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REGULATING INFORMATION FLOWS: States, Private Actors, and E-Commerce

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■ **Abstract** Growing interdependence between jurisdictions means that states are increasingly using private actors as proxies in order to achieve desired regulatory outcomes. International relations theory has had difficulty in understanding the exact circumstances under which they might wish to do this. Drawing on literatures in both international relations and legal scholarship, this article proposes a framework for understanding when states will or will not use private actors as proxy regulators. This framework highlights the relationship between state preferences and the presence or absence of a "point of control," a special kind of private actor. The article then conducts an initial plausibility probe of the framework, assessing how well it explains outcomes in the regulation of gambling, privacy, and the taxation of e-commerce.

INTRODUCTION

On April 7, 2005, the appellate body of the World Trade Organization (WTO) ruled on a dispute over services between the United States and the state of Antigua and Barbuda. The United States had taken various measures to restrict U.S. citizens' access to online gambling and betting services based on Antiguan territory. In particular, U.S. authorities had sought to prevent third-party businesses, such as banks and credit card agencies, from allowing financial transactions between U.S.-based gamblers and Antiguan gambling websites. This led the Antiguan government to take an action at the WTO, claiming that the behavior of the United States violated its commitments to free trade in services.

The details of the WTO's final decision (which seemed to favor the United States) are of more interest to international trade lawyers than to most scholars of international politics. However, the underlying dispute between the United States and Antigua exposes an important lacuna in our theories of international relations: how and when states rely on private actors to achieve policy goals. In pressing credit card agencies and banks into service as regulators of the offshore gambling industry, the United States was using private actors as proxies to achieve international outcomes that it would otherwise have had difficulty achieving. These actions "effectively prohibit[ed] all supply of gambling and betting services from Antigua to the United States" (Sanders 2004), although they may prove ineffective in preserving the U.S. gambling regime over the longer term.

State–private actor relationships of this kind play a key role in many areas of international economic regulation. States are increasingly willing to use private actors as proxies to achieve policy goals at second hand. Moreover, the relative ability of states to influence private actors can have important implications for international and domestic political outcomes.

In order to understand why, it is necessary first to appreciate the nature of the underlying problem. Globalization, and in particular the rapid increase in the flows of financial resources and information across borders, has important consequences both for policy interdependence and for the role of the state. The weakening of controls on cross-border information and resource flows is greatly increasing the interdependence between states' domestic policies (Farrell 2003a). One state's domestic choices about how to regulate information flows influence the choices of other states. The rapid development of e-commerce and the Internet have led to international controversy in sensitive social areas such as access to gambling, pornography, and extremist political material. Any individual state will find it difficult to limit its citizens' access to materials or services when other states allow the dissemination of these materials or services on the Internet.

This increased interdependence is leading to a new politicization of the state as a protector of social values that are challenged by economic and informational flows across state borders (Berger 2000). As the flow of information across borders increases, and as the domestic policy choices to regulate certain kinds of information (say, to ban pornography) are undermined, we may expect increasing demands placed on states to regulate these flows and restore the *status quo ante.* One way in which states can do this is to press private actors into service as regulators on their behalf, as the United States did, in policy areas where the states themselves lack the tools or expertise to provide effective regulation (Mattli & Büthe 2005, 2006).

Yet even if we can describe the secular changes in underlying structural conditions that make states more likely to consider using key private actors as proxies, we still have difficulty in making useful predictions. When exactly will states rely on private actors to achieve their policy goals, and when will they employ other policy instruments (international treaties, bilateral cooperation, and the like)? When will states succeed in pressing private actors into service, and when will they fail? Only in the past decade or so has international relations theory really begun to advance testable propositions about the role of private actors in the global economy. Most work to date has examined how private actors may influence states, or how private actors might (or might not) be creating separate spheres of governance for themselves, independent of state authority. Until very recently (Mattli & Büthe 2005), little sustained attention was paid to the question of how and when states might seek to influence private actors, or work through them.

Private actors play an especially important role in the governance of many aspects of e-commerce and the Internet. Legal scholars have engaged in a wide-ranging debate over what this means, but with a few exceptions (Kobrin 1998, Farrell 2003b, Drezner 2004), there has been little effort to connect this debate to the arguments being conducted in parallel in political science. Although the legal academic literature is largely oriented either toward empirical description or toward normative questions, it provides important insights. In particular, some legal scholars (Benkler 2000, Zittrain 2003, Birnhack & Elkin-Koren 2003, Reidenberg 2004) have begun to ask interesting questions about the intersection between the formal jurisdiction of states and their ability to influence private actors. Even though this vein of scholarship has sought more to offer a nuanced description than to provide testable propositions, it can be developed to offer some interesting hypotheses.

In this article, I seek to bring these two literatures—the debate on state–private actor relations in political science and the literature on Internet and e-commerce governance among legal scholars—together. A creative combination of arguments from both literatures can provide the basics of a unified framework for understanding (*a*) when states will seek to use private actors as proxy regulators rather than working through other policy instruments and (*b*) when they will succeed in pressing private actors to implement their preferences. By combining political scientists' arguments about bargaining strength with legal scholars' claims about regulatory arbitrage and "points of control," I construct a basic explanatory framework. I do not undertake to provide an exhaustive test of this framework in this article, but I show that it seems to provide a good explanation for controversies over Internet gambling, privacy, and e-commerce taxation.

The framework presented here does not aspire to provide a complete account of state–private actor relations. It does not examine how private actors may influence states (Sell 2003), nor how private actors may cooperate with states to create rules (L. Mosley, unpublished manuscript), nor yet the circumstances under which states may press for the creation of private regulatory actors where no such actors exist. By adopting a narrower focus, it provides a set of testable predictions as to the circumstances under which states will use private actors as proxy regulators.

