



TECHNOLOGY
POLICY
INSTITUTE

**The UK's Digital Competition Report:
The Anticompetitive Risks of a Pro-Competition Policy**

May 2019

Thomas Lenard

The UK's Digital Competition Report: The Anticompetitive Risks of a Pro-Competition Policy

Thomas M. Lenard

I. Introduction

The emergence of large tech platforms over the past decade has precipitated increasingly intense debates about antitrust policy. Critics claim these platforms have amassed too much market power and, as a result, the digital economy is not realizing its potential in terms of consumer benefits and innovation. In response to this concern, the United Kingdom commissioned a Digital Competition Expert Panel, chaired by former Obama Council of Economic Advisers Chairman Jason Furman, to examine the issue and make recommendations for improving the UK's digital competition policies.¹

The Panel's Report argues that standard competition policy, particularly merger policy, needs to be updated and strengthened, but that relying on antitrust and merger enforcement alone is insufficient for the digital economy. The bulk of the Report presents a case for a new policy regime that actively promotes competition in the digital sectors. In contrast to traditional *ex post* antitrust enforcement, the pro-competition policy would consist of a set of *ex ante* regulatory requirements that would apply to large platforms with "strategic market status" regardless of whether they behaved in an anticompetitive manner harmful to consumers.

This new regulatory regime would represent a radical departure from standard competition policy, at least as practiced in the U.S. Although the Report endorses the consumer welfare standard for antitrust, it fails to present analysis showing that its proposals would, in fact, enhance consumer welfare or pass a cost-benefit test. In addition, although the Report says it rejects public utility regulation for large digital platforms, its proposals resemble public utility-style regulation in important ways.

The proposed regulatory regime would present many opportunities for rent seeking and anticompetitive behavior by platforms and other affected parties, both in the initial development

¹ Unlocking digital competition: Report of the Digital Competition Expert Panel, 2019 (hereafter, Report), at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf

of the new functions and in their subsequent implementation. If the recommendations are implemented, incumbents may become more firmly entrenched and entry may be more difficult, contrary to the Panel's intent.

The Report also argues for stronger merger enforcement, particularly concerning acquisitions by large platforms of firms that might become competitors. Blocking mergers based on speculation about how companies and technologies might develop over time would represent a major change in merger enforcement. Acquisition by a large platform, such as Facebook or Google, is a frequent exit strategy for successful tech startups, so making that strategy more difficult would be a disincentive to investing in those startups. The Report does not provide any guidance concerning how authorities should incorporate this innovation effect in their decisions.

II. Is There a Competition Problem?

The Panel's policy prescriptions are predicated on the view that the economic characteristics of digital markets create a serious digital competition problem. Digital markets are often characterized by strong economies of scale and scope and network effects that may make them subject to "tipping", where the winner takes all, or most, of the market. This problem, the Panel argues, is exacerbated by the data advantage incumbents enjoy. The Panel believes this data advantage is a major barrier to entry.

The Report implicitly assumes that more competitors is always a good thing, as it generally seems to endorse almost any policy that might further that objective. However, the presence of strong economies of scale and scope means that additional firms do not necessarily enhance efficiency or consumer welfare. As long as anticompetitive behavior is not discouraging entry, then policies that artificially encourage entry may simply deprive consumers of savings from scale and scope economies. In other words, encouraging entry when no market failure is preventing it, and when consumers are happy with the *status quo*, may simply waste resources.

Even if data is a barrier to entry—and I discuss that question below—the data advantage that incumbents may enjoy may also benefit consumers. Data can directly improve the quality and quantity of a platform's content—for example, by improving the accuracy of search results. Data can do so indirectly by providing better targeted advertising that is worth more to advertisers. Increased advertising revenues can be used to improve content, which is beneficial to consumers.

