

ONLINE PLATFORMS AND THE FUTURE OF REGULATION

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Abstract: Online platforms are certainly disruptive; so disruptive that a new concept appeared: the uberization of the economy. Regulators were called for regulating these platforms which often operate exploiting what was perceived as “holes” in traditional regulation (from labor law to competition law). If such an attention is certainly required, it is also necessary to consider the ability of these platforms to regulate an industry. This paper will show that, from a theoretical point of view, regulation through (a certain type of) online platform could be more efficient than traditional regulation or could, at least, complement legal regulation.

Key words: regulation, transaction costs, online platform, digital platform

I. INTRODUCTION

Since the 2000's, online platforms¹ such as Uber, Airbnb, LinkedIn, Google, Ebay, Amazon or Facebook are disrupting many parts of our economy.

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¹ Defining online platform is far from being easy and there is no widely accepted definition. The European Commission defines them as “an undertaking operating in two (or multi)-sided markets, which uses the Internet to enable interactions between two or more distinct but interdependent groups of users so as to generate value for at least one of the groups. Certain platforms also qualify as intermediary service providers” (Commission, ‘Consultation on Regulatory environment for platforms, online intermediaries, data and cloud computing and the collaborative economy’, 24 September 2015, 5). This definition is of course extremely broad to be really operational since it does not explain what intermediary or interdependent means. It also begs the question of the difference between online platform and internet society services (Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations and of rules on Information Society services; OJ L 204, 21 July 1998). For the OECD, online platforms are “pure intermediaries” (a definition which would exclude platforms like Amazon or Netflix) (OECD, ‘The economic and social role of Internet intermediaries’, 2010, 10). It is possible to find other definitions in specialized papers. In the rest of this paper, we will consider online platform as a platform which allows producers and consumers to trade when they would not have traded without the existence of the platform.

They are now contributing to between 25% to 55% of the GDP growth of developed countries.² Most notably, they allow for new suppliers to enter the market (e.g. drivers through Uber, small suppliers through Amazon, etc.) and they offer consumers new services which were not previously available (e.g. it is no way easier to find a driver, second-hand goods, a medical appointment, or even a date). Despite their diversity,³ their business revolves around a simple idea: lowering transaction costs (and thus facilitating the “match” between a supplier and a consumer). By doing so, they contribute to improve welfare⁴ through an increase of market transactions (which would not have happened otherwise) but also market opportunities (for car owners, homeowners, “jobbers”, application developers, etc.). By doing so, they also forced existing operators to adapt, be they cabdrivers (e.g. fixed fares became more common and service improved), hotels managers (with an emphasis on services), banks (with the boom of online banking), or traditional distributors of goods (e.g. Kering and Richemont launched a second-hand luxury goods website⁵ and ensure that these goods are “authentic”)...and thus to innovate to better satisfy their consumers.

As any disruptive event or technology, new regulatory challenges appeared (since, by definition, these services were not anticipated by existing regulation and enjoy pointing out the fact that most regulation is outdated) and were called for (especially by traditional operators). What is the nature of the services provided by online platforms?⁶ What should be the status of Uber drivers from the point of view of labor law?⁷ How are we to create a fair competition between traditional operators and new operators and how should competition law deal with these new entrants?⁸ Should we ban Uber or certain of its services?⁹ What about the protection of consumers? How are we to tax services and revenues provided using these online platforms?¹⁰ How are we to tax these online platforms? How are we

² Commission, ‘A Digital Single Market Strategy for Europe – Analysis and Evidence’, 2015, 5.

³ The European Commission identified 11 types of services provided by online platforms: : Internet search; specialised search tools; maps; news aggregators; online market places; payments systems; audio-visual and music; video-sharing; app stores; social networks; and collaborative economy (Commission, ‘A Digital Single Market Strategy for Europe’, Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2015, 5).

⁴ Welfare will be understood as the sum of consumers’ surplus and producer’s surplus.

⁵ Vestiaire Collective: Buy and Sell Designer Second Hand Fashion, <<https://fr.vestiairecollective.com/>>.

⁶ ECJ, 20th December 2017, Case C-434/15. Uber is considered to provide a transportation service and not an information service.

⁷ In France, a uber driver was considered to be an “employee” of uber (Cour De Cassation, Civile, Chambre Sociale, 4 March 2020, 19-13,316).

⁸ For some time, these platforms were not considered as “special” from the point of view of competition law. Now, the vast majority of academics and court consider that competition law should develop new tools to address online platforms behavior.

⁹ In Italy, Uber is banned in some part of the country, for example in Campania.

