

# THE ETHICS OF REGULATING THE SHARING ECONOMY

Alexandra Zrenner

The term “Sharing Economy” refers to individuals directly interacting with each other online to exchange goods and services, which is also known as collaborative consumption. Individuals connect to each other through websites or phone applications, like Airbnb or Uber, which create the market space for peer-to-peer interactions. Through these sites and apps, people rent out their extra rooms on Airbnb, or rent the empty backseats of their car for travellers on Uber. However, Uber and Airbnb are beginning to face regulation concerns, which introduces the questions of what, why and how to regulate these companies. This case study will use the ethical frameworks of utilitarianism and Rawlsianism to address the regulatory issues of collaborative consumption, specifically the companies Airbnb and Uber.

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## Background

Collaborative consumption has many economic benefits: the decline of transaction costs, increased efficiency and thus increased profits. The Internet, namely websites and phone applications, minimizes the transaction costs – the cost to the producer and consumer to conduct business – by directly connecting suppliers and consumers. Collaborative consumption companies also enable individuals to sell the unused potential of an owned good for another’s temporary use, which further increases efficiency. Owners profit from the unused potential, and consumers save from renting rather than owning. The result of the growing collaborative economy and its efficiency is a peer-to-peer rental market worth \$26 billion.<sup>1</sup>

Airbnb and Uber are two popular examples of collaborative consumption companies. Airbnb is a website on which Hosts offer their homes, or rooms in their homes, to Guests for visits. Uber is an application for smartphones that connects Riders to pay Drivers for a ride. The companies’ Terms of Service, which users agree to upon using Airbnb or Uber, define the companies as the platforms that facilitate the transactions between all users and the company. Given these Terms of Service, Airbnb and Uber are not held to full legal responsibility for the actions of the site or application users.

## Regulations

The practices of Airbnb and Uber create regulatory concerns related to market competition, consumer protections, and the legality of the companies’ practices. Regulators must balance protecting established industries and assisting developing industries; decide to what standards of consumer safety the companies should be held; and determine the legality of the new companies’ practices.

## Competition

The expectation in a capitalist and competitive economy is that innovation encourages competition and vice versa, which further increases efficiency. Airbnb and Uber use innovative online technologies to offer consumers new ways to find a place to stay or a ride. For example, consumers can choose to pay an Airbnb Host or a range of hotels for similar services, so Airbnb and hotels must compete for the consumer. Airbnb can offer lower prices to a consumer due to the company’s use of innovative online technology that minimizes production and transaction costs. The hotel industry has higher costs that must cover workers’ wages and property maintenance.

Stephen Dubner, writer of *Freakonomics: The Hidden Side of Everything* and host of the podcast by the same name, discussed how the innovations of Airbnb and Uber might fit the “creative destruction” model in economics.<sup>2</sup> The term “creative destruction” was first presented in 1942 by Austrian economist Joseph Schumpeter to describe how new innovations or companies compete with the established technologies or companies, and the success of the new means the disappearance of the established.<sup>3</sup> Within this model, the prediction is that, more consumers would choose Airbnb and Uber, increasing Airbnb’s and Uber’s profits. Simultaneously, the profits of the hotel and taxi companies would fall until every hotel and taxi company leaves the industry, leading to the disappearance of those industries.

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1 “The Rise of the Sharing Economy.” *The Economist*. The Economist Newspaper, 09 Mar. 2013. Web. 27 Mar. 2015.

2 Dubner, Stephen. “Re: Regulate This!” Audio blog comment. *Freakonomics: The Hidden Side of Everything*. Freakonomics, LLC, 4 Sept. 2014. Web. 1 Apr. 2015.

3 W. Michael Cox and Richard Alm, “Creative Destruction.” *The Concise Encyclopedia of Economics*. 2008. Library of Economics and Liberty. 27 March 2015. <<http://www.econlib.org/library/Enc/CreativeDestruction.html>>.

Airbnb, Uber, hotels and taxi companies, and regulators are aware of the creative destruction model's prediction. In this model, Airbnb and Uber would be "winners": the competition between Airbnb and Uber and hotels and taxi companies should increase the overall welfare of those within the room- and ride-providing markets.

On the other hand, local, state and federal policymakers aiming to protect careers in the hotel and taxi industries argue that the disappearance of these industries would cause greater harm to society than the improvements that would result from the newer companies.

