

**FTC Call for Public Comment on Competition and Consumer Protection in the 21<sup>st</sup> Century**  
**Rethinking Competition, Consumer Protection and Innovation at the**  
**Leading Edge of a Knowledge Revolution**

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**I. The FTC’s Remit Should Be Deemed to Cover Competition, Consumer Protection and Innovation**

When the FTC was established in 1914, few economists considered the role played by innovation in economic prosperity. As the level of interest among economists in the idea of innovation as a source of economic prosperity gradually increased over the course of the 20<sup>th</sup> century, the focus was on “research and development” departments inside companies or intellectual property as a legal regime creating incentives for innovation. It was only toward the end of the 20<sup>th</sup> century that the relationship between innovation and economic prosperity came to be widely studied in economics, public policy and law.

The FTC is the only US administrative agency with a mandate broad enough to cover the public interest in innovation. In recent years, the agency’s vision of promoting a “vibrant economy characterized by vigorous competition and consumer access to accurate information” and its demonstrated commitment to harnessing the “creative destruction” of innovation as an engine of economic prosperity, implies a commitment to innovation, even though this has not yet been explicitly acknowledged. When asked in 1970 why his opinions on certain issues in economics had changed over time, the economist Paul Samuelson replied, “Well when events change, I change my mind. What do you do?” By explicitly acknowledging that innovation as well as competition and consumer protection are within its remit, the FTC can increase the integrity and effectiveness of its enforcement and policy efforts in the information economy.

## II. From Industrial Revolution through Information Revolution to Knowledge Revolution

Since Congress enacted the original FTC Act in 1914 with a focus on “trust busting,” the scope of the FTC’s mandate has expanded to cover unfair and deceptive trade practices and a wide range of other harmful behaviors that economically disenfranchise American citizens. The most recent wave of technological innovations has the potential to empower Americans by giving them access to new problem solving tools. If the FTC explicitly acknowledges innovation as within the scope of its mandate, it can work to ensure that those innovations fulfill that potential.

Just as the Industrial Revolution transformed the world in the 19<sup>th</sup> century, and the Information Revolution transformed the world in the 20<sup>th</sup> century, a Knowledge Revolution is transforming the world in the 21<sup>st</sup> century.

During the Industrial Revolution, the successful commercialization of many new “general purpose technologies” exponentially increased productivity of industry. These GPTs included steam and internal combustion engines, new institutional arrangements for production such as the modern factory, and new products that improved the quality of human life such as electric lighting.

Starting in the mid-20<sup>th</sup> century, an “Information Revolution” resulted in the successful commercialization of new information and communications technologies (ICTs or IT) that exponentially increased the effectiveness of administrative processes as well as industrial production.

At the beginning of the 21<sup>st</sup> century, new GPTs are transforming decision-making itself through human-computer symbiosis, producing a “Knowledge Revolution” that blurs industrial economy distinctions between information and products, processes and products, and markets and products. This Knowledge Revolution increases Americans’ capacity for economic self-determination by increasing the transparency, accountability and inclusiveness of economic activity. When Americans can freely choose among the tools for making better decisions now being forged in the crucible of the Knowledge Revolution, then they can act as the architects of their own economic destiny.

But just as “excessive” competition can diminish rather than increase consumer welfare, so too “excessive” or “unproductive” innovation may diminish rather than increase the scope of Americans’ capacity for economic self-determination. By acknowledging explicitly that management of the tradeoffs among competition, consumer protection and innovation is at the core of the agency’s mission, an approach that has been successfully adopted by the new UK Payment System Regulator, the FTC could reduce the risk that its interventions in the economy would inadvertently block constructive innovation or fuel wasteful innovation.

In an article on “Architectural Innovation” published in *Administrative Science Quarterly* in 1990, Harvard Business School professors Rebecca Henderson and Kim Clark highlighted several different tradeoffs that emerged at the intersection of technological innovation and business strategy. These tradeoffs are now often presented in an “innovation matrix”:

Innovation Matrix		Context	
		Well Defined Context	Context Not Well Defined
<b>Problem</b>	<b>Well Defined Problem</b>	Sustaining Innovation	Breakthrough Innovation:
<b>Definition</b>	<b>Problem Not Well Defined</b>	Disruptive Innovation	Basic Research

Government funding is often used to finance basic research that increases scientific knowledge as a public good. Such efforts to sustain innovation are an entirely appropriate role for government. Such a role is compatible with the idea that the FTC’s mission covers more than competition and consumer protection. Breakthrough and disruptive innovation shift institutional boundaries. A narrow interpretation of the FTC’s mission risks stifling the kind of breakthrough and disruptive innovation that contributed to the rise of the United States as the leader of the global information economy.

