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before the

Federal Trade Commission

Workshop on
"Possible Anticompetitive Efforts to Restrict Competition on the Internet"

October 8, 2002

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I am pleased to submit comments to the Federal Trade Commission on the issue of how middlemen are erecting legal and regulatory barriers to e-commerce. I am Rob Atkinson, Vice President and Director of the Technology and New Economy Project of the Progressive Policy Institute. PPI is a think tank whose mission is to define and promote a new progressive politics for America in the 21st century. For several years, PPI has been keenly interested in promoting public policies to foster e-commerce, since we see it as a major driver of economic growth. However, we see the growth of laws and regulations that protect incumbent bricks-and-mortar companies from e-commerce competitors as a major threat to the growth of e-commerce.

E-commerce can bring dramatic savings to consumers. Selling homes on the Internet can reduce agent commissions by half. Buying a car directly from the manufacturer is estimated to lead to savings of thousands of dollars. Selling corporate and municipal bonds directly over the Internet can eliminate most of the 2 percent to 5 percent commission charged by middlemen. Drawing up a will online can be 75 percent cheaper than using a lawyer. As Americans realize they can save money by buying everything from books and CDs to contact lenses and airline tickets over the Internet, e-commerce grows. The Census Bureau reports that in the second quarter of 2002 e-commerce retail sales grew 10 times faster than all retail sales.

The Middlemen Fight Back

Not everyone benefits from the lower prices, expanded consumer choice, and enhanced convenience enabled by e-commerce. In "*The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting American Consumers,* PPI documented how a host of brick-and-mortar retailers, distributors, brokers, and agents—including wine and beer wholesalers, auto dealers, music stores, travel agents, pharmacies, mortgage brokers, real estate agents, auctioneers, lawyers, radiologists, and even college professors—are fighting against e-commerce competitors.

But rather than competing fairly in the market by providing lower costs or better service, these middlemen are seeking the aid of government or colluding among themselves to stifle on-line competitors. These battles are played out at different levels and branches of government. In some cases, companies seek federal action -- pressure by Congress, anti-trust enforcement, and regulatory and procurement decisions – to protect them from e-commerce competition. For example:

- The National Customs Brokers and Forwarders of America have fought against a proposal by the federal government to create an International Trade Data System to electronically collect trade related information.

- On anti-trust grounds, the travel agents and their trade associations have lobbied Congress and the administration to shut down Orbitz, the online travel site.

Because many industries are regulated at the state level, many battles are playing themselves out in states. In the old economy, where the buyer and seller met face-to-face in the same state, states were the logical nexus for applying industry-specific consumer protection laws. However, many of these laws and regulations now unintentionally hinder e-commerce. In other cases, middlemen have been able to convince state legislators and regulators that new protections were needed. In all cases, the simple fact that national e-commerce businesses are subject to 50 different state laws can raise their costs of doing business significantly. For example:

- Representatives of Colorado's bricks-and-mortar pharmacies lobbied for legislation to make it illegal for pharmacy benefit manager programs to impose lower co-pays for drugs purchased from through mail order and the Internet.

- In Maine, optometrists lobbied for a prohibition against releasing prescriptions to their patients, to prevent consumers from ordering contact lenses online.

- Texas, at the behest of car dealers and their trade groups, stopped Ford Motor Co. from marketing used cars on the web, despite significant savings to consumers.

- Seventeen states require companies brokering a mortgage to hire residents of the state and maintain a physical office there.

States differ widely on the extent to which their laws and regulations hinder e-commerce. In PPI's report, *The Best States for E-Commerce*, we ranked the states on 11 factors, including eight directly related to middleman resistance. The least restrictive states were Oregon, Utah, Indiana, and Louisiana. The most restrictive were South Carolina, New Mexico, Alabama, and somewhat surprisingly, California. But no state had a perfect record; all had at least one law or regulation that imposed barriers to e-commerce and consumer choice.

Finally, these threatened middlemen don't always rely on government to stymie their competitors; they rely on hardball commercial practices. One of the main reasons many manufacturers have been slow to sell their products over the Web, particularly at a lower price, is their fear of retaliation from the retailers they depend on for sales of their products.[1] In a survey of 50 consumer-goods manufacturers by Forrester Research, 66 percent indicated that conflict with retail channels was the biggest issue they faced in their online sales strategies.[2] PPI found that producers in many industries, including autos, perfume, clothing, golf equipment,[3] shoes,[4] makeup,[5] and bicycles[6] have all delayed or scrapped plans to sell online due to fear of such retailer retaliation. While individual companies can legally choose what companies' products they want to distribute, they cannot collude in this process. However, in some case, including contact lens and autos, the government has been able to prove collusion.

Overall all these kinds of restrictions are costly. PPI estimated conservatively that American consumers annually pay a minimum of $15 billion more for goods and services as a result of such e-commerce protectionism by middlemen.[7]

Consumer Protection or Producer Protectionism?

To listen to middlemen one might believe that without these laws consumers would be subject to the worst kinds of abuses. Wine wholesalers and retailers say that laws prohibiting wine sales on the Internet are needed to protect state tax revenues and limit underage drinking. Travel agents claim that they "act as the public's representatives and help keep prices low," while providing the buying public with choice.[8] Car dealers claim that cars are so complex that dealers are needed to protect the consumer.[9] Optometrists argue that buying contact lens' online will lead to eye damage.

The reality is that states can design regulatory regimes that protect consumers without squashing competition. States that allow direct purchases over the Internet require that wine or beer shipments use a carrier that requires proof of age upon delivery. States can require that patients present a valid prescription order to obtain a prescription from an online pharmacy, and can pass reciprocity laws giving consumers legal recourse to file suit against out of state doctors.