## Consumer Protections

Many established regulations for the hotel and taxi industry exist for consumer protection: safety standards, anti-discrimination laws, etc. However, Airbnb and Uber are not a hotel or taxi service; they are platforms that are not directly legally responsible for the same standards a hotel or taxi may be responsible to. Airbnb and Uber argue that they developed methods to be regulated by themselves and their users. Competitive economic theory holds that producer- or consumer-based methods of regulation will provide the most efficient outcome, and that government regulations are comparatively inefficient. Producer-based regulation is called "delegated regulation": the local government sets standards and allows Airbnb and Uber to determine whether or not they met these standards themselves. The consumer-based method of regulation is reviews: users write reviews of Airbnb Hosts and Uber Drivers, incentivizing positive Host and Driver behavior, and regulating the quality and standards of the Hosts and Drivers.

Regulators concerned with consumer safety do not consider delegated regulation and consumer reviews adequate substitutes for government standards of consumer protection. Consumer reviews may not address fire standards of the apartment or emissions standards of a car. In addition, producer-based delegated regulation lacks accountability measures to ensure the companies protect the consumers. While the government can set the standards, the companies must hold themselves accountable, which worries regulators.

Consumer-safety regulators and sometimes even Uber customers criticize Uber's practice of surge pricing as a violation of consumer protections. Uber uses an algorithm to surge prices – an increase of prices resulting from an increase in demand (as economic theory would predict). The increase in price should signal more drivers to offer rides. This in turn should increase consumers' welfare since they have more access to the service, and the drivers' welfare should increase from receiving higher profits.

Although Uber references this economic theory to explain the use of surge pricing, some critics have questioned the wisdom of allowing an algorithm in all situations and scenarios. For example, Uber's algorithm surged prices during the Sydney, Australia shooting and during natural disasters like Northeastern winter storms. Consumers do not know the algorithm, and question if Uber is abusing the consumer's safety during natural disasters or perilous situations.

## Taxes & Legality of Practice

Airbnb and Uber have been criticized for their Hosts and Drivers not complying with city, state or federal law. In cities where Airbnb and Uber operate, the legality of renting out your empty rooms or backseats varies and may be ambiguous depending on the location.<sup>4</sup> New York and California have existing laws on zoning, home rentals, and taxi regulations that address the legality of ride-sharing or charging guests for temporary home or room rentals.

In many cities, temporary home or room rentals or charging individuals for rides require city permission. However,  
<sup>4</sup> Streitfeld, David. "Airbnb Listings Mostly Illegal, New York State Contends." The New York Times. The New York Times, 15 Oct. 2014. Web. 27 Mar. 2015.

the average Host or Driver does not seek out city operating permits because the Hosts and Drivers don't know how to obtain the permits, or don't think they would need a permit for their primary residence or car.

Governments, mainly at the local and state levels, are concerned about the questionable legality of Airbnb and Uber transactions, and the lack of taxes collected from these transactions. To address these concerns, Airbnb is reaching out to cities and states to help legislators draft or adjust legislation. In addition, on the "Frequently Asked Questions" page, Airbnb informs and requires Hosts to be aware of and comply with local laws and their landlord's rental policies, both of which may prohibit short-term rentals. Airbnb has worked with San Francisco, Portland, New York and the District of Columbia to address the concerns of the city and to help legislatures draft new laws to ensure that Airbnb users do not violate city laws. For example, Airbnb recently started to collect hotel taxes from Washington, D.C. Hosts and to send the collected funds directly to the city.<sup>5</sup> In doing so, Airbnb protects the information of its Hosts so that the city could not punish the Hosts for the ambiguous legality of their actions, and ensures the city does not financially suffer from loss of tax revenue. Airbnb's active efforts to work with governments to address regulatory concerns are an example of self-regulation happening within the market. As such, some supporters of Airbnb argue that the company does not need any additional outside governmental regulations.

Uber, in contrast, has not reached out to address legislative or tax concerns, and its main concern is regulatory. Uber's interactions with governments have resulted in government delegating regulatory responsibilities to Uber rather than the typical arrangement of the government regulating the company.<sup>6</sup> Some advocates argue that this delegated regulation is efficient, so any further government regulation would be inefficient and unnecessary.

Nonetheless, regulators may be concerned that these Airbnb and Uber-created regulations are still insufficient to meet government standards.

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<sup>5</sup> Badger, Emily. "Airbnb Is about to Start Collecting Hotel Taxes in More Major Cities, including Washington." *Washington Post*. The Washington Post, 29 Jan. 2015. Web. 27 Mar. 2015.

<sup>6</sup> Uber argues that its methods regulating Drivers with background checks are sufficient if not better than government background checks. Uber is pushing and lobbying against regulations that are similar to taxi regulations that may hinder Uber growth. Regulators, however, question Uber's concern of legality and consumer safety.

Isaac, Mike. "Uber's System for Screening Drivers Draws Scrutiny." *The New York Times*. The New York Times, 09 Dec. 2014. Web. 07 Apr. 2015.