The first main section summarizes international relations debates over the relationship between states and private actors. The next section discusses debates among lawyers over Internet regulation, which provide both rich empirical accounts and important theoretical insights. Then, building on both discussions, I seek to provide a basic framework of analysis. The penultimate section shows how this framework may be applied to various issue areas affected by cross-border information flows. Finally, I consider the implications of this argument for other areas of the international political economy.

INTERNATIONAL RELATIONS AND NONSTATE ACTORS

International relations theory has historically been a profoundly state-centered discipline, at least in North America. Dominant strains of thought (most prominently realism) have placed state interaction and the forces that structure it at the core of international politics. Until quite recently, nonstate actors have been studied only at the margins of the discipline. Although some early work (Keohane & Nye 1971, Keohane & Ooms 1975) illustrated that various nonstate actors influenced international politics, it did not go beyond this observation to create a theoretical framework. Accordingly, serious debate about the role of private actors and their relationship to the state system was usually conducted by international relations scholars who self-consciously dissociated themselves from the North American mainstream.

This was not true of comparative political economy, where scholars of Western Europe began in the late 1970s to study how states not only were influenced by interest groups but could use corporatist institutions to coopt these interest groups so as to achieve economic stability (Schmitter 1979, 1981; Molina & Rhodes 2002). A thriving literature in German (the *Steuerung* approach) sought to build more generalizable theories about the conditions under which states could influence private actors (Lütz 2003). Scholars of corporatism found that it was difficult to reproduce corporatist-style institutions at the international level, even in institutionally thick settings such as the European Union (Streeck & Schmitter 1991, Crouch & Menon 1997). Similarly, scholars of *Steuerung* concluded that it had no proper analogy in the international sphere, where there was no overarching state authority (Mayntz 1998).

Perhaps surprisingly, this literature in comparative politics has had little impact on debates among international relations theorists. The resurgence of interest in nonstate actors among the latter (O'Neill et al. 2004) can be traced back to two partially overlapping bodies of literature. First, constructivists began in the early 1990s to argue that nonstate actors—particularly nongovernmental organizations—played an important role in international politics. Much of this work sought specifically to undermine the existing state-centered perspective by arguing that nongovernmental organizations and other nonstate actors were creating a transnational "civic society" that transcended national boundaries and that might eventually replace the traditional structures of international politics (Wapner 1995). From this perspective, states (or, more precisely, governments and government agencies) were only one set of actors among many in an increasingly complex and multilayered global system. Some scholars (Kobrin 1998) in this tradition implicated technological change in their accounts of the breakdown of traditional state structures. They argued that the Internet and other communications technologies were helping create an international system that in some ways resembled the Holy Roman Empire, with complex, overlapping jurisdictions and loyalties. Others made narrower arguments about the role of private actors in international politics, not necessarily arguing that they were fundamentally transforming the international system but exploring the specific ways in which they affected international outcomes. In particular, a group of moderate constructivists sought to examine the circumstances under which states and international institutions could be influenced by nonstate actors (Risse 1995, Keck & Sikkink 1998; see also Sell 2003).

Second, international relations theorists began to build on the work of Strange (1996) and on radical approaches to international political economy, arguing that the increasing power of financial markets not only limited the policy choices that were open to states but also transferred power to nonstate actors in the financial sector and elsewhere. Marxists such as Cutler (2003) argued that private actors were constructing their own transnational systems of governance through the *lex mercatoria* and other instruments, and thus insulating themselves from pressures of democratic accountability. Others made more general arguments about the increasing power of private actors to create transnational systems of governance, and the challenges that this created for traditional conceptions of international politics (Cutler et al. 1999, Hall & Biersteker 2002, Cutler 2003, Kahler & Lake 2003, Stone-Sweet 2004).

Crucially, both of these literatures emerged in contention with the existing state-centric perspective. Thus, they sought explicitly or implicitly to deny the realist claim that nonstate actor activity is epiphenomenal and more or less determined by the structure of interactions among states, by pointing to (*a*) the ways in which nonstate actors may construct realms of interaction that are not under the control of states (and that might perhaps in time undermine the existing state system, or (*b*) the direct and measurable influence of nonstate actors on state preferences and choices. With only isolated exceptions (Grande & Pauly 2005), they devoted little if any attention to the ways in which states might influence nonstate actors. Nor, with very occasional exceptions (Farrell 2003a, Lehmkuhl 2003, Drezner 2004), did their critics seek to examine this aspect of state–private actor interaction. Realist theory in particular has difficulty in conceptualizing the circumstances under which states might *want* to work through private actors. As a consequence, there is an important gap in the literature. We have an extensive literature discussing the circumstances under which private actors may influence states, a somewhat less extensive debate about how private actors may be reshaping the fundamentals of the Westphalian system, and a growing body of work on how private actors may create their own systems of governance, independent of states. Very little work indeed discusses the circumstances under which states might wish to work through private actors in order to affect outcomes, or the circumstances under which they might succeed (L. Mosley, unpublished manuscript; Mattli & Büthe 2005).

