Digital Markets Taskforce Consultation Response

*Sam Bowman**

ICLE Antitrust & Consumer Protection Research Program

White Paper 2020-07-31

*Sam Bowman is the Director of Competition Policy at the International Center for Law & Economics, based in London.
ICLE is a nonprofit, nonpartisan research center headquartered in Portland, OR, with offices in Washington DC and London. ICLE promotes the use of law & economics to inform public policy debates. We believe that intellectually rigorous, data-driven analysis will lead to efficient policy solutions that promote consumer welfare and global economic growth. ICLE has received financial support from numerous companies and individuals, including firms with interests both supportive of and in opposition to the ideas expressed in this and other ICLE-supported works. Unless otherwise noted, all ICLE support is in the form of unrestricted, general support. The ideas expressed here are the author's own and do not necessarily reflect the views of ICLE's advisors, affiliates, or supporters. Please contact the author with questions or comments at icle@laweconcenter.org.

1. Introduction

There is a danger that the UK is heading for a significant and potentially damaging overhaul of its competition policy on the basis of thin evidence, rushed analysis, and no attempt to measure the costs, benefits and risks of the approach being undertaken. The fact that the Digital Markets Taskforce consultation period was only one month is itself an example of this – one month is an unreasonably short period of time if the consultation was being taken seriously, and suggests that instead it is merely window-dressing to give procedural cover to whatever the government plans on doing anyway.

This would be a mistake. The two main documents that have led to the creation of the Digital Markets Taskforce, the Furman Report and the CMA's digital advertising market study, do not provide strong justifications for the changes they propose, which are sweeping. Neither of them consider the trade-offs involved with the interventions they propose in any serious detail, let alone attempt to measure them quantitatively, yet these trade-offs and risks – lower investment, reduced competition, less innovation, fewer startups being founded in the UK, and worse productivity growth for the UK over the years ahead – are potentially enormous, and could weaken the UK's technology sector.

While the Furman Report gave a broad overview of competition in digital markets, it often based its conclusions on assumptions and evidence only loosely related to digital markets – an example of this, in the section on mergers and acquisitions, is given below. It is largely a combination of desk research, stakeholder interviews, and the opinions of the review panel. While it may be a reasonable basis for the *beginning* of a debate about competition in digital markets, it is better seen as raising questions rather than answering them.

On the other hand, the CMA's digital advertising market study final report, while extremely detailed about the *mechanics* of the markets it surveys, is light on economic analysis and ignores a number of important overarching economic trends altogether, such as the large fall in the cost of digital advertising compared to other forms of advertising over the past decade. It also takes an explicitly static view of the market, ruling out analysis of incipient competitors like TikTok and actual competitors like Amazon. Decisions like this, to exclude significant and growing players without an economic justification for doing so, assume the report's conclusions that Google and Facebook do not face serious competitive pressures from other businesses.

The CMA's proposals are, of course, based on its study of the digital advertising market, yet many would affect companies with no or virtually no advertising business at all. Even if the government feels that the digital advertising market study *is* a reasonable basis for regulation of Google and Facebook, there is nothing in it to suggest that equivalent regulation of marketplaces (such as Amazon's Marketplace or Apple's App Store) are desirable.

The Call for Information issued for this consultation document also assumes the Taskforce's conclusions, asking questions exclusively about the workings of the interventions proposed by the Furman Report and CMA market study report and for *additional* powers and scope that these interventions should have. There are no questions at all about the potential costs of these interventions, let alone their costs if the UK is alone in implementing them. This suggests that the Taskforce is merely considering how to implement the proposals made in the Furman Report. To do so, regulating one of the most important sectors of the UK economy without a proper consideration of the costs and risks of doing so, could do serious harm to the UK's economy.

II. The Furman Report's weak evidence base

The Furman Report recommended that the UK should overhaul its competition regime with some quite significant changes to regulate the conduct of large digital platforms and make it harder for them to acquire other companies. But, while the Report's panel is accomplished, and its tone is sober and even-handed, the evidence on which it is based does not justify the recommendations it makes.

