

Regulating the Platform Economy: Problems, Challenges, Tools

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Platform-based organisations are assuming increasing importance in the provision of both old and new services. This paper shows how platforms are giving rise to a series of regulatory challenges, with a focus on their legal definition, labour-related issues in the digital sphere and the role of data between privacy protection and competition.

Introduction

New opportunities given by the Internet and by the evolution of connectivity technologies and devices have made it possible to bring together demand and supply in a wide spectrum of markets, dramatically reducing transaction costs and awakening assets that have economic potential. Furthermore, real-time technologies enable economic players to be constantly connected and active, both as consumers and suppliers of services, with relevant effects in terms of potential for growth of new business models.

The combination of technical advancements and socio-economic factors led to the rise of what has been labelled as ‘sharing economy’, ‘collaborative economy’ or ‘collaborative consumption’ (Botsman and Rogers 2010). A central role is played by the concept of a ‘platform’, intended both as a digital place where demand and supply meet each other and as an organisational entity that supervises the realm of the transactions between the two sides of such digital markets.

Major efforts have been made to address the aspect of competition between old, traditional industries and new players such as platforms (Uber, Airbnb, etc.). However, existing regulation does not seem effective and sufficient to respond to emerging challenges.

The aim of this paper is to show the most relevant and complex aspects of the platform economy, thus providing policymakers and stakeholders with a theoretical toolbox and a more general vision.

Trust

Trust and reputation lie at the core of markets evolution, maturity and destruction, and public policy should never underestimate them.

In the domain of platforms, the main potential obstacle to the development of trust and safety in transactions is represented by a particular case of market failure, labelled by the economic theory as ‘information asymmetry’.

An information asymmetry is ‘an issue in any market where the quality of goods would be difficult to see by anything other than casual inspection’ (Akerlof 2003) and consists of an uneven distribution of information about the quality of a good between the seller of that good and its potential buyers. This asymmetry can sometimes lead to the collapse of a transaction or even of entire markets. Platforms cope with this potential factor of market failure by adopting public peer review mechanisms, based on rating systems which allow both parts of a transaction to evaluate each other. This unveils the agents’ behaviours, prevents opportunistic conducts that could make markets collapse, and aligns demand/supply incentives.

In the digital world, trust is also important from an antitrust perspective. In this case, the key concept is trust portability: can platform users transfer the social capital (in terms of trust and reputation) they accumulated on one platform to another platform?

Trust portability could be an important tool for lowering barriers to entry for new platforms, thus promoting a more competitive market structure. However, the advantage deriving from the use of a platform is often determined by the so-called network externalities; that is, the existence in the same place of a large number of potential consumers and suppliers searching for the opportunity to be matched and to transact. When a platform is characterised by a high level of network externalities, the cost of switching and leaving such a dense network is potentially too high. This can lead to the persistence of monopolistic markets, making trust portability unable to generate a more competitive market structure.

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Microeconomics of platforms, market disruption and legal aspects

A first step towards classifying different types of platforms should be based on understanding their economic goals and motivational roots. According to this approach, it is possible to outline the following taxonomy:

- Consumer platforms, managed on a voluntary basis by participants and driven by the goal **to gain market power** in buying goods and services;
- Platforms that **intermediate** between demand and supply, gaining a fee for each transaction and allowing parties **access to a specific good or service**;
- Platforms that **offer users the possibility to interact without charging any fee**, with the final goal of acquiring data to be monetised by selling them to other service providers.

Platforms that intermediate have seen the largest expansion in recent years, disrupting sectors such as commerce, mobility, travel services and accommodation.

The microeconomic foundations of platforms development lie in two distinct features of goods and needs (a and b) and a peculiar market effect (c):

- Granularity and underutilisation of indivisible assets
- Pulverisation/customisation of needs
- Network effect.

The matching between under-utilised resources and pulverised needs is enabled today by technological means that greatly reduce the costs of searching, negotiating and executing (that is, transaction costs) and lie at the basis of the success of platforms.

The ability to abate transaction costs explains part of the expansion of digital markets (DMs). In fact, DMs show also low/zero marginal costs (COEURE 2015). This means that the cost of producing one more unit of a service is near zero from the viewpoint of a platform owner. In the case of Uber, for example, the cost of supplying one more ride is up to the driver, not the platform.

Furthermore, from the demand viewpoint, DMs are characterised by low price-comparison costs and high inspection costs (COEURE 2015). However, the latter can be easily reduced by the availability of peer review systems, which – as already seen – erase the problem of information asymmetry.