The Report cites high concentration levels for various platform “markets”, but these figures are misleading. Although the Report uses the term “market” in an antitrust discussion, it does not use it in a way consistent with an antitrust definition. Moreover, the Report does not accurately reflect the dynamic competitive conditions in these markets. For example, the Report does not reflect the fact that today’s digital giants—Google, Facebook, Amazon, Apple, and Microsoft—compete vigorously in various areas with each other.² Some specific examples from the Report highlight these issues.

Google’s 90-percent share of the “general” online search market is presented without providing evidence that general search is a meaningful antitrust market. In fact, Google faces much more competition than the 90-percent figure would suggest. For example, consumers use both Google and Facebook to obtain news;³ nearly half of U.S. internet users go to Amazon first for product searches, compared to about 35 percent for Google;⁴ and consumers use many other platforms for specific searches, such as real estate and travel.

Google also faces competition in general search from Microsoft’s Bing, Duck-Duck-Go, and other smaller search engines. These search engines provide real competition to Google, despite their small market share, because users can easily switch (or use more than one). The fact that Bing’s market share remains low is not because Microsoft lacks resources. The fact that Google remains dominant, despite low switching costs and a competitor with deep pockets, suggests most users prefer it.

With respect to social media, the Report cites figures showing that UK users spend more than 70 percent of social media time on Facebook and Instagram, but doesn’t explain why this is a competition problem. Maybe it’s because people prefer these services to the alternatives. The Report also notes that this share has fallen from 92 percent over the last few years, suggesting these platforms are not as firmly entrenched as some might believe. The Report also does not discuss other media and activities that compete for users’ attention.

The Report notes that Google and Facebook combined have 54 percent of digital advertising spending, but does not show that digital advertising by itself is an antitrust market. In the U.S.,

² See, for example, <https://codavate.com/are-google-facebook-competitors/>

³ <https://www.businessinsider.com/facebook-and-google-are-now-media-companies-2017-10>

⁴ <https://www.emarketer.com/content/more-product-searches-start-on-amazon>

digital ad spending is just over half of total ad spending.⁵ Moreover, we are seeing entry into the digital advertising space. Amazon, for example, is increasingly active. Although still small relative to Google and Facebook, Amazon now ranks third in digital advertising revenues. Amazon's digital advertising business is projected to grow by 50 percent annually over the next several years.⁶

The Report notes that Google (Android) and Apple (iOS) together account for almost all mobile phone operating systems. Microsoft put a lot of resources into its own mobile phone operating system several years ago, but was unsuccessful, suggesting insufficient consumer demand for a third major player. The Report implies that only two major mobile operating systems is a problem, but doesn't explain why.

The Report describes Amazon as dominant in a "meaningful distinct sector of online retail,"⁷ with eBay as its closest competitor. The Report recognizes that offline physical stores and other online sellers exist, but suggests they don't provide meaningful competition. In the U.S. at least, retailers, such as Walmart and Target, compete with Amazon offline and are investing heavily in their online platforms.⁸ The Report notes that for many small online sellers, Amazon is a gateway to consumers. This is undoubtedly true, but having that gateway available is a major benefit to those sellers and to their customers. Consumers also benefit from the ability to search for products from many sellers in one place rather than having to go to multiple platforms.

The Report claims that access to capital for entrants is limited by the fact that a large portion of investment for digital companies is in intangible capital and that digital companies may incur losses for many years before becoming profitable. The basis for these assertions is unclear, given the very active venture capital market (at least in the U.S.) and equity valuations for online platforms that incorporate future growth. The most prominent example is Amazon, which focused on growth at the expense of profits for many years.⁹ Ride sharing companies Uber and Lyft have yet to earn a profit, but enjoy high market valuations.

⁵ <https://www.emarketer.com/content/us-digital-ad-spending-will-surpass-traditional-in-2019>

⁶ <https://www.forbes.com/sites/jeanbaptiste/2018/09/20/amazon-is-now-the-3-digital-ad-platform-in-the-u-s-behind-google-and-facebook-says-emarketer/#47d4e81c3926>

⁷ Report, 1.57.

