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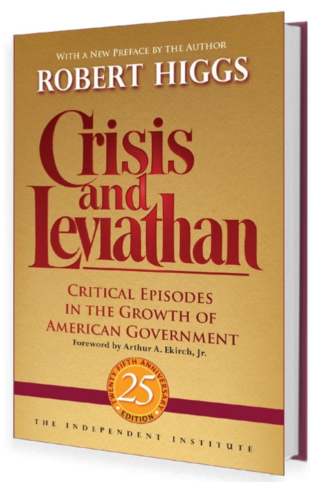

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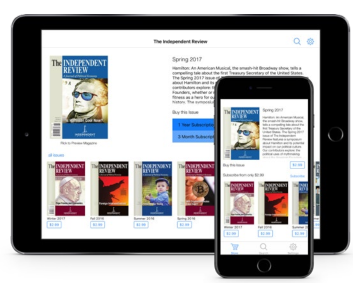

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Tomorrow 3.0

The Sharing Economy

MICHAEL C. MUNGER

Right now, we own stuff. I do, you do, the people across the street who can't get their car in the garage do . . . we own a ton of stuff. The self-storage industry in the United States has nearly fifty thousand facilities, with more than 15 billion cubic feet of space (Clark 2014) cluttered with . . . stuff.

But people don't fundamentally want *stuff*. What they want is the *stream of services* that stuff provides over time. So if people own stuff—clothes, tools, cars, houses—rather than rent that stuff, it is because owning secures services more reliably and at lower transaction costs than renting. But this "preference" for owning is not real. It might change quickly if entrepreneurs were able to figure out a way to sell reductions in transaction costs.

And that's the thesis of this essay. The future will look very different from the past and the present because in the future entrepreneurs *will have* figured out how to sell reductions in transaction costs. Almost everything we own will soon be a potential rental item, or we won't own it all because we'll rent it from someone else. And (almost) everything will be better. Except for the things that will be worse.

Revolution Is Disruptive

There have been two enormous "revolutions" in human history. The first was the Neolithic Revolution, or the wide-scale switch from a nomadic hunter-gatherer life-style to fixed agriculture. The second was the Industrial Revolution, or the wide-scale concentration of production in processes that took advantage of division of labor and

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capital-intensive work. The most salient feature of both revolutions was unprecedented expansion: after the Neolithic Revolution, cities developed, and populations increased in ways that transformed the landscape.

After the Industrial Revolution, production processes developed in ways that within just a few generations afforded a set of consumer items for the poor that had been unattainable even for the wealthy just a century earlier. So where the Neolithic Revolution resulted in an explosion of population, the Industrial Revolution resulted in an explosion of capital accumulation and cheap consumer products.

Jared Diamond (1987) called the move to fixed agriculture a "mistake," perhaps tongue in cheek. Still, it is true that liberty, nutrition, and hygiene suffered. But for something to be a mistake there has to have been an alternative. For both revolutions, things could not have been otherwise. Suppose we grant that people were individually worse off for a few generations at least. The consequences of realizing economies of scale in military action and the benefits of access to the products of increased specialization overwhelmed the ability of any but the most isolated tribes to choose any other form of society (see Hummel 2012 for background).

Adam Smith summarized the larger economic reasons that division of labor is important, and Émile Durkheim and others later echoed it. The title of chapter 3 of book 1 of *The Wealth of Nations* puts it this way: "That the Division of Labor Is Limited by the Extent of the Market" (Smith [1776/1904] 1981). Returns to scale are not linear in terms of the "size" of society. Rather, the nature and quality of the products and services available have dramatic and increasing returns to scale.

This conclusion is so obvious that it escapes our attention most of the time. In a tribe of one hundred, there may be someone who is skilled at beating bones on a rock. In a clan of one thousand, there may be someone who can play a flute and others who can manipulate a string tightened on a bent piece of wood. In a city of one hundred thousand, there are chamber orchestras. And in a city of one million there is a symphony, with highly specialized instruments and people who make a living playing or repairing those instruments. The tribe couldn't support a symphony, and the expectations of the city's citizens are too advanced to be satisfied with the guy beating bones on a rock.

Of course, the same thing goes for coercion. If you are a tribe of hunter-gatherers, your "army" of forty adult males will be overwhelmed by the ten thousand trained warriors from the city on the other side of the mountains. There is no hope of resistance, so you settle down to farm. The choices were either to accept the consequences—economic, political, and social—or cease to exist.

The third revolution will be like that, too. And it has already started.

Tomorrow 3.0

The two previous revolutions made each of us more dependent on all of us, though perhaps in a good way. I could specialize in some narrow activity because I could rely on other people to specialize in producing all the other things I needed, from food to the nice woolen coat Adam Smith made famous as an example. Smith's point, which is even more true today, is that each of us can afford more *and* better stuff because of specialization.

But we still rely, even in the best circumstances, on ownership. We end up with far more stuff than any of us actually need or could use. We store the stuff in closets, garages, cupboards, and "U-Store" facilities. The result is that we have to pay the *average* cost of everything—pretty much everything.

