

Inside Institutional Emergence and Change: The Case of New Markets in Collaborative Consumption Goods.

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Abstract: The legal-economic nexus is the structure of legal institutions within which a market operates, and is determined by the array of property rights and duties owned by each individual. With the emergence of markets for collaborative consumption goods (X) exchanged through services such as Uber or Airbnb institutions that define the rights and duties of market participants must be created through formal (legal) or informal (norms) means if a market is to function. This research will examine the institutional structure in new collaborative consumption markets by examining (a) the institutions necessary for a market to operate, (b) the institutional structure created by firms engaged in facilitating the exchange of collaborative goods, (c) the legal or non-legal disputes that are or could affect the institutional structure that controls market exchanges in collaborative goods, and (d) general lessons to be learned by examining inside the emerging legal-economic nexus of institutions related to markets for collaborative consumption goods.

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The recent emergence of the phenomenon of “collaborative consumption” provides an opportunity to examine emergence and change in market institutions. Though the same processes of emergence and change are operating at all times in all existing markets, the examination of these processes in new markets provides greater clarity of the fundamental processes at work. Most importantly, this process of institutional emergence and change involves the definition of the rights and duties of market participants that must be created through formal (legal) or informal (norms) means if a market is to function.

This research will examine the institutional structure in new collaborative consumption markets by examining (a) the institutions necessary for a market to operate, (b) the institutional structure created by firms engaged in facilitating the exchange of collaborative goods, (c) the disputes, including legal actions, that are or could affect the institutional structure that controls market exchanges in collaborative goods, and (d) general lessons to be learned by examining inside the emerging legal-economic nexus of institutions related to markets for collaborative consumption goods.

The Emergence of Collaborative Consumption Markets

Collaborative consumption is the exchange of tangible goods as a service or of less tangible assets such as time, space, skills, and money that occurs in “systems of organized sharing, bartering, lending, trading, renting, gifting, and swapping” (Botsman and Rogers). The recent emergence of the phenomenon of collaborative consumption is marked by rapid growth. A 2015 study by Price Waterhouse Cooper found that 44% of the US adult population had heard of the “sharing economy” and 19% of it had engaged in a sharing economy transaction, with younger Americans being more likely to be providers in such transactions. Moreover, market growth is demonstrated by an example firm, Airbnb, which averages 425,000 guests per night, nearly 22% more than a “traditional” firm such as Hilton Worldwide. At the same time, consumers expressed concerns about trust in collaborative consumptions goods providers (69%) and consistency of sharing economy experiences (72%) (Price Watershouse Cooper). In such an environment of rapid growth mixed with consumer uncertainty, the issue of the institutional rules governing the market game will inevitably arise.

Institutions and Emerging/Evolving Markets: The Legal-Economic Nexus as the Foundation of the Market

Every market for every good operates within a system of institutional “rules of the game” that determine the (distributional) outcome of that market game. This combination of legal and economic institutions is the legal-economic nexus that governs the economy’s market process. This nexus of legal-economic institutions are “matters of human social construction [and reconstruction]” in which legal/political and economic institutions are mutually determined with “the polity impacting on the economy and the economy impacting on the polity” (Samuels, 2007, p. 7). At its most fundamental level, the legal-economic nexus is a process of defining and re-defining the institutions governing the process of exchange in the economy. The institutional framework of the economy is “the sets of ordered relationships among people that define their rights, their exposure to the rights of others, their privileges and their responsibilities [duties]” (Schmid, 2004, p. 6). As such,

The allocation of resources takes place largely through markets which are formed and structured by legal rights which are in turn defined and assigned by government (legislature, executive agencies, courts)...The process of [determining and] redetermining rights and their economic significance is inevitable: the definition and assignment by law of new rights... has the inexorable effect of creating or altering the structure of relevant markets and thereby the economic significance and values of hitherto existing rights and the opportunity sets of economic actors (Samuels, 1989, p. 1563-1565).

This process of defining and redefining legal rights and duties determines the costs and benefits associated with each opportunity in the opportunity set of each participant in the economy. The ownership of a right by one economic actor is the power to impose a cost on another economic actor when (a) the first actor competes with the second actor in supplying a good, (b) the second actor buys a good from the first actor, (c) the second actor is under a legal duty to pay for the right to use a resource or input owned by the first actor, or (d) the consumption of a good by the second actor is affected by the production or consumption of a different good by the first actor.

