White Paper

September 13, 1999

Multiple Levels of Policy: International, National, State --Or None of the Above? by Daniel T. Griswold and Solveig Singleton

---

This paper was prepared for The White House Workshop on Priorities for Federal Innovation Reform
September 13, 1999

In an age of international commerce, which governments should determine the rules of the game? Municipalities, states, national governments, and international bodies jostle for control over many areas, including

- taxation of electronic commerce;
- copyright and trademark issues;
- mergers and competition;
- genetically manipulated plants
- consumer protection.

Too many layers of regulation imposed by different jurisdictions create will stifle innovation around the world. Our understanding of this familiar problem at the state level is driving us rapidly towards federal and international regulatory regimes. But there are drawbacks to federal and international involvement as well. These are less familiar, but can be no less serious.

This paper outlines these problems and offers guidelines towards a long run solution. What is the best policy for an age when jurisdiction not just by every, but by *any* jurisdiction is very costly? Global markets will generate the greatest benefits for innovation when it is most free of regulation--at all levels.

Problems with Multiple Jurisdictions

This section outlines some of the familiar problems with regulation sponsored by multiple jurisdictions. The high-tech sector most obviously afflicted by these has been communications, which is regulated at the state and local level as well as the federal level. But there is no reason that any other innovative sector would be immune.

- Cost, in time and money, to businesses that must learn how any plans or developments will mesh with

the regulations of 50 different states or 200 different nations.
- Inconsistency of laws.
- Discrimination against "foreign" interests. A corporation based in Florida might not get a fair deal before a commission in Texas, in a conflict with a Texas corporation (this is purely hypothetical--there's no reason to think Texas would be any worse than any place else).
- Irrelevance. Does it make sense to tie those operating in the environment of the Internet, for example, to any particular geographic jurisdiction.
- Enforcement. With more global transactions, how could national laws be enforced as a practical matter?

What makes these problems more severe for high-tech? For many high-tech sectors--genetics, E-commerce, and so on, the problem is more acute simply because almost every single transaction raises the problem of "what the law?" and "which jurisdiction?"

In the communications sector, the problem is even more acute because there is so much regulation. There is everything from mandatory price averaging across regions under universal service, to price caps and other forms of interstate and intrastate price regulation—some "protecting" consumers, some "protecting" smaller carriers and resellers—to wireless service licensing, and state and federal reviews of mergers. And much of this regulation isn’t "law" at all, that is, "law" meaning rules set down in writing somewhere, knowable and certain, even if they are different from those in the next state. Much of telecommunications regulation is an endless series of decrees and Benthamite calculations of social utility, and the lobbying that comes with such a level of bureaucratic activism. The bother of dealing with lack of uniformity of law in ordinary commerce is multiplied a thousand-fold in a heavily regulated sector.

Current Trends: The Federal Approach.

As noted above, the problem of multiple jurisdictions is perhaps most familiar to us in communications, from networks to copyright law. The solution most familiar to us, therefore, has been the telecommunications approach--to increasingly move regulation to the federal level.

This has worked well in telecommunications--historically. But will it continue to work well? Will it work well for other innovative sectors?

In stepping in over the past several decades the Federal Communications Commission or Congress has preempted state or municipal laws and regulations--until the 1990s, with the positive result of deregulation overall. Because state regulation was preempted but not replaced with federal restrictions, the federal government became something of a hero of deregulation.

Because of this history, when state and local taxation of the Internet loomed, no one wanted to wait for the onslaught of local measures to become a reality. Congress stepped in as a prophylactic measure, imposing a moratorium on state and local taxation of the Internet. At least with communications, then, the "obvious" answer to the problem of multiple jurisdictions is, increasingly, to regulate at the federal level.

At the same time, however, the federal commitment to deregulation has lagged. From universal service to interconnection, market forces are subsumed to political goals, and micro-managed competition, not deregulation, is the order of the day.

It is, therefore, be time to ask whether more federal preemption is *necessarily* the answer to the problem of multiple jurisdictions across the high-tech sector. What are the drawbacks of the federal approach.

Drawbacks of the Federal Approach

- **Competition between jurisdictions has benefits often overlooked**. Competition among the 50 states in high-tech regulation offers companies and consumers more choices. Such competition would produce natural pressures towards minimal regulation and free markets, as it has with corporate law. This is sometimes called the "race to the bottom," but it doesn't deserve such a pejorative term. In ordinary commerce, the states' voluntary adoption of the Uniform Commercial Code shows that states, at least, will not be needlessly perverse in refusing to accommodate the needs of business for certainty and uniformity.

Regulation, even carefully crafted with the best of intentions, is expensive. It adds to the costs that companies bear and to the costs that consumers pay. The more regulation, the more costs. Whenever the benefits do not succeed the costs, companies and customers should be free to opt out by moving their operations to another place.

When a single federal regime is imposed from the top down, the range of choices becomes narrower. Opportunities for different states to experiment with new ideas are closed off. An importance source of pressure on bureaucracies to cut ineffective and wasteful rules is eliminated. What remains is the natural tendency of bureaucracies to expand their own mission. If a program fails to get the results we want, the logic of the regulator says, we must devote more resources to it--stricter rules, more enforcement, more funding. The idea that this might be doing more harm than good is lost entirely.

- **Policy Becomes Politics.** Under the federal spotlight inside the Beltway, policy issues become occasions for grandstanding and power politics. The debate over whether we need universal service subsidies, or how to fund them, for example--a serious problem--has been abandoned. Even the moderate policy supported by many economists--funding universal service out of general tax revenues and targeting them only to low-income users--is no longer under discussion for political reasons. Playing to the national press lowers the level of debate about these issues.

