GPPR
Georgetown Public Policy Review

How the Sharing Economy Creates More Efficient Markets

Patrick Spencer
October 9, 2015

One of the most controversial areas of policy making in recent years has been efforts to regulate the new 'sharing-economy'. A firm that epitomizes this struggle has been Uber, the taxi sharing company who operate (at time of writing) in 168 cities in the US and 58 countries across the globe. In numerous locations they have been met with hostility from regulators, legislators and the local taxi industry. Claims have been made that Uber exploit drivers through low pay and poor employee rights, while failing to provide a safe service to passengers. In California Uber have faced lawsuits that may force them to reclassify drivers, and fines for advertising that they are safer than taxis. In New york, Mayor De Blasio threatened to limit the growth of Uber on the basis that Uber taxis increase congestion. In France, two Uber executives were arrested on charges of enabling illegal taxi services and the illegal storage of personal data. Taxi industry strikes over Uber have occurred in the UK, India, Spain, Germany and many others.

The environment for companies operating in 'sharing markets' has been hostile. It poses the question for policymakers: is the sharing economy a force for good which needs to be fostered or does it require pro-active regulation to correct negative externalities?

I want to put forward the argument that that the sharing economy is a force for good and should be supported by policy makers because it helps create more efficient markets. Firms operating in this sector, whether it be Uber, Lyft, AirBnB or others, help create a more transparent pricing system which better reflects supply and demand. Sharing markets have lower barriers to entry, and technology has reduced the friction between buyers and sellers. Finally many sharing markets correct the problem of asymmetric information.

Market Prices

Efficient markets require an effective pricing mechanism that responds to surges in both supply and demand, while being completely transparent for both buyers and sellers to see. The most obvious example of a 'sharing app' meeting this requirement has been AirBnB. Homeowners can list their house for rent at any price they wish, whilst being able to see the price of other homes in their local neighbourhood. This allows for both competition on pricing between local vendors and differentiation of products available.

The owner renting out his one bedroom apartment can see that similar offerings in his local area are listed at $120/night. He may choose to undercut the competition marginally or considerably in the hope of attracting demand. Alternatively, after inspection of the other apartments to rent in the area, he may choose to improve the quality of his offering; updating the interior, improving internet access, including perks such as a pre-paid cleaner within the deal. Consequently he could opt to offer his one bedroom at $150/night. This could be part of a larger strategy to fill a gap in the market for better quality one bedroom apartments in his area. Either way, transparency on prices and product offerings equip vendors to better serve demand and increase market efficiency.

The other aspect of an efficient market pricing mechanism is ensuring demand and supply filter through into the price. The taxi service Uber is an example of this with its dynamic pricing model. Large numbers of Uber drivers allow for Uber fares to undercut conventional city regulated taxis. A recent survey by taxifarfinder.com and Uber found that cab fares (including tips) for the same 5 mile ride at 30mph were 100% larger than the Uber equivalent in Los Angeles, 70% greater in San Fransisco and 80% higher in Chicago. However the surge pricing technique kicks in during hours of high demand, allowing Uber taxi's to charge 2x or 3x their standard rate. This attracts more Uber drivers out onto the road to meet the demand.

Overall technological innovation has allowed for more transparent marketplaces to emerge. Technology has allowed for more transparent pricing in financial markets, the housing market, markets for automobiles, holidays and utility providers. More transparent pricing is to the sole benefit of consumers and wider society.

Low Barriers to Entry

A crucial condition for efficient markets is the ease by which actors can enter and exit the market both as buyers and sellers. This is evident across the sharing economy, at all levels of the market from platform providers, to local vendors and customers.

Technology has reduced start-up costs and lowered the marginal costs of production for many businesses. Consumer software programmes allow amateur coders to build apps and run businesses online without the need of heavy tech infrastructure or R&D expenditure. A sharing market therefore takes little investment and time to be set up.

