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Adaptive governance and decentralization: Evidence from regulation of the sharing economy in multi-level governance

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ABSTRACT

When does decentralization lead to adaptive governance? This study proposes a conceptual framework of the necessary conditions in which decentralization may result in adaptive governance. We thereby consider two distinct forms in the context of multi-level democratic governance: central and local governments. Based on prior findings that local governments are more sensitive to democratic influences than central ones, we point out that decentralization may hinder the process of adaptation if the considered policy embodies entrepreneurial politics (i.e., if the adaptation generates widely distributed benefits but narrowly concentrated costs). To support our analyses, we use the example of the recent rise of the sharing economy, as manifested by Airbnb, and present qualitative evidence suggesting that higher-tier (central or federal) governments are relatively more favorable to such sharing services than lower-tier (local or city) governments.

1. Introduction

Governments are often required to adapt to changes in the political, social, and technological environments to provide better service. This is especially true in today's turbulent times, when policy environments and citizens need to interact in a highly variable and unpredictable manner. The new challenges resulting from the rapid growth of the global economy and technological developments (e.g., cybersecurity and online privacy) can offer a partial explanation for how turbulence has become the "new normal" in public governance (Ansell, Trondal, & Øgård, 2016). Despite the increasing need for adaptability in such circumstances, the risk-averse nature of government agencies tends to prefer stability to change, thus lagging behind environment changes (Wilson, 1980).

Prior research has explored characteristics or strategies that allow governments to become flexible, agile, and adaptive without becoming unstable (Gong & Janssen, 2012; Janssen & Van der Voort, 2016; Mergel, 2016). Among the many possible characteristics of adaptive governance, scholarly attention has been drawn to the implementation of decentralized, bottom-up decision-making in governments (e.g., Brunner & Lynch, 2010; Janssen & Van der Voort, 2016). For instance, according to Janssen and Van der Voort (2016, p. 3), the "core characteristics of adaptive governance are decentralized decision-making, engagement of many stakeholders in decision-making and the use of tacit decentralized knowledge."

In this study, "adaptive governance" is defined as governance that advances public interests through greater responsiveness leading to a change in policies that are no longer beneficial to society in keeping with the changes in the environment. The need for adaptive governance arises from "the mismatch between the characteristics of the environment and the way organizations are governed" (Janssen & Van der Voort, 2016, p. 3). Building upon previous literature concerning agile and adaptive governance, this study presents a conceptual framework that may help answer the following question: *Under what conditions does decentralized governance become more conducive to adaptive governance?* Decentralized governance may take many different forms. Decentralization is usually considered with regard to the entire government structure (rather than limited to a single public organization). We look at two distinct forms of governance in the context of multi-level democratic governments: first, complete centralization, with only the central government having authority over major policymaking; second, total decentralization, under which local governments assume greater roles. This study challenges the notion that decentralization necessarily leads to adaptive governance, and it proposes necessary conditions for the former (decentralization) to become the latter (adaptive governance). Specifically, using Wilson's (1980) typology, we argue that decentralization generally hinders adaptive governance in entrepreneurial politics (which is an adaptation that generates widely distributed benefits but narrowly concentrated costs).

This study uses the examples of the accommodation service Airbnb, which are representative of the recent rise in the so-called "sharing economy." Specifically, we propose a conceptual framework that

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explains why regulators at the central and local government levels may respond differently to these new sharing services. As we explain later, public administrators in local governments are incentivized to be more responsive to democratic forces. This is because the chain of command between executives facing elections and lower street-level bureaucrats is significantly shorter in local governments. The greater responsiveness of local governments may indicate that decentralization leads to adaptive governance if the governments' adaptation to new environments produces benefits to the electorate within the local jurisdictions. Conversely, if governments' proposed adaptation imposes costs on the local electorate (albeit producing net benefits to society as a whole), then decentralization would not be conducive for adaptive governance.

This research is related to several strands of prior scholarly work. Primarily, this conceptual study has implications for the literature on governments' responses to newly emerging technologies and industries, specifically in debates over adaptive and agile governments (Gong & Janssen, 2012; Janssen & Van der Voort, 2016; Mergel, 2016). Second, it also contributes to the literature on multi-level governance and federalism (Feiock & Carr, 1997; Hong, 2017; Hooghe & Marks, 2003; Ostrom, Bish, & Ostrom, 1988; Wright, 2001). Further, this study's logic is related to the public choice literature, which assumes that rational politicians and bureaucrats seek to maximize their own benefits (e.g. Voigt & Blume, 2012; Hong & Lim, 2016; Hong & Kim, 2017).