¹⁰ In France, this question was raised considering the reselling of second-hand goods. More generally, tax law is not structured to deal with short term contracts, part-timers, etc...

to make sure that the possibility to use Airbnb will not reduce house availability for “normal” renting?¹¹ And, of course, how are we to regulate the collection and the use of personal data?¹²

Instead of identifying all challenges that these online platforms generate – this task would also require developing a typology of online platforms¹³ – and inquiring into the need for new regulations, this paper would like to stress upon the ability of online platforms to regulate certain industries, sometimes more efficiently than any legal regulation (which is certainly the case for the taxi industry). In other words, online platforms are not only a challenge to existing laws and regulations; they are also a source of new opportunities when regulation and regulatory strategies are considered.

To do so, I will first inquire into the business of these online platforms, taking uber as their prototype (since it is mostly this type of platform which is challenging from a regulation point of view).¹⁴ I will show that it provides what government regulation also provides, a decrease in transaction costs which will facilitate exchanges and thus increase welfare (II). I will then show that, at least theoretically, there are reasons to believe that uber-like platform’s regulation could be more efficient than legal regulation (III). A Few insights on the difficult question of striking the right balance between legal and platform regulation will be provided by the end of this paper.

II. UNDERSTANDING THE BUSINESS OF “UBER-LIKE” PLATFORMS

In 2013, Evans and Schmalensee offered a functional definition of multi-sided platforms: “Multi-sided platforms create value by bringing two or more different types of economic agents together and facilitating interactions between

¹¹ In France, and more especially in Paris and many major cities, Airbnb is a possibility for homeowner if and only if they are not using it more than a certain number of nights per year (120 nights). Night Limits in France: Frequently Asked Questions, <https://www.airbnb.co.uk/help/article/2108/night-limits-in-france-frequently-asked-questions?_set_bev_on_new_domain=1634998445_NDDmOWRiODNjYmQ4>.

¹² Even if this question is not specific to online platforms. We can mention the right to be forgotten for example (CJEU, 13 May 2014, C-131/12, Google Spain v AEPD and Mario Costeja Gonzalez).

¹³ The OECD uses six categories based on the kind of services consumers may use through online platforms: i) Internet access intermediaries, ii) hosting and data processing providers; iii) online e-commerce intermediaries; iv) search engines, v) portals; and vi) participative networked platforms (OECD, ‘The economic and social role of Internet intermediaries’, 2010, April 9). As already mentioned, the European Commission distinguishes between 11 types of services.

¹⁴ I will thus focus much more on collaborative economy platforms (Uber, Airbnb, Blablacar, NeedHelp, etc...) and, up to some point, information platforms (like TripAdvisor or Yelp) than on platforms like Amazon (and online marketplace) or Google (as a search engine). Nevertheless, most what will be said about collaborative economy platforms could easily be transposed to other type of platforms as it will be made clear in the conclusion of this paper.

them that make all agents better off”.¹⁵ Uber-like platforms are of course multi-sided such that this definition also identifies the function of online platforms. Their prime function is to lower transaction costs (A) – online platforms are economic catalysts – and they make money by charging a fee when a good or a service is bought through their platform or through the use of personal data which they can resale for marketing purposes. This first function is certainly crucial when the question of regulating their activity is considered (if the regulation leads to lower the number of transactions, it will have to be justified by some other benefits to society; seen this way, an online platform merely provides a service to both suppliers and consumers for which it is paid).

It would also be possible to conceptualize this function differently by considering that online platforms play a regulatory function in the industries in which they operate (B). After all, many legal regulations also try to lower transaction costs (e.g. property law, contract law, tort law, corporate law, etc.)!

A. THE PRIME FUNCTION OF “UBER-LIKE” PLATFORMS IS TO LOWER TRANSACTION COSTS

1. In 1937, Ronald Coase developed the concept of “transaction costs” (even if he is not using that term) to make sense of the existence of firms in the economy.¹⁶ As Coase mentioned: “The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism”.¹⁷ This cost is (still) not (fully) considered in traditional neoclassical microeconomic analysis which was considered as a flaw by Ronald Coase; if they were, the attention would have shift to the incidence of institutional arrangements on transaction costs. This concept gained popularity after his 1960’s paper *The Problem of Social Cost*¹⁸ and even led to a subfield of economics called “transaction cost economics”.¹⁹ In that paper, Coase also provided a first (non-exhaustive) “typology” of these costs: “In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on”.²⁰ The traditional typology of transaction costs²¹ (search costs, bargaining and decision costs, policing and

¹⁵ David S Evans and Richard Schmalensee, ‘*The antitrust analysis of multi-sided platform businesses*’ (2013), NBER, Working Paper 18783, 2.