Why not just pay the *marginal* cost rather than the *average* cost? After all, if I own an apartment, I'm already paying for utilities and making mortgage payments. But what if I'm not always there or if I have an extra room I almost never use except for storing junk? I would be willing—maybe even happy—to offer someone else my place to stay for whatever I can get to pay toward my fixed costs and the cost of having to clean it afterward. If I can actually get more than my fixed costs, I would be pleased to offer the apartment for rent.

I'm willing to offer rides at the cost of gas, my time, and wear and tear on the vehicle. It's also true that density helps both buyer and seller because waiting times are reduced as more people use a service. Overall, a "shared" apartment owned and often occupied by someone else can provide lodging services far more cheaply and still benefit both parties.

The reason we don't see more sharing is "transaction costs" (Lucas 1979; Langlois 1992). If I go to bars or perhaps to street corners in Raleigh, North Carolina, and ask random strangers if they want to spend the night at my place, the experiment won't go very well. (Don't ask me how I know that; just take my word for it!) And it won't go much better if I walk around in some other city and ask folks if I can spend the night with them. (Again, don't ask how I know that.) But it's perfectly true that there are some people who have extra room and others who need a place to stay in a strange city. What's missing is (1) information about identity and location; (2) a way of making payment that both parties can trust; and (3) a way of outsourcing trust on performance of the terms of the contract.

The usual answer to this problem is "hotels," of course. But hotels are expensive because they have to cover their average costs: all of their expenses are involved in the business of selling rooms by the night. That's not true of apartments or homes where people live because those other expenses are being paid already. The price required to make the seller willing to rent a room or an apartment during the summer when they are away is much lower.

That arrangement is better for the buyer also, of course, as long as the three components listed earlier can be satisfied reliably. It isn't easy for seller and buyer to find each other, make a payment transfer, and outsource trust at a reasonable cost. Of course, because of Airbnb and other home-"sharing" software platforms, that's no longer true. And the existing stock of "stuff" can be used far more efficiently. As transaction costs fall—which means as entrepreneurs find new ways to "sell" reductions in transaction costs—much of what we now own will change its status. All of us will rent more and own less. Some of us may specialize in being "sellers" in these new rental markets for things we do own. But, overall, each of us will have actual possession of far, far less stuff at any given time.

From Owning to Renting, from Companies to People

We are used to thinking of getting stuff from companies or firms that own products or provide services. This model is changing in two ways that are connected but distinct. The first change is the move from owning to renting. The second change is the ability to transact peer to peer instead of business to consumer. The interaction between these two changes will have far-reaching implications.

From Companies to People

The biggest change in the software-platform-driven revolution in transaction costs is that people will skip companies except as middlemen. We are already used to this jump with Airbnb and Uber, both of which provide access to privately owned services (rooms and rides, respectively) for private citizens. All the software does is provide information, take care of security (through ratings and reputation), and process the transaction (removing most of the risk of robbery or reneging).

But there are hundreds of other examples for stuff you may not have thought of renting. One company, Spinlister, brings together people who have but currently aren't using bikes, surf equipment, and ski equipment and people who need those things. All three of these goods are relatively durable, sometimes not used for long periods, and expensive. For instance, Rent Luggage is Uber for luggage and expensive hiking gear. Private individuals have stuff. Other private individuals need the stuff for a short period. With high transaction costs, the choices previously were either to buy the stuff (expensive in terms of cash and storage) or to do without it. If an entrepreneur can sell the reduction in transaction cost through a software platform, private individuals will make much more intensive use of the stuff they already have.

In a short time, the result will be that many of us will have much less stuff. I won't need to own a laptop, a bike, a car, luggage . . . or maybe even clothes. A company called RentTheRunway rents "unlimited clothing and accessories" for $99 per month. The offer is not really unlimited, of course. Customers (it's supposed to be for women, but to each her or his own) can have only one of each item per category at a time. But when the customer is finished with the dress or shoes or purse, he or she sends it back. RentTheRunway takes care of the shipping and the dry cleaning.

The Dark Side

The good news is that we all will own and store much less stuff. The bad news is that . . . well, that's the bad news, too. An economy in which entrepreneurs have always been focused on making new products or on making more old products more inexpensively will be shaken to its foundations.

Instead of 90 million power drills sitting in closets and garages, we'll need only 10 million because we'll be able to rent rather than own a drill. The drills will be more expensive and sturdy, commercial rentals rather than cheap consumer models. But the decline in production-line requirements will be enormous. We'll need far fewer cars (and much less real estate devoted to parking), fewer bikes, fewer hotel complexes—less of just about everything.

But some people, probably many people, will lose their jobs. And they won't get new jobs, at least jobs in the sense that we understand them. They may work "gigs" or temporary periods as parts of teams, the way the construction industry or Broadway plays operate now.

Will this change be good or bad? As in the previous two revolutions, that hardly matters because the economic logic is inescapable: it's just going to happen. Nevertheless, I think it's fair to say that for most people the effect will be positive because although nominal wages may fall, the quality-adjusted price level will fall by more, implying an actual increase in real wages.

Not least, the effects on the environment, considered broadly, will be largely positive. Cities won't need parking spaces or underground garage spaces. Houses won't need garages or nearly as many closets. Energy use in manufacturing and the amount of waste produced from packaging and discarding broken or unused products will plummet.

If Andy Warhol were alive today, he might describe the new world this way: in the future, people will own stuff for fifteen minutes.

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