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ON
REGULATORY BARRIERS TO INTERNET COMMERCE

BEFORE THE
FEDERAL TRADE COMMISSION
WASHINGTON, DC
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Good morning. Thank you for inviting me to testify on this important topic and for holding this hearing. It evidences that the Federal Trade Commission takes seriously its role as a guardian of freedom of commerce in the Internet era.

I testify on behalf of the Institute for Justice, a public interest law firm whose mission is to protect individual liberty and to limit the scope and power of the regulatory welfare state. In that regard, among other issues we litigate in support of economic liberty and consumer freedom, two pillars of a free society. Of specific relevance to today=s hearing are two ongoing cases we are litigating in federal court: a challenge to the State of New York=s prohibition of direct interstate sales and shipments of wine to consumers, and Oklahoma=s ban on the direct sale of caskets to consumers. Both directly and substantially impede Internet commerce.

If there was a single primary impetus for the founding of the United States, it was to eradicate protectionist trade barriers erected among the original states. Tariffs and other economic regulations prevented free trade among the states, to the detriment of producers, consumers, and national unity and prosperity. The Constitution vested in Congress the power to regulate commerce among the states, and implicitly forbade trade barriers by the states, thereby creating a single and ultimately powerful and prosperous national economic union. The genius of this design was such that more than two centuries later it is emulated in the European Economic Union and other international free trade compacts.

The Internet has increased exponentially the ability of producers and consumers across the world to engage in voluntary exchange, creating breathtaking potential to fulfil consumer wishes in an efficient and highly personalized manner. Its greatest virtue is depicted in a term that unfortunately is a jargonistic mouthful: disintermediation. What that term imparts is that the Internet reduces or eliminates the need for the middleman. That makes economic transactions more efficient and less costly for consumers, increases the possible range of consumer choices, and allows a much greater (indeed infinite) number of producers to market their goods and services to consumers.

Whenever technological change brings about a change in markets, those whose position is threatened either must adapt or fight to prevent the change. Our free-market economyBand the Constitution that enshrines itBestablishes an imperative for adaptation rather than for protectionist legislation. Unfortunately, that does not at all impede defenders of the status quo from resorting to political processes to preserve through government regulation their advantaged position. That has occurred through state regulation that regulates or prohibits direct interstate transactions, over the Internet or otherwise, in such areas as automobile sales, wine, insurance, contact lenses, and caskets. Like all interferences with free trade, those regulations raise costs and limit consumer choices. States, often eager to protect in-state industries and to increase tax revenues, are all too often complicit allies with industries seeking shelter from competition.

Wine is a classic example. There are thousands of wineries in the United States, the overwhelming majority of them small, family-run enterprises with small production. The number of wine wholesalers, by contrast, has shrunk markedly in recent years. Wine is not a fungible product; wine enthusiasts hold strong and highly individualistic preferences regarding their favorite wines. The Internet holds vast potential for consumers to obtain precisely the wine they wish, matching small producers with consumers who wish to patronize them. Yet about half the states have erected trade barriers forbidding the direct interstate sale and shipment of wine to consumers, while often at the same time allowing such shipments by in-state wineries. The rationale is to protect against underage access to alcoholic beveragesBwhich aside from government-sponsored sting operations is a nonexistent problemBand collection of tax revenue. But the real driving force is the multi-billion dollar wine wholesaler industry, which is determined to preserve its monopoly over wine sales at any cost.

If that wasn=t totally clear before we filed our New York lawsuit, it became vividly so in the few days after we filed. The lawsuit, filed on behalf of two small out-of-state wineries and three New York consumers who would like to buy their wine, was filed against officials of the State of New York. Within days, six entities with a powerful stake in the status quo intervened as defendants: the state=s four largest wholesalers, the liquor store association, and a transportation union. Those entities have completely taken over the litigation from the state, demonstrating in the strongest possible way exactly whose interests are implicated by Internet commerce.

Fortunately, the principles of free trade embodied in our Constitution are more salient in the Internet era than ever before, once again vindicating the wisdom of the framers. A number of constitutional provisions provide powerful tools to those who wish to protect free trade over the Internet. Among them:

B*Commerce Clause*. Absent explicit federal intervention, the commerce clause forbids protectionist state trade barriers. Where state regulations expressly discriminate against interstate trade, the state must demonstrate a compelling interest served in the least restrictive possible fashion. Where state regulations do not overtly discriminate but impose a burden on free trade, the courts will balance the state's interests against the national interest in freedom of commerce.

B*Privileges and Immunities Clause*. States may not impose greater burdens on citizens of other states than they impose on their own citizens. One of the foremost privileges of national citizenship is freedom of enterprise. Where states discriminate against out-of-state producers, they must demonstrate that their regulations are closely related to an important state interest.

B*First Amendment*. All Internet commerce involves speech, which enjoys special constitutional protection under the First Amendment. Even pure commercial speech, which proposes a commercial transaction, is protected. Commercial transactions that involve speech itself receive even greater protection.

States are free, of course, to apply nondiscriminatory regulations that genuinely seek to protect public health and safety and consumer interests. But the courts have recognized that the Internet raises special concerns about parochial regulation, because the Internet cannot abide geographic or political boundaries. Hence to comply with government regulations, a producer engaged in Internet commerce must adhere to the greatest regulatory denominator or risk exposure to liability. For instance, rather than attempting to navigate the array of different state regulations regarding interstate wine shipments, many wineries simply do not ship directly to consumers as all, and most shippers refuse to transport wine. As a result of the prospect of excessive parochial regulations, courts will inspect closely such regulations to balance their impact on free trade with the state's professed interest. If the courts honor the intent of the original constitutional design, we will see very aggressive judicial action in curbing parochial trade barriers under the commerce clause, privileges and immunities clause, and the First Amendment.

The Federal Trade Commission has an important role to play. As the foremost watchdog over national free trade, it should investigate state trade barriers that separate producers and consumers, and it should weigh in on federal legislation that impacts free trade and in court cases that raise issues of free trade. Never before has the role of the FTC been more important. The promise of our constitutional design—and the vast potential of the Internet to produce greater consumer freedom than ever before—demand your vigilance.