¹⁶ Bylund Perl, ‘Ronald Coase’s “Nature of the Firm” and the Argument for Economic Planning’ (2014) 36 *Journal of the History of Economic Thought* 305.

¹⁷ *ibid* 390.

¹⁸ Ronald Coase, ‘The Problem of Social Cost’, (1960)3, *The Journal of Law and Economics*, 1.

¹⁹ Oliver Williamson is certainly the most famous representant of this economic school.

²⁰ Coase (n 19)15.

²¹ As it is presented in most economic textbooks or criticized by economic textbooks.

enforcement costs) derives from this list. He added: “These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost”²². In other words, in a world of zero transaction costs, all welfare enhancing transaction would happen and efficiency would be the rule (logically the goods and services will end up in the hands of the economic agent which is valuing it the most). Despite having coined that situation a “very unrealistic assumption”,²³ the Coase theorem largely focus on zero transaction costs: in a zero-transaction cost world, if property rights are well defined, the allocation of resources will be efficient.²⁴ From this theorem, it could be derived that lowering transaction costs, when possible, will lead to more transactions, and thus improved efficiency and increased welfare. Of course, lowering transaction costs could be a business, in that an operator could be paid for the “service” (lowering transaction costs) it provides.

2. At many levels, the business of online platform is precisely to lower transaction costs.²⁵ It is even possible to wonder if it would not be possible to derive a typology of online platform by focusing on the type of transaction costs they contribute to reduce.²⁶

That online platforms reduce search costs²⁷ is obvious. Online platforms not only collect information, they also organize it such that it is easier to find what you want. Less time is required to identify a book and assess its availability using Amazon or Abebooks than a “normal” library (not to mention the increased variety of products). It is also easier to identify other books from the same author or the same publishing house. Less time is also required to identify a website with the relevant information thanks to search engine like Google, available hotel rooms in a foreign country thanks to applications like Hotels or Booking, homeowners ready to rent their room or their home thanks to Airbnb (which diversified to also offer you “experience” through local guides), or sellers of collectible through Ebay or Catawiki. For firms, access to customers have also been lowered. They can now reach customers they would not have had the possibility to access without a platform (e.g. travelers ready to rent a room in a private apartment) or

²² Coase (n 19)15.

²³ *ibid* 15.

²⁴ The Coase theorem was not developed by Coase but by Stigler, more than a decade after the publication of Coase’s article. Coase later recognize that if transaction costs were zero, law would not be required since it would be possible to bargain in order to determine the allocation of rights. Of course, this situation is purely unrealistic.

²⁵ In this subsection, only examples will be provided. Its purpose is thus not to reach exhaustivity but to show that, indeed, the purpose of these online platform is to lower transaction costs.

²⁶ Surprisingly, no typology used transaction costs as a key for understanding the diversity of online platforms.

²⁷ The costs necessary for potential buyers and sellers to identify the possibility of a mutually beneficial contract being established.

offer new products (e.g. selling not absolutely fresh perishable at a cheaper price). They could also have an easier access to consumers' feedback through comments they might post. The use of big data²⁸ could similarly be considered as a way to lower search costs for potential customers (but also to improve services by tailoring the information provided to the tastes of the consumers). In some ways, one of online platforms' main function is to aggregate supply or demand or both.

In the case of Uber, the reduction of search costs is undeniable: through its application, it is possible to identify agents ready to drive you and potential customers. It is not required to get out of a building and search for a taxi and you can know, in real time, where your driver is and when he/she will pick you up. This will obviously save time.

Online platforms also contribute to lower bargaining and decision costs.²⁹ This is evident when comparison websites are considered. It is now possible to compare the price of flight tickets, train tickets, the costs of alternative options to go from point A to B (e.g. cab, metro, bus, walking) or any other goods or services either directly because the platform performs such comparison (e.g. kayak, googlemaps) or indirectly because the platform merely aggregate customers experience (through a forum for example, consumers might ask other consumers if the price paid is adequate). It will also be (relatively) easier to assess the "quality" of a product (good or service) through comparative platforms (e.g. Yelp, TripAdvisor, Zomato) or feedback left on some (specialized) platforms. Moreover, because of increased transparency (directly or indirectly, both regarding the price and the quality) and reduced barriers to entry, online platforms contribute to increase competition between different providers of goods (new and used) and services which will, quite often, benefit consumers through improved price or quality. GetTransfer allows you to post a demand for a car ride from an airport to a determined address and will then send you "offers" by potential suppliers, thus lowering both bargaining (if a price is not regulated and thus bargaining required) and decision costs when you try to get a ride once at the airport. Reciprocally, for collectible and second-hand goods, a platform like Ebay will leave potential buyers to determine the price they are ready to pay for the good which will lower bargaining costs.