In the process of defining or redefining rights and duties, the legal-economic nexus determines the costs, prices, quantities, and distribution of income in the economy (Norris, et. al.). Thus, the array of costs and prices determined by the legal-economic nexus will determine the outcome of the market process, or as noted by Dugger (1988, p. 984):

The real forces [of the market] operate behind the market in determining whose interests will be benefitted and whose actions will be allowed. The market [outcome] merely reflects the working rules established through power play, adjudication, and legislation.

The legal-economic nexus provides the foundation of a market and thereby defines the rules within which transactions, and their resulting exchanges, take place (Schmid, 1992). As such, at least four major types of rules are important in any market (Schmid and Shaffer, pp. 18-24), including rules related to:

- Competitor (seller) and customer (buyer) entry and exit
- Competitive methods
- Quality (or homogeneity) of goods
- Definition of inputs

Thus, in any case of emerging markets for new goods, or even in the case of modifying markets for existing goods, the definition of these rules will affect the performance (distributional) consequences of the market. With the emergence of collaborative consumption goods, new issues have arisen regarding the institutional structure of the markets for these goods. This research will examine the issues raised and the institutional structure in three of these types of rules.

Regulations Related to Competitor and Customer Entry and Exit

Most important in the exchange of collaborative consumption goods is the role of competitor entry regulations. Such regulations define “who can participate in certain kinds of economic activity and engage in certain kinds of transactions [by defining] the legitimate access to or exclusion from specified economic activity” (Schmid and Shaffer, p. 18-26). By defining access to or exclusion from a market, such rules have significant impacts on the distributional consequences of the defined market for both producers and consumers.

Perhaps the most visible issue in the growth of collaborative consumption goods involves those institutions governing competitor entry. In the case of transportation network companies such as Uber or Lyft, the issue of entry regulations has created some of the greatest public disputes surrounding collaborative consumption goods. In particular, regulations related to competition between existing taxi drivers and Uber drivers (competitor access and exclusion) has resulted in controversies including legal challenges and physical confrontations between taxi drivers and Uber or its drivers. An example of the importance of such regulations is also obvious in the fact that in some jurisdictions, Uber, after being refused access to a market, has operated in defiance of existing regulations in an act of “spontaneous liberalization” of the

jurisdiction's market (Geradin).

The importance of entry regulations is shown in the distributional consequences of Uber's entry into a market. For example, the price of a medallion required to operate a taxi in New York City (representing the discounted future value of the income stream arising from ownership of the medallion's right to operate a taxi) decreased by 17% to \$872,000 in October 2014 after reaching its peak in the spring of 2013. Other cities witnessed similar declines in medallion prices (Barro).

Institutions governing market access or exclusion give rise to what are often cited as "pecuniary externalities" that arise when person A's "physical good remains intact, but its ability to command other goods in exchange is affected" (Schmid, 1978, p. 173). Though economists often ignore pecuniary externalities because such exchange value (price) changes are considered the normal consequences of a market's operation and "private property rights protect private property from physical changes [externalities] chosen by other people, no immunity is implied for the exchange value of one's property" (Alchian, p. 818), such distributional consequences are in fact the center of most public policy disputes, including those surrounding collaborative consumption goods.

Regulations Related to Quality (or Homogeneity) of Goods

A second set of institutions critical in the emergence of markets of collaborative consumption goods are those regulations related to product quality. Such regulations typically apply in those situations in which goods possess a high information cost for consumers to determine the quality of the good (Akerlof). Such asymmetric information can arise for a number of collaborative consumption goods, with the distributional consequences arising from such situations being determined by the legislative or judicial rules applicable to the situation.

In particular, issues relating to product quality often arise as issues of liability in collaborative consumption goods. The issue of product quality and liability is particularly apparent in the case of Airbnb, the lodging network company. Airbnb connects hosts seeking to rent homes or apartments on a short term basis with guests seeking accommodations. In such situations, issues of quality can arise that involve the safety of guests renting a host's property. Cases involving an injury or other damages to a guest raise new liability issues: Is the guest, the host, or Airbnb liable for damages related to the guest's injury?

Under common law (The Second Restatement of Torts), and various legislative actions, innkeepers and persons who operate hotels have certain duties, such as "premises liability, a warranty of habitability, and liability for failure to warn of known dangers" (Loucks, 2015, p.333). In essence, operators are legally required to provide safe accommodations and to warn and reduce any risks to guests. To date, Airbnb hosts have not been considered innkeepers and thus guests are not afforded these same legal protections. In fact, Airbnb guests have not even been considered gratuitous licensees (a person invited to be on a property) with no additional responsibilities assigned to the landowner. Essentially, guests have been found to hold no protections from hosts under such laws. In addition, unless Airbnb is held liable for guest safety through the agency theory of vicarious liability ("derived from the doctrine of *respondet superior* which holds an employer liable for an employee's wrongful acts") when a guest brings a claim against a host, then the guest can only recover damages against the individual host, not Airbnb (Ibid.).¹

¹It may be the nature of the product exchanged or a commentary on liability but it is interesting to compare this situation to one in which an Uber driver seeks damages from a passenger. A guest at an Airbnb location at the very least has an address to reference when seeking any claims against the host. However, when McGillis an Uber driver wanted the address and contact information of the passenger who opened his car door which was involved in an accident with a scooter driver, Uber denied him such information, and he had no means through previous

In this way, Airbnb has been treated as travel agents and includes a release of liability in its terms of service.

