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RESEARCH SUMMARY

THE SHARING ECONOMY AND CONSUMER PROTECTION REGULATION
The Case for Policy Change

Technology has allowed the development of the "sharing economy," including companies like Uber, Airbnb, and Lyft, where consumers can connect with producers online by touching a button on a handheld device. In a paper for the Mercatus Center at George Mason University, scholars Christopher Koopman, Matthew Mitchell, and Adam Thierer demonstrate that the sharing economy makes Americans better off by offering new innovations, more choices, service differentiation, better prices, and higher-quality services.

Unfortunately, many regulatory agencies now seek to apply outdated rules to these services, without evidence that such restrictions will help average Americans. Continued application of outmoded regulatory regimes may harm consumers by decreasing options and driving up prices. A better option would be to roll back old restrictions that limit competition instead of extending them to new businesses.

To read the paper in its entirety and learn more about its authors, please see "The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change."

THE SHARING ECONOMY CREATES VALUE

Formally, the sharing economy is defined as any platform that brings together distributed networks of individuals to share or exchange otherwise underutilized assets. It encompasses all manner of goods and services shared or exchanged for both monetary and nonmonetary benefit.

The sharing economy creates value in at least five ways:

- It allows people to put "dead capital"—underutilized property such as cars, kitchens, and apartments—to more productive uses.
- It allows markets to become more competitive and businesses to specialize even further.

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- It reduces transaction costs because traders can more easily agree to terms and monitor performance.
- It corrects information problems because reviews by past consumers and producers provide important information for future market participants.
- It serves as an end-run around captured regulators who have allowed current businesses to become inefficient and unresponsive to market forces due to regulatory protection.

THE INTERNET PROVIDES MORE CHOICES AND INFORMATION TO CONSUMERS

The Internet has allowed entrepreneurs to accomplish things that regulation has failed to do, by providing the following benefits:

- *A broader range of goods and services*. Due to its wide availability and ease of use, the Internet gives consumers access to a broader range of goods and services than would be available otherwise. New firms can enter the market with lower prices and better goods and services.
- *Expanded information*. The Internet allows consumers to search and monitor business reputations, leading to more and better choices. These tools reduce search and transaction costs in commercial interactions, and unlike regulatory solutions, cannot be captured by firms.
- *Consumer empowerment via reputational feedback mechanisms*. Product rating and review systems allow consumers to share information with future consumers, establishing trust between suppliers and consumers. Firms either adjust and adapt to feedback or suffer the reputational consequences of failing to do so.

REGULATORY CAPTURE AND RENT-SEEKING: CAUSES AND EFFECTS

Regulatory restrictions can undermine competition, resulting in higher prices, fewer choices, lower-quality service, or some combination of these harms.

- Despite regulators' often noble intentions to protect consumers from a variety of perceived "market failures," such as different levels of information and unequal bargaining power, historical analysis of regulation demonstrates that the results of regulation often fall short of the "public interest" goals of regulators.
- Powerful and politically well-connected incumbent firms have an incentive to "capture" the regulatory system intended to restrain them, and use it to limit the entry of new firms and raise the costs of rival firms. Incumbent firms can organize more easily than consumers, have an informational advantage over regulators, and can apply pressure on regulators both from within (because firm insiders often become regulators themselves) and through the political process.

- Regulatory capture encourages firms to engage in socially costly "rent-seeking" behavior. It means that firms expend scarce resources on political activity and that entrepreneurs innovate along socially destructive margins rather than productive margins. It also means that the status quo can get "locked in" by law, retarding the adoption of new technologies and business models.

INNOVATIVE FIRMS STRUGGLE WITH REGULATION

Due to capture, innovative firms that seek to do things differently often run up against "barriers to entry" and protectionist policies that restrict their ability to differentiate themselves and compete.

- For example, New York City's government requires all taxicabs to be painted the same color. Consumers are thus unable to differentiate between brands, which undermines competitive rivalry and reduces the incentive for firms to provide excellent customer service. Such restrictions can also limit consumer choice: in 1931 there were 21,000 licensed taxicabs in New York City, but there were only 12,799 in 2006, despite the increase in population.

- In a competitive market with open entry and exit, firms can find innovative ways to cut costs and pass savings on to consumers. Alternatively, they can seek to differentiate their products from those of competitors. When regulators restrict price competition, competition on quality becomes more intense. Unfortunately, this gives firms an incentive to seek regulations that restrict competition on quality.

CONCLUSION

The technological advances that have made the sharing economy possible solve the problems that old-style regulation cannot. Policymakers should relax old restrictions rather than expanding them as new firms challenge the status quo.

By attempting to regulate away every hypothetical worst-case scenario, regulators may discourage best-case scenarios of improved consumer welfare through innovation and competition. Regulations such as licensing requirements, price controls, service area requirements, marketing limitations, and technology standards may place new entrants at a disadvantage compared to incumbents. Regulators should seek to level the regulatory playing field by deregulating down to the least-burdensome denominator.