

Conflicting Missions: The Risks of the Digital Markets Unit to Competition and Innovation  
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At the end of 2020, the UK government announced plans to create a Digital Markets Unit (DMU) charged with implementing an ex ante regulatory regime for certain digital platforms. Following the recommendations of the Digital Markets Taskforce, led by the Competition and Markets Authority (CMA), this DMU would serve as the de facto regulator of large tech companies that had been designated as having “strategic market status” (SMS). Accordingly, the DMU was formally established within the CMA in April 2021, although Parliament will need to legislate to give it the powers proposed by the Digital Markets Taskforce. That authorization is likely to come in 2022. Until then, the DMU will prepare draft codes of conduct, and potentially conduct further analysis to add more firms to its remit (so far, only Google and Facebook have been proposed as firms to be regulated, following the CMA’s Digital Advertising Market Study).

This announcement followed several official reviews claiming that some digital markets are not working properly because of the dominance of a few platforms. Based on these reports, the DMU would be given powers to designate dominant platforms as having “substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position”, which would lead to their being given the SMS designation. This would make platforms subject to a bespoke code of conduct, potential procompetitive interventions (PCIs), and increased scrutiny of their merger and product expansion decisions.

At first glance, none of these powers may appear novel. Codes of conduct have been used in other sectors, such as groceries and energy markets, and PCIs were part of the package of remedies in the CMA’s 2015 retail banking market review.

But these interventions were limited to a small number of clearly delineated sectors, firms, activities, or products. By contrast, the DMU’s remit will cover all “digital markets”. This is an already large and growing proportion of the UK economy that comprises many different activities, from digital advertising and e-commerce to online search, social media, and news publishing (among others). And it increasingly encompasses markets like taxis, groceries, entertainment, and other sectors that are becoming significantly “digitalised”. What may seem to be a focused mandate now is, over the coming decades, likely to grow to encompass more and more of the economy.

The DMU will thus combine the powers and operating structure of a narrow sector regulator with a cross-sector purview that is much closer to the CMA's economy-wide reach. And it will do so for one of the most vitally important parts of the economy, where entrepreneurialism is central and where misguided regulation of incumbents may have systemic effects. The implications of this—creating a de facto regulator with goals that are often conflicting, with powers that lack many of the checks and balances that the CMA usually faces, and with a remit that could be as broad as the economy itself have been given little scrutiny so far, with some assuming the DMU's scope is much narrower and more focused than it really is.

Proponents might view this level of ambition as fit for the challenge presented by digital markets, where strong competition is vital and where markets may naturally gravitate toward a small number of large competitors. And given the broad variety of activities undertaken by digital platforms and the rapidity of technological change, they may argue that an effective regulator needs both a broad remit and extensive powers to act quickly. But there are also clear costs and risks in creating such a powerful new agency, and these have not yet been widely appreciated by many with an interest in economic policy in Britain.

To get the measure of those costs and risks, this paper evaluates the challenges that the DMU will face as a novel regulator tackling firms with complex and highly differentiated business models, whose actions have distinct effects in several markets and startup ecosystems. It focuses on the structure and goals of the DMU, the first pillar of its powers—the codes of conduct it is expected to write and enforce—and the checks and balances that the CMA's proposals lack. The other two pillars of its powers—procompetitive interventions and changes to the mergers regime—are just as important substantively, but require further consideration in a future paper. We do discuss one element of the mergers proposals below, however, given its importance to startups.

**Section 1** sets out the main findings of several official reviews that preceded the announcement of the DMU.

**Section 2** summarises the duty and powers that the Digital Markets Taskforce proposes to give to this new regulator.

**Section 3** considers the problems of operationalising the DMU's primary duty, given its vague objectives and different constituencies. Without a clear vision for what success looks like and how to manage the trade-offs involved, the DMU could easily become a hindrance to competition and innovation, instead of a positive force. The number of firms subject to SMS designation, and the consequent interventions, could steadily increase without improving consumer outcomes, because there would be no straightforward way to decide whether regulation worked.

Further, because the determinants of innovation for any given firm or in any given market are so poorly understood, the heightened scrutiny of SMS firms contemplated by the Digital Markets Taskforce's recommendations could inadvertently chill innovation, both by SMS

firms themselves, as well as by small firms and startups, whose venture capital may depend in part on their prospects of being acquired by an incumbent.

Moreover, in its current proposed form, the DMU could influence the activities of companies beyond those found to have market power. This could create major barriers to inter-platform competition — a key part of competition in platform markets, as platforms vie with each other to keep users within their ecosystem and attract new ones. And, if it makes it harder for smaller firms to be acquired, it could reduce both the founding of, and investment in startups in the UK.

Because SMS firms will only be able to contest designations and the associated interventions via judicial review, there is also a bias in favour of intervention built in to the DMU's design. Lacking meaningful checks and balances, the DMU's mistakes could go uncorrected for years, further weakening innovation, competition, and startup formation in the UK to the detriment of consumers and the British economy itself.

All of these could combine to create significant unseen costs for British consumers, which go ignored and uncorrected even as they worsen consumer welfare and weaken competition and innovation in the markets the DMU is supposed to be working to improve.

**Section 4** evaluates the Taskforce's proposed participative approach. We consider existing models of conduct-based regulation in the UK, finding that these precedents have generally had much narrower goals and remits than those of the DMU, and that they therefore constitute a poor template for the new regulator. Where existing conduct-based regulation has had a broader remit, such as with the Financial Conduct Authority, it has been criticised by firms as unclear and unpredictable and by other stakeholders as ineffective. We also consider in this section whether co-regulation—mixing statutory objectives with private governance—might best achieve the government's purpose for the DMU, given the need to optimise across many different margins and the difficulty of doing so from the top.

**Section 5** concludes with high-level recommendations to help ensure that the DMU actually serves to promote competition and innovation in UK digital markets. Before moving forward, the government should focus the DMU on the CMA's core objective, which is to promote competition for the benefit of British consumers. And it should be clear that the codes of conduct it is charged with drafting and enforcing should be done only to promote competition, not to regulate the conduct of incumbents for the purpose of promoting other social goals that may conflict with the goal of promoting competition.

The government should also narrow the scope and extent of the DMU's powers so that it promotes competition in the specific markets in which it has determined a firm has "strategic market status", and does not grow into a bloated regulator of these companies' other activities in competitive markets, or of the wider economy wherever "digitalisation" is taking place. The DMU should be genuinely participative, allowing stakeholders to actively assist in decision-making instead of just offering advice. It should give special consideration to startups, and to the effects of its behaviour on entrepreneurs' and venture capitalists'

incentives to start and fund a business. Finally, it should allow for appeals on the merits to allow the DMU to be held accountable by courts for its decisions.

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