



White Paper

May 7, 1999

Self-Regulation: Regulatory Fad or Market Forces? by Solveig Singleton

- Regulation of electrical appliances and equipment through the Underwriters Laboratories.
- Green Seal, which develops standards for environmentally sound products.
- Certifications for kosher and halal food.
- Financial rating services, such as Dun & Bradstreet and Moody's.
- The MPAA motions picture ratings, the Comics Code, and the Recreational Software Advisory Council.

Some of these systems of self-regulation arrived in response to varying degrees of government pressure, including the MPAA ratings and proposals for self-regulation on privacy. The blacklisting of spammer Internet Service Providers by anti-spam groups like the Open Relay Blocking System and the MAPS Realtime Blackhole list, is a good example of purely private, market driven conduct. **Why Self-Regulation?** From the standpoint of legislators or regulators, self-regulation is less costly than traditional command and control regulation. First, it is less costly to the economy. Command and control rules are for obvious reasons unsuited to the rapid changes of technology in the innovation age.

- the impact of tighter controls on personal information on competition and small business;
- what innovative business models might be driven out of the market should government impose top-down privacy goals;
- the costs of enforcement, and the overall costs to consumers.

Cost-benefit analysis in the privacy context seems to be confined to repeated assertions on the part of the FTC that consumers will not develop trust in electronic commerce without privacy regulation. There is something odd about this picture, for electronic commerce is clearly exploding. Might it be that answers to consumer surveys are misleading in some way? (I take this question up again further below). **Judging Self-Regulation** Self-regulation with substantial government involvement is substantially different from a market process.

- True self-regulation tends to offer consumers a choice of competing third-party rating systems, as with kosher food labels.
- "Self-regulation" urged on the market by government imposes goals from the top-down; goals are assumed not to be evolving or diverse.
- "Self-regulation" may be uncertain and lawless, and may impose substantial regulatory costs with little or no benefit.

- Janet says she would prefer to buy T-shirts made in the U.S.A to save American jobs. But when shopping, she picks the \$15.00 shirt over the \$20.00 made in U.S.A. version every time.
- Thousands of executives say that they would like to spend more time with their families, but they never do, revealing their real preferences when faced with the tradeoff between career and family.
- A thousand consumers say they are concerned about privacy on the Internet, but flock to Amazon.com. Some of them find Amazon's tracking of their purchases unnerving, but not so much that they are willing to go to the local bookstore and pay cash instead.

- A million consumers say that they are annoyed by junk mail. But by "junk" they mean the catalogs they throw away--they don't think of the dry cleaning coupons as "junk," or the C.W. clothing catalog. They forget that they learned by perusing the Sak's Fifth Avenue catalog that it is too pricy for them, or how much they saved in time and gas by buying through mail order instead of going through the mall.

Talk is cheap. Surveys do not reveal customers' real attitudes nearly as well as actions. If concerns about privacy emerge in an ephemeral manner in response to a prompting from a survey, and are never acted upon, they are not worth transforming into regulatory goals. If, by contrast, concerns about privacy do affect consumer behavior, then they will emerge in the market with no need for regulation. **Games with Numbers** A second error in the debate about the state of privacy policies on the Internet has been the focus on absolute numbers of companies that have privacy policies--as opposed to the rate at which this number is increasing.

For example, the FTC's June 1998 survey of how many web sites posted privacy policies showed that 14% of a comprehensive sample posted privacy policies (around 70 percent of the 100 most popular sites did have such policies). But the important question is not whether 4 web sites have privacy policies, or 40, or 400. Assuming for a moment that most sites ought to have privacy policies--*the key question is how many web sites had such policies a year before? At what rate is the number of sites with such policies increasing?* If the rate of increase is substantial, there is clearly no need for regulation, even if today the absolute numbers of sites remains relatively low. Note that even if the rate of increase is low, or negative, does not make the case for regulation either; other key questions remain. **Some Final Thoughts** True systems of self-regulation are not enforced in a top-down manner. To state the blindingly obvious, these systems are voluntary. Companies opt to abide by the standards--or they do not. Some food companies might choose to qualify for a kosher food stamp shaped like the state of Texas, others will not. But generally, those who expect self-regulation to produce uniform enforcement across the electronic marketplace are not talking about self-regulation at all--they are talking about thinly masked government action.