The FTC Did Not ‘Fumble the Future’ in Its Google Search Investigation
March 26, 2021
Geoffrey A. Manne and Dirk Auer

Politico has released a cache of confidential Federal Trade Commission (FTC) documents in connection with a series of articles on the commission’s antitrust probe into Google Search a decade ago. The headline of the first piece in the series argues the FTC “fumbled the future” by failing to follow through on staff recommendations to pursue antitrust intervention against the company.

But while the leaked documents shed interesting light on the inner workings of the FTC, they do very little to substantiate the case that the FTC dropped the ball when the commissioners voted unanimously not to bring an action against Google.

Drawn primarily from memos by the FTC’s lawyers, the *Politico* report purports to uncover key revelations that undermine the FTC’s decision not to sue Google. None of the revelations, however, provide evidence that Google’s behavior actually harmed consumers.

The report’s overriding claim—and the one most consistently forwarded by antitrust activists on Twitter—is that FTC commissioners wrongly sided with the agency's economists (who cautioned against intervention) rather than its lawyers (who tenuously recommended very limited intervention).

> One thing that really comes through in [@leah_nylen] excellent set of articles on the FTC decision to abandon the GOOG lawsuit is just how *wrong* the economists were. /1
>
> — (((haroldfeld))) (@haroldfeld) [March 16, 2021]

> Reading through [@leah_nylen]'s incredible scoop on how FTC dropped the ball on Google in 2013. This passage from the economics memo stands out as emblematic of the ways economists have repeatedly fumbled antitrust enforcement. [pic.twitter.com/lKBgVfxI4H]
>
> — Marshall Steinbaum (@Econ_Marshall) [March 16, 2021]

> 16. But the biggest reason is the point of the post. Economists. The commission's antitrust economists made a very strong, and entirely wrong, argument against the case, which in retrospect rested on a set of laughably inaccurate predictions. [pic.twitter.com/L5ecQcurAd]
>
> — Matt Stoller (@matthewstoller) [March 23, 2021]

Indeed, the overarching narrative is that the lawyers knew what was coming and the economists took wildly inaccurate positions that turned out to be completely off the mark:

> But the FTC's economists successfully argued against suing the company, and the agency's staff experts made a series of predictions that would fail to match where the online world was headed:
>
> — They saw only "limited potential for growth" in ads that track users across the web — now the backbone of Google parent company Alphabet's $182.5 billion in annual revenue.
>
> — They expected consumers to continue relying mainly on computers to search for information. Today, about 62 percent of those queries take place on mobile phones and tablets, nearly all of which use Google's search engine as the default.
>
> — They thought rivals like Microsoft, Mozilla or Amazon would offer viable

> competition to Google in the market for the software that runs smartphones. Instead, nearly all U.S. smartphones run on Google's Android and Apple's iOS.
>
> — They underestimated Google's market share, a heft that gave it power over advertisers as well as companies like Yelp and Tripadvisor that rely on search results for traffic.

The report thus asserts that:

> The agency ultimately voted against taking action, saying changes Google made to its search algorithm gave consumers better results and therefore didn't unfairly harm competitors.
>
> That conclusion underplays what the FTC's staff found during the probe. In 312 pages of documents, the vast majority never publicly released, **staffers outlined evidence that Google had taken numerous steps to ensure it would continue to dominate the market** — including emerging arenas such as mobile search and targeted advertising. [EMPHASIS ADDED]

What really emerges from the leaked memos, however, is analysis by *both* the FTC's lawyers *and* economists infused with a healthy dose of humility. There were strong political incentives to bring a case. As one of us noted upon the FTC's closing of the investigation: "It's hard to imagine an agency under more pressure, from more quarters (including the Hill), to bring a case around search." Yet FTC staff and commissioners resisted that pressure, because prediction is hard.

Ironically, the very prediction errors that the agency's staff cautioned against are now being held against them. Yet the claims that these errors (especially the economists') systematically cut in one direction (i.e., against enforcement) and that all of their predictions were wrong are both wide of the mark.

