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Economic and Business Dimensions
The Dark Side of the Sharing Economy … and How to Lighten It

Improving the sharing economy will require addressing myriad problems.

BECAUSE WE LOVE the sharing economy we want to improve it. But most pundits are telling only half the tale: Naysayers are too bombastic and boosters too unrealistic. Improving the sharing economy means dealing realistically with its dark side. To assure sharing will grow up, we need to avoid market and regulatory failures that allow parts of the market to gain unfair advantage over others. Regulatory arbitrage is not the right answer. Instead, sharing must ultimately create real consumer value.

It is not too early to begin. Sharing is quickly spreading. People already have access to rooms (AirBnB, Roomorama), tools (SnapGoods) cars and bikes (RelayRides, Wheelz), and ad hoc taxi services (Uber, Lyft). These two-sided platforms offer many advantages by unlocking the value inherent in sharing spare resources with people who want them.[4] The size of the sharing economy is estimated at $26 billion.[1,16] Internet mediaries now match demand and supply in real time on a global scale. The potential macroeconomic gains are colossal, but problems abound.

The Sharing Economy's Dark Side

The Hotel Zone. Transients and tourists do not always respect the sensibilities of long-term residents. Conflicts over tenement buildings helped motivate the first U.S. zoning laws[5] that sharing now circumvents. In addition, short-term rentals create shortages of affordable long-term housing when nightly rates exceed monthly rentals. Passing that tipping point can hurt individuals at lower income levels[11] even as it boosts income for homeowners. It takes time to balance conflicting needs, but sharing is growing quickly.

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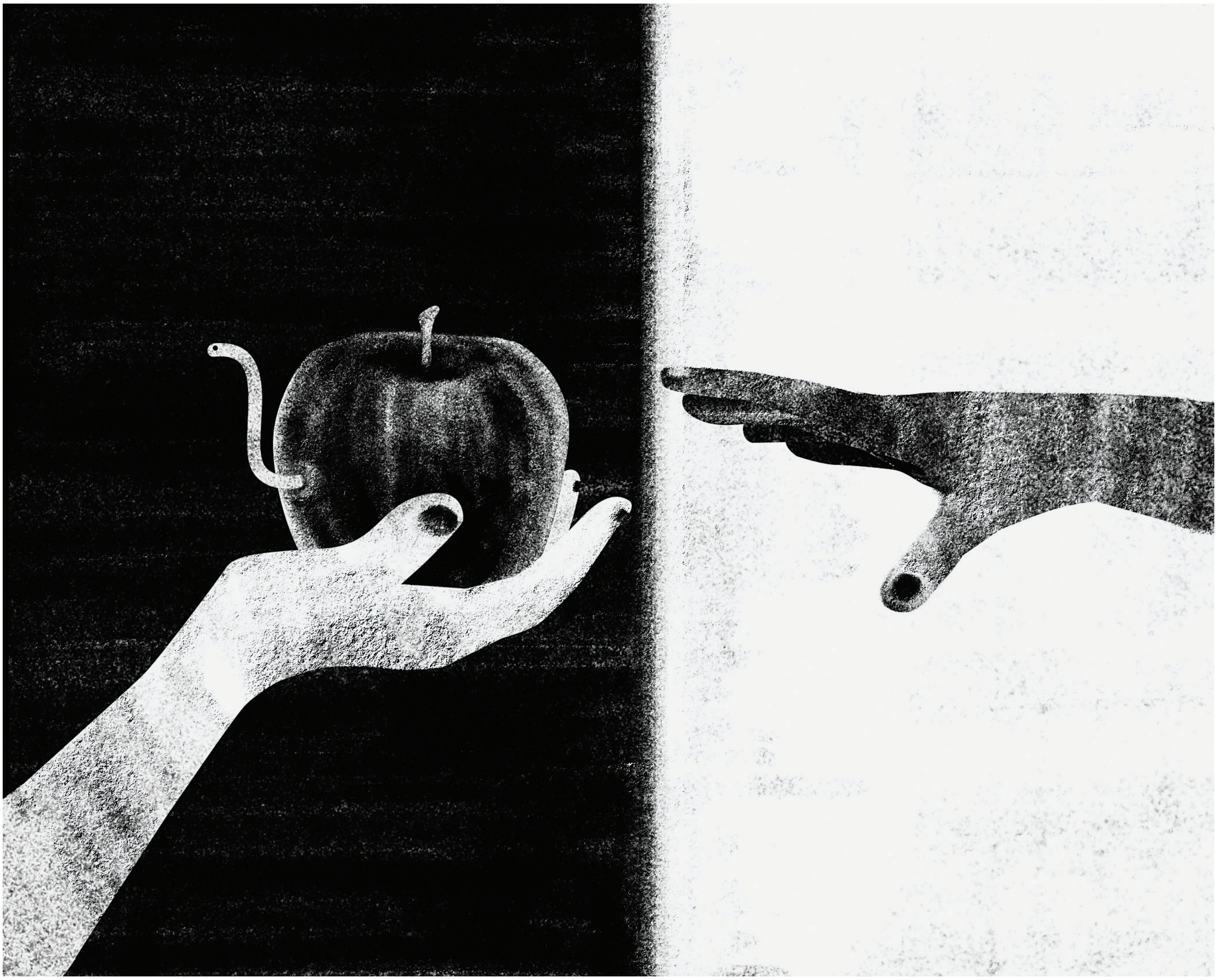
No Soup for You. In a famous episode of "Seinfeld," one of the lead characters was denied soup by a renowned but humorous cook.[a] Sharing biases online is as natural as sharing cars and couches. But when