There is, however, a related literature that provides some predictions as to when states will be successful in influencing private actors to work on their behalf, although it has less to say about when they will want to work through private actors in the first place. This small but important body of work borrows from both sanctions theory (Rodman 1994, Shambaugh 1996) and comparative politics, examining how market power and domestic institutions affect the ability of states to influence private actors. Different modes of state–private actor interaction are likely to be associated not only with differences in the domestic political economy (Lütz 2003, Newman & Bach 2004) but also with variation in international outcomes (Rodman 1994; Shambaugh 1996; Farrell 2003b; D. Bach & A. Newman, unpublished manuscript, Mattli & Büthe 2003). Rodman (1994) argues that the power of both political authorities and nongovernmental organizations to make multinational corporations disengage from South Africa was limited because they could offer only inducements, not commands. Shambaugh (1996) examines the success of the U.S. sanctions regime in inducing compliance in foreign firms as a function of the foreign firms' dependence on U.S. markets. Farrell (2003b) argues that differences between the domestic regimes of the European Union and the United States explain their relative abilities to shape international outcomes in e-commerce policy. David Bach and Abraham Newman (unpublished manuscript) seek to explain outcomes in the international regulation of personal information and financial services by looking to differences in domestic regulatory systems. Mattli & Büthe (2003) provide evidence that domestic institutional legacies have important consequences for battles over international technical standards.

Although these scholars work from different traditions in rational choice and historical institutionalism, they all emphasize some version of bargaining power (Krasner 1991, Knight 1992) as the key explanatory factor. A state's ability to induce cooperation from a private actor will depend on its ability to make credible threats or promises to the private actor. Thus, for example, in Shambaugh's account, the U.S. government was able to induce foreign firms to comply with extraterritorial sanctions by making a credible threat to cut off access to U.S. markets for noncomplying firms. Where the United States did not have bargaining leverage of this kind, it had little success in inducing compliance. Shambaugh (1996), like Drezner (2004) and others, argues that the key determinant of state bargaining power vis-à-vis private actors is the size and importance of a state's internal market. However, this view leaves out the role of institutions as a crucial intervening variable—states will not be able to use market size as leverage unless appropriate regulatory instruments are available (Newman & Posner 2005). The domestic institutional capacities of states are a key component of their bargaining power (Grande & Pauly 2005).

Other scholars have sought to incorporate institutions directly into their theories as a factor conditioning bargaining power. For example, both Farrell and Bach & Newman include institutions as a key variable, arguing that the two key factors explaining a state's bargaining power vis-à-vis a particular private actor are (*a*) whether the state has effective jurisdiction over an important asset of the private actor and (*b*) whether the institutional framework within the state provides policy instruments that allow it to make credible threats or promises with respect to this asset. All other things being equal, when a state has both effective jurisdiction and the means to make credible threats, it will be in a strong position to press the private actor to conform to its preferences.

In summary, there is an important gap in our understanding of international politics; remarkably little work has been done to identify the circumstances under which states might wish to work through private actors, rather than through other available means. A small body of work provides an approach to one aspect of state–private actor relations—theorizing the relative influence of states vis-à-vis specific private actors. However, it does not provide much help in answering a broader set of questions. When will states choose to use their possible influence on private actors to press these actors into service as effective regulators? When will they choose other instruments, such as multilateral organizations? In order to begin to answer these questions, it is necessary first to discuss a second body of literature—legal scholars' work on Internet governance—and then to integrate insights from these two literatures into a common framework.

LAW AND THE INTERNET

Debates among legal scholars over the political implications of e-commerce and the Internet provide an important set of complementary insights into the changing relationship between states and private actors. In addition to discussing how new technological developments would affect specific areas of the law, legal academics have engaged in a far more wide-reaching discussion of the implications of the Internet for law, politics, and society. These debates have centered on two issues of direct relevance to political scientists: the extent to which the Internet and e-commerce have empowered private actors vis-à-vis governments, and the extent to which the Internet and e-commerce challenge basic notions of states' territorial jurisdiction.

Both debates had their beginnings with Johnson & Post's (1996) essay on law, borders, and cyberspace. The authors observed that cyberspace undermines the relationship between physical geography and activities that could easily be transferred online. As a result, it undermined traditional law, which relies on the existence of borders in physical space. Because events on the Internet occur both everywhere and nowhere, no one government has any more right than any other to subject actions to its law. Johnson & Post argued that cyberspace should be considered independent of existing geographic territories, and that independent self-regulatory structures should be allowed to govern it and to provide its "law." Johnson & Post's prescriptions fit well with a more general enthusiasm among libertarians for the Internet, which they saw as fostering individual freedom and potentially undermining the power of governments to dictate how their citizens communicated with each other (Barlow 1996). In the much quoted (but difficult to source) words of John Gilmore, libertarians perceived that the Internet "interprets censorship as damage, and routes around it." Scholars argued too that e-commerce would be governed not by states but by self-regulation and by the preferences of firms (Simon 2000, Spar 1999, but also see Spar 2001). U.S. government decision makers claimed that self-regulation was the best approach to most policy problems associated with e-commerce and sought to encourage its international spread (White House 1997).

These views came under sustained criticism toward the end of the 1990s. Lessig (1999) argued that libertarian visions of cyberspace grossly underestimated the extent to which computer code could be used as an instrument of control. There was no compelling reason to believe that "open" forms of code, which enhanced individual freedom, would continue to predominate. Goldsmith (2000) contended that jurisdictional problems were greatly overstated, and that states, far from being paralyzed, were willing and able to take unilateral action in order to achieve their policy goals. By 2003, Geist (2003) felt safe in concluding that many of the truisms of early debates on the Internet had been decisively refuted; contrary to initial predictions, the Internet and e-commerce were increasingly subject to effective state regulation.

Even if some of Johnson & Post's (1996) arguments about self-regulation are no longer applicable, their claim about the jurisdictional consequences of the Internet is still compelling. States continue to face pervasive problems of jurisdictional ambiguity in the realm of e-commerce, which traditional legal doctrines have difficulty in resolving (Geist 2001). In many issue areas, it is still unclear which state's laws should prevail when. The ability of states to take unilateral action in order to pursue their policy goals complicates matters even further (Benkler 2000, Geist 2003). A state may be challenged not only by the behavior of private actors (which may be able to relocate their activities to avoid state regulations) but also by the behavior of other states seeking unilaterally to regulate an issue area according to their own principles, which may not be the preferred principles of the state in question (Reidenberg 2002).