- **A single federal policymaker will become the focus of lobbying, and more liable to "capture."**

The fewer jurisdictions, the more power the remaining jurisdictions enjoy. As today in telecommunications, because more is at stake in federal regulatory battles than before, the harder companies will try to turn the agency's efforts to their own benefit. No company can rationally devote itself to arguing in favor of neutral rules that will provide the most opportunities for *everyone* in the long run. To take the long run view is to lose the regulatory battle in the short run. But this means that the FCC hears *nothing* but arguments about short-run benefits. It is no wonder that the FCC has abandoned the drive towards deregulation. A federal agency that hears frequent appeals for relief from state regulation will gain, not lose, institutional credibility by striking them down. But a federal agency that sponsors regulation itself may be reluctant to admit it has made a mistake.

- **Why stop with federal law?** For E-commerce or internationally traded goods like software, genetically modified foods, and so on, there are still too many national jurisdictions. From one standpoint, federal regulation doesn't go far enough.

Until recently, then, federal policymaking happened to work out for telecommunications. But it by no means should unquestionably be adopted for every new issue or technology. Competition between jurisdictions is very important.

Additional Drawbacks of the Internationalization

The logic that leads us to look to the federal government as a leader in high-tech policy issues leads inexorably towards regulation of telecommunications at the international level. If dozens of states are intolerable, why are dozens of nations any better? Businesses frustrated by conflicting national regimes have begun to increase pressure for internationalization. National governments irritated by the ease with high-tech escapes national regulations will be tempted to impose controls at an international level. Internationalization has all of the same problems of federalization, and many new problems of its own.

- **Internationalization pressures reflect, in part, a conflict of interest between government and citizens.** Much of the pressure for "harmonization" at the international level comes from business. But governments are driving the movement, too. It would be wonderful (for a governmental standpoint) if one need no longer fear business taking off for greener pastures in other nations. Competition between different national legal (and tax) regimes could be decreased as countries enact treaties for uniform law. This, in the long run, helps preserve the status quo, but it won't do anything for innovation.

- **International decision making is an undemocratic process.** International lawmaking is an obscure, elite process little understood by most ordinary people. Lobbying at the international level is expensive and often corrupt. It would not be desirable for resolution of key policy issues to be moved away from Congress into ITU, WIPO, or other bureaucratic bodies.

- **Global agreements, when reached, are likely to be hopeless vague.** It is inconceivable, for example--and very lucky--that most countries will ever agree about what content on the Internet should be censored. Holocaust revisionism is anathema in Germany, but constitutionally protected political speech in the United States. Sexually explicit speech is frowned upon in the United States, but much more acceptable in Denmark. Thus "harmonization" in many areas will be impossible--fortunately, instead, innovation markets will enjoy new freedom.

Vastly different societies will only reach consensus on a few basic rules--or, more alarmingly, *on meaningless sets of vague principles*. In some ways, this could be the worst of all possible worlds--a world of uniform baffling uncertainty, exploited by the most politically adept players to gain regulatory protection.

- **Global harmonization may turn the United States from leader to follower.** In some areas, such as telecommunications deregulation, the United States has been an international leader. Our economy is not plagued by the stifling bureaucracies or oppressive regimes that harm innovation in many other countries. Perhaps because of our success, other nations may resent U.S. attempts to take the lead in guiding the substance of a harmonized innovation policy. The United States' will have to compromise substantially to bring its laws into harmony with those of other nations. The result could be disastrous for our economy.

For example, the United States is now facing pressure from the European Union to impose something like Europe's regulatory privacy regime. Such a regime would make it harder for businesses to use information about consumers to develop new products, reach their first customers, and cut costs. Little or no attention has been paid as to how this would hurt consumers. Our best policy here is to support the U.S. tradition of freedom of information.

Avoid harmonization for its own sake. Harmonization is of some practical value, but it has costs, as well.

Suggested Policy Approaches

- **Welcome trade.** Expanding trade drives innovation. The dynamic impact of trade can be seen readily in places such as the Interstate 85 corridor that runs through Virginia, the Carolinas and Alabama. In the last five years, the region has lost an estimated 35,000 jobs in the apparel, furniture, and textile industries. But that is less than half the story. Today, according to a recent report in the Wall Street Journal, "the corridor is booming with semiconductor plants, pharmaceutical companies, auto-assembly operations and new steel mills that export to markets around the globe. In all, the corridor has added about 65,000 new manufacturing jobs despite the losses in textiles and furniture.

- **What about trade deficits?** By almost any measure, America's economy has performed better in years in which the trade deficit rose compared to years in which it shrank. During years of rising deficits, the growth of real gross domestic product averaged 3.2 percent per year, compared to 2.3 percent during years of shrinking deficits. If trade deficits really are a drag on growth, why does the economy grow so much faster when the trade deficit is getting bigger?

On the issue of jobs, the story is much the same. During those dark and troubling years of rising trade deficits, the unemployment rate has, on average fallen by 0.4 percentage points. During those bright and happy years of "improving" trade deficits, the unemployment rate has, on average, jumped 0.4 percentage points.

Without a trade deficit, Americans could not import the capital we need to finance our rising level of investment in plants and new equipment, including the latest computer technology. The strong dollar helps keep a lid on inflation while lower import prices raise the real wages of the vast majority of American workers.

- **The less law, the better.** In innovative markets, regulation by *any* jurisdiction imposes high costs. Regulators move too slowly, and they don't know better than entrepreneurs. This is yet another reason to begin to strip the existing regulatory regimes--local, state, federal, and international--down to a bare minimum. The fewer rules there are, the less it matters if some of them vary slightly from state to state or nation to nation.

In this deregulated world, what would protect consumers? Choice. Freedom of Information over the Internet. The amazing power of markets to deliver a better product at a lower price than any known system of distributing resources.