

## **Retail Rent-Seeking: Erecting Barriers to Freedom**

Prepared Statement by the Honorable Bob Hagedorn, State Senator, Colorado  
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*Possible Anticompetitive Efforts to Restrict Competition on the Internet*

### **Background**

I would like to thank the Federal Trade Commission for hosting this conference and for inviting me to speak. By way of background, I am the Chair of the Tax & Fiscal Policy Task Force at the American Legislative Exchange Council (ALEC). With over 2400 legislative members, ALEC is the largest, bipartisan, individual membership organization of state legislators. ALEC's mission is to advance the Jeffersonian principles of free markets, limited government, federalism and individual liberty among America's state legislators. I proud of the work ALEC has done, and continues to do, to protect the Internet from unnecessary and harmful regulation.

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How many times does it take for a person to say, "The Internet has forever changed the way we conduct business and communicate" before it becomes a cliché? What is so special about the Internet: The rapid exchange of information, the infinite supply of information, or its remarkable ease? While all of these attributes of the Internet are revolutionary, it is the freedom of choice that makes the Internet special.

The Internet provides an open and free market, able to rapidly respond to consumers' needs and desires. It is the great equalizer, enabling small businesses to compete with large. Its also the great consumer advocate, saving consumers' money, time, and hassle. Electronic commerce is the ultimate environment for trade. Yet despite all of the applause for the Internet, there are many people who stand in fear of this technical revolution. Rent seekers and regulators' are desperate to break the speed at which the Internet and all of its wonders are making life better for individuals in the global market place. What is it about this medium for commerce and communication that incites such a need to regulate?

### **Old v. New: Government's Hunger to Tax**

The "new economy" has developed a wonderful, and sometimes staggering, degree of inter-connectedness. It enables us to exchange goods, while increasing market power, at an astonishing pace. Its impact has been so revolutionary, it has often been coined the basis of the "new economy."

Despite all of its promise, the “new economy” faces daily struggles with “old economy” regulation. The process of fitting the “new economy” with the laws of the “old economy” can be like trying to fit a square peg in a round hole. Applying old economy regulations, such as sales and use tax administration, to new economy commerce is the largest barrier to consumer freedom that the Internet faces.

In the face of a rising e-commerce tide, states and localities find themselves with a tax structure that is based on the real world and not cyber-space. The problem between traditional, in person, sales and online shopping lies with use tax administration. The use tax is basically the equivalent of the sales tax, but is only due on those sales that occur across state borders. While consumers who buy Shaker furniture in Ohio and drive it to their homes in Illinois are suppose to remit use tax, the furniture maker is not. The furniture maker and other retailer are protected by the Supreme Court, which ruled that a state cannot force a business to collect use tax if the business is not located within the taxing state’s jurisdiction. Many states attempt to increase use tax compliance by providing a line on state income tax forms, but unless taxpayers recognize and acknowledge the line on their income tax return and honestly report (if they even remember) how much money they spent on out-of-state purchases, the state cannot collect the use tax in this manner.

If this all sounds terribly unfair, that’s because it is. Common sense tell us that states can only tax those activities that occur within their borders—the legal concept is known as *jurisdiction*.<sup>1</sup> If states were free to tax activities outside their borders, in an extra-jurisdictional manner, the very existence of the states would be threatened. In fact, the Interstate Commerce Clause of the Constitution was designed to prevent extra-jurisdictional taxation, providing for a “free-trade” agreement among the states.<sup>2</sup>

What does all this have to do with the Internet and the “new economy”? Big government advocates predict that on-line shopping will significantly erode the states’ sales tax base. Fiscal conservatives are getting in the act too, claiming the need to protect “Main Street” retailers from “unfair competition” over the Internet, since the former have to collect sales taxes and the latter do not. This unholy alliance between right and left now wants to petition Congress to allow them to force out of state vendors to collect sales and use tax under the auspices of the Streamlined Sales Tax Project (SSTP).<sup>3</sup> SSTP’s mission is to “develop measures to design, test and implement a sales and use tax system that radically simplifies sales and use taxes.”<sup>4</sup>

The SSTP movement is inherently flawed because it seeks to apply the “old” tax rules, designed for an early 20<sup>th</sup> century tax system, to the “new economy” of the 21<sup>st</sup> century. Such “old” rule application to e-commerce is one of the most serious threats to

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<sup>1</sup> Black’s law dictionary defines jurisdiction as “...the power of the court to decide a matter in controversy and presupposes the existence of a duly constituted court with control over the subject matter and the parties.”

<sup>2</sup> See U.S. Constitution, Article I § 8.

<sup>3</sup> SSTP would require Congressional approval since it would be an interstate compact.

<sup>4</sup> See Streamlined Sales Tax Project website (<http://www.geocities.com/streamlined2000/>).

the vitality of the rich medium of exchange and economic growth that the Internet provides.