⁸ <https://www.cnbc.com/2018/11/20/walmart-target-to-grab-more-online-sales-this-holiday-but-at-a-cost.html>

⁹ <https://www.statista.com/chart/14887/amazon-quarterly-profit/>

A fundamental theme of the Report is that large digital platform markets are not contestable and, moreover, the incumbents are in the best position to extend their positions into new areas such as artificial intelligence and machine learning. Despite examples of companies being replaced by entrants (e.g., MySpace by Facebook), the Report argues the potential for this happening in the future is limited, absent dramatic policy changes. A major reason, according to the Report, is that consumer data is more of a barrier to entry today than when these companies started out. I turn to this question in the next section.

III. Is Data a Barrier to Entry?

The Panel’s policy recommendations stem from its view of “the central importance of data as a driver of concentration and barrier to competition in digital markets...”¹⁰ The Report states this “is a key theme of the evidence gathered by the review,”¹¹ but does not cite this evidence. Moreover, there is persuasive evidence to the contrary.

For example, Catherine Tucker addresses this issue in a recent paper, which “asks whether the large amounts of digital data that are typically observed on large technology platforms—such as Google, Facebook, Uber and Amazon—typically give rise to structural conditions that would lead to antitrust concerns.”¹² Specifically, she examines whether possessing large amounts of digital data enhances market power due to either network effects or switching costs. She also examines whether data should be considered an essential facility.

Tucker finds little empirical evidence of economies of scale and scope in digital data. The ability to know what to do with data—to develop smart predictive algorithms— is much more important. Knowing how to work productively with data is a form of learning by doing, with benefits for consumers, which entrants may have difficulty matching.

Tucker argues that network effects are weaker than when they were connected to hardware, which was central to the antitrust case against Microsoft. Tucker also argues that while network effects can facilitate the growth of platforms, they can also accelerate their demise, which provides an opportunity for entrants. She argues that data can strengthen network effects only if

¹⁰ Report, p. 9.

¹¹ *Id.*

¹² Catherine Tucker, “Digital Data, Platforms and the Usual [Antitrust] Suspects: Network Effects, Switching Costs, Essential Facility,” *Review of Industrial Organization* (June 2019), forthcoming.

pooling data provides visible benefits to consumers. For example, a genetic-data-sharing website devoted to helping people trace their genealogy and find relatives using DNA will benefit from having more people and more data. A hospital deciding whether to join a health information exchange would benefit from a platform that has more data from more providers. But for many platforms the sharing of data among participants is not an important function.

Tucker’s analysis suggests that large quantities of data are less valuable than many believe—the most important thing is the analytical capability to use the data for predictive purposes. In addition, data are non-rival and widely available, consumption of data by one firm does not decrease its availability to others, and multiple firms can gather consumer data at the same time. Moreover, data is commercially available from a number of large data brokers. As Tucker observes, “for most elements of consumer behavior that might be part of a data set that is owned by a large technology platform, it is possible for a rival firm to gain that insight through purchasing data from a data broker.”¹³

IV. Proposed *Ex Ante* Regulatory Framework

To remedy concerns raised by the largest digital incumbent platforms, the Report proposes an *ex ante* pro-competition regulatory framework. This new framework is intended to compensate for what the Panel views as inherent limitations of *ex post* antitrust enforcement in digital markets.

The principal components of this new regime are:

- A new digital markets unit (DMU) that would identify digital platforms with strategic market status (SMS)—companies in a position to exercise market power over a gateway or bottleneck in a digital market—and focus its enforcement on those companies.
- The DMU would have three key functions, to be applied on a market-by-market basis:
 1. Develop a digital platform code of conduct applicable to platforms designated as having SMS;
 2. Develop standards for personal data mobility and open standards that would help make systems interoperable; and

¹³ *Id.*

3. Develop standards for data openness, allowing access to data held by SMS companies by other firms.

The first issue the new DMU would face is identifying platforms with SMS. This would not be a simple exercise. Firms are likely to advocate aggressively to have themselves excluded and other firms included in this category. The definition of a “digital platform” itself is unclear—does it, for example, include Walmart and Goldman Sachs, which have extensive consumer digital operations? Technology is so pervasive that where the line should be drawn is not obvious.