In the case of Uber, the platform allows you to compare the price between different types of cars and different type of services. In India, Uber will allow you to choose, for example, between an autorickshaw, a car with AC, a car without AC for the same trip. It also offers the possibility to choose to make the trip using an electric or a hybrid car in France. It moreover lets you choose between the possibility to share or not to share your ride. Besides, Uber eliminates

²⁸ The term designates the statistical use of a vast majority of consumers' data in order to identify patterns and thus better targets consumers.

²⁹ The costs which need to be incurred in order to define a contract.

bargaining between you and the driver... which is especially useful in a foreign country. More often than not, Uber clients also compare Uber prices with the prices offered by its competitors (Lyft or Free Now for example) which, of course, increases competition.

Finally, online platforms have a function in decreasing policing and enforcement costs.³⁰ Amazon offers a A to Z warranty for goods bought on its “marketplace” (offered by third parties). Ebay or Paypal provides mechanisms for dispute resolution. Paypal or Zolando offers “free return shipping”.³¹ Leboncoin (a French online platform of second-hand goods) developed a mechanism to secure transaction by playing the function of an intermediary: it will keep the money paid by the buyer until the buyer confirms he received the good. It will then wire the money to the seller. Of course, it charges a fee for this service. To these mechanisms, we should add “rating” systems which will incentivize buyers and/or sellers to behave properly if they want to be repeated users of the platform (since reputation is a fundamental asset on these platforms). These systems, which have a signaling function,³² contribute to lower policing and enforcement costs by lowering the incentives to behave opportunistically. It will then be possible for participants to “trust”³³ other participants in the platform.

In the case of Uber, both the drivers and the drivee are “rated” and this will have an incidence on their business or on their ability to use the platform. Moreover, since Uber tracks the drivers, the driver will have no reason to take a longer route in order to increase its income, or to “mug” his / her client. Finally, the driver knows, he / she will be paid after the ride and that his / her client will behave properly (or that the risk of not being paid is extremely low).

B. UBER-LIKE PLATFORMS AS A REGULATION “TECHNOLOGY”?

Using transaction costs to figure out the business of online platforms and consider how to regulate them is certainly relevant. However, it is also possible to conceptualize things differently. By lowering transaction costs, and especially decision and bargaining costs or policing and enforcement costs, online platforms could be considered as a “regulation” technology.

³⁰ The costs which must be incurred in order for a contract to be enforced.

³¹ Returning Something? Safer Online Shopping, <<https://www.paypal.com/au/webapps/mpp/returns>>.

³² Michael Spence, ‘Job Market Signaling’ (1973) 87(3) *The Quarterly Journal of Economics*, 355.

³³ On this issue, Todd Henderson and Salen Churi, *The Trust Revolution* (Cambridge University Press 2019). The book offers many insights but it focuses way more on trust than on transaction costs.

1. From an economic point of view, the purpose of regulation is (or should be) to increase the welfare of the society subjected to these regulations.³⁴ Quite often, neoclassical economics mostly focus on the (potential) ability of regulation(s) to curb market failures (monopoly power, externalities, asymmetric information, public goods³⁵). Seen this way, online platforms evidently participate in the reduction of market failures. By aggregating supply and demand, or lowering entry barriers, they contribute to the reduction of market power of sellers and buyers. By offering “rating” and “reviews”, they also participate in the reduction of asymmetric information. They might even contribute to the reduction of externalities when, for example, they provide information on the production process of different goods. For public goods, their function is less obvious since excludability is always an option, but Wikipedia could be considered as a public good since, as for now, it remains free for consumers and the good provided is non rival. Other “information” platforms could also be considered as public goods even if the consumer indirectly pays by allowing cookies on his/her device.

Focusing exclusively on market failures, neoclassical economics forgot the structuring function of law and regulation³⁶ when a market is considered. It is nevertheless undeniable that property law or contract law (but also competition law, corporate law, fiscal law, economic liberties, etc.) play a role for defining the market and how it operates. And, once again, online platforms also have a role in structuring the market, for example when they provide dispute resolution mechanism, when they offer to “secure” the transaction (e.g. through digital certificates), or when they facilitate access to credit for both consumers and producers (e.g. through crowdfunding).

2. It is also possible to consider regulations through the lens of transaction costs. Doing so will make it even easier to identify how (and which kind of) online platforms could be considered as contributing to the regulation of the market on which they operate.

Legal regulations could contribute to the reduction of search costs, even if it is probably not their main function. For example, regarding public procurement, European law³⁷ now imposes tender opportunities to be published on tenders electronic daily (TED)³⁸ – which is a type of online platform – and to make sure that

³⁴ See for example, Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation, Theory and Practice*, (Oxford University Press 2012).