These features, together with the advantages deriving from the so-called network effects or network externalities that tend to characterise digital marketplaces, explain the ease with which DM operators like platforms disrupt traditional industries.

Such disrupting market behaviour has been challenged by incumbent players in legal terms on the grounds of unfair competition. This forced regulators to understand how to define platforms in order to apply the most appropriate competition regime, with concretely relevant consequences as in the case of Uber.

At the end of 2017, the European Court of Justice (ECJ) refused to consider Uber as part of the family of digital markets classifying it as ‘a service in the field of transport’ rather than ‘an information society service’ (EU:C:2017:981). Consequently, Uber was prevented from freely establishing its UberPOP service in the EU.

The ECJ judgment came after the Advocate General’s Opinion, according to which Uber offers a mixed service, both physical and digital. Since Uber was also deemed to exert a relevant amount of control over the physical part of its service (setting the maximum price of a ride, establishing vehicles quality requisites, vetting prospective drivers), the company could not be qualified as a simple digital intermediary.

The Uber case clearly shows that intermediation vs. active role in service provision is the core issue of the ongoing debate on the exact nature of platforms. However, technology has blurred the distinction between these two general categories, generating uncertainty regarding how to correctly classify these new economic players and which regulatory regime should apply.

Regulation overhauling

Where should regulators start from when approaching platforms? Platforms are, in a way, self-regulated and self-policed (McKee 2017): they impede or allow users to transact according to internal and self-established rules. Since protecting the interests of the contracting parties is also an interest of the host platform, incentives are aligned, steering towards self-regulation. Therefore, the question, from a public policy perspective, is whether these internal rules are aligned with the public interest, particularly with consumer protection and competition policy.

Public welfare perspective puts consumers at the centre: consumer interest is not only about prices, but also about quality, variety and innovation. Innovations that enrich

consumers' possibility of choice should be fostered and accompanied by public regulation.

Market failures are the theoretical ground for public regulation of markets: market power, information problems, accessibility and fairness, public goods and externalities account for a large proportion of such failures. From this perspective, regulators should consider that technology shakes the borders of market failures and sometimes erases them, as in the case of information asymmetries reduced by the availability of public reviews on the web. This concretely implies that if the peer review system is able to guarantee the quality of the service provided through a platform, it will not be necessary to set new standards applying to that service.

As shown by the ECJ decision on Uber, regulation – particularly at the European level – has paid more attention to the physical dimension of platform-based services than to the ability of platforms to reduce transaction costs, and thus create value by means of digital tools. In other words, regulation has preferred to focus on objects instead of needs. However, such regulation of objects, coupled with licensing systems that limit the scope and size of markets, have advantaged incumbent players like taxi drivers. This creates the risk of banning platforms' business models without giving adequate consideration to consumer protection issues.

Policy options

As some scholars have argued (Biber *et al.* 2017), the disruptive effect coming from platforms business models is mainly a matter of policy rather than markets. According to these scholars, a key concept is *policy disruption*, which Biber *et al.* (2017) said is due to 'a *business innovation* threatening an *incumbent industry* in such a way as to create a *policy problem* that the *existing regulatory regime* does not effectively manage'.

Regulators can choose among four different policy strategies when it comes to making decisions about the regulation of an industry affected by policy disruption:

- Block (which implies the exclusion of outsiders from entering the market and competing with incumbents)
- Free Pass (which not only gives outsiders the possibility to compete, but also exempts them from the existing regulation)
- OldReg (extending the current legal framework to outsiders)
- NewReg (allowing outsiders to compete under a new regulatory framework that encompasses both outsiders and incumbents) (Biber *et al.* 2017).

Before coming to a decision, regulators should assess whether the existing regulatory regime can be considered organisationally neutral. Regulatory neutrality should be the default principle that allows both incumbents and outsiders (potential competitors) to be subject to the same set of rules.

However, it can be held that there are some public policy concerns that outweigh neutrality principle. For example, Airbnb could be given a FreePass since it has been found that its activity creates welfare gains for consumers, especially in those times and places where hotels are capacity-constrained and therefore more prone to raise prices (Farronato and Fradkin 2018).

On the contrary, it could be noted that these new players create other major policy concerns that justify the adoption of a new regime, sometimes with severe implications for platforms operations. For example, new zoning policies or caps could be necessary to limit Airbnb's expansion at the urban level, since it has been found that an increase in Airbnb supply is associated with an increase in long-term rent and house prices, with negative effects for consumers of the traditional housing market (Barron *et al.* 2018).