The Panel proposes that the pro-competition rules, including the code of conduct and the various standards for mobility and openness, be developed collaboratively by the DMU together with the platforms themselves as well as other affected parties, because “[e]ngagement with stakeholders will be essential to its effective operation so that the codes and standards developed draw upon and balance the perspectives of large and small digital businesses, and the interests of consumers.”¹⁴

It is somewhat ironic to argue that a pro-competition agenda is necessary due to market power of the largest firms and then invite these same firms to get together to develop the rules of the game. In other circumstances, this might be considered *per se* anti-competitive and a recipe for “rent seeking”. It is predictable that the parties at the table will all try to advance their own interests and disadvantage their actual and potential competitors.

Regulation typically favors large incumbents vis-à-vis smaller incumbents and entrants. Although the Report indicates that enforcement would focus on large platforms with SMS, many of the regulations, such as the standards for data mobility and open standards, would affect all firms including new entrants. Incumbents would be able to use the collaborative processes envisioned by the Report to erect barriers to entry. Thus, a framework designed to facilitate entry might end up doing the opposite.

¹⁴ Report, 2.103.

A. Code of Conduct

The Panel recommends adopting a binding pro-competitive code of conduct for companies with SMS. The code would clarify acceptable conduct for digital platforms and would be developed collaboratively by the DMU with platforms and other stakeholders.

The suggested code of conduct would require access to the platform (including rankings and reviews) on a fair, consistent and transparent—i.e., non-discriminatory—basis. These principles are characteristic of common carrier, or public utility-style, regulation. They also reflect the principles embodied in net neutrality (or other forms of neutrality—e.g., search neutrality).

The code would preclude conduct that is common in competitive markets, which typically are not “fair and non-discriminatory,” generally to the benefit of consumers.¹⁵ The typical supermarket, for example, does not have market power, but engages in practices that, from a regulatory perspective, would be considered unfair and discriminatory. Examples include the price discrimination that accompanies “frequent shopper” cards and the slotting fees for shelf space and shelf placement. These practices are key to the sometimes messy system by which the competitive marketplace allocates scarcity (shelf space, consumer attention, etc.). We see analogous messy competitive (and arguably “unfair” and “discriminatory”) process on digital platforms—e.g., preferential rankings.

Even for monopolists these arrangements are frequently efficient, because, under any market structure, increasing the value of the platform to consumers will increase demand for the platform. Moreover, especially for producers with large fixed and low marginal costs, which is frequently the case for digital platforms, discriminatory behavior—e.g., price discrimination—may be the efficient, and in some instances, the only way to cover costs. To the extent that non-discriminatory open-access requirements such as those proposed in the Report preclude efficient arrangements, investment incentives and consumer welfare would suffer.

¹⁵ Thomas M. Lenard and David T. Scheffman, “Distribution, Vertical Integration and the Net Neutrality Debate, in Thomas M. Lenard and Randolph J. May (eds.), *Net Neutrality or Net Neutering—Should Broadband Internet Services Be Regulated* (Springer, 2006).

B. Data Mobility and Open Standards

The Report recommends policy measures for data mobility and open standards. These policies are designed to lower the costs to consumers of switching between platforms, and to make it easier for entrants to compete with incumbent firms that have already amassed large amounts of consumer data.

If the value of a platform to a consumer depends significantly on the platform having the consumer's historic data, then switching costs may be significant. Tucker observes that “for most consumer-facing applications, it is difficult to see there would be real switching costs due to the storage of historic data,”¹⁶ and gives Amazon as an example. Amazon has a consumer's historic purchase records, but that seems unlikely to prevent the consumer from buying from another platform.

