REGULATING THE SHARING ECONOMY:

APPLYING THE PROCESS FOR CREATIVE DESTRUCTION

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Date: 12/21/2015

Word Count: 2,470
Introduction

The rising popularity of sharing platforms such as Uber, AirBnB, Taskrabbit and others is democratizing access to services as part of a larger sharing economy phenomenon. The sharing economy is a hub of peer-to-peer activity for obtaining, giving, or sharing access, and is coordinated through a web interface featuring community feedback.\(^1\) Uber, AirBnB and other such firms are drawing the attention of regulators as the sharing economy operates within a gray zone that is not contained within the existing regulatory framework. As new technology is accelerating the emergence of new forms of economic activity, regulators must adopt quicker measures in order to remain relevant. This paper first examines the reasons that cause governments to regulate, the problems currently affecting the regulatory framework, and the trade-offs regulators must consider in formulating the appropriate regulatory response. This paper then calls for possible solutions by proposing a regulatory framework that is flexible and responsive enough to allow these companies to operate into the future. Responsiveness can be enhanced by creating an inter-jurisdictional task force that will develop government’s foresight and anticipatory abilities, and applying the process of creative destruction toward regulations that can solve the problem of outdated regulations.

The Need for Regulation

Governments regulate for a number of reasons however according to “public interest theory” the central purpose is to serve the common good.\(^2\) This is normally accomplished by regulating market behaviour to protect the public from externalities, asymmetric information, and other market failures.\(^3\) Governments normally regulate by adopting the precautionary principle. This philosophy is intended to encourage and even oblige policy makers to consider the suspected risks of a policy, with the burden of proof placed on the party taking the action.\(^4\) When there is a reasonable suspicion of harm coupled with scientific uncertainty about the cause and the effect, then there is a duty to take action to prevent harm. There are now 20 such international agreements and conventions that incorporate this principle into the regulatory process.\(^5\) The benefits of regulation, although recognizable, are difficult to quantify as they normally occur in the form of costs prevented or avoided.\(^6\) As an example, environmental pollution control is recognized but cannot be given a value as the regulation prevents the deterioration of air and water quality. Since the regulation has prevented a particular event from occurring, the event has not occurred in the market and thus, a value has not been placed on the event.\(^7\) With the increasing rate of self-employment within the sharing economy, the benefit of

regulation will be in the enforcement of labour protections as well as proper representation of this economy in labour market statistics. In creating effective regulations, governments use criteria such as the ten regulatory principles as endorsed by the Working Group on Regulatory Reform.  

(See Appendix C) Companies that are part of the sharing economy such as Uber and AirBnB have understood the public interest rationale for regulation and have openly called for more regulation.  

However, governments realize that there are several problems and limitations in making these decisions.

Current Regulatory Problems:

Governments find it difficult to regulate the sharing economy as it presents trade-offs such as acting in the public interest, the need for innovation and economic growth, soaring consumer demand, and fairness for incumbents. The current problems that prevent effective regulation of the sharing economy are outdated regulations, radically different organizational culture, and the absence of inter-governmental collaboration between governments.

Existing regulations contain outdated or obsolete information such as that for hotel owners, as found in the Ontario Innkeepers Act. The act applies to hotels however almost one-quarter of the regulations pertain to how an inn owner can place a lien on a customer’s horse.  

Outdated regulations also allow new entrants within the sharing economy to exploit gaps and loopholes which leave governments with many unanswered questions on the rights and safety for workers and consumers. In classifying workers as ‘independent contractors,’ Uber does not become responsible for driver behaviour or vehicle maintenance costs and AirBnB does not become responsible for the maintenance, repairs or cleaning of rental units. This makes these companies highly profitable as they are able to offload the responsibility for liability, regulatory compliance, and taxes onto private contractors. This practice subverts the social safety net as our current definition of employment is related to the employment relationship. Regulators have also expressed safety concerns for consumers which have been addressed to some degree. Uber has employed a number of safety related features such as background checks, records of financial transactions, and a self-governing peer review system that reviews and can suspend drivers that fall below a certain level. AirBnB has also employed safety features such as an ID verification check and a peer review system. The peer review system that is common in both is an important function for companies operating within the sharing economy as it acts as a form of self-regulation, providing accountability from within the system for both workers and consumers. In this way, self-regulation is not deregulation, but rather, “a reallocation of

8 See Appendix A
regulatory responsibilities to parties other than the government”.\textsuperscript{15} The rise of self-regulation should compel governments to act decisively on the issue in order to restore confidence in the regulatory process.