Decisions Under Uncertainty

In seeking to make an example out of the FTC economists' inaccurate predictions, critics ignore that antitrust investigations in dynamic markets *always* involve a tremendous amount of uncertainty; false predictions are the norm. Accordingly, the key challenge for policymakers is not so much to predict correctly, but to minimize the impact of incorrect predictions.

Seen in this light, the FTC economists' memo is far from the *laissez-faire* manifesto that critics make it out to be. Instead, it shows agency officials wrestling with uncertain market outcomes, and choosing a course of action under the assumption the predictions they make might indeed be wrong.

Consider the following passage from FTC economist Ken Heyer's memo:

> The great American philosopher Yogi Berra once famously remarked "**Predicting is difficult, especially about the future**." How right he was. And yet predicting, and making decisions based on those predictions, is what we are charged with doing. Ignoring the potential problem is not an option. **So I will be reasonably clear about my own tentative conclusions and recommendation, recognizing that reasonable people, perhaps applying a somewhat different standard, may disagree.** My recommendation derives from my read of the available evidence, combined with the standard I personally find appropriate to apply to Commission intervention. [EMPHASIS ADDED]

In other words, contrary to what many critics have claimed, it simply is not the case that the FTC's economists based their recommendations on bullish predictions about the future that ultimately failed to transpire. Instead, they merely recognized that, in a dynamic and unpredictable environment, antitrust intervention requires both a clear-cut theory of anticompetitive harm and a reasonable probability that remedies can improve consumer welfare. According to the economists, those conditions were absent with respect to Google Search.

Perhaps more importantly, it is worth asking why the economists' erroneous predictions matter at all. Do critics believe that developments the economists missed warrant a different normative stance today?

In that respect, it is worth noting that the economists' skepticism appeared to have rested first and foremost on the speculative nature of the harms alleged and the difficulty associated with designing appropriate remedies. And yet, if anything, these two concerns appear even more salient today.

Indeed, the remedies imposed against Google in the EU have not delivered the outcomes that enforcers expected (here and here). This could either be because the remedies were insufficient or because Google's market position was not due to anticompetitive conduct. Similarly, there is still no convincing economic theory or empirical research to support the notion that exclusive pre-installation and self-preferencing by incumbents harm consumers, and a great deal of reason to think they *benefit* them (see, e.g., our discussions of the issue here and here).

Against this backdrop, criticism of the FTC economists appears to be driven more by a prior assumption that intervention *is* necessary—and that it was and is disingenuous to think otherwise—than evidence that erroneous predictions materially affected the outcome of the proceedings.

To take one example, the fact that ad tracking grew faster than the FTC economists believed it would is no less consistent with vigorous competition—and Google providing a superior product—than with anticompetitive conduct on Google's part. The same applies to the growth of mobile operating systems. Ditto the fact that no rival has managed to dislodge Google in its most important markets.

In short, not only were the economist memos informed by the very prediction difficulties that critics are now pointing to, but critics have not shown that any of the staff's (inevitably) faulty predictions warranted a different normative outcome.

Putting Erroneous Predictions in Context

So what were these faulty predictions, and how important were they? *Politico* asserts that "the FTC's economists successfully argued against suing the company, and the agency's staff experts made a series of predictions that would fail to match where the online world was headed," tying this to the FTC's failure to intervene against Google over "tactics that European regulators and the U.S. Justice Department would later label antitrust violations." The clear message is that the current actions are presumptively valid, and that the FTC's economists thwarted earlier intervention based on faulty analysis.

But it is far from clear that these faulty predictions would have justified taking a tougher stance against Google. One key question for antitrust authorities is whether they can be reasonably certain that *more efficient* competitors will be unable to dislodge an incumbent. This assessment is necessarily forward-looking. Framed this way, greater market uncertainty (for instance, because policymakers are dealing with dynamic markets) usually cuts against antitrust intervention.

This does not entirely absolve the FTC economists who made the faulty predictions. But it does suggest the right question is not whether *the economists* made mistakes, but whether virtually *everyone* did so. The latter would be evidence of uncertainty, and thus weigh against antitrust intervention.