In short, even though the massive expansion of the Internet and of e-commerce has not substantially curtailed state power, as some hopeful libertarians predicted, it has had important consequences for states' relationships with private actors and with each other. Private actors are not replacing states and creating their own forms of order, but they are often able to exploit jurisdictional ambiguities to their own advantage within the existing state system. As Froomkin (1997) argues, the Internet presents private actors with new opportunities for arbitrage in many sectors of activity. The Internet vastly lowers the cost of transborder communication, making it easier for some private actors to avoid undesirable forms of regulation by relocating their activities from one jurisdiction to another. The ability of actors to engage in such arbitrage will vary according to the degree to which states differ in their regulatory goals and capacity in a particular policy area. For example, Froomkin (1997) suggests that the ability of private actors to use regulatory arbitrage to avoid taxes will be limited because few regimes offer strong banking secrecy (complications are discussed below). Further, some private actors are more able than others to engage in arbitrage. Swire (1998) argues that "mice" (small, mobile private actors) find it far easier to relocate their activities than "elephants" (large actors with substantial, relatively immobile assets). For example, if a state seeks to shut down a small-scale pornography or gambling website that breaches its laws, the website's owners may quickly and easily set up a new site in a different jurisdiction with looser regulation. The same is by no means necessarily true of the websites of large firms with valuable corporate reputations and fixed assets.

However, states too have new tools. As Swire (1998) also points out, states are not limited to direct regulation; they can use indirect means, pressing Internet service providers (ISPs) or other actors to implement state policy. For example, states might require ISPs to block their users from having access to a particular site, or to take down sites with certain kinds of content. More generally, to adopt the terminology of Zittrain (2003; see as an alternative Birnhack & Elkin-Koren 2003), a small group of privileged private actors can become "points of control"—states can use them to exert control over a much broader group of other private actors. This is because the former private actors control chokepoints in the information infrastructure or in other key networks of resources. They can block or control flows of data or of other valuable resources among a wide variety of other private actors. Thus, it is not always necessary for a state to exercise direct control over all the relevant private actors in a given issue area in order to be a successful regulator.

On the one hand, states can use points of control effectively to recreate national borders in some issue areas. For example, some European states require their domestic ISPs to block users from accessing neo-Nazi websites that are operated from the United States and elsewhere (Frydman & Rorive 2002, Reidenberg 2004), and the U.S. government uses ISPs to regulate access to copyrighted content (Birnhack & Elkin-Koren 2003). On the other hand, states may be able to use points of control to affect what private actors located in *other* jurisdictions can or cannot do. Some key private actors (e.g., multinational corporations, international self-regulatory bodies) are able to limit the options of a wide variety of other private actors, across various jurisdictions. In issue areas where states disagree, these actors' rules and standards provide an effective international regulatory lowest common denominator (Farrell 2003b). For example, in the absence of international agreement on which kinds of goods can or cannot be sold through auction, the rules enforced by major e-commerce firms such as eBay or Yahoo! effectively set the standards for what is allowable. If these firms forbid their users from buying or selling a particular kind of item, it will obviously become considerably more difficult for sellers of these items to find buyers and for buyers to find sellers. If states are successful in pressing these powerful private actors into service as points of control, they can not only reassert control over actors within their own jurisdiction (i.e., recreate their borders) but also assert control over private actors located in other jurisdictions where the powerful private actor holds a chokepoint. As Benkler (2000, p. 179) notes in a somewhat different context:

> If states can affect how all multi-jurisdictional players in the Internet service market structure their relationships to their users everywhere, then the practical reach of each state's jurisdiction to increase the costs of, and shape the way people in other jurisdictions interact with, information it deems harmful—say, Nazi propaganda or pornography—is in fact quite extensive.

Clearly, the extent to which states can use certain private actors as points of control will depend on the extent to which these private actors actually occupy chokepoints in the information infrastructure and can control flows of information or resources. This will vary considerably from issue area to issue area. But in many issue areas, there are private actors that do indeed occupy such chokepoints. These actors' ability to control what other private actors and individuals can do may have gaps (it is usually possible for determined and technologically adept users to avoid these chokepoints) but still serves as a reasonably effective substitute for traditional regulation.

The work of legal scholars on the governance of the Internet and e-commerce provides a rich body of both empirical information and theoretical insights, from which we can perhaps begin to construct a more general account of state–private actor interaction. I turn to this task in the next section.

A FRAMEWORK FOR ANALYZING STATE–PRIVATE ACTOR RELATIONS

Building on the existing literatures in international relations and Internet law, I argue that three factors are likely to affect states' desire and ability to press private actors into service as regulators on their behalf. First and most obvious is states' need to deal with problems of policy interdependence in a given issue area. Building on Froomkin's (1997) arguments about regulatory arbitrage, I argue that this will depend on the degree of homogeneity or heterogeneity of states' regulatory preferences and practices. Second is the presence or absence of suitable private actors in a given issue area. I borrow from Zittrain (2003) and from Birnhack & Elkin-Koren (2003) to argue that this will depend on the presence or absence of private actors that serve as points of control. Finally, building on the existing literature in international relations theory, I argue that states' bargaining power relative to private actors will determine their ability to press suitable private actors into service on their behalf.