The organizational culture of companies within the sharing economy is also “worlds apart” from that of the governments that seek to regulate them. The sharing economy is centred on openness of information and collaboration whereas the public sector keeps information closely guarded, is risk averse, and operates in rigid hierarchies.\textsuperscript{16} Governments seek to regulate the sharing economy because the danger of inaction may result in endangering the health and/or safety of the public which can lead to negative media attention. This can become politically costly for the government. Governments also face procedural and organizational challenges in regulating the sharing economy as consultations have to be performed, processes have to be followed, and legislation has to be debated. This slows the organizational response as governments must also consider all of the impacts and the context when regulating because failure in the policy process can result in whole communities or societies becoming affected.\textsuperscript{17} As ministers are the executive heads of their departments, failure can also become politically risky to their careers. All of these factors slow governments in their ability to act in an environment driven by high speed change.

The third regulatory problem is the lack of organizational collaboration between regulators at different levels of government. In an age of technological competitiveness, dated bureaucratic structures resemble vertical silos which fail to respond quickly enough in a highly collaborative age. The lack of a coordinated response from the different levels of government has led to a confusing mix of policy, essentially becoming a game of ‘whack-a-mole.’\textsuperscript{18} The City of Ottawa presents such an example where Uber is considered a ‘bandit taxi service’ and is currently illegal. For municipal employees on city business, reimbursement is not provided for rides using Uber, but is given for rides in licensed taxis. In contrast, federal government employees are using Uber for work purposes and have been reimbursed. The federal government has stated that they are aware of employees using Uber for work purposes but has not developed a policy response.\textsuperscript{19} In the run up to the 2015 federal election, even political leaders in each of the major political parties were either unsure or vague in their approach to regulating the sharing economy.\textsuperscript{20}

\textsuperscript{17} Peter, Aucoin, ‘Aucoin Reader on Public Administration in Canada’. N.d. Dalhousie University
Regulatory Considerations:

Governments must consider several issues when regulating the sharing economy. These considerations include the market, socio-economic benefits and the public popularity for these services. As governments act in the public interest, they must carefully determine the market implications for any new regulations. This is because regulation can produce winners or losers in the market. Incumbents may welcome new costly regulations from government simply because they present barriers to entry for new competitors.21 Given that established incumbents already have large scale investments and money in upholding the status quo, they have much to lose and are incentivized to “capture” the regulatory system that is intended to constrain them.22 This is due to the fact that smaller interests are more concentrated than larger diffused interests. For example, it is easier for angry cab drivers from a taxi group to lobby the government than it is for a broad diverse base of Uber drivers. New and emerging companies have no relationship built with regulators to tap into and thus can be at a disadvantage. On the other hand, traditional taxi operators for instance, face existing regulations from governments which limit their prices according to consumer demand, the types of vehicles they can operate, etc. New entrants have not had to follow such rules as these companies do not own their own fleet, but rather act as online platforms for independent contractors to use their own vehicles. This has caused incumbents to lobby governments for fair rules and new regulations on ride sharing companies such as Uber, Lyft and others in order to ensure that these companies play by the rules. As innovation is a form of technological progress that can lead to economies of scale and market efficiencies, regulators have acknowledged that caution must be used when regulating. In the Federal Trade Commission’s (FTC) Workshop on the Sharing Economy, the Commissioner said, “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.”23

The second consideration for governments to consider is the socio-economic benefits of the sharing economy. The sharing economy allows underutilized resources to be monetized. Empty rooms can be rented out and empty vehicle space can be used up. This provides entrepreneurs or service providers with new opportunities to work as Uber drivers, TaskRabbit runners, AirBnB hosts and others. In light of this, governments must act in a manner that is fair and based on procedural justice. Given the sharing economy’s unregulated status, obtaining data is difficult to find, however projection estimates state that the sharing economy has the potential to increase global revenues from $15 billion to $335 billion by 2025.24 This presents significant revenue generating opportunities for governments that cannot be overlooked. The sharing

economy also provides environmental benefits such as reductions in smog and emissions which have been observed. In the case of Uber, Lyft, and others, a study found that every car sharing vehicle removes between 9 and 13 other vehicles from the road. This provides new avenues for car-pooling, reducing urban smog and reliance on gas while also allowing for economic growth to occur. Hospitality companies such as AirBnB reduce carbon impacts by allowing pre-existing housing to be used more efficiently and reducing the need for more commercial hotels. A study on carbon emissions from the tourism industry found that hotels were responsible for 21% of carbon emissions.