Most of the citations in the Report are of news reports or simple reporting of data with no analysis, and there is very little discussion of the relevant academic literature in each area, even to give a summary of it. In some cases, evidence and logic are misused to justify intuitions that are just not supported by the facts.

1. *Killer acquisitions*

One particularly bad example is the report's discussion of mergers in digital markets. The Report provides a single citation to support its proposals on the question of so-called "killer acquisitions" — acquisitions where incumbent firms acquire innovative startups to kill their rival product and avoid competing on the merits. The concern is that these mergers slip under the radar of current merger control either because the transaction is too small, or because the purchased firm is not yet in competition with the incumbent. But the paper the Report cites, by Colleen Cunningham, Florian Ederer and Song Ma, looks only at the pharmaceutical industry.[1]

The Furman Report says that "in the absence of any detailed analysis of the digital sector, these results can be roughly informative". But there are several important differences between the drug markets the paper considers and the digital markets the Furman Report is focused on.

The scenario described in the Cunningham, et al. paper is of a patent holder buying a direct competitor that has come up with a drug that emulates the patent holder's drug without infringing on the patent. As the Cunningham, et al. paper demonstrates, decreases in development rates are a

[1] Colleen Cunningham, Florian Ederer, and Song Ma, *Killer Acquisitions* (April 19, 2020), *available at* https://ssrn.com/abstract=3241707.

feature of acquisitions where the acquiring company holds a patent for a similar product that is far from expiry. The closer a patent is to expiry, the less likely an associated "killer" acquisition is.

But tech typically doesn't have the clear and predictable IP protections that would make such strategies reliable. The long and uncertain development and approval process involved in bringing a drug to market may also be a factor.

There are many more differences between tech acquisitions and the "killer acquisitions" in pharma that the Cunningham, et al. paper describes. So-called "acqui-hires," where a company is acquired in order to hire its workforce en masse, are common in tech[2] and explicitly ruled out of being "killers" by this paper, for example: it is not harmful to overall innovation or output overall if a team is moved to a more productive project after an acquisition. And network effects, although sometimes troubling from a competition perspective, can also make mergers of platforms beneficial for users by growing the size of that platform (because, of course, one of the points of a network is its size).

The Cunningham, et al. paper estimates that 5.3% of pharma acquisitions are "killers".[3] While that may seem low, some might say it's still 5.3% too much. However, it's not obvious that a merger review authority could bring that number closer to zero without also rejecting more mergers that are good for consumers, making people worse off overall. Given the number of factors that are specific to pharma and that do not apply to tech, it is dubious whether the findings of this paper are useful to the Furman Report's subject at all. Given how few acquisitions are found to be "killers" in pharma with all of these conditions present, it seems reasonable to assume that, even if this phenomenon does apply in some tech mergers, it is significantly rarer than the approximately 5.3% of mergers Cunningham, et al. find in pharma. As a result, the likelihood of erroneous condemnation of procompetitive mergers is significantly higher.

In any case, there's a fundamental disconnect between the "killer acquisitions" in the Cunningham, et al. paper and the tech acquisitions described as "killers" in the popular media.[4] Neither Facebook's acquisition of Instagram nor Google's acquisition of YouTube, which FTC Commissioner Rohit Chopra recently highlighted,[5] would count, because in neither case was the acquired company "killed." Nor were any of the other commonly derided tech acquisitions — e.g., Facebook/WhatsApp, Google/Waze, Microsoft/LinkedIn, or Amazon/Whole Foods — "killers," either.

In all these high-profile cases the acquiring companies expanded the service and invested more in them. One may object that these services would have competed with their acquirers had they

2 *See, e.g.,* John F. Coyle & Gregg D. Polsky, Acqui-Hiring, 63 Duke L. J., 281 (2013).

