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Regulating the Digital Economy

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ABSTRACT

This Special Report highlights and builds on key themes from a panel discussion on "Regulating the Digital Economy", hosted by the Observer Research Foundation and Google in New Delhi on 2 November 2015. The first part analyses the different models for regulating the internet landscape, and the second part highlights the role and strategy of lawmaking in strengthening the digital economy. The paper also examines the need for evidence-based, *ex post facto* regulation as opposed to prophylactic regulation which are neither based on empirical markers nor carry any guarantee of success.

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I. INTRODUCTION

The term 'digital economy' was coined in 1995, during the early days of electronic commerce, by technology analyst Don Tapscott. In his book, 'Digital Economy: Promise and Peril in the Age of Networked Intelligence', Tapscott predicted how the internet would drastically change the way business was done and create an economy built on networks. The accuracy of this prediction is evidenced by the fact that the internet economy of just the G-20 countries is expected to reach US$4.2 trillion in 2016. The magnitude and pace of such growth has changed the face of internet and created an impact which no business, industry or government can afford to ignore. This fast-changing nature has brought with it specific challenges for governments in determining its role in relation to the industry.

The Indian government has also been grappling with similar issues over the last few years. According to the Internet and Mobile Association of India (IAMAI), India had 278 million internet users as of October 2014. Despite mobile phones being the primary contact for internet access in the country, only three in one hundred Indians use smartphones. This means a significant part of the population is still to play a role in the growth of the digital economy. Thus, internet regulation also has the responsibility of ensuring and increasing access to the internet and promoting it as a basic human right. A startup economy based on the government's 'Digital India' initiative must balance the twin concerns of market competition and greater internet access.

The regulatory vacuum in which disruptive and "permissionless" innovations are thriving on the internet is also creating concerns for the Indian government. Uber and Ola are two such examples where advances in smartphone technology have disrupted the entire taxi service industry, rendering their regulatory model perfunctory. How can regulators—faced with fast-paced innovation—reimagine new rules for the future? Further, how can governments ensure that the values of privacy, fair competition, and equality are not compromised in the digital economy? This report highlights and builds on key themes from a panel discussion on "Regulating the Digital Economy", hosted by the Observer Research Foundation in partnership with Google in New Delhi on 2 November 2015. The first part analyses the different models for regulating the internet landscape and the second part highlights the role and strategy of lawmaking in strengthening the digital economy. The paper also examines the need for evidence-based, *ex post facto* regulation as opposed to prophylactic regulation which are not based on empirical markers and have no guarantee of success.

II. CHOOSING THE MODE OF INTERNET REGULATION

Internet regulation models vary in different parts of world, influenced as they are by the constitutional and political framework present in each country. The United States, for example, has a strong foundation in free speech set by the First Amendment to the Constitution and therefore regulatory interference online is minimal. On the other hand, the European experience is centred on treating the internet as a public utility and therefore regulated in public interest by the government. In the Indian context, there is no comprehensive regime for the

regulation of the digital economy. However, the Indian government has stressed on the need to develop internet regulation, which it has defined as 'culturally sensitive'.[1]

Internet regulatory models can be broadly classified into three types: First, the traditional model of control or supervisory function undertaken by the state itself through a regulatory body of experts. The Federal Communications Commission in the United States and OFcom in Britain are examples of state regulators. However, most state regulatory models have had mixed results, as they have failed to meet the challenges of a constantly evolving internet economy and remain vulnerable to be co-opted by vested interests to resist competition.

The other end of the regulatory model spectrum is self-regulation, where industry associations determine their own code of conduct. Historically, self-regulation has been most successful in press councils where the code of ethics governs the activities of their members. Proponents of self-regulation in the internet industry view the internet as a platform which works autonomously and without government interference. They point out that since competition in the market is very high and public perception in the openness of a platform like the internet is very important, the market is capable of handling any wrongdoing by a particular player. However, if government interference through regulation is unavoidable, then they call for the principle of 'subsidiarity', which states that intervention shall be very specific and close to the issue in question. In this context, cyberspace experts say, “codes instead of laws” are required for overseeing the internet economy.[2]

However, a fully unregulated landscape also poses a number of threats. To maximise social benefit, there should be enough deterrence against the natural tendencies of dominant actors to abuse their position in the market and create monopolies. Self-regulating organisations have been known to attract anti-trust concerns in the United States.[3] An economic limitation of self-regulation is the 'free rider' problem where firms who are not part of the self-regulatory system may reap the benefits of the regime without paying for the costs. Self-regulation can also attract other concerns, such as in Europe where privacy is seen as equivalent to a fundamental right and mere self-regulation without punitive consequences would be seen as insufficient.[4] In essence, self-regulatory organisations tend to be seen as working for the interests of their own industry rather than operating in the larger public interest.

