholars also discussed the sharing economy's policy implications and the role for government within the sharing economy's efficient, self-regulating markets.[1]

In this *Perspectives from FSF Scholars,* I will address the following eight takeaways from the FTC's sharing economy workshop. Some of the takeaways were specifically discussed at the workshop, while others, I believe, should have been discussed more.

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[1] For reading in addition to the comments submitted by FSF scholars, see Randolph May's and my July 2014 *Perspectives from FSF Scholars* entitled "The Sharing Economy: A Positive Shared Vision for the Future."

1. Reputational Feedback Mechanisms Have Enabled Bisymmetrical Trust

2. Bisymmetrical Trust Relationships Balance Privacy With Transparency

3. Self-Regulation Is Not the Same as No Regulation

4. Deregulate Down Rather Than Regulate Up to Address Legitimate Equity Considerations

5. Horizontal Mergers Are Only a Concern if Regulations Eliminate Contestability

6. Vertical Mergers Are Only a Concern if Regulations Eliminate Contestability

7. Positive Externalities and Spillovers of the Sharing Economy Were Not Discussed Enough

8. The Sharing Economy Benefits Low-Income Users More Than High-Income Users

**Reputational Feedback Mechanisms Have Enabled Bisymmetrical Trust**

The emerging "sharing economy" empowers consumers through Internet-enabled applications to make informed decisions about market transactions. As the FSF scholars wrote in their comments to the FTC:

> The sharing economy is also characterized by the novel ways in which its applications facilitate trust relationships that drive the sharing and exchanging processes. Of course, trust relationships between strangers established through the incentives of voluntary trade long pre-date the Internet. But the sharing economy uniquely emphasizes trust-building through online applications.

Reputational feedback mechanisms, which are inherent in sharing economy applications, enable trust among users on *both sides* of the transaction due to the ability to rate the sharing experience and provide critical reviews. This is why workshop panelist Andrey Fradkin, Postdoctoral Fellow at the National Bureau of Economic Research, described this relationship as "bisymmetrical trust."

In the case of ridesharing, reputational feedback is a beneficial tool for riders to determine which drivers are safe and cautious based on feedback previous riders have provided about a specific driver. Drivers find the tool equally beneficial in determining which riders are courteous and responsible while in the drivers' vehicles based on the feedback previous drivers have provided about a specific rider.

Roomsharing might be a more obvious example of how both sides use reputational feedback mechanisms to find a fitting counterpart. On Airbnb, hosts will use reputational feedback to filter through strangers in order to find guests responsible enough to share a living space with. Yet guests are just as likely to rely on this reputational feedback mechanism to avoid unsafe or

unhealthy living spaces. The transparency provided by competitors' ratings and reviews allows hosts and guests to easily compare the trustworthiness of respective counterparts. Additionally, even if a host or guest is a first time user, the accountability provided by reputational feedback mechanisms incentivizes the user to be as responsible as possible.

**Bisymmetrical Trust Relationships Balance Privacy With Transparency**

Privacy is a significant policy concern with the sharing economy and all Internet-enabled transactions. How can consumers' information be protected? Who monitors what? How will the government regulate the sharing economy without access to users' information?

It is important to consider that consumers sometimes are willing to forgo some sort of privacy in order to receive some sort of benefit. Just like when an individual is willing to forgo some privacy when shipping a package in a public place, users of sharing economy applications are willing to forgo some privacy in order to provide transparent and accountable market transactions.

At the FTC's workshop, both Josh Gans, Professor of Strategic Management at the University of Toronto, and Adam Thierer, Senior Research Fellow at the Mercatus Center at George Mason University, agreed that, as fathers of teenagers, they value the service Uber provides because of the transparency within each transaction. They trust letting their children use Uber to travel across town alone because they can monitor the vehicle during the duration of the trip.

Simply by choosing to avail themselves of sharing applications, users often forgo some level of privacy. However, by forgoing privacy, whether it be credit card information, background checks, or smartphone location settings, value is created in the respective marketplace because other users have information about possible trading partners. In the sharing economy, transparency is pivotal for bisymmetrical trust. Such trust cannot exist without users relinquishing some private information for other users to gather in order to complete a transaction.

**Self-Regulation Is Not the Same as No Regulation**

Arun Sundararajan, Professor of Information, Operations, and Management Sciences at New York University, said during the workshop that self-regulation, no regulation, and government regulation are three different things. He stressed that the sharing economy has emerged successfully because of many applications' self-regulating mechanisms. This connects with the first two takeaways: (1) sharing economy applications achieve efficient, transparent, and accountable market transactions through the use of reputational feedback mechanisms; and (2) sharing economy applications can self-regulate because users voluntarily forgo some level of privacy in order to create bisymmetrical trust.