As the introduction argues, globalization and the Internet do not confront states with a loss of authority so much as with a new set of challenges stemming from increased policy interdependence. Private actors are not empowered vis-à-vis states in any absolute sense and are highly unlikely to take up the reins of command. Instead, to adapt Froomkin's argument slightly, the increased interdependence resulting from the Internet and associated technologies will increase private actors' ability to engage in regulatory arbitrage where there are substantial differences between states' regulatory systems. All other things being equal, small, flexible private actors with few fixed assets can take advantage of differences between regulatory systems, locating their activities in that state where the regulatory system is most congenial to them. For example, U.S. businesses seeking to profit from online gambling were able to relocate their activities to countries such as Antigua, which had lax regulation of gambling. Similarly, private citizens located within the boundaries of the United States could evade the regulatory power of the state by gambling online through services located in offshore locations such as Antigua or Gibraltar.

Logically, then, the degree to which private actors can engage in regulatory arbitrage will depend on the degree of similarity between states' regulatory preferences. These preferences will be a function of previously existing domestic social bargains within states; as Berger (2000) suggests, states will feel obliged to protect these bargains against outside pressures. If all states have the same regulatory preferences and can enforce them reasonably well, then there is little scope for private actors to engage in regulatory arbitrage. Even small, flexible private actors will have no strong reason to locate their activities in one jurisdiction rather than another besides the usual reasons of labor and capital costs, infrastructure, etc. In contrast, if there are substantial differences between states' regulatory preferences (or, to a lesser degree, their ability to enforce those preferences), private actors will have very considerable scope indeed for regulatory arbitrage. All other things being equal, small, flexible private actors will have a strong incentive to locate their activities in jurisdictions where the regulatory preferences of the state provide them with the greatest freedom to purvey their product. By the same token, individuals located within a jurisdiction that bans a particular online activity will themselves be able to engage in a form of arbitrage. They can evade the laws of their own jurisdiction by using the Internet to transact with entities located in other jurisdictions.

Thus, the degree to which states' regulatory preferences are similar or dissimilar will be a key dimension dictating a state's decision to use or not use private actors as regulators. In issue areas where states have similar preferences, cross-border information technologies such as the Internet will not provide significant arbitrage opportunities either for private actors who are willing to relocate their activities offshore or for individuals seeking services that are illegal in the individuals' home jurisdiction. This is not to say that there will be no scope for arbitrage whatsoever. Even if all states have the same regulatory preferences, it may be more complicated for them to regulate cross-border activities; different national enforcement agencies will need to coordinate with each other, share information, etc. Still, the scope of these arbitrage opportunities will be limited. In contrast, there will be far greater arbitrage opportunities in contexts where states' regulatory preferences differ substantially. Here, we expect (*ceteris paribus*) that nimble private actors will locate their activities in friendly jurisdictions and that individuals will use the Internet to procure services that are illegal within their own jurisdiction but not in a different state with different preferences.

The second key dimension that explains state choice is the presence or absence of private actors that could serve as points of control in a given issue area. We may reasonably expect that where such private actors exist, states will have a strong incentive to seek to press them into service as regulators where they can. By so doing, states can not only gain substantial control over a wide variety of other private actors, as discussed above, but also offload some of the costs of regulation onto a third party. In contrast, in issue areas where there are no such points of control, we expect states either to use more traditional instruments of regulation, where these are available, or not to regulate at all, where they are not.

Mapping these two dimensions against each other produces the following 2x2 table, which describes the likely regulatory outcome for each combination of state preferences and presence or absence of points of control. In Table 1, the vertical axis

TABLE 1 Points of control and states' regulatory preferences

States' regulatory preferences/points of control	Points of control present	Points of control absent
Similar regulatory preferences	hybrid regulation (private actors embedded in international agreements)	traditional forms of regulation (domestic/international)
Dissimilar regulatory preferences	recreation of borders/states vying for influence over points of control	stalemate

represents the similarity or dissimilarity of states' regulatory preferences in a given issue area. The horizontal axis represents the presence or absence of private actors that might serve as points of control in that issue area. Where states have similar preferences and points of control are present, we expect that states will opt for hybrid forms of regulation (Farrell 2003a). In hybrid regulation, states agree on an international framework that lays out the principles of cooperation in a given issue area—but delegate much of the implementation of these principles to the relevant private actors, which become points of control for the states in question. As with traditional international institutions, states may bargain over the specific features of the institution, and the distribution of costs and responsibilities associated with it. However, they will delegate as much as possible of the actual implementation of their preferences to private actors that have more extensive technical knowledge and are better positioned to block or redirect information flows.

Where states have similar preferences over regulation and points of control are absent, we are in the traditional world of international regulation described exhaustively by Keohane (1984) and other institutionalists. States will create international institutions where necessary to reduce transaction costs and to monitor compliance, perhaps distributing the burdens and benefits of cooperation according to the underlying bargaining power of the states in question (Krasner 1991).

Where states have dissimilar preferences and points of control are present, we expect one of two outcomes. If states are primarily interested in protecting their own domestic bargains and have little interest in what other states do, we expect them to use points of control to recreate national borders. That is, they will seek to use points of control to reassert authority over their own citizens by regulating citizens' access to services and materials located outside their national borders. Depending on which private actors are pressed into service, this may have knock-on consequences for other states. For example, France and Germany have pressed Internet auction services such as Yahoo! and eBay to regulate their citizens' access to Nazi materials and paraphernalia (Farrell 2003b). Both Yahoo! and eBay have introduced policies that prevent any user from buying or selling Nazi-related materials, no matter where the user lives. Thus, France and Germany's preferences have implications for the citizens of states, such as the United States, which do not forbid the sale of Nazi-related materials. This may potentially lead to clashes between states. The risk of disputes between states will be even more marked where states are interested not only in protecting their own social bargains but also in influencing how individuals and private actors in other states behave. Here, we expect to see states actively vying for influence over potential points of control. Each state will seek to ensure that the points of control in a given issue area implement its regulatory preferences rather than the (clashing) preferences of another state. In the absence of any basis for agreement among states, the policies of key private actors may indeed set an effective international regulatory lowest common denominator, although the extent to which this is true will obviously vary with the scope of influence of these private actors.