3 Cunningham, Ederer & Ma, *supra,* note 1 at 47.

4 *See, e.g.,* Gilead Edelman, *Why the FTC Wants to Revisit Hundreds of Deals by Big Tech*, WIRED (Feb. 12, 2020), https://www.wired.com/story/ftc-special-order-review-big-tech-killer-acquisitions/

5 Rohit Chopra (@chopraftc), Twitter (Feb 11, 2020, 9:54 AM), https://twitter.com/chopraftc/status/1227289729214881798?s=20.

remained independent,[6] but this is a totally different argument to the scenarios described in the Cunningham, et al. paper, where development of a new drug is shut down by the acquirer ostensibly to protect their existing product. It is thus extremely difficult to see how the Cunningham, et al. paper is even relevant to the digital platform context, let alone how it could justify a wholesale revision of the merger regime as applied to digital platforms.

A recent paper (published after the Furman Report) does attempt to survey acquisitions by Google, Amazon, Facebook, Microsoft, and Apple.[7] Out of 175 acquisitions in the 2015-17 period the paper surveys, only one satisfies the Cunningham, et al. paper's criteria for being a potentially "killer" acquisition — Facebook's acquisition of a photo sharing app called Masquerade, which had raised just $1 million in funding before being acquired.

In lieu of any actual analysis of mergers in digital markets, the Report falls back on a puzzling logic:

> To date, there have been no false positives in mergers involving the major digital platforms, for the simple reason that all of them have been permitted. Meanwhile, it is likely that some false negatives will have occurred during this time. This suggests that there has been underenforcement of digital mergers, both in the UK and globally. Remedying this underenforcement is not just a matter of greater focus by the enforcer, as it will also need to be assisted by legislative change.[8]

This is weak reasoning. It does not logically follow that the (presumed) existence of false negatives implies that there has been underenforcement, because overenforcement carries costs as well. Moreover, there are strong reasons to think that false positives in these markets are more costly than false negatives.[9] A well-run court system might still fail to convict a few criminals because the cost of accidentally convicting an innocent person was so high.

The CMA did commission an ex post review of six historical mergers in digital markets[10], including Facebook/Instagram and Google/Waze, two of the most controversial in the UK. Although it did

[6] Cristina Caffarra, Gregory Crawford, Tommaso Valletti, *'How Tech Rolls': Potential Competition and 'Reverse' Killer Acquisitions*, VOX EU (May 11, 2020), https://voxeu.org/content/how-tech-rolls-potential-competition-and-reverse-killer-acquisitions.

[7] Axel Gautier and Joe Lamesch, *Mergers in the Digital Economy* (CESifo Working Paper No. 8056, 2020), *available at* https://ssrn.com/abstract=3529012.

[8] Unlocking Digital Competition: Report of the Digital Competition Expert Panel 91, HM Treasury (March 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

[9] Geoffrey Manne and Joshua D. Wright, *Innovation and the Limits of Antitrust*. George Mason Law & Economics Research Paper No. 09-54, Lewis & Clark Law School Legal Studies Research Paper No. 2009-26, *available at* https://ssrn.com/abstract=1490849.

[10] Elena Argentesi, Paolo Buccirossi, Emilio Calvano, Tomaso Duso, Alessia Marrazzo, and Salvatore Nava, *Ex-post Assessment of Merger Control Decisions in Digital Markets*, LEAR (May 9, 2019), *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803576/CMA_past_digital_mergers_GOV.UK_version.pdf.

suggest that the review process could have been done differently, it also highlighted efficiencies that arose from each, and did not conclude that any has led to consumer detriment.

2. Recommendations

The Report is vague about which mergers it considers to have been uncompetitive, and apart from the aforementioned text it does not really attempt to justify its recommendations around merger control.

Despite this, the Report recommends a shift to a "balance of harms" approach.[11] Under the current regime, merger review focuses on the likelihood that a merger would reduce competition which, at least, gives clarity about the factors to be considered.[12] A "balance of harms" approach would require the potential scale (size) of the merged company to be considered as well.

This could give basis for blocking any merger at all on "scale" grounds. After all, if a photo editing app with a sharing timeline can grow into the world's second largest social network, how could a competition authority say with any confidence that some other acquisition might not prevent the emergence of a new platform on a similar scale, however unlikely? This could provide a basis for blocking almost any acquisition by an incumbent firm, and make merger review an even more opaque and uncertain process than it currently is, potentially deterring efficiency-raising mergers or leading startups that would like to be acquired to set up and operate overseas instead (or not to be started up in the first place).