³⁵ It is possible to offer a different typology of market failures but this typology is the most commonly used in microeconomics textbooks.

³⁶ Katharina Pistor, *The Code of Capital, How the Law Creates Wealth and Inequality* (Princeton University Press 2019).

³⁷ See Directive 2014/24/EU on public procurement, Directive 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors, Directive 2014/23/EU on the award of concession contracts.

³⁸ See <<https://ted.europa.eu/TED/browse/browseByMap.do>>.

procurement documents are accessible electronically. As the Commission explains, “The aim is to make them [pre-award and post-award phases] simpler for businesses to participate in and for the public sector to manage”.³⁹ In other words, the purpose is to lower search costs. In France, regarding employment, before 2005 and thus before the boom of online platforms, it was required for an employer to send a copy of a job offer to a centralized public agency (which would then play to function of a platform). For French taxis, the fact that a roof sign (with three small lights for indicating the tariff) must be present and illuminated to indicate availability is also a way to lower search costs (even if they are still significant). The mandated use of a particular taxi color (for example in New York) is also a way to simplify search. The French government also developed its own platform(s) to lower search costs regarding the price of gasoline⁴⁰ (and thus mandate gas station to report their prices) or social housing.⁴¹ More generally, the French government provide many kinds of information⁴² which could be relevant when a transaction is considered (regarding jobs and housing). Even if this last platform is not considered as contributing directly to regulating a specific sector.

Legal regulations can also contribute to reduce bargaining and decision costs. This function is probably more fundamental than the previous one. Through mandated disclosure, price regulation (e.g. for taxi or certain drugs), public labels and other hygiene or quality standards (e.g. for a product: protected designation of origin, protected geographical indication, traditional specialty guaranteed; or for an activity: stars for a hotel, regulation regarding a vehicle for a taxi), activity regulation (e.g. a lawyer or a surgeon must have a certain diploma), safety standards for goods and services, regulations facilitate informed decisions and lower its costs (since consumers know that the good they will buy will not be dangerous for example). Believing that the standard is enforced reduces the required care when a decision is being made and thus smoothen transactions. Sometimes, a regulation was enacted to facilitate buying decisions, such as the possibility to return a good bought online in Europe within 15 days of its reception or the possibility to be reimbursed after a fraudulent online use of a credit card (which will lower the cost of deciding to buy a good online). The logic of nudges is also perceived as a way to lower decision costs (suffice it to think of energy labels in Europe or nutritional score in France, or other default rules, regarding organ donation for example). More largely, through the provision of “default” contracts (in France for sales, renting, etc.) or default clauses, contract law can also lower bargaining and decision costs (a lawyer will not be required for establishing most contracts) when the default is well chosen. It is also possible to mention consumer law which logically decreases decision costs since the consumer knows he / she is sufficiently protected (against “abusive clauses” for example).

³⁹ See <https://ec.europa.eu/growth/single-market/public-procurement/digital_en>.

⁴⁰ For France, see: <<https://www.prix-carburants.gouv.fr/>>.

⁴¹ For France, see: <<https://www.ecologie.gouv.fr/sru/>>.

⁴² For France, see: <<https://www.data.gouv.fr/fr/>>.

Finally, when a regulation is enacted to increase competition, it will also lower bargaining and decision costs: more competition means that the market power of each supplier will be reduced which means that their ability to determine their prices will be subjected to some form of market discipline. Of course, more suppliers might also mean more choices and an increase in decision costs, but this increase is supposed to be compensated by the decrease in prices and bargaining costs.

Lastly, legal regulations also contribute to decrease policing and enforcement costs. Contractual remedies obviously make it more believable that both parties will fulfill their obligations⁴³ (assuming, of course, that the legal system works sufficiently well) and will facilitate settlement (if contract law is sufficiently clear). Criminal law makes it less likely that a good will be counterfeit or that a customer will use counterfeit money to pay for a good or a service. Registration of real property through a notary in France makes it virtually impossible to sell a good which does not belong to the seller. The fact that both parties could also use the judicial system (quite often for free) in case of a dispute also (sometimes) lowers enforcement costs and facilitate trade between strangers.

3. The purpose of this subsection was not to reach exhaustivity and to identify all the ways in which a regulation could contribute to lower transaction costs. It was to show that legal regulations could be conceptualized as tools to lower transaction costs. In other words, legal regulation and online platforms can sometimes be considered as performing the same regulatory function.