In that respect, it is worth noting that the staff who recommended that the FTC intervene *also* misjudged the future of digital markets.For example, while *Politico* surmises that the FTC "underestimated Google's market share, a heft that gave it power over advertisers as well as companies like Yelp and Tripadvisor that rely on search results for traffic," there is a case to be made that the FTC *overestimated* this power. If anything, Google's continued growth has opened new niches in the online advertising space.

Pinterest provides a fitting example; despite relying heavily on Google for traffic, its ad-funded service has witnessed significant growth. The same is true of other vertical search engines like Airbnb, Booking.com, and Zillow. While we cannot know the counterfactual, the vertical search industry has certainly not been decimated by Google's "monopoly"; quite the opposite. Unsurprisingly, this has coincided with a significant decrease in the cost of online advertising, and the growth of online advertising relative to other forms.

Politico asserts not only that the economists' market share and market power calculations were wrong, but that the lawyers knew better:

> The economists, relying on data from the market analytics firm Comscore, found that Google had only limited impact. They estimated that between 10 and 20 percent of traffic to those types of sites generally came from the search engine.
>
> FTC attorneys, though, used numbers provided by Yelp and found that 92 percent of users visited local review sites from Google. For shopping sites like eBay and TheFind, the referral rate from Google was between 67 and 73 percent.

This compares apples and oranges, or maybe oranges and grapefruit. The economists' data, from Comscore, applied to vertical search overall. They explicitly noted that shares for *particular sites* could be much higher or lower: for comparison shopping, for example, "ranging from 56% to less than 10%." This, of course, highlights a problem with the data provided by Yelp, et al.: it concerns only the websites of companies complaining about Google, not the overall flow of traffic for vertical search.

But the more important point is that *none* of the data discussed in the memos represents the overall flow of traffic for vertical search. Take Yelp, for example. According to the lawyers' memo, 92 percent of Yelp searches were referred from Google. Only, that's not true. We know it's not true because, [as Yelp CEO Jerry Stoppelman pointed out around this time] in Yelp's 2012 Q2 earnings call:

> When you consider that 40% of our searches come from mobile apps, there is quite a bit of un-monetized mobile traffic that we expect to unlock in the near future.

The numbers being analyzed by the FTC staff were apparently limited to referrals to Yelp's website from browsers. But is there any reason to think that is the relevant market, or the relevant measure of customer access? Certainly there is nothing in the staff memos to suggest they considered the full scope of the market very carefully here. Indeed, the footnote in the lawyers' memo presenting the traffic data is offered in support of this claim:

> Vertical websites, such as comparison shopping and local websites, are heavily dependent on Google's web search results to reach users. Thus, Google is in the unique position of being able to "make or break any web-based business."

It's plausible that vertical search traffic is "heavily dependent" on Google Search, but the numbers offered in support of that simply ignore the (then) 40 percent of traffic that Yelp acquired through its own mobile app, with no Google involvement at all. In any case, it is also notable that, while there are still somewhat fewer app users than web users (although the number has consistently increased), Yelp's app users view significantly more pages than its website users do — 10 times as many in 2015, for example.

Also noteworthy is that, for whatever speculative harm Google might be able to visit on the company, at the time of the FTC's analysis Yelp's local ad revenue was consistently increasing — by 89% in Q3 2012. And that was without *any* ad revenue coming from its app (display ads arrived on Yelp's mobile app in Q1 2013, a few months after the staff memos were written and just after the FTC closed its Google Search investigation).

In short, the search-engine industry is extremely dynamic and unpredictable. Contrary to what many have surmised from the FTC staff memo leaks, this cuts *against* antitrust intervention, not in favor of it.

The FTC Lawyers' Weak Case for Prosecuting Google

At the same time, although not discussed by *Politico*, the lawyers' memo also contains errors, suggesting that arguments *for* intervention were also (inevitably) subject to erroneous prediction.

Among other things, the FTC attorneys' memo argued the large upfront investments were required to develop cutting-edge algorithms, and that these effectively shielded Google from competition. The memo cites the following as a barrier to entry:

> A search engine requires algorithmic technology that enables it to search the Internet, retrieve and organize information, index billions of regularly changing web pages, and return relevant results instantaneously that satisfy the consumer's inquiry. Developing such algorithms requires highly specialized personnel with high levels of training and knowledge in engineering, economics, mathematics, sciences, and statistical analysis.

