
The Economic Benefits of Balanced Information Use

Marty Abrams

In olden days, before computers and the Internet, local merchants met face-to-face with their customers and knew exactly what they wanted to buy. In today's marketplace we've lost the intimacy of that old neighborhood shopping district, but we are trying to replace it with more knowledge about consumers, so that their specific service and value needs can be met. Information technology allows us to do that in ways that are revolutionizing the market. For example, Jacques Nasser, CEO of Ford, told *The Wall Street Journal*, "I want to know the watch you wear and the coffeepot you use, so I can produce the right car for you."¹ In essence, he believes that the more Ford knows about consumers' preferences, the better it can design their cars. Ford envisions an interactive system that allows a buyer to go online to order a customized vehicle, and exchange information on financing, insurance, warranty, and repairs. This information will be linked to the production, marketing, and distribution processes, which should result in improved efficiency, reduced cost, and greater customer satisfaction. It also means fewer inventory shocks, giving us longer economic expansion.

The Ford example illustrates the shift from a production-based to a service-based economy. Modern economies are becoming demand-driven rather than production-driven. The sum of individual demands drives economic processes, from shopping for the right product or service to delivery and customer service. To make the system work effectively, information must flow smoothly between consumers and suppliers. But the imposition of rigid data rules gets in the way. In a speech at the Chicago Federal Reserve Bank in May, 1999, Chairman Alan Greenspan maintained that the application of information technology has increased the level of productivity in the United States. "This use of information creates great wealth," he said.²

Such positive changes would not have occurred without the free flow of information. The US is the only country that has successfully made the transition from a production-based to an information-based economy. The free flow of information between sectors and the application of technology have fueled economic growth while keeping inflation in check.

A recent study using Fannie Mae data defined the role of information in fueling the growth of the mortgage market.³ Every mortgage is created to be resold, therefore the market for mortgages is always liquid. Mortgage buyers must know the risk related to each mortgage, and robust data flows make that possible. Interest rates are lower than they would be without information and knowledge that leads to liquidity and greater home ownership. That means that the typical consumer saves about 200 basis points, or \$4,000 a year, on a \$200,000 mortgage. For the economy as a whole, that's \$85 to \$100 billion in additional income that people have to spend, save, or invest. Such savings are not available in economies where information is more restricted.

The information culture in the US has made a vibrant service economy possible. The four cornerstones of our information economy are: freedom of speech; a robust, usable public record; shared data; and the intolerance of information use. The fourth cornerstone acts as a check-and-balance on inappropriate information flows. Information that is used in an egregious fashion will result in a public backlash. Companies that misuse customer information are compelled to change their behavior by market forces or by legal action. This unique information infrastructure facilitates the information economy.

The concerns of privacy-sensitive individuals about information collection and use, and extensive media coverage of real or alleged privacy abuses by businesses and government agencies, have spilled into the political arena. Consequently, legislation has been enacted to require companies to ask for a consumer's consent (opt-in) before using certain public-record information. Other laws give consumers the right to opt out of having their financial records used for marketing purposes. A number of

states have established privacy commissions, and more privacy-protection legislation is expected at both the state and federal levels.

To understand the growing concern over privacy, we should look at the “tri-deficits” of knowledge, trust, and decision making. The knowledge deficit means that consumers, policy-makers, and companies don’t understand the linkage between value they receive and flexible information use. Not only do most consumers not realize that they save money on their mortgage because of the free flow of information, they also don’t understand that our more competitive information-driven economy has increased the value of their 401(k)s. Policymakers don’t understand the economic growth that is generated by information flows, or the effects on the economy of restricting such flows. Finally, most companies don’t understand how information fuels their growth and profitability, so they can’t make persuasive arguments to politicians, the public, and the media on the importance of free information flows.

The second deficit is trust. Unfortunately, many consumers, who are privacy pragmatists, don’t believe information collected and used by business is serving their purposes. They don’t trust data users to know where the limits are, and many people believe that data use is out of control. There are two components of the trust deficit, actual harm and consumer expectations. Laws and regulations are available to remedy the use of information that harms consumers. But, to build and retain trust, companies must change their behavior to not go beyond consumer expectations of appropriate information use.