Finally, where states have dissimilar and incompatible preferences, and points of control are absent, we expect stalemate (Moravcsik 1997). States will be unable to reach agreement over international institutional arrangements, since they do not agree about the underlying principles of regulation for a given issue area. However, they will also be unable effectively either to rebuild national borders through points of control, or to use points of control to shape the international regulatory lowest common denominator.

The two cells where points of control are absent receive extensive discussion in the existing literature. The cells where points of control are present are of considerably greater relevance to the research agenda that this article proposes. What is likely to determine specific outcomes in these cells? To be more precise: When will states be successful in pressing private actors into their service as points of control? When states vie for influence with each other over potential points of control, which states are likely to win, and which to lose?

In order to answer these questions, it is necessary to return to the sources of state bargaining power vis-à-vis private actors. As noted, market size is often a poor measure of power (Newman & Posner 2005); states may be unable to deploy market power effectively without appropriate regulatory structures. Market size can affect a state's bargaining power relative to a given private actor (*ceteris paribus*, states with larger internal markets are likely to offer greater market opportunities to such actors than states with smaller markets), but only if the state can selectively grant market access to private actors who comply with its wishes and withdraw access from those who do not comply. Therefore, it is necessary to supplement an examination of market size with a focus on whether existing domestic rules allow a state to deploy its market strength in a given area of regulation (Farrell 2003b; D. Bach & A. Newman, unpublished manuscript). More specifically, a state's ability to bargain with a given private actor will depend (*a*) on the private actor's specific exposure to the jurisdiction of the state (a function *inter alia* of market opportunities and the extent to which the private actor's fixed assets are subject to the jurisdiction of the state), and (*b*) on the regulatory instruments through which the state can make credible threats or promises to the private actor in order to induce the private actor to implement its preferences.

This has some interesting implications. First, we can reasonably expect that states as a collectivity will be in a stronger bargaining position vis-à-vis private actors that offer potential points of control when they share regulatory preferences than when they do not share them. Second, where states disagree over how a particular issue area should be regulated, some states will be better positioned than others to exercise influence over points of control. Specifically, states that not only have jurisdiction over assets belonging to the relevant private actors, but also have appropriate policy instruments they can use to convert that market power into bargaining leverage, will be better able to influence potential points of control than will states with small markets, or even states with large markets but without appropriate policy instruments that would allow them to make credible threats or promises. Thus, in issue areas where states have strongly opposed interests and preferences, private actors that offer potential points of control will be more likely to be influenced by states that (*a*) have jurisdiction over their assets or provide substantial market opportunities for these actors and (*b*) have policy instruments that allow them to make credible threats or promises with regard to these assets or opportunities.

In summary, I suggest that we need to understand the interaction of three factors: the congruity or incongruity of state regulatory preferences, the presence or absence of points of control, and the bargaining strength of states vis-à-vis potential points of control, in order to explain regulatory outcomes. By looking at the interactions between state preferences and the presence or absence of points of control, we can explain the broad regulatory structures that are likely to emerge in different issue areas. By focusing more closely on the determinants of bargaining strength, we can make predictions as to which states are likely to win and which to lose, where state preferences clash, and where points of control are present.

APPLYING THE FRAMEWORK TO E-COMMERCE REGULATION

Although an exhaustive test of hypotheses derived from the above framework is outside the scope of this article, a brief plausibility probe, drawing on case studies in the existing literature, may help establish whether the framework seems likely to provide a useful description of reality. First, the dispute over gambling regulation described in the introduction is a case in which states clearly had conflicting preferences, but in which points of control (U.S.-based financial institutions) were present. Second, the dispute between the European Union and the United States over privacy regulation (Farrell 2003a) is a case in which states (eventually) had compatible preferences, and in which there were points of control (self-regulatory organizations). Finally, the vexed issue of e-commerce taxation (Paris 2003) is a policy area where state preferences clash but where there are no obvious points of control.

Internet gambling exemplifies an issue area where states have different—and conflicting—preferences. On the one hand, the U.S. federal government has typically sought to regulate gambling through electronic communication, and some state-level officials have aggressively sought to shut down gambling operations. Although Congress has failed to pass legislation that explicitly bans Internet gambling, the government has interpreted the existing Wire Wager Act as forbidding it and has sought to prosecute those involved. This has prompted figures from the U.S. gambling industry and elsewhere to set up Internet gambling operations in more gambling-friendly jurisdictions such as Antigua, which sought their main custom from U.S. consumers. Although U.S. authorities were successful in prosecuting individuals who had maintained a U.S. presence, and in preventing gambling operations from offering shares for purchase to U.S. citizens, they were unable either (*a*) directly to prevent U.S. citizens from gambling using offshore websites or (*b*) to shut down these websites, which were outside the jurisdiction of U.S. law. Nor did Antigua have any incentive to shut down gambling operations at the behest of the United States; at one point gambling operations accounted for more than 10% of Antigua's gross domestic product (Thayer 2004).