However, reputational feedback mechanisms are not the only form of self-regulation in sharing economy markets. For example, Airbnb provides hosts with a $1 million insurance policy to cover unforeseeable losses. Uber, Lyft, and other ridesharing applications perform background checks on drivers. Also, when disputes between two parties occur, many sharing economy

applications have customer service representatives who investigate such disputes. Customer service representatives may refund or fine users in those instances where they determine one party or another is at fault.[2]

Despite these self-regulating mechanisms, it is not unreasonable to think that problems still could arise. At the workshop Adam Theirer mentioned that although the self-regulating mechanisms of the sharing economy are not perfect, the success of these business models is the result of "permissionless innovation." The term describes the ability of entrepreneurs to enter markets without having to pay large regulatory costs, such as licenses, fees, permits, or other requirements. He added that because of this success, any problems that arise due to the imperfections of these self-regulating mechanisms can be resolved through common law mechanisms, such as tort law.

Similarly, the FSF scholars stated in their comments to the FTC that safety, health, and consumer protection issues discussed in sharing economy debates are already generally protected by existing laws:

> Of course, health, safety, and consumer protection laws and regulations of general applicability can be enforced against sharing economy service providers and hosts, just like entities that operate under legacy business models, as long as they are not formulated and implemented in a discriminatory fashion.
>
> Sound public policy regarding the sharing economy should take into consideration the fact that services enabled by Internet-based applications have depended on the avoidance of regulatory barriers and burdens. A presumption of marketplace freedom and against regulation should guide public policy concerning the sharing economy. Clear and convincing evidence of an actual or likely harm to consumers should be demonstrated by any federal, state, or local regulatory authority or petitioning party advocating regulation before any sharing economy-specific regulatory proscription or intervention is considered.

This makes for a smooth segue into my next takeaway from the FTC's workshop.

**Deregulate Down Rather Than Regulate Up to Address Legitimate Equity Considerations**

As the FSF scholars stated in their comments to the FTC:

> Incumbent service providers typically argue that if they were required to incur regulatory costs and overcome barriers in order to enter the market, why shouldn't these new sharing economy services have to do the same? But the answer is simple: If the laws or regulations applicable to incumbent businesses no longer make sense, they should be changed. It always harms consumers when public policymakers attempt to "level the playing field" by subjecting entities to regulatory restrictions that are not needed. The

[2] I've used Uber more than 100 times and have had only two complaints. Both times I was contacted immediately by Uber's customer service team and both times I was refunded the full amount of my purchase within an hour of sending the complaint.

> proper way to respond to "level the playing field" claims is to remove unnecessary regulations wherever they apply, not to expand them to new entities.
>
> Special or partial laws and regulations designed to protect incumbent competitors from new sources of competition, even if undertaken under the pretense of protecting competition, are unjustifiable and will harm consumers. Hopefully, market incumbents opposed to the proliferation of innovative and disruptive new Internet services and applications will less frequently succeed in manipulating laws and regulations to stifle sharing economy services merely because they possibly may adversely impact preexisting businesses.

Two panel participants at the FTC's workshop – Matthew Daus, Windels, Marx, Lane & Mittendorf, LLP, and Vanessa Sinders, Senior Vice President and Head of Government Affairs for the American Hotel and Lodging Association – stated that ridesharing companies, such as Uber, and roomsharing companies, such as Airbnb, do not have to abide by the same set of requirements as taxicabs and hotels.

Indeed, regulations and taxes should not be levied on businesses differentially without legitimate reasons. As I wrote about in a blog earlier in June 2015, David Hantman, Head of Global Public Policy for Airbnb, and the FSF scholars agree on that principle. However, subjecting new entities, like Airbnb, to old regulations lessens the competitiveness of the market because smaller firms and/or emerging firms are often not well-established enough or profitable enough to cover the costs of such unnecessary burdensome regulations.

To the extent there are concerns about the impact of differential regulations not based on legitimate reasons, equity should be accomplished by deregulating down, not by regulating up. Deregulating down gives consumers the freedom to choose which businesses provide the most value. As FTC Commissioner Maureen Ohlhausen stated during the workshop's opening keynote address, "it is not for us in government to pick the winners and losers in the marketplace."

**Horizontal Mergers Are Only a Concern if Regulations Eliminate Contestability**

At the FTC's workshop there was a concern expressed by several panelists about future mergers. Mergers can sometimes harm consumers by decreasing competition and subsequently consumer choice, but sometimes consumers benefit from mergers in markets where economies of scale are needed – usually markets with high fixed costs.

One of the reasons sharing economy applications have become successful in disrupting competition is because the markets in which they have emerged are contestable. In other words, the markets have low barriers to entry. (Adam Thierer calls this "permissionless innovation.") Regulations that require permits, licenses, or other costs of approval increase the barriers to entry and decrease the contestability of markets.

