On Privacy, Europe And California Are Not Good Models

By **Thomas Lenard** (February 4, 2019)

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Facebook Inc. CEO Mark Zuckerberg's recent Wall Street Journal op-ed reflects the intense scrutiny Silicon Valley is under at the beginning of 2019, which many believe will be the year Congress finally enacts comprehensive privacy legislation. Somewhat belatedly, Zuckerberg is trying to explain how Facebook uses data, and the benefits of the advertising-supported model for consumers.

Zuckerberg's piece gives a nod toward regulation, reflecting the fact that major tech companies have joined consumer advocates and politicians across the spectrum in supporting some form of privacy legislation.

Why would major tech companies support privacy legislation? Nothing prevents Facebook from offering Zuckerberg's suggested regulatory privacy principles of "transparency, choice, and control," or other quality attributes, if its customers are willing to pay for them.

New legislation, however, would require all companies to spend more on privacy — or at least whatever the legislation deems privacy — whether or not their customers want it. Mandating costs typically advantages large incumbents, who can absorb the costs more easily than smaller companies and startups. The experience with Europe's new General Data Protection Regulation already confirms this problem — smaller companies are leaving Europe,[1] and non-European websites, like the Chicago Tribune's,[2] are blocking access in Europe, to avoid large compliance costs and exposure to fines of up to 4 percent of global revenue.

Of the large Silicon Valley companies, Apple Inc. has been most vocal in its support of privacy legislation. Apple CEO Tim Cook has been openly critical[3] of Facebook's and Google Inc.'s privacy practices, observing, "We have to admit when the market is not working, and it hasn't worked here."[4]

But is Cook correct? Is there a failure in the market for privacy? The existence of data breaches or other privacy problems doesn't necessarily mean the market is not working. One key to determining whether a market failure exists is whether firms internalize the costs of these problems.

Numerous studies show firms that experience security breaches face decreases in their stock price and significant negative reputational effects,[5] which is what a properly functioning market should deliver. Equifax Inc., for example, lost about $6 billion in market capitalization after its data breach in 2017.[6]

A recent New York Times exposé[7] about Facebook's data sharing practices sent the company's stock down 13 percent in three days,[8] even though there was no evidence of harm to consumers. Facebook shareholders also saw their equity value decline by 14 percent the week after the Cambridge Analytica episode became public.[9]

This financial punishment should reassure Sen. Richard Blumenthal, D-Conn., who has called for "severe penalties" for companies that fail to protect consumer data.[10] Penalties the market imposes are more consequential than new government sanctions, and they provide a stronger incentive to make the investments necessary to reduce the likelihood of future episodes.

Many proponents of federal legislation favor prescriptive models[11] along the lines of the European GDPR and the California Consumer Privacy Act, which limit the amount of data collected and how it is used, regardless of actual privacy harms. Relative to the current U.S. regime, where the Federal Trade Commission generally takes enforcement action only after finding actual consumer harm or determining that a company violated its own terms of service, little or no evidence suggests that the prophylactic approach yields benefits.

But the European and California approaches do entail costs in the form of lost services, advertising that is less useful to consumers, and lower spending on content. This is because better data enable more accurate targeting of advertising to consumers' interests, which increases the amount advertisers are willing to pay and thus the revenues platforms have available to invest in content and services.

Moreover, many of the most innovative benefits from data are realized when data are shared, combined with other data sets, or used for new purposes. The European and California regulations discourage these practices. Thus, it is doubtful whether a similar federal privacy law would make consumers better off.

Silicon Valley increasingly supports federal legislation, at least in part because politically it is seen as a necessary price for preempting state laws, such as California's. But preemption may not be so easy to achieve, because of opposition from states and advocates who want a federal law to be a floor, not a ceiling.

Congress may face a choice between two unsatisfactory alternatives: Enact some variant of the European-California model, which would regulate the use of data and likely be a drag on innovation, or leave consumers and firms to deal with a patchwork of inconsistent state laws. With no good options on the table, 2019 may not be the year of privacy legislation after all.

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[1] https://www.ft.com/content/3f079b6c-5ec8-11e8-9334-2218e7146b04

[2] https://www.nbcnews.com/tech/tech-news/chicago-tribune-los-angeles-times-block-european-users-due-gdpr-n877591

[3] https://www.cnbc.com/2019/02/01/apple-stood-up-to-facebook-and-google-and-made-a-powerful-point.html

[4] https://www.businessinsider.com/apple-ceo-tim-cook-on-privacy-the-free-market-is-not-working-regulations-2018-11

[5] https://dl.acm.org/citation.cfm?id=2902155

[6] https://www.cnbc.com/2017/09/14/equifax-will-not-survive-fallout-from-massive-breach-says-technology-attorney.html

[7] https://www.nytimes.com/2018/12/18/technology/facebook-privacy.html

[8] https://www.google.com/search?q=facebook+stock+price+chart&rlz=1C1CHFX_enUS594US594&oq=facebook+stock+price&aqs=chrome.4.69i57j0l5.11331j0j7&sourceid=chrome&ie=UTF-8

[9] https://www.marketwatch.com/story/facebook-valuation-drops-75-billion-in-week-after-cambridge-analytica-scandal-2018-03-23

[10] https://www.multichannel.com/news/marriott-breach-spurs-new-calls-for-government-action

[11] https://www.cnet.com/news/privacy-advocates-tell-senators-what-they-want-in-a-data-protection-law/