



The  
CEO  
SERIES

*Business Leaders: Thought and Action*

**A Policy for E-Commerce:  
Stifle Regulation, Not Innovation**

*An Original Essay Written for the Weidenbaum Center*  
by Richard J. Mahoney

CEO Series Issue No. 44  
January 2001

# A Policy for E-Commerce: Stifle Regulation, Not Innovation

*by Richard J. Mahoney*



*Richard J. Mahoney*

E-commerce has emerged as an increasingly important factor in business dealings, and predictably the reaction among legislators is to regulate it, with a number of proposals circulating at both the federal and state levels.

While the subjects for legislation and regulation run the gamut from Internet gambling to online sale of pharmaceuticals, the major initial focus has been in two areas—consumer privacy and taxation. Consumer privacy is an issue because business sees e-commerce as an opportunity for cross-selling and targeted selling, while consumer groups see the e-commerce potential for abusive intrusion. The tax issue arises largely because state and local sales tax receipts are in jeopardy as online purchasing increases as a percent of retail sales. Some 7,500 jurisdictions can impose sales taxes, and sales tax receipts represent about 25 percent of total state revenue. While current law protects Internet sales from state and local sales tax, the issue is front and center in Washington, D.C. And states are watching legislative proposals in California that call for taxing Internet sales in much the same way as catalog sales—if you have a retail operation in the state, your electronic sales there are taxable.

While e-commerce tax policy may be the subject of a future publication, this paper deals exclusively with the regulatory aspects of e-commerce. The Weidenbaum Cen-

---

*Richard J. Mahoney is distinguished executive in residence at the Weidenbaum Center at Washington University in St. Louis. He is former chairman and CEO of Monsanto Company. Please see back cover for information on the renaming of the Center.*

ter has long been a leader in encouraging sensible regulatory policy and in evaluating the costs and benefits of new regulatory proposals. The Center is also well-known for its annual analysis of the costs associated with maintaining the regulatory apparatus in the federal government as well as examining its effect on the overall U.S. economy.

In order to provide a framework for thinking about regulation in this new arena, we are proposing E-COMMERCE REGULATORY GUIDELINES. These are broad principles for legislators and regulators to consider in developing rules for e-commerce oversight. Some of these reflect the time-tested regulatory principles of the Center's founder, Murray Weidenbaum, and my own experience heading a company often on the receiving end of regulations, while others are specific to the circumstances of e-commerce.

The overriding principle we propose is:

Act only if the market fails or is highly likely to fail in protecting citizens and consum-

ers. The burden should be on the proponents of regulation to make a convincing case for market failure and the need for regulation rather than the reverse. Regulatory proponents should also make a strong and defensible case that the market failure has large potential consequences and that their regulatory remedy would not make matters worse.

For example, in the highly contentious area of consumer privacy, some companies might see the issue as one of potential competitive advantage and then provide guarantees that consumer information will not be transmitted to other organizations (including within their own company) without the specific approval of the consumer—who might then be compensated with product coupons or other incentives.

One could well conclude that the privacy issue should be allowed to “simmer” for a while to see if the market can provide the necessary protections before the heavy hand

---

*The overriding principle we propose is:  
Act only if the market fails or is highly  
likely to fail in protecting citizens and  
consumers.*

---

of government writes “comprehensive” rules. Perhaps the threat of such regulatory action along with perceived market opportunity will solve much of the problem. If not, one can always impose regulations. Adding regulations is infinitely easier than stopping them once a bureaucracy has arisen. Indeed, some companies find the regulations helpful as a business advantage over those less able to cope, and thus become allies of the regulators. Obviously, the marketplace is not always successful in self-regulation, but it’s not a bad place to start.

If e-commerce regulation by government is considered necessary, we propose that it follow these guidelines:

**1. Allow all affected parties an opportunity to give their views both in the legislative process and the regulatory activity that follows.** The open procedures for congressional hearings on legislation have usually served us

well. The regulatory process, however, is far less transparent and less participative in practice. It often hits those most affected by expensive regulatory

---

*Allow all affected parties an opportunity to give their views both in the legislative process and the regulatory activity that follows.*

---

surprise. And worse, it hits “innocent bystanders” in the inevitable law of unintended consequences whenever deliberations are not out in the open.