Mergers, by definition, decrease the number of competitors in a market. However, if markets are contestable and thus have low barriers to entry, then mergers should not be a threat to competition. Mergers may lead to the merged firm increasing prices or providing lower quality

service if the market has substantially less competition as a subsequent result of the merger. But if the market is contestable, entrepreneurs will be incentivized to enter and provide a lower price or better service quality.

**Vertical Mergers Are Only a Concern if Regulations Eliminate Contestability**

For all the reasons stated in takeaway no. 5, vertical mergers should also not be a concern unless the surrounding policies create a market with high barriers to entry and low contestability. I was perplexed while sitting through the FTC's workshop that mergers were even discussed because it is the policies that surround markets which make mergers harmful to consumers, not the mergers themselves.

The hypothetical examples of vertical integration given at the workshop involved Airbnb buying housing and Uber buying cars. These examples seemed farfetched. It is not the case that such integrations could never happen. Rather, the tone of the discussion was characterized by extreme examples of hypothetical anti-competitive conduct by hypothetically integrated entities that would severely harm consumers or workers within the sharing economy.

Extreme hypotheticals aside, in a contestable market environment it is more probable that if Airbnb bought housing to rent out, it likely would not disallow hosts from sharing their living space. Similarly, if Uber bought driverless cars, it would not eliminate drivers from the using Uber's platform. These vertical integrations might provide competition to the sellers on sharing economy platforms, such as drivers and hosts, but I cannot foresee how these hypothetical examples would harm consumers, so long as the markets remain contestable.

Regarding market concentration and mergers in general, "price gouging" – the act of a business raising prices because consumers have few or no alternatives – is often discussed as the biggest threat to consumers. However, keeping barriers to entry low by avoiding burdensome start-up requirements eliminates this threat because innovators would have the incentive to *immediately* enter the market at a lower price.

**Positive Externalities and Spillovers of the Sharing Economy Were Not Discussed Enough**

Externalities are costs (negative) or benefits (positive) incurred by individuals outside of a transaction. Spillovers are simply economic effects that can occur as the result of the emerging sharing economy. Unfortunately, at the FTC's workshop, the negative externalities of the sharing economy were discussed much more than the positive benefits and spillovers.

a. Less Drunk Driving

A January 2015 report from Uber and Mothers Against Drunk Driving showed that Uber's availability in California has caused a 6.5 percent decrease in alcohol-related automobile crashes among drivers under the age of 30 since July 2012. In Seattle, it was found that since Uber's arrival in 2013, DUI arrests decreased by 10 percent.[3] Obviously, communities vastly benefit more when intoxicated individuals decide to use a ridesharing service rather than risk driving

[3] Both of these reports used empirical data and found statistically significant results.

home. Less injuries and/or fatalities lead to more economic activity and less need for police in certain areas should generally lead to lower public costs.

b. More Parking

Because the availability of ridesharing services has caused some individuals to drive less, more parking is available for those who still choose to drive. Of course, ridesharing has incentivized some people to drive more in order to make money for doing so. But unlike taxicab drivers, drivers of ridesharing applications rarely park to wait for their next passenger because the demand for almost instantaneous transactions is often too high.

c. More Mobility

Sharing economy applications incentivize individuals to travel to places that they would not otherwise. It might be intercity travel like deciding to go out downtown one night because competition between ridesharing services and taxicabs allows for inexpensive transit. As I mentioned in takeaway no. 2, parents are more willing to let their children travel by themselves because they can monitor them through ridesharing applications. It could also be international travel. Roomsharing applications, like Airbnb, incentivize people to travel to places that they would not otherwise. As I wrote in this blog:

> Airbnb lowers the cost of going on vacation and incentivizes tourism. Not only can vacationers often find cheaper alternatives than hotels and/or cleaner alternatives than hostels, they can also capitalize off of the service by sharing their living space and earning some extra income while they are gone.
>
> Airbnb may be especially helpful in Europe, where more than half of its business occurs according to a New York Times article. Airbnb's service is a great complement to the European Union's (EU) free migration policy. For individuals who want to travel throughout many European countries, staying at someone's house or apartment is good way to experience the local culture.

The positive externality of additional mobility can be a couple different things. It could be the extra security a parent feels when knowing exactly where their child is. It could be the benefits of learning new cultures and spreading them among friends and family when arriving back from the trip. It could be the ability to outsource workloads because flightsharing (if permitted) and roomsharing allow for less expensive travel.

d. More Commercial Competition in Specific Areas

Businesses, commerce, and housing emerge in areas accessible to transportation. This is why cities emerged along rivers and coastlines. And today it is why apartment buildings often follow public transportation routes. But as ridesharing allows for additional mobility that would not have occurred otherwise and provides greater benefits for low-income users (see takeaway no. 8 for explanation), entrepreneurs and businesses will adapt to these new mobility patterns, creating more competition to existing businesses in specific areas.