a See the *No Soup for You* episode summary: http://bit.ly/X5rBCE.



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biases are unfounded and consumers or producers bludgeon each other unfairly in social media, who will intercede? Biases can mislead, ostracize, shill unearned praise, and damn worthy competitors. A recent study found 16% of Yelp reviews are not genuine.[10] By posting unfounded complaints, customers can punish providers for their transgressions. In some cases, providers will have to fight back to save their reputations.[b]

Taxing the Taxi. Unlike licensed taxi drivers, private citizens providing ride-share services do not always purchase medallions. They also do not take licensing exams, or necessarily carry commercial insurance. For these reasons and because they are not required to honor all ride requests, a German court banned Uber's basic service throughout the nation.[3] Licensed taxi drivers are saddled with greater costs, which hampers their ability to compete with ride sharing. Arguably, ride sharing is growing by circumventing costs and regulations that govern incumbent businesses. Ride sharing can exploit loopholes to avoid rules and taxes. When this occurs, the sharing economy becomes the skimming economy.

Shared Economies or Shared Serfdom. A commentator at *The New York Times* concluded that what he earned by ride sharing barely covered gas and depreciation.[c] Peer-to-peer exchange based on sharing ideas or performing work (such as Mechanical Turk or TaskRabbit) "on the cheap" strips opportunity from the bottom of the pyramid, as jobs move from traditional manufacturing and services to micro-services.[12] Micro-outsourcing that pays for only the task at hand can shed overhead but mortgage the future by covering only marginal costs and leaving nothing for new skills, health care, or retirement. If information goods are an indicator, marginal costs approach zero, so even covering them might not pay much. Jaron Lanier's book *Who Owns the Future?*[9] calls this issue a matter of dignity: "if you have to sing for your supper for every meal, you're ... one run of bad luck from losing [everything]."[d] Going freelance is hollow freedom when the wage for labor is free.

b One restaurateur fights back against an unjustified Yelp review: http://bit.ly/1tTJDTq.

c See comments on Sundararajan, A. "Trusting the 'Sharing Economy' to Regulate Itself" Economix Blog *New York Times* (Mar. 3, 2014); http://nyti.ms/1krGSHo.

d See http://bit.ly/1nSYIn9.

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Whose Ox Gets Shared? Sharing creates a subtle tug-of-war between the primary producer and secondary sharer. Secondary sharing can become tertiary taking. Consider the extreme case of a Netflix subscriber who pays $20 per month, rents three DVDs from Netflix, and then rents each for $1 per night to other individuals. The subscriber makes $90 ($1\times3\times30$) each month while paying substantially less for an asset he or she never owns. Similar to the way put and call options share the value of other people's stocks, sharing allows us to go long or short on physical assets. It might be economically efficient, but it can harm the demand for Netflix and the people who produced the movies. Broadcasters sued the startup Aereo for leasing a device that let individuals capture broadcast TV signals to stream shows to devices they (or others) own. The suit reached the U.S. Supreme Court and, on the basis of copyright infringement, the U.S. Supreme Court ruled against Aero.[e] The City of San Francisco likewise shut down a subversive sharing service. Counselors issued a cease and desist order to producers of a mobile app that rewarded drivers for sharing news of their willingness to vacate public parking. It then auctioned off their spaces.[f] Insider sharing just became the latest form of insider trading.

The Dark Side of the Moonlighting. Last New Year's Eve, an off-duty driver for the ride-sharing service Uber killed a pedestrian while hunting for fares. Since the driver was a "contractor," the sharing service would not compensate the victim's family.[g] The contract stipulates that the service is a matching platform and "the company does not provide transportation services, and ... has no liability for services ... provided by third parties."[h] Who then will bear the costs of such disasters? Jaron Lanier says these new business models enjoy profits while offloading risk to others. When society picks up the tab, these new business models raise concerns. Maybe they are no cause for celebration.