A third model of regulation which is increasingly seen as a compromise between the previous two is the idea of co-regulation, or in other words, 'regulated self-regulation'. Here there is voluntary self-regulation which is supervised by legal recognition thus transforming it into a co-regulatory scheme. This is widely present in the US, for example, where the Network Advertising Initiative (NAI) is founded on principles as a self-regulatory scheme which is approved by the Federal Trade Commission (FTC). This idea has gained traction in the Indian context, too; the Justice AP Shah Committee Report on Privacy commissioned by the Planning Commission in 2012 recommended a system of co-regulation for privacy protection where equal emphasis is given on Privacy Commissioners as well as Self- Regulating Organisations to ensure compliance with the laws. This represents a sea change from the licensing regime present earlier in the telecommunications sector.

III. REGULATORY LAWS VS. PROMOTING LAWS: NEED FOR *EX POST FACTO* REGULATION

The need of the hour is laws that promote innovation rather than those which simply regulate the digital economy. This is particularly relevant as most existing regulatory systems were put in place for technologies which predated the new-age internet. Traditional regulatory processes can also be slow and risk-averse in its approach as opposed to the fast paced digital economy.

A possible way forward in this regard might be using the idea espoused by Jessica Rosenworcel, regulator at the Federal Communications Commission in the United States. She calls for borrowing a leaf from the functioning of software developers who build 'sandboxes' into their programming. What a 'sandbox' does is to allow others access to a portion of the coded program without bringing harm to the host platform. Thus it provides a space for experimenting with the program before the same program is introduced on a larger scale. Entrepreneurs, for instance, use the idea of sandboxes to dry-run their ideas and assess the response of users before launching the product. The advantage of this approach is that the new concept does not have to be perfected and made risk-proof at the outset.

In the current regulatory process, there is little space for experimentation and to make changes based on real-world data. Added to this, the cost of ineffective rulemaking is high— both from the prospect of long-drawn litigation against the government as well as negative public perception in the government's capacity to promote innovation and industry.

In fact, the FCC has already experimented with this model in the realm of broadcasting and telecommunications. When the United States Congress passed legislation in 2012 to encourage the sharing of airwaves by television stations for broadcasting, the FCC (which was the appointed regulator), instead of making anticipatory regulation, decided to create a sandbox for experimenting the change.[5] By allowing two broadcasters in Los Angeles to create this framework of sharing spectrum, the FCC was able to gather real-world information about the possible technical and legal issues that could arise on a larger scale. It might be worthwhile to borrow this idea from the digital economy itself to render the regulatory processes more agile and innovative.

Take the example of the hotly debated topic of net neutrality. The Telecom Regulatory Authority of India has sent out a consultation paper and intents to *ex ante* regulate net neutrality. The same approach has also been taken by the FCC on this issue. *Ex ante* regulation is problematic considering the definition of 'net neutrality' is centred on the effect on the market and its scope itself is not well defined. The result of such regulation would be to force companies to not innovate on business models, fearing a potential violation of the net neutrality rule.[6]

An *ex post facto* approach to the issue could be better, as it would focus on prosecuting actors after the effect of their conduct on the market is apparent. It would not only reduce regulatory costs significantly, but also not deter companies from innovating on newer business models. It avoids prejudging business models or imposing prophylactic regulatory regimes. This approach would also help in

collecting evidence on the real-world effects of net neutrality violations so that regulations can be fine-tuned at a later stage.

Firms respond best to competing forces in the market rather than regulatory threats. Thus the government's role should be to decrease barriers to competition and let the competition take care of stopping market abuse. The presence of a strong and sophisticated anti-trust regulator is, of course, a prerequisite. Recent market studies have also indicated that in a competitive market, if the consumers are looking for net neutrality, the firms will be forced to provide the same. For example, following the introduction of the Apple iPhone and the App store, all wireless carriers and device manufacturers have opened up their networks to third-party applications.

IV. CONCLUSION

The role of the private sector in regulation is significant. The private sector is well-positioned in the digital economy to increase awareness among consumers on the best practices required for the industry. Further, it should also participate extensively with the government to create a co-regulatory framework to maintain the digital economy.

The risks associated with internet regulation are clear. While a heavily regulated landscape would act as a deterrent to innovation, which is the bedrock of the digital economy, an unregulated landscape might lead to uncompetitive practices and the stifling of technological progress. The role of the government then is to make "light-touch" regulation which neither interferes nor is unresponsive. A pro-innovation approach would understand that markets are more likely to resolve issues of abuse rather than regulators because of its nature of disruptive innovation. Further, regulation must be narrowly tailored and based on empirical evidence rather than a peremptory judgment of newer business models. It is essential to conduct broad-based research to determine the effect of policies undertaken on the market and then decide on the best way forward. ORF

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ENDNOTES:

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