**2. Limit regulators.** The legislation should not be so tight as to be prescriptive and inflexible. But at least as important, it should not be so loose as to have unelected regulators “write the legislation.” Worse yet would be to have the legislation so loose that the courts would decide what the legislators intended. To be sure, arguing for this balance may sound like the advice of the baseball manager to the pitcher in the ninth inning: “Don’t give him anything too good to hit—but don’t walk him.” However, there are examples of well-crafted legislation that meet the intent of Congress without excessive “interpretation” by the regulators.

**3. Use benefit-cost analysis before passing the laws and issuing the rules.** Despite executive orders by suc-

Weidenbaum Center  
“Ten Rules for E-Commerce Regulation”

**DO**

1. Open the regulatory process.
2. Limit the regulators' scope.
3. Use benefit-cost analysis.
4. Clearly define liability.
5. Provide for an automatic sunset review.

**DON'T**

6. Ignore the international consequences.
7. Change the rules retroactively.
8. Set up a new bureaucracy.
9. Uniquely punish e-commerce.
10. Stifle innovation.

cessive administrations requiring such analysis, the principle is today largely in disarray and seldom properly honored. If the practice continues to be ignored in regulating e-commerce, it could have a “stillborn” effect on the launch of this new economic engine. The benefit-cost analysis should establish a high threshold before deciding to regulate. Regulating trivial risks saps economic resources. In business management it's often posed this way: “What's the worst that can happen if this activity is approved or allowed to continue?” If the worst consequences are tolerable, then the activity is approved. Likewise, regulation when the worst consequences are “tolerable” is inappropriate. Regulators have not often applied this simple test. A further explicit consideration in the benefit-cost analysis should be the special effects of regulation on small business. These companies often are in the forefront of e-commerce and have few resources to cope with burdensome e-commerce regulations. Needless cost can kill this important source of innovation.

**4. Don't make laws and regulations retroactive.** A regulatory “Decision Rule” should be *prospective*. Punishing people for actions that were performed legally at the time is simply unfair and stifles intellectual curiosity, innova-

tion, and problem solving. Superfund, probably the single most unproductive legislative measure in modern times, suffered from that desire to punish retroactively. As a result, it wound up causing companies to spend hundreds of millions on litigation rather than on cleanup of waste sites. Likewise, new regulation should include compensation for loss of property rights. Too often a necessary regulation imposes new rules on people who acted properly under the old assumptions. They should not be punished twice by forbidding future practices while penalizing past, legal practice, effectively confiscating their property.

**5. Use existing regulatory agencies for e-commerce within their assigned areas rather than create new regulators specific to this field.**

The subject of e-commerce will become so pervasive in the economy that it will start to fall within existing regulatory purviews. It can be as-

sumed that existing agencies will compete to regulate. What is not needed is a dual-track system where a new agency writes

---

*The subject of e-commerce will become so pervasive in the economy that it will start to fall within existing regulatory purviews.*

---

rules while existing agencies write their own—likely in conflict. Likewise, the all-important regulatory *enforcement* should stay within existing jurisdictions and be explicitly stated by Congress when drafting laws. A body of law on regulatory compliance has developed over the years, and its checks and balances should be considered an asset not to be squandered. Here again, benefit-cost analysis must be rigorously applied in measuring compliance.

**6. Consider and coordinate the international implications of proposed regulations.**

E-commerce impinges at virtually every point of its activity on worldwide commerce. The rules imposed on U.S. participants must be in harmony with those imposed by our trading partners. When you log on to the Internet to purchase a product or service, the user is not constrained by national origin. This is one of the beauties of the Internet. International regulators stifle this freedom at their peril, but their activities must

be coordinated among major trading partners.