Take the ridesharing industry, taxi regulation was a way to lower transaction costs because customers could easily identify taxis (lowering search costs), knew that different taxis were supposed to charge the same price for the same ride and that the car used will be of a sufficient quality (lowering bargaining and decision costs), they also could be confident that the driver is an experienced one and that he is not a criminal. Moreover, since a fare receipt is mandatory, on which the registration number of the taxi, the dates and times of departure and arrival, the places picked up and dropped off at, the amount of the fare, any extra charge(s), and the postal address to which any complaints may be made, the likelihood of opportunistic behavior is lowered. Isn't Uber performing the same function as taxi legal regulation?

Take hotel regulation, the "stars" rating was a way to inform consumers about the size and the quality of a hotel. Aren't the reviews on TripAdvisor performing the same function?

⁴³ See for example, Schwartz A and Scott R, 'Contract Theory and the Limits of Contract Law' [2003] SSRN Electronic Journal, 541.

From a regulation point of view, if legal regulation and online platform performs a similar function (both are regulatory technologies), the question of their relative efficiency cannot be escaped and there are reasons to believe that the latter could be more efficient than the former.

III. THE THEORETICAL EFFICIENCY OF REGULATION BY UBER-LIKE PLATFORMS

If lowering transaction costs is perceived as enhancing the welfare of a society, the question of the most efficient way to do so should be asked. Is legal regulation the cheapest way to lower transaction costs in a society in which online platforms also perform such a function? It surely was when the society evolved from a tribal society to a larger one and social norms were not sufficient to ensure this function, is it still the case in a digital society? There are reasons to believe that legal regulation is not as performant as online platform regulation (A). This does not mean that online platforms provide a perfect regulation (B)... but in certain domains they seem to be the most efficient technology to regulate.

A. THE PATHOLOGIES OF LEGAL REGULATION

It is possible to identify at least four reasons why legal regulations could be less efficient than platform regulations.

1. From a cost perspective, the burden of a legal regulation (design, enactment, and enforcement) falls on taxpayers whether they use the good or the service regulated or not. Even if I do not use taxis or restaurant, part of my income (through taxes) will serve to design regulation regarding these services and to enforce enacted regulations in this domain. In some ways, it means that the consumers of these regulated goods or services (who benefit from the regulation) are subsidized by non-consumers (which are thus paying without benefiting from the regulation). This also means that the price of the regulated good or service is artificially too low since it does not incorporate the costs associated with its regulation. When a regulation benefits all citizens, it makes sense to make them pay for it (e.g. the judicial system), when it only benefits an identifiable subpart of the population, it is possible to wonder if this subpart should not pay for it.

When a platform is used, the regulation provided is only paid by the consumers of that platform (and the cost of the regulation could fall on the supplier or the consumer of the good or the service facilitated by the platform). When a customer uses Uber, he / she will pay (directly and indirectly) for the regulation provided: the price paid includes Uber fees and some personal data might also be used and sold by Uber. When a customer use Paypal, part of the price will serve to finance the warranties offered by the platform.

Logically, enforcement levels should also be more efficient in the case of a platform (which has an incentive for the regulation to be sufficiently enforced to keep its customers) than for a legal regulation (which could under or over enforce a regulation). Moreover, when a platform is used, enforcement will also happen through consumers reviews (which are often mandated by a platform) which means that the cost to society for enforcement should be lower than when a specialized entity oversees the regulation.

For this reason, when the government suffers from budgetary constraints (which will be the case in most developing countries) it is unclear how a legal regulation could lower transaction costs since, to perform this task, consumers should believe that the regulation is sufficiently enforced. From this point of view, they will logically prefer trading through an online platform than through the use of more “traditional” channels (e.g. involving traditional contract law and judicial enforcement) since they will consider that the platform has an incentive to make sure that its regulation is enacted (otherwise, it will lose customers).

2. There are reasons to believe that legal regulation will be more subjected to capture⁴⁴ than online platform regulation. Indeed, legal regulation is the product of a political process which means that regulators will not necessarily be incentivized (ex-ante or ex-post) to identify the “efficient” regulation (he / she will not bear the consequences or only minimal consequences if a regulation is inefficient). After all, a regulation can be enacted for symbolic reason and to maximize a political support function.⁴⁵

Take the example of taxi regulation in France. In 2014, a law was enacted by the parliament,⁴⁶ among the disposition, three are especially puzzling in terms of efficiency:

- (1) the prohibition against chauffeured vehicles (VTC) other than taxis charging a per-kilometer fee.
- (2) the prohibition on “electronic roaming” by chauffeured vehicles, i.e., the use of a smartphone application that shows the location of nearby available vehicles to potential customers in real-time.
- (3) the requirement that, after each ride, chauffeured vehicles return to their home base or stop in a place where they are authorized to park.