The treatment of mergers is just one example of the shallowness of the Report. In many other cases — the discussions of concentration and barriers to entry in digital markets, for example — big changes are recommended on the basis of a handful of papers or less. Intuition repeatedly trumps evidence and academic research.

One might argue that such a limited, casual approach is inevitable in such a broad report. In this sense the Report may function perfectly well as an opening brief introducing the potential range of problems in the digital economy that a rational competition authority might consider addressing. But the complexity and uncertainty of the issues is no reason to eschew rigorous, detailed analysis before determining that a compelling case has been made. Adopting the Report's assumptions — and in many cases that is the very most one can say of them — of harm and remedial recommendations on the limited bases it offers is sure to lead to erroneous enforcement of competition law in a way that would reduce, rather than enhance, consumer welfare.

[11] Unlocking Digital Competition, *supra*, note 8 at 99.

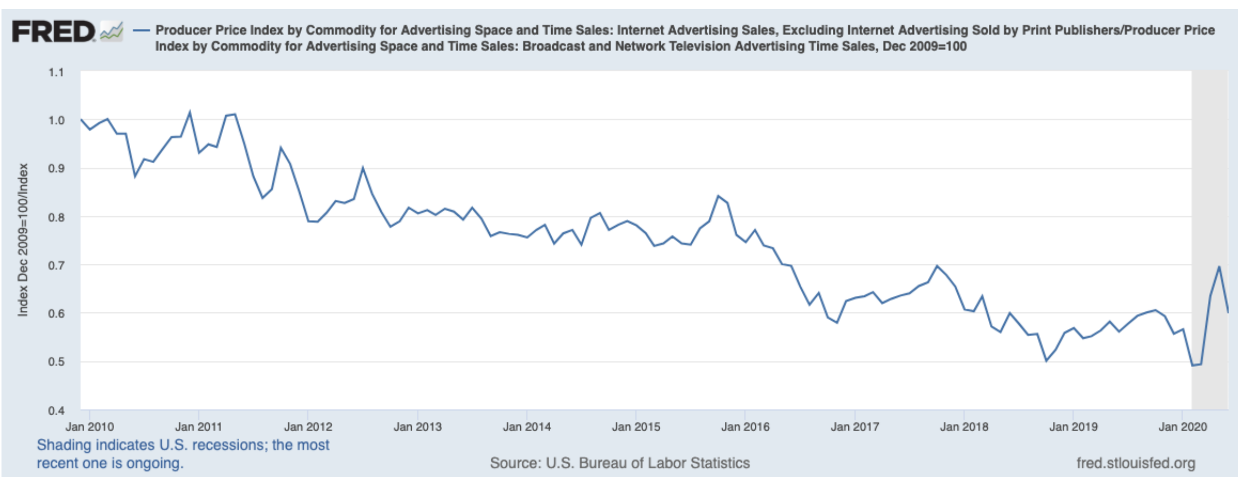
[12] Competition Commission and the Office of Fair Trading, *Merger Assessment Guidelines* (2010), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf.

III. The CMA's Digital Advertising Market Study

The market study is comprehensive about the mechanical and technical workings of the digital advertising market and is a useful resource for that reason. However, it is light on economic analysis and its recommendations do not match its findings. It does not identify any real-world consumer harms arising in the market, and instead speculates about how consumers "might" be worse off, without providing any evidence that this is the case, yet still proposes sweeping changes, many of which may be more economically costly than the benefits they bring (if any), and one of which would be a threat to the rule of law.

The report relies on assertion too much without considering counterfactuals. For example, it asserts that prices in certain segments are too high without any suggestion of what prices "should" be.[13]

Google and Facebook's advertising businesses are assumed to be in separate markets, which, perversely, would imply that the two companies could merge without harming competition, since they do not currently compete with each other. This implication stems from the CMA's approach to market definition, which was based more on market surveys than on economic analysis of how price changes between different forms of advertising affect spending.