**7. Clearly define liability under the regulation.** What are the penalties, if any? In imposing penalties, a fine imposed for failure to comply is generally preferable to giving states and individuals a legal cause of action and financial redress. The courts are already clogged with class-action lawsuits that provide trivial financial redress to individuals and primarily benefit the trial lawyers “acting on their behalf.” Is there a “safe harbor” provision that automatically limits liability if certain standards are met? Is there an appeals process? Does the statute or regulation preempt similar action by state and local authorities? Coping with one set of federal regulations is usually difficult enough without trying to fathom the obligations under potentially 50 other jurisdictions—or indeed hundreds if local governments are allowed to set their own regulatory standards.

**8. Provide for an automatic “sunset review” after a fixed period, for example three years after enactment.** While regulators are usually adamant in defense of their regulations and it’s virtually impossible to change them without a new statute, a sunset review hearing should be required to allow registration of grievances. Such a review could force modification or perhaps even cause the regulation to be scrapped.

**9. Don’t uniquely penalize e-commerce by controlling certain activities while allowing similar activities to go on in sectors that compete with e-commerce.** This also means having governmental agencies subject to the regulations. The environmental laws are a good example of what happens when government is excluded—major government agency polluters like the Department of Energy and the Department of Defense escape the fate of private citizens. Additionally, in the case of e-commerce, it will be instructive to government to have to live with the compliance rules set for others in the use of personal data. Ideally, the laws would extend to state and local governments as well, where personal data from auto registration, for example, is often made available to outsiders. Of course, some collected and disseminated governmental data will be part of an inherently government function (i.e. provid-

ing information to law officers), but all others should be subject to the same disclosure rules as the private sector. Particularly sensitive in this regard both in the public and private sectors is personal health information, but there are many other data collection issues as well.

**10. Test each proposed regulation against this question: Will it stifle beneficial innovation?** The United States is in the lead in e-commerce partly because we have allowed it to grow. Europe, by contrast, is scrambling to catch up—partly because it suffers from the malaise of regulating toward protecting the “least common denominator” country. Innovation that is both beneficial and accompanied by minimal but appropriate regulation will win.

To test these rules for e-commerce regulation we selected three pending bills—one in the House and two in the Senate. We scored them from 0 (worst) to 10 (best) in each of the regulating principles. Because of the 50-50 makeup in the Senate and their need to closely collaborate, we examined a Republican bill (sponsored by Sen. John McCain) and a Democratic bill (sponsored by Sen. Ernest Hollings), both of which are aimed at regulating consumer privacy on the Internet. It is important to note that this is only the *legislative* portion. It remains to be seen what the regulators—primarily the FTC—will do with this legislation. ↪

## H.R. 3321 (Electronic Privacy Bill of Rights Act)

### **Bill Sponsor's Synopsis:**

A bill to prevent unfair and deceptive practices in the collection and use of personal information, and for other purposes.

**Sponsor:** Rep. Edward Markey (D-Mass.) **Cosponsors:** Rep. Bill Luther (D-Minn.), Rep. Shelley Berkley (D-Nev.)

### **DO:**

---

#### **1. Open the regulatory process.**

**Grade: 10**

The bill calls for the FTC to be the regulator, and the FTC regulatory process is typically an open one—whether in calls for comment by affected parties on the regulation or in the holding of public hearings.

#### **2. Limit the regulators' scope.**

**Grade: 6**

The bill is *both* prescriptive and sufficiently vague so that FTC has quite broad powers. The regulators under the law could be zealous to a fault in interpreting congressional intent—i.e., the required consumer protection information on the web site could dwarf product sales information if FTC carries out a “search and destroy mission.” The proposed law does not mention this caveat as a principle. On the plus side, it does provide for industry to regulate itself if it can provide standards and a self-policing process acceptable to the FTC.

#### **3. Use benefit-cost analysis.**

**Grade: 0**

The bill assumes that since “only 9.5% of Web sites surveyed (by Georgetown Business School) contained a (suitable) privacy policy it is important to establish personal privacy rights now....” There is no mention of benefit-cost analysis or making the “dose fit the malady” or even an assessment of the extent of invasion of privacy currently taking place. “We need it and we need it now” is the sense one gets in reading the bill.