Governments should also consider public opinion when determining the regulatory tools they use as regulating the sharing economy is a public policy issue. Companies within the sharing economy increase competition for services which drives innovation and leads to consumer benefits. Much of what drives the popular demand for the services in the sharing economy is trust. In one such survey, 64% of consumers claimed that in the sharing economy - peer regulation was more important than government regulation and 69% said they will not trust sharing economy companies unless they are rated by someone they trust. In the case of Uber, various public opinion polls have placed Uber’s support at over 75% both in Toronto and Ottawa.

Towards the Future

As innovation is a moving target, a successful regulatory strategy will require flexible and responsive regulations in order to keep up with the pace of technological innovation. As procedural constraints on public governance slow the organizational response within the public sector, regulation would be best served with collaborative structures between various levels of government. Thus, governments should consider establishing a regulatory foresight taskforce composed of several elected officials from provincial, federal and various large municipal governments. The task force should be assigned to perform a sunset review of regulations affecting the sharing economy every 2 years in order to ensure they are updated and responsive for future innovations. A citizen advisory committee should also be in place that will draw upon the general public to provide meaningful contributions to the work of the task force. Another successful regulatory strategy would be one of active cooperation between new entrants and governments. Progress is already occurring from new entrants as they seek to avoid costly slowdowns in the regulatory process. Uber and AirBnB have both openly called for more

regulation in attempts to cooperate. This is mutually beneficial as regulators may be unfamiliar with the sharing economy business model. AirBnB has worked with regulators in various cities such as Amsterdam and London in approving ‘AirBnB friendly laws’ and Uber has also applied and received regulatory approvals in Houston and in Las Vegas. Uber also recently received national approval from the Philippines as well.

Regulators can also remedy outdated regulations by applying the process of creative destruction within the regulatory framework as it will bring about a process of regulatory “mutation,” which destroys old patterns of regulatory structures and creates new ones. This means regulations should be “destroyed” and rebuilt from the ground up to suit the regulatory structure of the day. Today it is the sharing culture, tomorrow it may be something else.

**Conclusion**

In order to remain relevant, governments will need to create regulations that are responsive and flexible enough to adapt to the new and emerging companies of the sharing economy. The current problems preventing effective regulation of the sharing economy are outdated regulations, a radically different organizational culture, and the absence of an inter-governmental collaborative structure between governments. Until these problems are addressed, there will continue to be regulatory uncertainty in the system as the pace of change within the sharing economy is quite substantial. The trade-offs regulators make in assessing the degree of regulation to use will need to take market considerations into context in order to allow innovation to exist. Considerations will also need to be made for the socio-economic benefits that the sharing economy can produce for the economy and the public’s appetite for peer-to-peer services. In order to keep up with the speed of technological innovation, an inter-jurisdictional task force should be established which can respond to such changes by performing sunset reviews of existing regulations. A citizen advisory committee should also be formed to assist in driving public participation on the issue. For outdated regulations, instead of revamping old regulations, it will be more suitable to create new regulations from the ground up. These are just some of the possible solutions in regulating the sharing economy.

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Appendix A:

The following ten regulatory principles have been used when considering, developing, implementing, and reviewing regulations:

1. Justify the need for regulation
2. Ensure transparent regulatory development and implementation
3. Assess the costs and benefits of regulation to inform decisions
4. Minimize the impact of regulation on a fair, competitive and innovative market economy
5. Minimize or eliminate divergent or duplicative requirements with other jurisdictions
6. Design results-based regulation where appropriate and to the extent practicable
7. Ensure timeliness in regulatory decision making
8. Write regulations so they are easily understood
9. Make regulations easily accessible
10. Evaluate and review regulations routinely
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