

Three Regulatory Principles to Promote Innovation
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Thank you to the Progressive Policy Institute for inviting me today. I value PPI's policy voice because you focus on generating innovative

our preconceived models. As Nassim Taleb points out in “The Bed of Procrustes,” his book of aphorisms, we often use this backward fitting approach without recognizing what we are doing. Even worse, sometimes we are oddly proud of our cleverness in reducing something complicated to something simple.

Needless to say, as regulators we should not force complex phenomena into simple boxes, let alone be proud of doing so. The lesson of Procrustes for regulators and policy makers is that we should resist the urge to simplify, make every effort to tolerate complexity, and develop institutions that are robust in the face of complex and rapidly changing phenomena.

There are many ways to apply the lesson of Procrustes, but today I’ll focus on three principles I try to apply to regulation: First, approach issues with regulatory humility recognizing the fundamental limits of regulation. Second, prioritize action to resolve areas of reook of

you may remember the early widespread skepticism directed toward online shopping. Today, let me just ask: how many of you bought something online this month? Early skepticism does not predict potential consumer harm. Conversely, as the failures of thousands of dotcoms show,

distributed throughout the industry, what Hayek calls “the dispersed bits of incomplete and frequently contradictory knowledge.”

Second, in most cases, critical information lies ~~in~~ in the minds of the individuals or in the institutional structures of the industry involved. That is, even those directly involved in the industry itself cannot themselves fully explain how things get done. James C. Scott, in his book

Principle 2: Focus on Identifying and Addressing Real Consumer Harm

My second principle, and a key way to practice regulatory humility, is to focus on identifying and addressing real consumer harm. As noted in the FTC at 100 Report, “[T]he improvement of consumer welfare is the proper objective of the agency’s competition and consumer protection work.”⁸ The most effective way to improve consumer welfare under the FTC’s mandate is to find and address the most severe consumer harms.

At the FTC, this focus is part of our statute. Congress charged us in Section 5 of the FTC Act with preventing deceptive or unfair acts and practices. Deceptive acts violate Section 5 only if they are material – that is, if they actually harm consumers. And practices are only unfair if there is a substantial harm that consumer cannot avoid and that outweighs any benefits to consumers or competition. In both cases, the law concerns itself with addressing actual consumer harms. Likewise the FTC carefully evaluates consumer welfare (or, its corollary, consumer harm) when it exercises its antitrust authority.

Not only does the law require the FTC to focus on consumer harm, such a focus is also good policy. Agencies have limited resources. We should generally spend those resources to stop existing or extremely likely harms, rather than trying to prevent speculative or insubstantial harms.

When we analyze harms and benefits, both in our enforcement efforts and in policy making more generally, we ought to follow the advice of Frederic Bastiat. In 1850, in a famous essay titled “That Which is Seen, and That Which is Not Seen,” Bastiat argued that he could tell

⁸ William E. Kovacic, THE FEDERAL TRADE COMMISSION AT 100: INTO OUR 2ND CENTURY, THE C

the difference between a good and a bad economist based on single methodological habit.
bad economist, he said, judges a policy or action based only on the “seen,” first order effects of

Internet. The FTC staff recently issued a staff report on this topic, with some recommendations. I agreed with some of the recommendations but dissented from others, with the difference essentially coming down to the presence of, or lack of, real consumer harm.

For example, the report prioritized as a primary concern the need for security of IoT technology and the personal data it collects and thus reiterated the Commission's recent unanimous and bipartisan call for general data security and breach notification legislation. I supported this recommendation because of the demonstrated harms to consumers from a lack of security. Some IoT devices have already experienced data security failures that have harmed consumers. Raising awareness of security issues, and adopting a precise standard for data security and a consistent data breach notification standard, could help secure consumer devices thereby benefiting consumers.

On the other hand, the IoT report also supports the practice of "data minimization." Without examining costs or benefits, the report encourages companies to delete valuable data that could have many unanticipated beneficial uses. The report proposes this practice out of concern over largely hypothetical future harms. This recommendation embodies what scholar Adam Thierer has called the "precautionary principle." It preemptively cuts off innovation, rather than focusing on real consumer harms. I therefore dissented from that recommendation in the staff report.

Principle 3: Use Appropriate Tools

To recap: Principle One regulatory humility. Principle Two: Focus on identifying and addressing real consumer harm. My final principle is this: use appropriate tools. The tools an

¹¹ Adam Thierer, Problems with Precautionary Principle-Minded Tech Regulation & a Federal Robotics Commission (Sept. 22, 2014), available at <http://techliberation.com/2014/09/22/problems-with-precautionary-principle-minded-tech-regulation-a-federal-robotics-commission/>

agency uses can make a large difference in the agency's effectiveness. For fast changing

Perhaps somewhat paradoxically, incremental approaches are particularly well-suited to dealing with fast-developing areas of technology. Small distortions in such fast-moving industries can quickly divert the industry from its previous trajectory. A case-by-case approach allows the regulatory body to address bad actors without derailing an entire industry, and it enables the law to evolve alongside the technology in a much more organic fashion.

Another nimble, transparent and incremental tool that is well-suited to regulation in fast-changing industries is industry self-regulation, with agency enforcement as a backstop. Compared to traditional government regulation, self-regulation has the potential to be more prompt, flexible, and responsive when business models or technologies change rapidly.

In contrast, the FTC recently settled a case with TracFone for practices that raise many of the same “net neutrality” concerns. TracFone offered its customers certain plans with unlimited