Yet rather surprisingly, Airbnb hosts have been categorized in courts more analogously to landlords. While this label brings its own legal responsibilities it greatly reduces responsibility for the safety of guests on the property. A victory for Airbnb hosts is thus an increased risk for Airbnb guests (Loucks, 334-335). The increased risk to guests is not shared by Airbnb any more than travel agents despite the fact that the risks to which guests are exposed is potentially greater. In addition, since travel agents typically operate with long-standing organizations with many peer evaluations and have a reputation to uphold, it is reasonable to assume that travel agencies have more information about their sites. There is likely greater asymmetrical information in the Airbnb exchange, of which Airbnb is held to a similar standard in facilitating a risk reduction.

In another form of product quality regulation, questions have also arisen relating to the duty of Airbnb hosts (and Uber drivers) to meet quality standards related to handicap accessibility and equitable access for consumers. For example, questions have arisen regarding the duty of Airbnb hosts to meet standards required by the Fair Housing Act (FHA) and the Americans with Disability Act (ADA). Airbnb's website informs hosts that "we prohibit content that promotes discrimination, bigotry, racism, hatred, harassment or harm against any individual or group, and we require all users to comply with local laws and regulations" but the only enforcement mechanism for this requirement appears to be that guests are permitted to report such violations. In the case of the FHA, Airbnb informs hosts that the FHA exempts owners of single family dwellings with less than four units and bed-and-breakfast establishments, but that "even if a host is exempt from the FHA, it is still illegal to advertise or make any statement that indicates a limitation or preference based on race, color, national origin, religion, sex, familial status, or handicap." In the case of the ADA, Airbnb informs hosts that the ADA does not apply to most residential housing (Airbnb). Similar issues of handicapped accessibility have arisen with Uber (Rogers).

Regulations Related to Input Use

The institutional structure determines the cost of inputs (Schmid, 1992; Norris, et al.). As noted by Coase:

If factors of production are thought of as rights, it becomes easier to understand that the right to do something which has a harmful effect (such as the creation of smoke, noise, smells, etc.) is also a factor of production....The cost of exercising a right (of using a factor of production) is always the loss which is suffered elsewhere in consequence of the exercise of that right."

In the case of collaborative consumption goods, as with all other goods, the cost of all inputs is determined not by nature but by the institutional structure that governs the rights of buyers and sellers of inputs. In the case of collaborative consumption, however, unique issues arise relating to the definition of "inputs" and the rights and duties of parties in the transaction for a collaborative consumption good.

In particular, the legal relationship of Uber drivers with the Uber company has become a major issue: Namely, are Uber drivers considered to be employees of Uber or are drivers considered to be independent contractors? Collaborative consumption firms such as Lyft, TaskRabbit, Instacart, Postmates, and

interactions to know such information (Hanks). Uber passengers are provided the photo and name of the responding driver, which would also help in subsequent contact needs. Thus, intentional or not, there is evidence of employees assuming more risk than either the intermediary companies or the users of such services. If sharing economy freelancers are primarily individuals who would otherwise be unemployed, then such institutional rules could disproportionately burden the already disadvantaged, who in their financial positions have fewer resources and options to defend themselves or recover losses.

Homejoy have also faced such questions.²

On the one hand, Uber drivers would historically be categorized as independent contractors rather than employees. Using some guiding questions provided by the IRS the following points impact this categorization: drivers often require no training or must acquire it themselves through another party (for example, Uber and Lyft drivers must earn their licenses through the state DMV rather than Uber or Lyft), drivers use their own equipment (car), which is a significant investment and determines the driver's opportunity for profit or loss, and they may work for multiple employers on their own flexible schedule. For example, hypothetically, a driver could drive for Uber and Lyft, and when he or she does not want to work they update their availability through the respective app.