**III. Self-Regulation as a Complement to Government Regulation**

As noted above, there is no reference to self-regulation among the eleven issues listed in the FTC’s call for public comments. But to insure that breakthrough and disruptive innovation serve American democracy and economic prosperity simultaneously, the FTC must explicitly incorporate the unique American aptitude for self-regulation into its enforcement and policy efforts.

In Democracy in America, Alexis de Tocqueville noted:

“Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. ...

Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.

I have often admired the extreme skill with which the inhabitants of the United States succeed in proposing a common object for the exertions of a great many men and in inducing them voluntarily to pursue it.”

In his book, OPEN STANDARDS AND THE DIGITAL AGE, economic historian Andrew Russell highlighted the importance of voluntary, consensus standard setting processes as a uniquely American form of industrial democracy with roots extending back to the 19<sup>th</sup> century. The revision of American antitrust laws in the 1980s expanded the range of permissible forms of collaboration among competitors to include the activities informal standard-setting consortia as well ANSI-accredited standard setting bodies devolved more regulatory authority to the American private sector and contributed to America’s rise to its current position as leader of the global information economy.

In the context of a Knowledge Revolution, no government agency can ever be prescient or nimble enough to articulate standards of conduct in sufficient detail to police the full range of private sector activities effectively. The FTC has tacitly acknowledged this for decades by incorporating the use of voluntary

industry codes of conduct and independent third-party assessment of compliance into its privacy protection strategies. The FTC use of voluntary codes of conduct to regulate Internet commerce echoes much older, very successful forms of voluntary private self-regulation in America such as that provided by the Better Business Bureau and industry self-certification schemes. The focus of the FTC should now be on improving the quality of such private industry self-regulatory efforts, not abandoning them in favor of direct government regulation.

Creating an environment within which evidence-based problem solving (also known as continuous improvement or design thinking) can flourish in both public and private sectors is the key to safeguarding America's position as the leader of the global information economy. The use of top-down command and control regulation often adopted by European regulators or the Consumer Financial Protection Bureau creates barriers to the use of evidence-based problem solving. Only forms of co-regulation that combine oversight by government regulators with private sector agenda-setting, norm creation and compliance monitoring are flexible and dynamic enough to protect the public interest in the use of evidence-based problem solving to address the regulatory challenges thrown up by the Knowledge Revolution.

Based on her study of self-sustaining self-regulatory institutions in traditional societies, Nobel Laureate Elinor Ostrom articulated eight principles for the design of effective private governance institutions:

1. Define clear group boundaries.
2. Match rules governing use of common goods to local needs and conditions.
3. Ensure that those affected by the rules can participate in modifying the rules.
4. Make sure the rule making rights of community members are respected by outside authorities.
5. Develop a system, implemented by community members, for monitoring members' behavior.
6. Use graduated sanctions for rule violators.
7. Provide accessible, low-cost means for dispute resolution.
8. Build responsibility for governing the common resource in nested tiers from the lowest level up to the entire interconnected system.<sup>1</sup>

The FTC could improve its management of the tradeoffs among competition, consumer protection and innovation, by incorporating Ostrom's design principles into its efforts to distinguish between legitimate and illegitimate uses of private self-regulation in economic arenas characterized by breakthrough and disruptive innovation.

#### **IV. The Emerging Geopolitics of Innovation**

The capacity of American private enterprise to build consensus among a wide range of stakeholders and establish legitimate, sustainable mechanisms of self-regulation, is a major source of competitive advantage for the United States in our competition with Europe and China to lead the global information economy. By explicitly acknowledging that the agency has the responsibility to manage tradeoffs among competition, consumer protection and innovation, the FTC can insure that the unique American aptitude for constructing new forms of global governance serves the American public as a whole at the same time it safeguards America's current position as leader of the global information economy.

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<sup>1</sup> Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (1990), p. 90

In the face of changing market conditions, the default regulatory competition strategy in the United States is to let the private sector lead. Legal historian Willard Hurst described the American proclivity to let the private sector take the lead in regulating the economy as making possible a “release of energy” in 19<sup>th</sup> century America. Legal historian Morton Horwitz characterized the American tendency to relax legal constraints to accommodate the transform of economic institutions before imposing direct government controls as an indirect subsidy for innovation. The same regulatory approach to entrepreneurship and risk in the 21<sup>st</sup> century have helped to consolidate America’s current position as the leader of the global information economy.

In the face of changing market conditions, the default regulatory competition strategy in the European Union is to try to strengthen the Single Market by increasing direct government control over economic activity thereby locking in anachronistic institutional responses to breakthrough and disruptive innovation. In the Lisbon Strategy announced in 2000, the EU proclaimed its intention to become “the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.” Such strategies have not been successful in challenging American dominance of global innovation markets. Far from subsidizing innovation, the EU taxes it with regulatory strategies based on the Precautionary Principle, not Hurst’s “release of energy” principle.