⁴⁴ George Stigler, ‘The Theory of Economic Regulation’, (1971)2, The Bell Journal of Economics and Management Science, < <https://www.jstor.org/stable/3003160?seq=1> > , 3.

⁴⁵ Sam Peltzman, ‘*Toward a More General Theory of Economic Regulation*’, (1976) NBER Working Paper, <<https://www.jstor.org/stable/725163?seq=1>> .

⁴⁶ LOI n° 2014-1104, 1st October 2014, relative aux taxis et aux voitures de transport avec chauffeur (regarding taxis and chauffeured vehicles). JORF n°0228 02/10/2014.

In theory, online platform regulation will not suffer from capture: if the regulation does not increase the welfare of the participants on the platform (both customers and suppliers), it will lose participants and revenue (in some ways, the platform is more accountable for the regulation it enacts). It thus has a clear incentive to regulate efficiently and to consider the costs (since new regulation in general increase costs) and benefits (in terms of the satisfaction of consumers and suppliers) of new regulations and their enforcement.

3. Considering the evolution of consumers' preferences, the evolution of technologies or the evolution of economic conditions, legal regulation suffers from inertia. It will take more time to modify an outdated regulation or to simply adapt the regulation to new economic realities since certain legal procedures must be followed (modifying a law implies drafting, discussion, voting, enacting and it will take a couple of months at least to complete a full procedure). This is obvious when cryptocurrency regulation is considered (are they currency or financial product? Can they be used for paying goods? Etc...), this is also clear regarding the evolution of taxi regulation or the regulation of products offered by online platforms.

When a regulation seems outdated or could simply be improved, online platforms have all incentives to modify as quickly as possible their rules since, especially when they compete with other platforms this could constitute a competitive advantage (and regulatory competition should work for the benefits of consumers and, indirectly, suppliers). For example, Uber developed Uberpool or UberPop to lower the cost of using a Uber (the latter one was banned in France); Facebook, Twitter or eBay regularly modifies its conditions of use; Leboncoin developed an online payment system to smoothen transaction; TripAdvisor added new categories to be rated since it corresponded to a demand from its users. And because modifying the conditions of use of a platform is not subjected to a particular legal procedure, online platforms can adapt and react way more quickly than legal regulation. This does not mean that they will not consider some form of "certainty" regarding their regulation since this certainty is also what will incentivize customers to use their platforms.

4. Legal regulation cannot be as tailored as the regulation provided by online platforms. For example, taxi fares regulation is valid whatever the situation of the demand or the quality of the car, but different fare could be applicable depending on the time of the day. Uber fares will evolve depending on the supply and the demand but also depending on the quality of the car, and sometimes the rating of both driver and consumer(s). It will also be different depending on the type of car (e.g. for Uber in France: Uber X, Uber comfort, Uber berline). Enforcing a legal regulation modeled on Uber's regulation would probably be prohibitive since enforcement will largely rely on police forces and since it would be quite difficult for a regulator to aggregate the supply and the demand for

determining fares except if it also uses an online platform. It should also be mentioned that what Uber is doing would appear as questionable if a legal regulation were doing the same, for example if a legal regulation were “rating” consumers!

This relative regulatory efficiency essentially concerns online platforms which are not only lowering search costs, but first and foremost, bargaining and decision costs and policing and enforcement costs since they directly contribute to the regulation of goods and services traded through their platforms.

B. IS PLATFORM REGULATION PERFECT?

1. There are reasons to believe that platforms’ regulation will not be perfect.

When platform regulation relies on ratings (and they often do), there is always a risk that these ratings will be manipulated. This will be the case when “bots” are used or when a supplier will “pay” consumers or other entities to review its good or its services. This risk is largely unescapable. However, this type of “manipulation” will have an incidence on the reputation (the perceived reliability) of the platform. In other words, the platform will have incentives to track these “fake” reviews or to lower the possibility to post “fake” reviews. For example, Hotels.com only allows customers who booked through its platform to review hotels which increase its reliability; Amazon also indicates if the reviewer bought the product and if the reviewer is among the “top” reviewers. Moreover, if a platform is sufficiently used by consumers (which provide many reviews), it is unlikely that “fake” reviews will have an incidence on the rating or that they will not be identified as the product of “bots”. The fact that the economic model of a platform is based on reliability will naturally incentivize it to track loopholes and manipulation. Such an incentive is not as strong when legal regulations are considered, and even more when regulators are so financially constrained that they must make difficult choices in what to regulate and what not to regulate (this tradeoff always exists but is more apparent when financial resources are highly constrained).