The study is organized as follows. In the Section 2, an overview of the literature on sharing economy is presented, which is the focal case of our argument. In Section 3, we set out the conceptual framework of the necessary conditions under which decentralization may lead to adaptive governance. In Section 4, we present the findings of our interviews with personnel from Airbnb, a company offering global accommodation-sharing services, which has had trouble with the existing regulations that block the company from fully entering a particular market. We also present key insights from interviewing several public officials in central and local governments in Korea, who are responsible for policies on operating sharing economy services. Finally, in Section 5, the discussions and conclusions are presented.

2. Regulating the sharing economy

The rise of the sharing economy has changed the way people throughout the world shop, commute, and travel (Belk, 2014; Bond, 2015; Cohen & Sundararajan, 2015; Cusumano, 2015; Malhotra & Van Alstyne, 2014; Zervas, Proserpio, & Byers, 2016). In giving consumers options for purchasing a variety of services at lower costs, the sharing economy has also disrupted traditional industries and created a new type of part-time work. The innovation of such "sharing services," which use internet-based platforms to match consumers and suppliers, has introduced unprecedented competition and threats to traditional transportation and accommodation industries.

Previous studies (Cramer & Krueger, 2016; Koopman, Mitchell, & Thierer, 2015) have generally found welfare gains associated with the sharing economy's growth. In fact, the most remarkable aspect of the sharing economy is that its internet platform significantly lowers transaction costs by connecting consumers with those willing to provide their underutilized assets at prices lower than those offered by traditional suppliers. With social welfare maximization defined as maximizing consumers' utility given the limited resources of traditional suppliers, the sharing economy certainly appears to benefit society from an efficiency perspective,[1] provided governments maintain fair competition between the sharing economy and traditional suppliers (Cannon & Summers, 2014; Cramer & Krueger, 2016; Koopman et al., 2015).

Government reactions to these new types of services, however, have not always been positive. As Cannon and Summers (2014) observe, "rather than rolling out the red carpet, city governments have resisted many of these new entrants issuing subpoenas and cease-and-desist orders." For instance, in Korea, from where we collected the evidence for this study, Uber faced strong opposition from taxi unions, and many of the company's services were eventually banned by the government. Similarly, in many European countries, including France, Germany, Spain, and the UK, taxi driver associations organized high-profile protests against Uber, and there is a rising concern that government regulators may respond to these complaints in favor of the associations.

One noteworthy observation is that regulators' responses to these new sharing services have differed across the multiple tiers of the government. The general trend across the world is that governments at the higher level (central or federal) are relatively more favorable to this sharing economy than governments at the lower level (local or city). For instance, in November 2016, the US' Federal Trade Commission (FTC) released a report discussing the economic implications of the rise of sharing economy companies (Federal Trade Commission, 2016). In this report, the FTC emphasized the significant consumer gains brought about by the competition between these companies and traditional industries, and clearly argued against regulations that protect incumbent suppliers. Despite such endorsement at the federal level, states and municipalities in the US are generally hesitant in removing entry barriers for these new companies. For instance, New York and San Francisco prohibit individuals from offering their residences for short-term rentals (*Forbes*, 2016).

Such different responses across multiple levels of government are observed in other parts of the world as well. In May 2016, the European Commission released guidelines arguing that any restriction imposed by EU member states on these new online services must be justified by public interest (*Reuters*, 2016). These guidelines were in response to many cities imposing an outright ban of several sharing economy services. In Korea, the central government drafted the Sharing Accommodation Act in 2016 to promote sharing economy industries. However, the central government faces a challenge from local governments that are unwilling to implement this policy (*Financial News*, 2016).

In what follows, we present a conceptual framework to understand how the manner of regulating the sharing economy may differ between central and local governments. Specifically, we explain why central or federal governments are, in general, relatively more accepting of this innovation than local, city, or municipal governments. We then present the findings from our interviews with Airbnb personnel and public administrators responsible for regulating the sharing economy's business operation in central and local Korean governments.

3. Conceptual framework

In this section, we present a conceptual framework explaining the conditions under which decentralization leads to adaptive governance. In Section 4, we present qualitative evidence showing the difference between the responses of regulators at the central and local governments toward the rising sharing economy businesses.

Our conceptual framework is based on the following premise. A situation requiring a policy change brought on by changes in the environment is always a new challenge for governments. Governments then consider adapting to the environmental change by implementing a new policy proposal that benefits the society they serve. Specifically, the proposed policy generates both benefits and costs that must be borne by the society's members. We assume further that the policy has a *net* benefit; in other words, the policy under consideration, if implemented, would improve social welfare from an efficiency perspective compared to the status quo. In such a setting, a government's implementation of the policy proposal is considered adaptive governance.

[1] By "efficiency perspective," we mean that emphasis is not on equitable distribution of welfare across the population in the society.