On the other hand, the value of a health analytics app might depend on having the consumer's health history, which could give rise to real switching costs. In these circumstances, open standards and interoperability could be beneficial for consumers and providers. That would presumably provide incentives for the market to develop along those lines. Whether the government should mandate such standards and participate in their development is another question.

The development of open standards and standards for data mobility involve complicated technical issues and present opportunities for strategic behavior on the part of market participants. The Panel does not discuss the potential for this process to be used for anticompetitive purposes or whether a government-directed standard-setting process envisioned by the Report would help or hinder innovation.

The Report presents Open Banking as a notable example of data mobility that has been implemented in practice.¹⁷ Open Banking provides a framework for a consumer's banking and financial data to be shared in a standardized way, with the consumer's consent. The purpose is to

¹⁶ Tucker, *Review of Industrial Organization* (2019), forthcoming.

¹⁷ Report, 2.62-2.67.

help consumers better manage their finances and to make it easier for new firms and services to enter the market.

Open Banking is a recent development and its costs and benefits have yet to be evaluated. More generally, the Report recognizes that “implementing personal data mobility is likely to involve considerable costs and complexities that will need to be carefully considered.”¹⁸ Further, the Report notes “the benefits of requiring specific data be caught should be weighed against the costs, particularly where businesses have invested in collecting observed or inferred data.”¹⁹ Indeed, the costs and benefits of measures such as this should be carefully evaluated before considering their adoption.

C. Data Openness

The Panel asserts that “the evidence suggests that large data holdings are at the heart of the potential for some platform markets to be dominated by single players and for that dominance to be entrenched in a way that lessens the potential for competition for the market.”²⁰ The Panel does not, however, cite the relevant evidence. As previously discussed, work by Tucker and others indicates that data alone are not very valuable and there are many alternative sources of data. The analytical resources possessed by the large platforms are more important and more difficult to replicate.

Because of its view of the overriding importance of data, the Panel recommends that the digital markets unit have the authority to mandate data openness in order to increase competition. Data openness means that “in some markets, the key to effective competition may be to grant potential competitors access to privately-held data.”²¹

Mandating access to a supposedly critical asset is a signal feature of public utility regulation. For example, under the 1996 Telecom Act, incumbents were required to lease their facilities to entrants at administratively determined prices.

¹⁸ Report, 2.66.

¹⁹ Report, 2.66

²⁰ Report, 2.89

²¹ Report, 2.81

So, the first question that arises with respect to requiring access to data is “at what price?” This would be a difficult question to answer both in theory and in practice. Moreover, data sets are different than physical assets. For one thing, to be useful, they need to be continuously updated.

Mandatory sharing requirements can have significant adverse effects on investment incentives, both for incumbents and entrants. The costs of assembling and organizing data sets can be substantial, including setting lower prices or offering higher quality to attract more users who provide the data.²² Requiring a firm to share these assets with competitors will diminish the incentive to undertake these investments. Similarly, the incentive for entrants to invest in data will be lower if they can obtain those data at a subsidized cost.

V. Strengthening Traditional Antitrust

A. Has Antitrust Facilitated Competition for Dominant Tech Companies?

The Report claims that the emergence of competition to tech giants IBM and Microsoft was “facilitated, in part, by government policy—in particular antitrust cases against these companies, without which the changes may never have happened.”²³ That conclusion is controversial. In both cases, technological developments may be more responsible for the new competition than the government’s antitrust case.

The government’s Sherman Act case against IBM, brought in 1969, alleged that the company had monopolized the market for computers and computer-peripherals equipment. When the government dropped its case 13 years later, the computer industry had changed so dramatically that the products initially in question were no longer being produced.²⁴

In the Microsoft case, the government imposed behavioral conditions designed to bring more competition to the market for desktop operating systems and internet browsers. The efficacy of this remedy is still debated. More than 15 years later, Microsoft still accounts for about 80 percent of the desktop operating system market. Microsoft’s share of the overall browser market has fallen to around 10 percent while Google’s Chrome is now the dominant browser. Whether

²² Michael Katz, “Multisided Platforms, Big Data, and a Little Antitrust Policy,” *Review of Industrial Organization* (June 2019), forthcoming.