#### **4. Clearly define liability.**

**Grade: 5**

The bill uses standard FTC processes for liability and provides for a “safe harbor” defense. It prevents state and local governments from imposing liability inconsistent with the federal bill. On the negative side, it permits direct suits by states and individuals—although the FTC is encouraged to intervene in that process. It would be far preferable to operate under a “fine” system rather than give license to litigate, especially in the inevitable class actions that these laws will foster. The allowance of private suits has such potential for expensive legal process that it substantially reduces an otherwise good grade.

#### **5. Provide for an automatic sunset review.**

**Grade: 0**

No provision.

### **DON'T:**

---

#### **6. Ignore the international consequences.**

**Grade: 0**

No mention. The bill regulates web sites that are in international commerce, but it is not clear whether someone in Bulgaria is protected by these rules, nor does the bill urge the FTC to consider the international

implications—especially the now-developing European Union rules on Internet privacy.

**7. Change the rules retroactively.** **Grade: 8**

Does not reach back, but neither does it instruct the FTC not to do so.

**8. Set up a new bureaucracy.** **Grade: 10**

Uses existing regulatory body (FTC).

**9. Uniquely punish e-commerce.** **Grade: 0**

The bill is silent on the effect of similar privacy intrusion in other competitive venues, nor does it include government activities like making available data on individuals without their permission.

**10. Stifle innovation.** **Grade: 5**

It is not the intention of the proposed law to stifle innovation, but, in reading it, the sense is that—to use a computerese term—the “default position” is that companies need to be controlled—and tightly. If regulation of privacy is only the first in a long list of steps to regulate the Internet requiring time-consuming procedures that far exceed benefits, then innovation will surely suffer. It would have been a positive step if the lawmakers had urged the agency not to “throw the baby out with the bath water” and had inserted somewhere a positive statement about the danger of stifling the Internet. The tone of the proposed law is control, control, control—a signal easily picked up by the regulators as congressional intent.

---

**TOTAL SCORE: 44 (F)**

Some improvement could easily be made, but it is doubtful that a high score could be achieved because of the antagonistic tone of the bill toward e-commerce and the negative regulatory signals it sends.

## S. 2928 (Consumer Internet Privacy Enhancement Act)

### **Bill Sponsor's Synopsis:**

A bill to protect the privacy of consumers who use the Internet.

**Sponsor:** Sen. John McCain (R-Ariz.) **Cosponsors:** Sen. Spencer Abraham (R-Mich.); Sen. Barbara Boxer (D-Calif.); Sen. John Kerry (D-Mass.)

### **DO:**

---

#### **1. Open the regulatory process. Grade: 10**

See 1 under H.R. 3321.

#### **2. Limit the regulators' scope. Grade: 10**

The list of things to be included in the FTC regulatory considerations is highly specific, but it also requires the FTC to engage the National Research Council (NRC) of the National Academy of Sciences to conduct an extensive evaluation of the problem and potential remedies before setting regulations—an excellent move.

#### **3. Use benefit-cost analysis. Grade: 10**

The NRC study is to include benefit-cost analysis of several aspects of the law's areas of interest.

#### **4. Clearly define liability. Grade: 8**

The bill is specific on fines (though high). It does allow individual states a cause of action rather than restricting action to fines by the FTC. But importantly, it does not permit private causes of action—a big plus since such class actions would inevitably lead to a trial lawyer's field day.

#### **5. Provide for an automatic sunset review. Grade: 0**

No sunset provision.

### **DON'T:**

---

#### **6. Ignore the international consequences. Grade: 0**

See 6 under H.R. 3321.

#### **7. Change the rules retroactively. Grade: 8**

See 7 under H.R. 3321.

#### **8. Set up a new bureaucracy. Grade: 10**

See 8 under H.R. 3321.

#### **9. Uniquely punish e-commerce. Grade: 9**

Specifically asks the NRC to “examine the differences, if any, between the collection and use of personal information by the online industry and the collection and use of personal information by other businesses.” However, it does not specifically encourage equity.

#### **10. Stifle innovation. Grade: 7**

The control tone is similar to 10 under H.R. 3321, but with a much “lighter touch.”

---

**TOTAL SCORE: 72 (C-)**

Passing, but without distinction. The intent—especially the use of the NRC—is so positive that the deficiencies could easily be remedied.