If there are barriers to entry in the search-engine industry, algorithms do not seem to be the source. While their market shares may be smaller than Google's, rival search engines like DuckDuckGo and Bing have been able to enter and gain traction; it is difficult to say that algorithmic technology has proven a barrier to entry. It may be hard to do *well*, but it certainly has not proved an impediment to new firms entering and developing workable and successful products. Indeed, some extremely successful companies have entered into similar advertising markets on the backs of complex algorithms, notably Instagram, Snapchat, and TikTok. All of these compete with Google for advertising dollars.

The FTC's legal staff also failed to see that Google would face serious competition in the rapidly growing voice assistant market. In other words, even its search-engine "moat" is far less impregnable than it might at first appear.

Moreover, as Ben Thompson argues in his *Stratechery* newsletter:

> The Staff memo is completely wrong too, at least in terms of the potential for their proposed remedies to lead to any real change in today's market. This gets back to why the fundamental premise of the *Politico* article, along with much of the antitrust chatter in Washington, misses the point: Google is dominant because consumers like it.

This difficulty was deftly highlighted by Heyer's memo:

> If the perceived problems here can be solved only through a draconian remedy of this sort, or perhaps through a remedy that eliminates Google's legitimately obtained market power (and thus its ability to "do evil"), I believe the remedy would be disproportionate to the violation and that its costs would likely exceed its benefits. Conversely, if a remedy well short of this seems likely to prove ineffective, a remedy would be undesirable for that reason. **In brief, I do not see a feasible remedy for the vertical conduct that would be both appropriate and effective, and which would not also be very costly to implement and to police**. [EMPHASIS ADDED]

Of course, we now know that this turned out to be a huge issue with the EU's competition cases against Google. The remedies in both the EU's *Google Shopping* and *Android* decisions were severely criticized by rival firms and consumer-defense organizations (here and here), but were ultimately upheld, in part because even the European Commission likely saw more forceful alternatives as disproportionate.

And in the few places where the legal staff concluded that Google's conduct may have caused harm, there is good reason to think that their analysis was flawed.

Google's 'revenue-sharing' agreements

It should be noted that neither the lawyers nor the economists at the FTC were particularly bullish on bringing suit against Google. In most areas of the investigation, neither recommended that the commission pursue a case. But one of the most interesting revelations from the recent leaks is that FTC lawyers did advise the commission's leadership to sue Google over revenue-sharing agreements that called for it to pay Apple and other carriers and manufacturers to pre-install its search bar on mobile devices:

> FTC staff urged the agency's five commissioners to sue Google for signing exclusive contracts with Apple and the major wireless carriers that made sure the company's search engine came pre-installed on smartphones.

Looking forward, an order should prohibit Google from imposing any contract terms that would prevent a mobile carrier or manufacturer from installing "competing software" on any mobile device. Competing Software would include any general search provider (*i.e.*, anything offering functionality similar to Google or Bing today), but should also be broad enough to include other products or services that generates revenue in competition with any Google product or service. For example, mobile applications represent another potential threat to Google's search advertising business.[79] We see stories almost daily about firms experimenting with ways to transfer business models to the mobile sphere. Similarly, we have testimony that Google continues to experiment with different mobile advertising formats and revenue sources.[80] While it is too early to tell whether or how the next threat to Google's business model will develop, we should prevent Google from banishing potential competitors from the mobile channel in the same way that it has already targeted search competitors.

The lawyers' stance is surprising, and, despite actions subsequently brought by the EU and DOJ on similar claims, a difficult one to countenance.

To a first approximation, this behavior is precisely what antitrust law seeks to promote: we want companies to compete aggressively to attract consumers. This conclusion is in no way altered when competition is "for the market" (in this case, firms bidding for exclusive placement of their search engines) rather than "in the market" (i.e., equally placed search engines competing for eyeballs).

Competition for exclusive placement has several important benefits. For a start, revenue-sharing agreements effectively subsidize consumers' mobile device purchases. As Brian Albrecht aptly puts it:

> This payment from Google means that Apple can lower its price to better compete for consumers. This is standard; some of the payment from Google to Apple will be passed through to consumers in the form of lower prices.