This leads to the third, decision-making deficit. Data users don’t understand how to judge how far to go with information. Some companies are so afraid of privacy backlash from consumers that they won’t use information, leaving value on the table. Others don’t know how to draw the line on use of information, so they will take the risks of a push-back by the public or lawmakers if they go too far. This means that organizations don’t know how to find the decision-making equilibrium between the two extremes. Nor do policymakers know how to regulate or

legislate privacy. That's not all bad, since premature restrictions on information have been avoided. Unfortunately, the political attractiveness of privacy-protection legislation is driving Congress and state legislatures to propose new and potentially onerous restrictions on information flows without understanding the consequences. And, finally, consumers don't know how to empower themselves to control the use of their information: They can say no, and they can refuse to do business with companies they don't trust to safeguard their information.

The Internet has made the information equation more complex, because it blends physical privacy (*e.g.* surveillance or keystroke monitoring) with informational privacy, which deals with databases and personal histories. Consumer profiling is an example of such blending, which has raised concerns among consumers and policymakers that the public has lost control over the use of personal information. Personal autonomy is an important issue in the digital age, because people want to feel that they have some sense of independence and control over their lives. A lack of autonomy leads to the erosion of trust.

There are two elements of trust. The first is value, that the products and services are right for the consumer, and that price and quality meet customer expectations. Consumers around the world want value to come from information use. The second is the privacy bundle, which includes security. Privacy is about appropriate information use, while security deals with safeguarding information from unauthorized access and change. Trust means privacy, security, and value. Because these elements are interrelated, privacy regulation can have an adverse affect on value, and decreased value reduces trust. Therefore, the good intentions of legislators to protect privacy may have unintended effects on consumers.

There are two fundamentally different approaches to privacy. There is data protection, which guards against wrongful processing, and information balance, which protects against harmful use. Wrongful processing means that companies use information in ways that are inconsistent with the notice to, and consent received from, the consumer.

Information balance means that companies are free to use the information, as long as they do no harm to consumers. The economic effect of each of these approaches is very different. Discussions of opt-in versus opt-out are about the difference between the sense of a contract that comes with data protection, and the sense of protecting against harmful use that is obtained with information balance. Information balance is the preferred approach, because it is the least disruptive to an ever-changing information economy. For example, identifying information from credit histories makes the Internet safer by authenticating consumers. This use is not consistent with the notices given consumers, but brings them great value.

The free flow of information in a vibrant economy is similar to the free flow of capital in a productive industrial economy. Data protection limits information flows and dampens the growth of services. For example, the European services sector is not growing as rapidly as the US services sector, because of data-protection constraints on the former.⁴ In contrast to the European system of data protection, the US approach, which favors the free flow of information, stimulates a healthy service-based economy.

Economic growth is facilitated by a system that encourages information balance, which involves some trade-offs between trust and flexible information use. The elements of consumer trust are law, self-governance, industry codes of conduct, company self-restraint, and value. On the other side, companies want to collect and use information as broadly as possible. But, if companies become too aggressive in using information, and go beyond consumers' expectations, public reaction forces a bounce-back in the form of new laws or regulations, or stricter self-regulatory measures. However, too much emphasis on trust results in a deflator for the economy and a loss of value for consumers.

So, the central dilemma is that consumers want trust and autonomy, which means restrained information use. Consumers demand value, which requires robust information use. Therefore, a balance must be struck between trust and flexible use of

information. The challenge for business is to make the value of information collection and use clear to consumers. Some companies are beginning to realize the importance of the value equation. For example, MyPoints provides consumers with points for helping it to target ads they would like to see. The more those ads are on the mark and are clicked through, the greater the point awards. This company understands that ads have to be tailored to consumer preferences, and that you have to add value if consumers are to buy into the information revolution.

In summary, we are at an early stage of the information revolution. The trust deficit is a critical component of this change. If consumers don't trust information flows, then politicians will feel the need to legislate. Value is not intuitively obvious. Businesses have to help the public understand the value that comes from information. The Internet has contributed to the public's feeling of a loss of autonomy, by combining physical and informational privacy. And lastly, the wrong public policy will depress the economy by restoring trust through non-productive means.

Notes

¹Fara Warner, "Engine of Change: Making Bold Strokes, Fine Points, Nasser Puts His Mark on Ford," *The Wall Street Journal*, April 7, 1999.

²Alan Greenspan, "The American Economy in a World Context," address at the Federal Reserve Bank of Chicago *35th Annual Conference on Bank Structure and Competition*, Chicago, Illinois, May 6, 1999.

³Walter F. Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns*, 7 (The Tower Group 1999).

⁴"Putting Services to Work," European Union publication, November 27, 1996.