A greater challenge to American leadership of the global information economy may come from China. In the decade since the Global Financial Crisis erupted in 2008, China has gradually abandoned the strategy it adopted when it committed to “Reform and Opening” in 1978 of “cultivating its abilities while biding its time.” China has signaled its intention to challenge American leadership in the international trade community with its Belt and Road Initiative, its Digital Silk Road Initiative, its Made in China 2025 initiative, its New Generation AI Development Plan, and its plans to build a mass surveillance system of unprecedented scope known as the “social credit system.” If China can execute successfully even a small fraction of these new initiatives, Western nations will soon find themselves confronting new Knowledge Revolution institutions and processes designed to strengthen authoritarian rule rather than liberal democratic rule.

## **V. Consolidate the FTC’s Position at the Leading Edge of Global Market Regulators**

In order to consolidate its position at the leading edge of global market regulators, the FTC must distill its recent successes in enforcement and policy making into models that can be widely replicated inside the United States and around the world.

### **A. The Enforcement as Precedent Model of Information Governance**

To encourage that private sector information governance practices evolve in a manner compatible with innovation, competition and consumer welfare, the FTC has created a new model of “smart regulation” that should be recognized as a global best practice by privacy and consumer protection regulators throughout the United States and around the world.

- The Microsoft Passport consent decree in 2002 was the first instance of an FTC enforcement action in which all the elements of the new model of smart regulation.

- Since 2002, the FTC has successfully brought and publicized the results of hundreds of enforcement actions related to information governance.

The elements of this new model include:

- Establishing risk-based governance systems as the default for both public and private information governance processes by:
  - Using risk-based assessment to guide the use agency enforcement resources
  - Mandating risk-based compliance as the core of remediation strategies in enforcement actions
- Fostering responsible innovation by:
  - Encouraging the integration of risk-based compliance efforts with continuous improvement governance practices
  - Incorporating independent third party oversight of risk-based remediation efforts
- Building a system of “de facto” precedent to guide the evolution of risk-based compliance efforts in dynamic markets
  - Disseminating information about both the nature of the violation well as the corrective and preventive action being taken to correct the violation
  - Adapting enforcement standards in light of current challenges and best practices in information governance
- Fostering public-private co-regulation collaboration by allowing emerging industry standards to help clarify how a broad, ambiguous statutory standard applies in particular contexts
  - Using policy statements and de facto enforcement precedent to structure enforcement strategy within a sweeping statutory mandate to police “unfair and deceptive trade practices”

This new model of “smart regulation” in the field of information governance is an innovation in administrative law that has the potential to have the same far-reaching impact as notice-and-comment informal rulemaking procedure did was when it was enshrined in the Administrative Procedure Act of 1946.

- As one of the leading architects of this new model of “smart regulation,” the FTC should distill its essential elements into a formal model and communicate clearly the benefits of this new model to all interested public and private sector parties within the United States and around the world.
- Because this new “smart” information governance model can help increase the global competitiveness of American enterprise and strengthen individual privacy protections simultaneously, the US should embrace it as a global regulatory competition strategy to counter both the top-down, bureaucratic approaches to data protection embodied in the GDPR and the ubiquitous surveillance approach to information governance emerging in China.

This new model of “smart” public sector oversight of private sector information governance is simultaneously more effective and more legitimate than the model of inefficient bureaucratic model of information privacy that currently dominates public debate in the United States and around the world.

- Top-down, command-and-control, check-box mandates are a regulatory tax imposed on the privacy sector that choke off innovation, reduce the productivity of business and produce symbolic rather than actual compliance.
- The “co-regulatory” approach taken by the FTC, fosters the development of a dynamic public-private partnership that can permit private sector compliance strategies to adapt quickly and effectively response to technological innovation and changing market conditions while continuing to increase effective compliance rates.

#### **B. Separate Platforms and Governance: *Nemo iudex in causa sua***

A fundamental principle of the rule of law is that no person should be judge in their own case. The current practice of allowing digital platforms to operate simultaneously as private governance mechanisms and as producers with the markets they create violates this principle. The solution is not to transfer governance of platforms from the private sector to the public sector, but to foster the development of responsible industry self-regulatory mechanisms that encourage platform owners to include other stakeholders in their decision-making processes, while operating under FTC oversight.

The practice of separating the commercial activities of platforms from their private governance functions was first described by political scientist Lester Salamon in a study of the successful “stakeholder governance” model practiced by the National Automated Clearing House Association. It was imposed by EU regulators on credit card networks in Europe as part of the EU’s multi-pronged effort to change the business models of card networks operating in Europe. It is consistent with the practice of ANSI-accredited standard setting organization and successful standard setting consortia such as the Open Compute Project organized by Facebook.