In many cases, the claims of consumer risk are just a smokescreen for protectionism. For example, as the suit by 33 state attorneys general against the American Optometrist Association states, "The industry has hidden behind claims of health concerns requiring that individuals get their contact lenses from certain professionals, but there is no scientific basis to that claim," since the lenses sold online are identical to those sold in the optometrist's office.[10] Travel agents' argument that they provide consumers with more choice and unbiased fare selection than online services is simply not true. The fact that consumer groups have opposed many of these protectionist practices, including auto dealer franchise and contact lens restrictions, suggests that these laws and regulations are designed to protect producers, not consumers.

If industries' claims of protecting consumers are a smoke-screen, what is their real motivation? It's much simpler: they seek to limit competition. For example, praising a decision by the state of Texas to prohibit Internet car sales by anyone other than car dealers, one Texas car dealer was quoted, in a moment of unusual forthrightness, as saying, "... I hope they [Internet car dealers] never take over."[11] The head of the Texas car dealers' association, in explaining his support of the restrictive franchise laws, stated that the association would always be about "the property rights of its members. Don't expect us to change that." We shouldn't expect these groups to change. But we also shouldn't expect policymakers or the judiciary to protect the narrow interests of a select few in business over the broader interests of American consumers.

Should federal government play a role?

Some may argue that the state level laws are the business of states, and that the federal government should not interfere. In my view, this is a misleading interpretation of the notion of states' rights. The framers of the Constitution respected the rights of states to govern internal activities, but made it clear that they could not restrict interstate commerce. James Madison wrote, "Such a use of the power by Cong (sic) accords with the intention and expectation of the States in transferring the power over trade from themselves to the Govt. (sic) of the U. S." [12] Federalism for the New Economy is not a paean to unlimited state freedoms. Rather, it requires a new bargain between Washington and states: on the one hand giving states more flexibility and accountability in many areas, as the Leave No Child Behind Act did; and on the other, developing national e-commerce governing frameworks in areas such as digital signatures, privacy, SPAM, do-not call lists, or in this case, e-commerce protectionism. Federal action to encourage competitive state laws, or even preempt state laws that restrain trade, is required to create a vibrant cross-border e-commerce marketplace.

What Should the Federal Trade Commission Do?

As the lead federal agency charged with protecting consumer interests, the FTC is uniquely positioned to play a lead role in making sure that laws protect consumers, not middlemen producers.

The most important role the FTC can play is to help shed light on these protectionist practices. Workshops like this one help raise awareness among policy makers and the public about the existence of these practices and their costs. In addition, your recent efforts to weigh in on these debates at the state level or in courts can play an important in adding a voice on behalf of consumers. I strongly encourage you to continue and expand your support your efforts in this area. In addition, as it becomes more widely known that these are the kinds of issues that the FTC is actively involved in, I would expect that the public and e-commerce companies will bring more cases to your attention.

Secondly, through it's competition bureau, the FTC can play a key role in ensuring that middlemen do not collude to stifle e-commerce competition. Your case against a group of 25 Chrysler dealers in the Northwest who established the Fair Allocation System is the model here. While it's difficult to prove collusion among "retaliating retailers" it's important for the FTC to work aggressively to find and prosecute such collusion when it does occur.

Third, there are areas where the FTC can set a national standard for consumer protection, it should. For example, I would encourage you to consider doing for contact lens what you did in 1979 for eyeglasses: simply say that prescriptions for contact lenses must be given to consumers, who can then choose where they want the prescription filled.

Conclusion

These are not just about intra-industry fights for competitive advantage; rather, they go to the heart of consumer welfare as protectionists in many industries limit consumer choice and keep more efficient competitors from the market. In a free market economy, consumers, not vested interests colluding and using the political process to impede competition, should decide how commerce is structured.

Endnotes:

1. Many producers who have begun to sell over the Web promise not to cut prices so as not to anger retailers. This not only hurts consumers, but limits the growth of this more efficient mode of distributing products and services.

2. Alorie Gilbert and Beth Bacheldor, "The Big Squeeze," *Information Week Online*, March 27, 2000, http://www.informationweek.com/779/channel.htm.

3. http://www.golfonline.com/news/golfweek/1999/October/internet1030.html.

4. http://www.bizjournals.com/milwaukee/stories/2000/02/28/story3.html.

5. "Ding, Dong, Web Calling," *Business 2.Com*, November 28, 2000, p. 72.

6. http://www.airborne.net/eready/janette/news.asp.

7 Robert D. Atkinson, *Revenge of the Disintermediated*, Progressive Policy Institute, January 2001 at http://www.ppionline.org.

8. Elizabeth Wasserman, "Stuck in the Middle," *Industry Standard* (March 6, 2000). Wasserman quotes Paul Ruden.

9. David Hyatt, "Franchise Laws in the Age of the Internet," White Paper, National Automobile Dealers Association, McLean, VA, January, 2001.

10. State of California, et al against The American Optometric Association, et, al, in United States District Court, Eastern District of New York, January 17, 1997.

11. Robert Elder and Jonathan Weil, "To Sell Cars in Texas, Online Firms Are Forced to Enter the Real World," *The Wall Street Journal*, January 26, 2000, *Texas Journal*, p. T1.

12 James Madison to Joseph C. Cabell, 18 Sept. 1828. http://press-pubs.uchicago.edu/founders/documents/a1_8_3_commerces18.html