Lightening the Dark Side

Absorb Risks that Benefit the Ecosystem. Shedding risk and never admitting culpability is standard lawyers' advice. In following this advice, Uber did not indemnify its driver yet has reversed itself dramatically expanding coverage. Putting share-rides into taxi-ride perspective, New York City experienced 44 taxi-related fatalities in 2009 alone.[i]

History informs us about the willingness of new businesses to accept risk. Banks originally opposed the Fair Credit Reporting Act (FCRA), complaining about the increased liability and responsibility for unauthorized transactions. Banks argued that FCRA would promote fraud, encourage people to be careless with credit cards, and reduce bank willingness to extend credit. Precisely the opposite occurred. The FCRA passed in 1970, with amendment 15 US § 1643 later limiting consumer liability to $50 for fraudulent credit card use. However, banks ultimately learned that protecting customers is good business: increased credit card use more than offsets growth in fraud-related costs. Most banks now do not even hold consumers responsible for the $50. If sharing moves in the same direction, sharers and society will be protected.

Invest in Your Customers. As a startup, Airbnb could not gain traction with renters as long as people put up low-quality listings and photos of their

e Steel, E. "Stung by Supreme Court, Aero Suspends Service;" *New York Times* (Jun. 25, 2014), A20.

f Coté, J. "SF Cracks Down on 'Monkey Parking' Mobile App" June 23, 2014; http://bit.ly/ToFDNA.

g Diamicis, C. "Uber driver hits, kills 6 yr old girl. Is 'Not our problem' still an appropriate response?" (Jan. 2, 2014); http://bit.ly/190hsft.

h See http://bit.ly/1pxnIgK.

i New York City Pedestrian Safety Study: Technical Supplement (Aug. 2010). http://on.nyc.gov/1AqODmU.

rooms. Improved listing quality doubled revenues.[j] That led Airbnb to educate its users in how to improve their listings.[k] Author Michael Schrage[13] points out that investing in customers helps them create more value. When they can create that value, the ecosystem wins. Gary Swart, past CEO of oDesk, had his company partner with SkilledUP to grant access to thousands of online courses because better-trained freelancers charge more for their work and deliver higher quality.

Community Policing and Self-Regulation. Platforms can be better than governments at spotting stalkers, running background checks on sharing service providers, and responding quickly to conflicts among members. Platforms are closer to the action; and they have an incentive to look after their communities. That is how they make money.[6] Venture capitalist Nick Grossman says peer-sharing systems develop scalable enforcement, like reputation systems, that are more inclusive than licensing regimes. Self-regulation can work (For examples see The American Medical Association and National Association of Realtors.[14]) Problems with self-regulation arise from harm to nonmembers, market power, and network effects that encourage firms to engage in anticompetitive behavior. But with care, these problems can be avoided. Moreover, sharing can also help government regulators. For example, health inspectors are using Yelp ratings to identify restaurants that may be sources of food poisoning.[8]

j See http://bit.ly/1gmYXSd.
k See http://bit.ly/1dvNMm1.

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Tax Fairly and Don't Promote Arbitrage. The City of Amsterdam has begun to support sharing economies.[15] Hosts renting their homes to others pay income and tourist taxes, and must ensure neighbors stay neighborly. Private individuals do not require liquor licenses or kitchen inspections as do major hotel chains. Regulations that lie between the individual and industrial levels in this fashion can be a wiser way to handle tax arbitrage. Individuals do pay reasonable taxes that support the community but do not pay at industrial levels.

Current laws that gouge one group to benefit another also need reform. If technology permits low-fee providers to substitute for high-fee ones, simplifying and designing laws that do not promote arbitrage is possibly a better answer. When was the last time your airport car rental cost less than you expected? Sticker shock sets in when cities impose head, gas, airport, and other taxes on tourists. Taxi medallions help regulate taxi services, but also create cartels where medallions offer investment-grade returns to their respective cities.[7] Taxes on private cars used in shared services might make sense because the roads still require maintenance. However, balance is essential. Internet-enabled sharing does not mean "no taxes," as Amsterdam has shown.

Create a FICO of Reviews and Fair Access of Resources

To a great extent, the viability of shared services hinges on the quality of review systems because people rely on them to decide whether and what to purchase. Authenticating the validity of reviews is critical to prevent abuse. An independent agency might help prevent glowing "sock puppet" reviews or unfair criticisms. Certification might even deflate mutual excess flattery. Credit scores and information have been monitored in a similar fashion for many years by several agencies, including FICO. Also regulators must ensure public access to public information. Sharing news must not be used to make public resources private. The sharing economy requires that complete information and trustworthy reputations be available to all parties.

The problem is not whether to bury or build the sharing economy: it is already on the ground. The gains are too great to pass up because of misdeeds on the part of a few self-serving actors. The larger opportunity is to move forward despite the disruption. In the short run, platform firms should indemnify users and self-regulate the health of their ecosystems. At the same time, consumers should choose sharing platforms based on short and long-term gains as well as individual and community benefits. Learning and appropriate regulation for fair reporting and fraud protection will be central—although it will need a light touch to encourage innovation while still watching for problems. The task is to share the pain and the wealth. If this sharing happens, the wealth will grow and endure.

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