Sharing apps are also designed for easy use, encouraging more individuals and groups to enter into the market. An example of this ease of use is taskrabbit.com which pairs individuals willing to do DIY, run errands, cook or clean with individuals who are willing to pay for these services. No exceptional skills, qualifications or investment is needed in advance of using this service. *'Taskers'* are subject to criminal records and background checks but this helps reinforce trust within the service. Taskers are then rated by customers according to the quality of service provided; a suitable means to weed out any low-performing vendors. The taskrabbit platform has allowed thousands of economic transactions to take place by allowing individuals to enter and exit markets easily, offering services whenever it best suits them, as opposed to being engaged long term in an over-regulated market. This is evident across the app market; Director of Strategy at Uber David Plouffe claimed the majority of Uber drivers in Chicago work for less than 10 hours per week. These are at times convenient to them, outside traditional working hours, made possible within a sharing market that prioritises informal standards.

In summary, technology has allowed sharing markets to be set up at lower costs and in less time. Through mobile apps, sharing markets are more easily accessible than ever before, encouraging more people to enter and exit markets at their convenience.

Reducing friction between buyers and sellers

One of the enduring problems that markets face surround the ability of buyers and sellers to utilise market information and trade accordingly. This is because of a phenomenon referred to as market frictions. Buyers can be faced with poor information, high initial costs in the form of fees and taxes, and complexity. An example of this would be the retail investment market. Savers who have the option of investing their money in the equity market may be dissuaded by the huge range of options available from the wide range of providers. Jargon used by salespeople (camouflaging risk as safe rewards) can also put young, old and the ill-informed off. Fees for setting up accounts, and the added burden of taxes on top of any capital gains earned may also prompt investors to remain safe and keep their money in current accounts at much lower rates of interest.

Sellers are also exposed to the problems of market friction in the labour market. Sellers of labour, workers, may find themselves unemployed for prolonged periods because excess demand and supply fail to clear each other out. This could be due to geographical restraints, job openings in Seattle are little use to unemployed graduate students in Washington DC, or knowledge issues, a barman in Miami Beach may not know that there are job openings at a club in Fort Lauderdale.

These markets struggle with inherent frictions, but apps operating in sharing markets can go some way to preventing some of these issues through better information and simplifying and formalising trades. The Lending Club is looking to replace the traditional banking system by matching savers with investment opportunities in a low cost and simplified environment. Taskrabbit.com provides a platform for local workers to advertise their services and employers a forum to find local contractors for basic services, thereby reducing knowledge friction. Yplan lists local events that aren't advertised and offers users the opportunity to take advantage of last minute deals. Uber matches drivers and passengers with the use of GPS software, thus reducing the waiting time for both groups. Market frictions are all but eliminated as sharing apps allow buyers and sellers to trade instantly, often at the touch of a button.

Asymmetric Information

The final aspect in which the 'sharing economy' helps create more efficient markets is in correcting the problem of asymmetric information. Asymmetric information occurs when one side of a trade holds more information than the other. Informational imbalance can lead to both price distortion and market failure. Asymmetric information has led to failures in the health insurance market and second hand ticket exchanges.

Sharing platforms have managed to engineer a mechanism by which rating both sides of the transaction instill trust through reputation. Alex Tabarrok and Tyler Cowen, from the Cato Institute, recently wrote "*Many of the exchanges in the sharing economy, including Uber (transportation), Airbnb (accommodations), and Feastly (cooks) use two-way reputational systems*… *Dual reputation systems can support a remarkable amount of exchange even in the absence of law or regulation*". Not only does this two-way reputational system boost trust and the level of economic activity, but it also rewards quality service. Vendors who fail to meet the expectations of customers will find their ability to operate in the market diminished. Likewise, contracting parties that fail to pay on time or employ workers in subpar conditions will equally find it difficult to continue to operate in the market with a poor reputation for everyone to see.

Conclusion

Free and efficient markets are the basis for economic activity, growth and a prosperous society. Traditional markets in products ranging from transportation, rented accommodation, and labour have been transformed. Markets in amateur cooks, dog walkers, second hand furniture, parking spaces, and local tour guides have all been liberalized and to the benefit of each market actor, both buyers and sellers. Jobs have been created, incomes increased and economic growth generated. David Plouffe from Uber in the same interview with CBS said that an Uber driver working part time for 10 hours a week can supplement his income by $12,000 a year. This would boost the average hypothetical US household income from $53,046 (2013, census.gov) to above $65k a year. This is a substantial increase in net-income for low and medium income households and the repercussions for society are huge.