This finding is not new. For instance, Ronald Coase famously argued that the Federal

Communications Commission (FCC) was wrong to ban the broadcasting industry's equivalent of revenue-sharing agreements, so-called payola:

> [I]f the playing of a record by a radio station increases the sales of that record, it is both natural and desirable that there should be a charge for this. If this is not done by the station and payola is not allowed, it is inevitable that more resources will be employed in the production and distribution of records, without any gain to consumers, with the result that the real income of the community will tend to decline. In addition, the prohibition of payola may result in worse record programs, will tend to lessen competition, and will involve additional expenditures for regulation. The gain which the ban is thought to bring is to make the purchasing decisions of record buyers more efficient by eliminating "deception." It seems improbable to me that this problematical gain will offset the undoubted losses which flow from the ban on Payola.

Applying this logic to Google Search, it is clear that a ban on revenue-sharing agreements would merely lead both Google and its competitors to attract consumers via alternative means. For Google, this might involve "complete" vertical integration into the mobile phone market, rather than the open-licensing model that underpins the Android ecosystem. Valuable specialization may be lost in the process.

Moreover, from Apple's standpoint, Google's revenue-sharing agreements are profitable only to the extent that consumers actually *like* Google's products. If it turns out they don't, Google's payments to Apple may be outweighed by lower iPhone sales. It is thus unlikely that these agreements significantly undermined users' experience. To the contrary, Apple's testimony before the European Commission suggests that "exclusive" placement of Google's search engine was mostly driven by consumer preferences (as the FTC economists' memo points out):

> Apple would not offer simultaneous installation of competing search or mapping applications. Apple's focus is offering its customers the best products out of the box while allowing them to make choices after purchase. In many countries, Google offers the best product or service … Apple believes that offering additional search boxes on its web browsing software would confuse users and detract from Safari's aesthetic. Too many choices lead to consumer confusion and greatly affect the 'out of the box' experience of Apple products.

Similarly, Kevin Murphy and Benjamin Klein have shown that exclusive contracts intensify competition for distribution. In other words, absent theories of platform envelopment that are arguably inapplicable here, competition for exclusive placement would lead competing search engines to up their bids, ultimately lowering the price of mobile devices for consumers.

Indeed, this revenue-sharing model was likely essential to spur the development of Android in the first place. Without this prominent placement of Google Search on Android devices (notably thanks to revenue-sharing agreements with original equipment manufacturers), Google would likely have been unable to monetize the investment it made in the *open source*—and thus freely distributed—Android operating system.

In short, *Politico* and the FTC legal staff do little to show that Google's revenue-sharing payments excluded rivals that were, in fact, as efficient. In other words, Bing and Yahoo's failure to gain traction may simply be the result of inferior products and cost structures. Critics thus fail to show that Google's behavior harmed consumers, which is the touchstone of antitrust enforcement.

Self-preferencing

Another finding critics claim as important is that FTC leadership declined to bring suit against Google for preferencing its own vertical search services (this information had already been partially leaked by the *Wall Street Journal* in 2015). *Politico*'s framing implies this was a mistake:

> When Google adopted one algorithm change in 2011, rival sites saw significant drops in traffic. Amazon told the FTC that it saw a 35 percent drop in traffic from the comparison-shopping sites that used to send it customers

The focus on this claim is somewhat surprising. Even the leaked FTC legal staff memo found this theory of harm had little chance of standing up in court:

> Staff has investigated whether Google has unlawfully preferenced its own content over that of rivals, while simultaneously demoting rival websites….
>
> …Although it is a close call, we do not recommend that the Commission proceed on this cause of action because the case law is not favorable to our theory, which is premised on anticompetitive product design, and in any event, **Google's efficiency justifications are strong. Most importantly, Google can legitimately claim that at least part of the conduct at issue improves its product and benefits users**. [EMPHASIS ADDED]

More importantly, as one of us has argued elsewhere, the underlying problem lies not with Google, but with a standard asset-specificity trap:

> A content provider that makes itself dependent upon another company for distribution (or vice versa, of course) takes a significant risk. Although it may

> benefit from greater access to users, it places itself at the mercy of the other — or at least faces great difficulty (and great cost) adapting to unanticipated, crucial changes in distribution over which it has no control….
>
> …It was entirely predictable, and should have been expected, that Google's algorithm would evolve. It was also entirely predictable that it would evolve in ways that could diminish or even tank Foundem's traffic. As one online marketing/SEO expert puts it: On average, Google makes about 500 algorithm changes per year. 500!….
>
> …In the absence of an explicit agreement, should Google be required to make decisions that protect a dependent company's "asset-specific" investments, thus encouraging others to take the same, excessive risk?

