Chapter 3
Public Sector Transformation and the Design of Public Policies for Electronic Commerce and the New Economy:
Tax and Antitrust Policies

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ABSTRACT

The current situation of taxation of electronic commerce is still in its infancy in regard to its actual implementation as well as in the existence of doctrinal principles and generally accepted guidelines on the characteristics and implementation of taxation. This chapter uses the concepts, analytical tools, and appropriate models of economic analysis to understand and explain the economic phenomena observed in the New Economy and how the public sector can adapt to the new challenges. Thus, the chapter analyzes the optimal design of tax policy for electronic markets, in particular electronic commerce, and the guidelines of antitrust policy in electronic markets. This chapter also analyzes the strategies that can be adopted by firms in the New Economy to avoid or minimize the risk of intervention by antitrust authorities.

INTRODUCTION

The markets of the New Economy include those sectors associated with technological changes, which result from heavy investment in R&D. Therefore, innovation is the main characteristic of the New Economy sectors. The public sector must transform itself to adapt to a changing environment. Thus, the basic factor in these industries is human capital, since R&D activities are intensive in highly skilled labor. Although there is an agreement that innovation is very important in the New Economy sectors, there is no consensus in determining the role of innovation in these markets.

Some authors argue that innovation determines the degree of competition in these sectors. Unlike other markets of the economy, where competition is primarily via prices, in the New Economy competition takes place via innovative efforts (measured, for example, through the level of spending on R&D). From this point of view, innovations in these industries are, mostly, drastic, which often implies the replacement of the leading firm in the market. This does not happen in traditional sectors, characterized by being capital intensive and whose innovations involve, usually, product enhancements or reduction of production costs. This means that the market leader can maintain its leadership position in perpetuity. However, other authors argue that the level of innovation does not need to determine the degree of competition, but rather the opposite. From this point of view, companies in the New Economy with a dominant position in the market can use innovation as a means of barrier to entry in order to continue to maintain its dominant position, which obviously is an anticompetitive practice.

In this chapter, we draw a stylized profile of the New Economy and the implications regarding public sector transformation. This chapter's goals are essentially limited to two areas. First, the optimal design of tax policy in electronic markets, in particular electronic commerce is stated. Second, the guidelines of antitrust policy in electronic markets are introduced.

The optimal design of tax regulations for electronic markets requires a detailed analysis by the public sector of the strategies of firms operating in them. In particular, the analysis of price and marketing strategies of companies is one of the most important, although not the only one. This chapter will make an initial contribution in the form of a state-of-the-art survey on pricing and marketing strategies by firms operating in e-commerce.

After analyzing business strategies, the chapter will reflect on the inherent difficulties that e-commerce poses to tax authorities. With this background, the chapter will move on to critically analyze the main initiatives in the taxation of electronic commerce, by highlighting those principles that generate greater consensus.

The second goal of this study involves analyzing antitrust policy in e-commerce. This chapter offers insights and guidance on the likely and/or desirable paths of antitrust policy applied to electronic markets. The intrinsic difficulty of this policy has increased significantly recently. The overall objective of "protecting competition" involves subtle concepts and public officials face both enormous complexities and enormous possibilities of welfare gains and huge social losses in case of errors in policy. The chapter offers an annotated guide including the most important cases and the arguments by both sides, as well as an interpretation of the consequences of failure and a summary of the principles that can be derived from the analysis.

BACKGROUND

The rise of electronic commerce represents a new and important challenge for the public sector. Markets usually change faster than the public sector structures. Firms are usually eager to adopt new technologies in order to obtain higher profits. In

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