### **The Spam and Privacy Sham**

Many people have a similar morning routine: they sip their coffee and delete the droves of unsolicited bulk email (spam) from their computer's in-box, the online version of junk mail. In truth, a lot of people really hate spam. However, not everyone deletes the same messages. Some keep sales announcements from their favorite retailer while others keep notices of community events. Despite the challenge to define what is bad spam, legislators have faced increasing pressure to address their constituents' crowded email boxes. Now, public policy leaders are beginning to tie online privacy with similar regulatory ropes as spam—constructing additional barriers to e-commerce.

Since the 2000 legislative cycle, spam legislation has swept the nation. Unfortunately, many pieces of legislation do not appropriately address the issues at hand. Rather, such legislation hurts electronic commerce with little benefit to consumers. Utah's spam law, enacted in May 2002, is just one example of reputable companies being brought to court.<sup>5</sup> Alternatively, Virginia passed spam legislation that constructively address spam and those who illegally infiltrate Internet service providers' (ISPs') systems and disseminate fraudulent email.<sup>6</sup> Unlike the Utah legislation, Virginia law protects e-commerce while allowing civil action against unlawful hacking and email practices.

Following a similar legislative pattern, harmful online privacy legislation has gained public policy attention. This spring, Minnesota was the first state to enact online privacy legislation.<sup>7</sup> California, Michigan, and Pennsylvania have also introduced legislation this year.<sup>8</sup> This type of legislation leaves industry and consumers in precarious positions, opening IPSs to massive class action lawsuits and inhibiting consumer choice from enriched goods and services. A more constructive approach has already taken root in commercial practices through market-based initiatives to ensure the safety of private information. Leave the market alone and e-commerce will prosper in direct relation to consumers' demands.

As is the case with so much political debate, the market can, should, and will take care of the growing concerns over unsolicited e-mail messages and privacy protections. In the case of spam, the market has responded to the public outcry. The Direct Marketing Association has issued guidelines for sending commercial email and businesses are already providing opt-in and opt-out choices for consumers.<sup>9</sup> ISPs curb fraudulent spam through their own "spam filters," blocking seemingly illegitimate bulk e-mail from their systems. Providing additional tools to block unwanted spam, the software industry has armed computer users with message filter programs, enabling users to filter their own messages.

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<sup>5</sup> Glasner, Joanna. *Sprint Calls Audible in Spam Suit*. Wired News. August 1, 2002.

<sup>6</sup> This legislation was the basis for ALEC's *Model Computer Protection Act*.

<sup>7</sup> MN 2001, SF 2908.

<sup>8</sup> CA 2001, AB 2297; MI 2002, HB 5774; PA 2002, SB 1409.

<sup>9</sup> Information is available on the

Industry has taken similar, self-led regulation measures, to protect consumer privacy. The Progress and Freedom Foundation has recently studied the privacy practices of commercial sites on the Internet. Its findings: The online market has responded favorably and swiftly to consumer concerns regarding the collection and use of personal information.<sup>10</sup> Among other privacy improvements, the study found that Web sites are collecting less information and privacy notices are more prevalent, prominent and complete.<sup>11</sup> Market forces have encouraged commercial Web sites to reduce the use of third party cookies, to track Internet surfing behavior, and third party sharing of information.<sup>12</sup> What this study demonstrates is that the market is responding to consumer concerns—without burdensome government regulation.

### **Rent-Seeking Regulation**

Regardless of the positive impact the Internet has on expanding markets to the consumers' benefit, industry specific rent-seekers have been urging for regulation to smother their online competitors. As the Federal Trade Commission has outlined, states such as Connecticut, North Carolina, Rhode Island, and Oklahoma are facing brick and mortar providers demanding that similar online services be prohibited.<sup>13</sup> Often these retail rent-seekers will claim that buying certain goods or services online leave the consumer at risk—claiming that the consumer will be unable to determine whether or not an online version is safe or practical. Protectionist policies such as banning online provisions of contact lenses, mortgages, or casket sales denies the opportunity for people to choose which goods and services best meet their needs. Policy makers should be hesitant to favorably consider discriminatory regulations that protect a market for one provider while simultaneously barring another.

### **Hurry Up and Do Nothing**

Despite taxation pleas, unwarranted privacy cries, and rent-seeking demands, policy leaders should not rush to regulate e-commerce. Public policy leaders should resist the trends to smother e-commerce through Internet taxation, excessive privacy and soliciting regulation, and other provider picking policies, and allow consumers and market forces to continue to shape the future of e-commerce. Please, hurry up and do nothing.

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<sup>10</sup> Adkinson, William,; etal. *Privacy Online: A Report on the Information Practices and Polices of Commercial Web Sites*. Progress & Freedom Foundation. Special Report March 2002.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Cruz, Ted. *Statement of the Federal Trade Commission Before the Subcommittee on Commerce, Trade, and Consumer Protection, Committee on Energy and Commerce, United States House of Representatives*. Washington, DC. September 26, 2002.