## S. 2606 (No Official Title Given)

### **Bill Sponsor's Synopsis:**

A bill to protect the privacy of American consumers.

**Sponsor:** Sen. Ernest Hollings (D-S.C.) **Cosponsors:** Sen. John Breaux (D-La.), Sen. Richard Bryan (D-Nev.), Sen. Robert Byrd (D-W.Va.), Sen. Max Cleland (D-Ga.), Sen. Richard Durbin (D-Ill.), Sen. John Edwards (D-N.C.), Sen. Russ Feingold (D-Wis.), Sen. Daniel Inouye (D-Hawaii), Sen. John Kerry (D-Mass.), Sen. John D. Rockefeller (D-W.Va.)

### **DO:**

---

**1. Open the regulatory process.** **Grade: 10**

FTC; see 1 under H.R. 3321.

**2. Limit the regulators' scope.** **Grade: 6**

See 2 under H.R. 3321.

**3. Use benefit-cost analysis.** **Grade: 0**

**4. Clearly define liability.** **Grade: 2**

The bill provides no safe harbor, does not encourage self-regulation, and encourages individual cause of action, including punitive damages—a potential disaster.

**5. Provide for an automatic sunset review.** **Grade: 0**

No sunset provision.

### **DON'T:**

---

**6. Ignore the international consequences.** **Grade: 0**

No international mention.

**7. Change the rules retroactively.** **Grade: 5**

Prevents use of prior data collected by the e-commerce company when it was legal to do so—"unless it is economically unfeasible...to comply..."

**8. Set up a new bureaucracy.** **Grade: 7**

Sets up a number of required reporting groups (example: the Office of Online Privacy at the FTC) that are well beyond existing roles—though it does not set up an entirely new regulatory group.

**9. Uniquely punish e-commerce.** **Grade: 10**

The bill reaches into areas competitive with e-commerce. While it does not incorporate government agencies into the privacy laws, it does state (uniquely among the three bills studied), "The Federal government should be a role model in securing its computer systems and should ensure the protection of private, personal information collected by Federal Agencies."

**10. Stifle innovation.** **Grade: 2**

The harsh tone throughout the bill virtually implies that e-commerce exists to violate consumer privacy. The signal to regulators is not to encourage this innovative commerce but rather to throttle it down.

---

**TOTAL SCORE: 42 (F)**

**Weidenbaum Center**  
**“Ten Rules for E-Commerce Regulation”**

<b>DO</b>	<b>H.R. 3321</b>	<b>S. 2928</b>	<b>S. 2606</b>
1. Open the regulatory process.	10	10	10
2. Limit the regulators' scope.	6	10	6
3. Use benefit-cost analysis.	0	10	0
4. Clearly define liability.	5	8	2
5. Provide for an automatic sunset review.	0	0	0
<hr/>			
<b>DON'T</b>			
6. Ignore the international consequences.	0	0	0
7. Change the rules retroactively.	8	8	5
8. Set up a new bureaucracy.	10	10	7
9. Uniquely punish e-commerce.	0	9	10
10. Stifle innovation.	5	7	2
<hr/>			
<b>TOTAL</b>	<b>44</b>	<b>72</b>	<b>42</b>
	<b>F</b>	<b>C-</b>	<b>F</b>





On January 1, 2001, the Center for the Study of American Business was renamed the Murray Weidenbaum Center on the Economy, Government, and Public Policy. The new name honors Murray Weidenbaum, the Center's founder and past director, and describes more precisely the Center's areas of research. The Weidenbaum Center retains the prior mailing address and telephone number: Weidenbaum Center, Washington University, Campus Box 1027, One Brookings Dr., St. Louis, MO 63130-4899, (314) 935-5630. The web site address is [wc.wustl.edu](http://wc.wustl.edu).

The Center continues to be a nonprofit, nonpartisan organization, funded entirely by grants from foundations, business firms, and private citizens. It is an integral unit of Washington University.

The opinions expressed herein are those of the author and do not necessarily reflect the position of the Center or Washington University.



Washington University in St. Louis