The solution adopted by U.S. authorities—first at the state level in New York, and then at the federal level—was to attack offshore gambling sites indirectly, by requiring banks and other financial entities to block transactions. These banks and financial entities provided a possible point of control for U.S. authorities; they occupied a chokepoint in the relationship between offshore gambling websites and their U.S.-based customers. Money had to flow back and forth between U.S.-based gamblers and offshore gambling operations if the former were to be paid when they won their bets and the latter were to make a profit. New York State Attorney-General Elliot Spitzer's office began to pursue financial institutions aggressively in 2002. The Attorney-General threatened Citibank with prosecution for profiting from illegal activity, and pressed it to make a substantial donation to counseling services for compulsive gamblers and to agree to block gambling transactions in the future (Manter 2003). A similar action against the popular Internet financial intermediary PayPal resulted in a substantial fine. The U.S. Department of Justice built on this precedent by threatening to prosecute any firm that provided financial services to offshore Internet gambling operations. These threats have resulted in the creation of a self-regulatory regime for financial intermediaries such as banks and credit card companies in which they seek to identify and block gambling transactions involving U.S. citizens.

It is unclear whether the United States' effort to block its citizens from gambling on the Internet will work over the longer term. Gambling sites are beginning to exploit ambiguities within the U.S. legal regime to promote and legitimize their activities. Furthermore, gamblers and gambling sites are beginning to make financial transfers through channels that are far more difficult for the United States to regulate. Nonetheless, in the short run, it has had devastating consequences for the Antiguan gambling industry, which has dwindled to a small fraction of its former size (Thayer 2004). This prompted Antigua to take an ultimately unsuccessful WTO action against the United States, arguing, in the words of Antigua's chief foreign affairs representative, that the United States enforced its prohibition on gambling by "blocking credit card transactions and penalising credit card companies and banks that facilitate them" (Sanders 2004).

Thus, in a policy area where (*a*) there was substantial disagreement between states' regulatory preferences, and (*b*) there were potential points of control in the financial industry, the United States sought to stop its citizens from using offshore gambling operations by requiring these points of control to block transactions—as the framework would have predicted. The United States had some success—at least in the shorter term—in recreating a national border and in reasserting its authority over U.S. citizens who wished to gamble using offshore websites. This had quite substantial knock-on consequences for another state, Antigua. Had Antigua itself had some leverage over the financial intermediaries involved, we might have expected it to seek to counter U.S. influence at that level; instead, it opted to seek recourse at the WTO.

Privacy is a highly important policy area. Consumers' persistent fears that their privacy was threatened by new technologies were frequently cited as a serious problem for the expansion of e-commerce (White House 1997). The World Wide Web and Internet, as well as more mundane technologies such as consumer loyalty programs, permitted new kinds of information gathering, while advances in computing power and database programs allowed businesses to engage in quite sophisticated forms of "data mining." There was substantial agreement among advanced industrialized democracies over what the goals of privacy protection should be, at least on the level of principle. The OECD Privacy Principles represented a general agreement among member states as to the basic principles of privacy regulation in an era of rapid advances in information technology. However, there was substantial disagreement among states as to how these principles should be implemented for the private sector; the United States preferred self-regulation and European countries preferred binding legislation.

These differences led to confrontation between the European Union and the United States (for a more complete account, see Farrell 2003a). In the late 1990s, the European Union passed a Data Protection Directive that sought to create a common European framework of "data protection" principles—but also to restrict the movement of individuals' personal data to countries outside the European Union that did not have "adequate" privacy protection. The reasoning behind this was clear. European officials feared that if they allowed personal data to be exported beyond the reach of European law, they would be giving businesses free license to circumvent the EU regime by exporting data, processing it abroad, and reaping the results at home. However, this clearly had adverse implications for EU trading partners that had less strict regimes, in particular the United States, which was highly unlikely to be considered "adequate" by EU authorities (Swire & Litan 1998). The United States initially responded to the European Union by making counterthreats, and by seeking to encourage the immediate creation of an effective self-regulatory regime through encouraging so-called privacy-seal organizations to begin offering their services to firms. These organizations were perceived by both EU and U.S. negotiators as important points of control; the United States hoped that they would diffuse a self-regulatory model of privacy protection internationally, while the European Union hoped that they might allow it to ratchet up private-sector standards of privacy protection within the United States (Farrell 2003a).

The result of this confrontation was an eventual agreement between the European Union and the United States on a "hybrid solution," the so-called Safe Harbor Arrangement. It combined elements of government oversight with a strong element of self-regulation, delegating many aspects of implementation to privacy-seal organizations. It is to be noted, however, that this solution did not emerge naturally or easily from the shared understanding of the European Union and the United States regarding privacy rights (although its emergence was greatly facilitated by the commitments of both European Union and United States to the OECD privacy principles). Instead, it required a serious reconsideration by both sides of the appropriate means toward privacy protection. In other words, some basic elements of the final agreement were not present in the *ex ante* views of privacy shared by both sides. Instead, a greater degree of agreement on the underlying issues of enforcement was created through argument that occurred in the process of negotiation (Farrell 2003a). It is quite possible that had negotiations gone slightly differently, the eventual solution of a hybrid regime would not have emerged.

Thus, the privacy case study provides only partial support for the framework. On the one hand, there was some degree of existing consensus on the basic principles of privacy regulation, which helped facilitate the creation of a hybrid regime combining an international agreement with points of control. But on the other, final agreement on this regime was possible only because of a process of argument and persuasion, which could have ended differently. Thus, although the arguments advanced in the simple framework above help to explain the empirical outcome, they clearly do not provide a complete account of the circumstances leading up to it.