For example, maybe low-income individuals start traveling across town to visit a specific shopping center that is not easily accessible by public transportation. This could incentivize competition for another shopping center or business nearby because the number of buyers in the market has now increased. Additionally, the popularity of Airbnb in specific areas might spur tourist attractions or culturally-oriented businesses to emerge.

**The Sharing Economy Benefits Low-Income Users More Than High-Income Users**

Building off of the last takeaway, sharing economy applications have incentivized individuals to go places and experience things that they might not have been able to do otherwise. Depending on the users' incomes, the marginal benefit a user receives from a transaction can vary quite a bit. As Arun Sundararajan discussed at the FTC's workshop, his April 2015 paper with Samuel Fraiberger, entitled "Peer-to-Peer Rental Markets in the Sharing Economy," empirically finds that sharing economy markets have a greater positive impact on low-income users than on high-income users.

The FSF scholars also wrote about this result in their comments to the FTC:

> Due to the accountability and transparency that many sharing applications provide about their users, the emergence of trust between individuals to share their goods and services has shifted consumer preferences from owning to renting. People who could not afford to own a house, car, or even a power saw can now more easily rent them from others and ultimately enjoy a higher standard of living than they would have otherwise. Additionally, people who would have owned a car or power saw in the past might now rent them instead, saving a significant portion of their income.
>
> Of course, consumers with high-incomes gain from the sharing economy as well. But the savings accumulated from a shift in owning to renting is more valuable to consumers with lower incomes. In economic terms, this is the law of diminishing marginal returns. All else being equal, each dollar earned is valued less than the previous one.
>
> Similarly, low-income consumers who already own goods that can be rented out stand to gain more from these transactions than high-income consumers. The extra income from sharing a car with someone is much more valuable to a poor college student than it is to a wealthy professional. Airbnb, for example, makes traveling less expensive, not only because it provides competition – and often lower prices – to traditional hotels, but also because travelers can share their living space while away. In other words, as a result of the sharing economy, the same traveler on the same trip may realize economic benefits in his or her capacity as both a lessor and lessee.

As Mr. Fraiberger and Mr. Sundararajan eloquently declared in the paper:

> We highlight this finding because it speaks to what may eventually be the true promise of the sharing economy, as a force that democratizes access to a higher standard of living. Ownership is a more significant barrier to consumption when your income or wealth is

> lower, and peer-to-peer rental marketplaces can facilitate inclusive and higher quality consumption, empowering ownership enabled by revenues generated from marketplace supply, and facilitating a more even distribution of consumer value.

**Conclusion: The FTC's Role Should Be to Encourage Consumer Choice and Market Innovation**

The general mission of the workshop was to discuss "competition, consumer protection, and economic issues arising in the sharing economy to promote more informed analysis of its competitive dynamics as well as benefits and risks to consumers." I would say that it succeeded in that goal. There was not much discussion on how the FTC will or should move forward. I generally think this is positive because I do not believe there is much of a role for the FTC other than encouraging a deregulatory and market-oriented approach by government. It is clear from the discussions and speeches at the FTC's workshop that such a deregulatory approach has been vital to the emergence and success of the sharing economy.

FTC Commissioner Maureen Ohlhausen's opening keynote speech set forth an important framework and key principles at the outset of the workshop:

> As a life-long advocate for the beneficial effects of competition, I see the rise of the sharing economy as yet another example of how free markets have the potential to introduce transformative change. When entrepreneurs are free to innovate and compete, sometimes they will succeed and sometimes they will fail. But over time, that repeated process of experimentation, adaptation, and revision creates meaningful improvements in all of our lives.
>
> Let me be clear where I stand: the evolution of markets should be driven by consumer demand, rather than artificial, regulatory preferences for one business model over another. Misguided government regulation can be the barrier to innovation that never falls, so regulators should tread carefully, particularly when considering hypothetical rather than demonstrated consumer harm.

The FSF scholars stated in their comments what they believe should be the proper FTC approach to the sharing economy:

> The Commission's primary focus should be on enhancement of overall consumer welfare and, concomitantly, consumer satisfaction. In this regard, a recent PWC study entitled "The Sharing Economy," reported these survey results:
>
> - 86 percent of US adults who are familiar with the sharing economy agree the sharing economy makes life more affordable
> - 83 percent agree it make life more convenient and efficient
> - 81 percent agree it is less expensive to share goods than to own them individually

- 43 percent agree owning today feels like a burden
- 57 percent agree access is the new ownership
- 64 percent of consumer say that in the sharing economy, peer regulation is more important than government regulation

They obviously provide support demonstrating the positive impact of the sharing economy with respect to increasing overall efficiency, affordability, convenience, and consumer satisfaction.

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