Even if consumers happily visited rival websites when they were higher-ranked and traffic subsequently plummeted when Google updated its algorithm, that drop in traffic does not amount to evidence of misconduct. To hold otherwise would be to grant these rivals a virtual entitlement to the state of affairs that exists at any given point in time.

Indeed, there is good reason to believe Google's decision to favor its own content over that of other sites is procompetitive. Beyond determining and ensuring relevance, Google surely has the prerogative to compete vigorously and decide how to design its products to keep up with a changing market. In this case, that means designing, developing, and offering its own content in ways that partially displace the original "ten blue links" design of its search results page and instead offer its own answers to users' queries.

Competitor Harm Is Not an Indicator of the Need for Intervention

Some of the other information revealed by the leak is even more tangential, such as that the FTC ignored complaints from Google's rivals:

> Amazon and Facebook privately complained to the FTC about Google's conduct, saying their business suffered because of the company's search bias, scraping of content from rival sites and restrictions on advertisers' use of competing search engines.
>
> Amazon said it was so concerned about the prospect of Google monopolizing the search advertising business that it willingly sacrificed revenue by making ad deals aimed at keeping Microsoft's Bing and Yahoo's search engine afloat.

But complaints from rivals are at least as likely to stem from vigorous competition as from anticompetitive exclusion. This goes to a core principle of antitrust enforcement: antitrust law seeks to protect competition and consumer welfare, not rivals. Competition will always lead to winners and losers. Antitrust law protects this process and (at least theoretically) ensures that rivals cannot manipulate enforcers to safeguard their economic rents.

This explains why Frank Easterbrook—in his seminal work on "The Limits of Antitrust"—argued that enforcers should be highly suspicious of complaints lodged by rivals:

> Antitrust litigation is attractive as a method of raising rivals' costs because of the asymmetrical structure of incentives….
>
> …One line worth drawing is between suits by rivals and suits by consumers. Business rivals have an interest in higher prices, while consumers seek lower prices. Business rivals seek to raise the costs of production, while consumers have the opposite interest….
>
> …They [antitrust enforcers] therefore should treat suits by horizontal competitors with the utmost suspicion. They should dismiss outright some categories of litigation between rivals and subject all such suits to additional scrutiny.

Google's competitors spent millions pressuring the FTC to bring a case against the company. But why should it be a failing for the FTC to resist such pressure? Indeed, as then-commissioner Tom Rosch admonished in an interview following the closing of the case:

> They [Google's competitors] can darn well bring [a case] as a private antitrust action if they think their ox is being gored instead of free-riding on the government to achieve the same result.

Not that they would likely win such a case. Google's introduction of specialized shopping results (via the Google Shopping box) likely enabled several retailers to bypass the Amazon platform, thus increasing competition in the retail industry. Although this may have temporarily reduced Amazon's traffic and revenue (Amazon's sales have grown dramatically since then), it is exactly the outcome that antitrust laws are designed to protect.

Conclusion

When all is said and done, *Politico*'s revelations provide a rarely glimpsed look into the complex dynamics within the FTC, which many wrongly imagine to be a monolithic agency. Put simply, the FTC's commissioners, lawyers, and economists often disagree vehemently about the appropriate course of conduct. This is a good thing. As in many other walks of life, having a market for ideas is a sure way to foster sound decision making.

But in the final analysis, what the revelations do *not* show is that the FTC's market for ideas failed consumers a decade ago when it declined to bring an antitrust suit against Google. They thus do little to cement the case for antitrust intervention—whether a decade ago, or today.

View Article