Finally, the rapid expansion of e-commerce poses a substantial long-term challenge to states' ability to raise taxes. [The following account relies extensively on Paris (2003).] The current international taxation regime faces extreme difficulties in accommodating e-commerce transactions. Typically, states collect direct taxes on the basis of source (they seek to collect taxes from those who have sources of income located in their jurisdiction), residence (they seek to collect taxes on the income of residents of their jurisdiction, even if the sources of income are elsewhere), or both. A complicated international tax regime has been created, which seeks to avoid "double taxation" of individuals and economic actors, in part by using the principle of "permanent establishment" (whether a business has a physical presence in a country) to determine the geographic location of sources of income and of individuals' residency. This determination, however, is extremely hard to make with regard to e-commerce transactions. Johnson & Post's (1996) logic applies with a vengeance; when an e-commerce transaction takes place across multiple jurisdictions, as many do, it is difficult to determine which jurisdiction(s) should be able to tax it. It is possible for a firm to do a substantial amount of business in a particular jurisdiction without having any permanent physical presence in that jurisdiction that would give rise to a tax liability. Multinational firms have always been able to engage in some degree of transfer pricing to lower their tax burden. However, the advent of e-commerce and of business based on cross-border information transfer radically increases the opportunity of firms to engage in this form of regulatory arbitrage. The business consultancy firm Ernst and Young recommends that their clients take advantage of the Internet to locate geographically neutral services in low-tax jurisdictions (Paris 2003).

This poses a challenge to states' abilities to raise revenues through direct taxation (and to a lesser extent through indirect taxation too). There are no reliable statistics on the size of the international e-commerce sector, but there is general consensus that it is important and growing. States—and especially high-taxation states—are likely to suffer increasingly large revenue losses as the e-commerce sector expands. However, few solutions are apparent. In contrast to many other policy areas affected by e-commerce, there are no obvious third parties that might serve as points of control. Furthermore, it is difficult for states to coordinate action with each other. Taxation is a notoriously sensitive topic for states. As the OECD's Technical Advisory Group on the topic notes:

> The fact is. . .that recourse to international exchanges of information and assistance in collection for purposes of taxing business profits is still the exception rather than the rule, especially for developing countries. (OECD 2003, p. 18)

The problem is that states seeking to tax business profits are unlikely to reach agreement; each wants to maximize its own tax revenues. More generally, the question of whether to reform the tax regime in order to better tackle the problems of e-commerce has strong and obvious distributional implications. States with low taxes on business profits are likely to prefer the status quo, as it means that international corporations are more likely to engage in transfer pricing arrangements that increase their revenues, and mobile actors are more likely to base themselves in these jurisdictions. States with high taxes on business profits equally clearly have the opposite incentive and are likely to want reform.

Paris (2003) argues that states nonetheless face a collective problem over the longer term that makes cooperation a functional imperative. Because e-commerce is likely to continue expanding in importance, and because the current regime is so poorly suited to capturing taxes from e-commerce (so that in principle some businesses may be able to avoid taxation altogether), states will probably have to move taxation to the international level. This new regime would require considerably higher levels of coordination and collaboration. In the long run, Paris may quite possibly be right, especially if the problems of e-commerce present a major fiscal challenge to powerful states such as the United States and EU member states. However, there is little evidence at the moment of any great desire among states to move in this direction, and considerable evidence of dissension. In the words of the OECD Technical Advisory Group:

> Most countries would probably evaluate any suggestion to change the current treaty norms on the basis of their current domestic law and the impact that this

> would have on their tax revenues. On that basis, it is likely that the process of reaching an international agreement concerning new rules for taxing business profits would be long and difficult. (OECD 2003, p. 26).

Thus, the taxation of e-commerce presents an example of an issue area where states have (*a*) conflicting preferences over whether and how the current regime should be reformed, and (*b*) no obvious points of control through which to reassert authority over the relevant private actors. As the framework would predict, the result is stalemate, and a continued inability to reach a mutually agreeable *modus vivendi*, as the combination of increasing interdependence and variation between states' taxation policies offers substantial arbitration opportunities for private actors.

In conclusion, then, a limited plausibility probe, drawing on three prominent cases in the recent literature, suggests that the explanatory framework set out in the previous section has some real explanatory value. As the case of privacy regulation illustrates, it has some limitations. Nonetheless, this framework, simple though it is, appears to offer a highly useful account of state choice in a world where states can work through private actors.

SUMMARY AND CONCLUSIONS

There is an important gap in our current understanding of the relationship between states and private actors. Despite a substantial body of knowledge on the circumstances under which private actors can or cannot influence states, and some hypotheses about the circumstances under which they can create their own spaces of transnational governance, we know very little indeed about the circumstances under which states are likely to wish to work through private actors in order to achieve policy outcomes. In part, this is a function of the way the international relations debate has developed; both those who privilege states and those who privilege private actors as the key actors in international relations have tended not to be interested in this relationship because of their underlying theoretical commitments. It is also the result of the fact that more recent debates on globalization tend to focus on very broad and general claims about secular changes (or the lack of same) in the relationship between states and private actors in world politics, neglecting inquiry into their specific microrelationships (Kahler & Lake 2003).

To provide a more specific understanding of the circumstances under which states will seek to work through private actors, I have built upon an important new body of work on states' bargaining strength vis-à-vis private actors. The rich body of legal-theoretical literature on the evolution of the Internet and e-commerce not only provides very useful empirical information but also contributes important theoretical insights. Arguments about state preferences and regulatory arbitrage, on the one hand, and the presence of private actors that offer points of control, on the other, can be brought together into a unified framework that provides predictions as to the kinds of outcomes we may expect in different areas of policy. A plausibility probe examining three cases from the existing literature supports the plausibility of the framework.

E-commerce and the Internet offer an especially rich testing ground for arguments about state–private actor relations. However, if the claims advanced in this article have merit, they can be expected to have explanatory power in other important areas of state–private actor interaction in the international economy, such as financial regulation (Goodman & Pauly 1993; L. Mosley, unpublished manuscript) and standard setting (Mattli & Büthe 2003). Testing these claims—and those of rival frameworks of explanation—constitutes an important future research agenda for international relations.

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