This employment status distinction greatly impacts liability issues, issues pertaining to risk, and other distributions of rights and protections. Companies who hire independent contractors are not required to pay overtime, some tax withholdings, health insurance, or workers' compensation. That means that when a sharing economy worker gets injured on the job, perhaps even by a customer as in numerous Uber and Lyft accounts (Huet), the driver is liable for their own medical costs, insurance and legal costs, and have no income security support through their contracting company.

Taxi drivers are 21 to 33 times more likely to be killed than other workers (Ibid.). As such, even though taxi drivers are also considered independent contractors, in many areas (although not all) taxi companies provide workers' compensation to drivers. Despite rhetoric that offering workers' compensation or insurance automatically categorizes the worker as an employee, to date offering these benefits has not been a determining factor in worker classification, rather working conditions and arrangements remain the primary determinant. Should companies such as Uber and Lyft be required to provide drivers' benefits similar to those provided by taxi companies? On the one hand the drivers are operating in the same high risk environment. And, doing so protects the companies from employee lawsuits regarding negligence for instance, and shows concern for workers. On the other hand, transportation service companies arguably reduce some of that risk (for example, they eliminate cash transactions) and have a much more geographically diverse and high turnover employment pool (Ibid.). In addition, there are complicating questions as to when an Uber driver is actually working and what his or her lost wages would have been.

While the tradeoff between flexible hours, clientele, and duties with increased liability and assumption of risk for on-the-job injuries has traditionally been seen as fair, the increase in independent contractors, especially in the new sharing economy, has raised ethical questions around the issue. In the past, exploratory research into dependent versus independent contractors and whether people are pulled or pushed into non-traditional employment schemes and the number of opportunities present there (or not) has reached Congressional consideration, however, there have been no legal efforts to extend more protections to non-employees. In addition to the disparities between employees and contractors listed previously, contractors are at another comparative disadvantage in that they are not protected under discrimination legislation.

For some individuals working in the sharing economy these risks may be acceptable- some wage is better than none. But for others, they either do not know about the trade-offs or are required to decide between two competing values. The first point is notable. When becoming an employee an individual may negotiate a compensation package. He or she is aware of predictable income, benefits, and basic protections through their contracts, handbooks, and breakroom or job description postings. Thus the employee is made aware of the conditions of accepting the payment both audibly and visually. He or she may also undergo training on the information. Finally, the postings, access to a handbook, discipline

² DeAmicis states that lawsuits related to employment status contributed to Homejoy's inability to raise additional funding which facilitated its end of operation.

documentation, and annual performance evaluations provide constant reminders of the terms of contract. In contrast, independent contractors are often not informed of what is lacking from their arrangements.

In 2015, the Florida Department of Economic Opportunity ruled that “Uber’s job description and modus operandi for drivers shared more in common with Internal Revenue Service’s definition of an employee than an independent contractor” (Lowensohn). Similarly, the California Labor Commission ruled that Uber drivers are employees. In response to the points posed earlier toward independent contractor status and regarding knowledge of employment arrangements, the commission ruled that Uber controls the tools of use (the app, which is the ride arrangement manager), monitors performance through approval ratings, and terminates access to the market/system when performance falls below 4.6 stars (California Labor Commission, 2015). Thus, Uber controls access to entry and exit and performs some of the traditional human resource management processes.

In September, 2015 a San Francisco District Judge ruled that Uber drivers were eligible to file a class action lawsuit against Uber (which depends on part in the classification of worker status). In his decision, the judge noted Uber’s contradictions in their legal arguments, stating that Uber individually properly classified every driver as an independent contractor while arguing that the class action ability be denied by the courts because drivers are too distinct to warrant such mass labeling and treatment (O’Conner, et al. v. Uber Technologies, Inc.).

Such institutional rules will define the costs of inputs for companies engaged in the markets for collaborative consumption goods. As a result, the determination of such rules will also determine the distributional consequences for all participants in the markets for such goods.

Implications and Lessons

Institutional change, both emergence of new institutions and evolution of existing institutions, is often triggered by changes in technology and other factors that cause changes in human interdependence. Changes in human interdependence, in turn, result in demands for changes in the institutional rules that govern economic transactions (Schmid, 1992). The emergence of markets for collaborative consumption goods, frequently triggered by changes in technology that make the sharing of such goods possible, provide an example of the issues that arise when institutional emergence or evolution occurs.

In particular, the institutions governing competitor/consumer access to or exclusion from markets, governing product quality and costs related to information asymmetry, and governing input costs are examples of the ways in which the definition and change of institutions determine market performance. The emergence of new institutions and the evolution of existing institutions are neither “obvious” nor “natural,” but are instead a matter of social construction and reconstruction. As such, institutional emergence and evolution are matters of human choice and the determination of whose preferences will count in the operation and performance of market.

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