²³ Report, p. 4.

²⁴ For a discussion of the IBM and Microsoft cases, see Robert Crandall, “The Dubious Antitrust Argument for Breaking Up the Internet Giants,” *Review of Industrial Organization* (June 2019), forthcoming.

Chrome's growth was due to the antitrust case or the development of the Android operating system for mobile devices—and the substitution of those devices for desktop PCs as the means to access broadband services—is debatable. In any event, the browser did not become a competitor to the operating system, as some had anticipated.

B. Merger Review

The Report argues that digital companies have used acquisitions to protect themselves from potential competition. The Panel believes competition authorities have been too lax with respect to mergers and should do more to block acquisitions of potential competitors by large digital platforms.

The Report suggests (as others have also) that, if authorities had blocked the Facebook-Instagram merger in 2012, Instagram might have emerged as a competitor to Facebook. However, the merger couldn't realistically have been blocked at the time because the major criterion was whether the merger would be anticompetitive and the two entities were not a significant part of any relevant market. Likely innovation or entry into a new market is speculative and a questionable criterion for stopping a merger.

The Report notes that merger policy is subject to two types of errors—*false positives* when a pro-competitive merger is blocked, and *false negatives* when an anti-competitive merger is allowed to go through. There have been no false positives involving major platforms since none of their acquisitions has been challenged. This lack of challenges suggests to the Panel that there has been under-enforcement since it is likely that some false negatives have occurred.

The problem facing stricter merger review is in identifying which acquisitions are of companies that might become an actual competitor and therefore should be blocked. Since this is difficult, and the probability of most acquisitions becoming significant competitors is probably small, the fact that none are blocked does not necessarily indicate under-enforcement. Determining which acquisitions might be competitors would likely become a highly subjective exercise and the subject of strategic advocacy by various interested parties.

The Panel suggests being tougher on acquisitions in adjacent spaces, presumably under the assumption that they are more likely potential competitors. This would produce some false positives, which the Panel suggests authorities should be willing to tolerate. This is consistent

with the Panel’s recommendation of a “balance of harms” approach, taking into account both the likelihood and the magnitude of the impact of the merger. Mergers should be blocked when expected to do more harm than good. This sounds good in principle, but would be difficult to implement in practice, precisely because prediction, particularly in dynamic industries, is so difficult.

The Report recognizes that acquisition by a major platform is an important exit strategy for startups and that a tougher merger policy might adversely affect incentives for entry. Indeed, when weighing the costs and benefits of the two error types, it is important to remember that the prospect of being acquired by a firm like Google or Facebook is a major reason entrepreneurs start firms in the first place. Thus a policy weighted toward rejecting acquisitions of new firms may discourage entrepreneurship by making exit more difficult. This could have a significant adverse effect on innovation in digital markets. However, the recommended policy does not appear to take this consideration into account.

Conclusion

The UK Report recommends expanded merger enforcement combined with a risky experiment in public utility-style regulation of the digital sector of the economy—a radical departure from traditional competition policy.

The proposals in the UK Report reflect an unwarranted confidence in government’s ability to micromanage this complicated sector of the economy in the interests of consumers. The Report does not weigh the costs and benefits of its proposals and therefore cannot conclude with any confidence that consumer welfare would be enhanced. Consumers may be harmed because, under the best of circumstances, the regulatory task is difficult. The economics of digital platforms are complicated, and whether certain practices are helpful or harmful to consumers is sometimes ambiguous.

The Report does not offer a convincing case that its proposals are pro-competitive. The merger proposals may adversely affect incentives to invest in startups and innovate. The regulatory regime envisioned by the Report seems to provide more than the usual amount of opportunities for rent seeking and anticompetitive behavior. It is quite possible that rather than becoming more

competitive, digital markets would become *less* competitive if the Report's recommendations are implemented.