Second, it is possible to consider that ratings and reviews are purely subjective and thus not fully reliable. It is certainly clear, for example, that different travelers will not value the same things regarding a hotel or that different people will not experience the same ride or the same dish in a restaurant similarly. However, to facilitate a “good” interpretation of the reviews, platforms often distinguish between different criteria (for a hotel, TripAdvisor asked reviewers to review four criteria: location, service, cleanliness, price quality ratio) and different types of customers (for Hotels.com, did you spend a night with your partner, your family, your friends, was it a business trip, etc.). They also provide the nationality of the reviewer and, sometimes, his / her declared age. Of course, such a system is not perfect, and it will be required to learn how to interpret this information.

However, it is difficult to consider that these reviews, even if subjective, do not contribute to lower asymmetric information and decision costs, especially when there is a diversity of platforms providing reviews of the same service or good. Moreover, it is unlikely that this type of reviewing could be organized through a legal and centralized regulation (since, besides the problem of legality, lobbying is to be expected). If the rating system were expanded to certain professions like a lawyer, a surgeon, or a psychotherapist, it is difficult to say that asymmetric information could be lowered sufficiently, but it is also possible to wonder if some information would not be better than no information.

Third, ratings only transcribe what consumers value, and it would be possible to consider that they do not know what is “really” good for them. The problem of this line of reasoning is that it will be extremely difficult to say that the regulator could know better. Moreover, these reviews will only consider things which are sufficiently visible for consumers to make comments. If the quality of something is difficult to assess easily, it is unlikely that platform reviews will be sufficient to ensure a minimum quality.

2. The question should not be whether platforms’ regulations are perfect but are they more efficient than legal regulation in certain domains? In other words, whether they can lower transaction costs more efficiently than a legal regulation would. Thus, my point is not that we need more or less regulation, but that a regulation can be provided by other means than a legal regulation.

a. For certain industries, there are reasons to believe that it would be the case.

The taxi industry is probably in this situation. It was certainly making sense before platforms to solve asymmetric information problems, but the fact that more and more people prefer to use Uber (or ridesharing platforms) instead of taxis reveals that they prefer the type of “regulation” provided by Uber! What would be lost if taxi regulation disappeared remains unclear. And the same could be said regarding the regulation of the type of vehicle which should be used when an agent decides to engage into this business. Indeed, the diversity of vehicle can be considered by a platform and would allow for price discrimination which will, once again, benefit consumers.

The efficiency of the star system for hotels is also dubious. First, considering that this system is different in different countries, it does not necessarily provide reliable information. Moreover, most consumers do not know that the star system is linked to the size of the room, often more than the quality of the hotel. Finally, it does not consider what consumers really value, which is the experience of the hotel which can only be provided through reviews and pictures. Abandoning this legal regulation or limiting it to a minimum would certainly make sense.

It is also possible to wonder if we need more than minimum regulation regarding the cleanliness of a restaurant (for example regarding hidden parts of the restaurant) since consumers will notice easily if the toilets are clean or if the dishes are done properly. More generally, whenever certain dimensions of goods or services could easily be rated by a customer, it is unclear how a regulation relative to the quality of these dimensions would improve things.

b. For other industries, it is unlikely that platforms' regulation would be more efficient because the quality or the safety of an installation, a good, or a service cannot easily be "rated". For example, maintaining a diploma requirement for certain profession (e.g. surgeon or doctor) still makes sense to lower decision costs and avoid adverse selection. It would also make sense to maintain safety standards for drugs, food and water quality, cars, or buildings. Zoning regulations and environmental regulations are similarly not concerned regarding their relative efficiency to what platforms could provide. Regulations regarding public health cannot likewise be replaced by any form of platform regulation. Labor law and competition law will still be required, and the list provided here is far from being exhaustive (I should also mention property law, corporate law, contract law, tort law, fiscal law, civil and economic liberties, etc.).

Platforms' regulation is thus not a threat for all legal regulation but a regulatory technology that regulators should not disregard considering its potential to lower transaction costs and improve welfare.

IV. CONCLUSION

In this paper, I demonstrated that what online platforms provide is a type of regulation for the goods or the services traded on online platforms. Moreover, I showed that there are reasons to believe that these regulations would be more efficient than legal regulation in terms of costs, adaptability, fairness, and reliability – deregulating would thus not mean the absence of regulation but a switch from legal regulation to platforms' regulation. Regulators should thus recognize the ability of online platforms to perform a regulatory function.

In this paper, I also offered some insights regarding the proper role of platforms' regulation vis-à-vis legal regulation. This is probably an under-researched domain since I was unable to find any paper addressing this issue. I am nevertheless convinced that extensive research in that field would be valuable for the regulation debate and could benefit both consumers and taxpayers.