These examples show that there is no single unique and prescriptive answer in the type of situations we are considering. We are talking about complex phenomena that should be monitored in order to understand their impacts and develop appropriate regulatory frameworks. Banning the entry of newcomers is only one extreme solution from a long menu of tools to effectively manage the rise of platforms.

Labour and platforms

Platforms also disrupt the traditional divide between employees and independent contractors. Considering themselves as pure middlemen that do not exert employers' traditional prerogatives, platforms aim to transfer a big chunk of the market risk to service providers (platform workers) in order to avoid paying the costs associated with those risks (illness, accidents and injuries, working time fluctuations).

Platform workers have frequently tried to draw on judicial decisions in order to solve problems relating to their working condition. Collective bargaining is another institutional tool that could effectively manage the conflict arising in the sphere of the so-called digital labour. Collective bargaining 'can stabilise labour markets and equalise bargaining power' between capital and labour, with the final result of 'taking wages out of competition' (Kaufman 2003). This issue is particularly important in the case of platforms, since platform workers often suffer from an ev-

ident weak position in terms of market power, which leads to put downward pressure on the overall level of workers' remuneration.

Giving platform workers the right to collectively bargain regarding their remuneration and working conditions could counteract the existing unbalance in market power, and induce platforms to reach a new level of maturity and compete on variables – such as innovation and qualitative improvement of the service – other than wage bills.

Data and regulation

The main finding from the development of markets and products relying on advanced forms of technological tools such as artificial intelligence and machine learning is the central role played by data in shaping the trajectories of expansion of old and new economies.

When talking about data in the context of the platform economy, the main question from an economic and regulatory perspective is: is the exchange of personal data for platforms services fair?

According to some scholars (Sokol and Comerford 2016), regulators should consider data collection and processing mainly as a source of potential harm to consumers privacy, rather than a pure antitrust and competition issue. From this view, the fact that huge masses of data are concentrated in the hands of few economic operators with powerful dominant or monopolistic positions in the market is not necessarily a reason for concern: 'mere possession of data alone therefore, even in large volume, does not secure competitive success – that can only be achieved through engineering talent, quality of service, speed of innovation, and attention to consumer needs' (Sokol and Comerford 2016).

A radically different school of thought contends that big data are also a potential source of harm to consumers on competitive and welfare grounds. According to one antitrust expert, Amazon – by exploiting the possibility of monitoring and observing its customers' online behaviour – 'is also able to tailor prices to individual consumers' (Khan 2017). This would change 'prices more than 2.5 million times each day' through 'constant price fluctuations', which would 'diminish our ability to discern pricing trends' (Khan 2017). Such practices have the potential to extract the highest possible value from consumers' preferences, according to a mechanism that the economic theory labels as 'first-degree price discrimination' (Khan 2017). In this view, big data are considered to be part of a family of tools used to become more and more dominant and maximise earnings.

The General Data Protection Regulation (GDPR) – the latest regulatory tool concerning data collection and processing issued at the European Union level – seems to merge and reconcile these two different approaches, using consumers' privacy protection as leverage to encourage competition in the digital environment. Article 20 of the GDPR defines users' right to data portability, in the hope of reducing barriers to entry for new players in markets largely dominated by few operators. However, this right does not apply when personal data is being processed on the basis of a 'legitimate interest' of the service provider, leaving the problems of data ownership and data management without a clear solution.

What seems necessary is the development of a more coherent legislative and regulatory framework. This would reduce the existing degree of uncertainty regarding the economic and legal nature of data and would better define the incentives of the different actors involved in the platform economy and, more generally, the digital economy.

Conclusions and regulatory agenda

It is possible to identify three main points that remain unresolved and shape the regulatory agenda for the near future.

- How to cope with the appearance of platforms potentially disrupting pre-existing markets. Rather than trying to block the development of new, digital-based business models because of their disruptive impact on old industries, policymakers should elaborate adaptive regulatory frameworks, keeping in mind that banning the entry of a newcomer is an extreme decision.
- How to address the problems relating to platform workers. Giving workers the right to negotiate with platforms to reach collective agreements could help reduce the existing unbalance of power between capital and labour, thus pushing towards a competition based on the quality of services instead of wages or workers' remuneration.
- Who has the right of ownership over the data generated in the digital realm? The GDPR has tried to solve this issue, but it seems that further updates are required to better define the incentives of all the actors involved in the platform and digital economies.

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