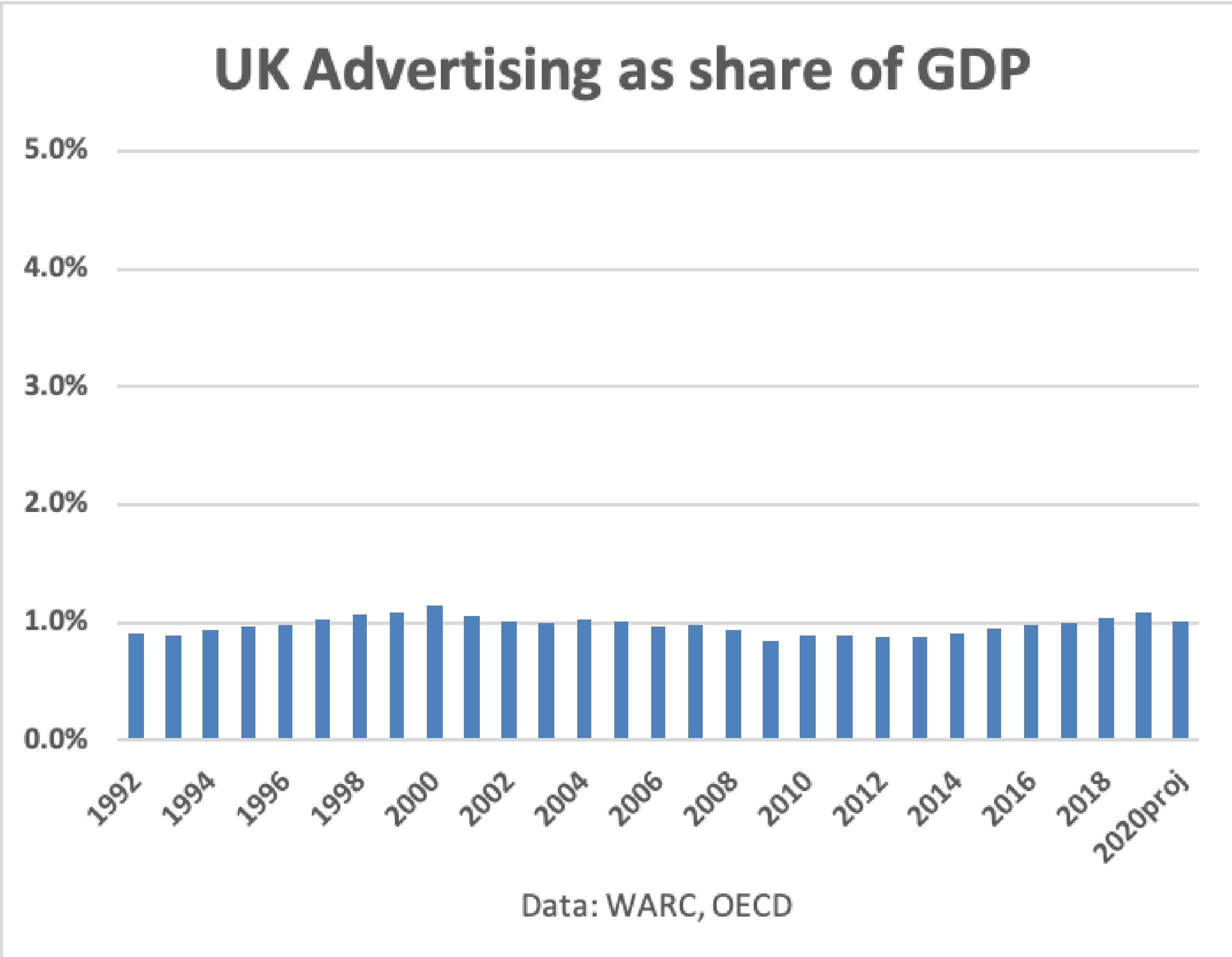


The report dismisses vast reductions in the price of digital advertising over the past decade relative to other forms of advertising – according to the US Bureau of Labour Statistics, for example, the price of digital advertising fell by 50% relative to the price of television advertising.[14] Overall spending on advertising as a share of GDP in the UK has remained essentially unchanged in the past 25 years, which difficult to square with the suggestion that consumer prices are being raised by

[13] Competition and Markets Authority, Online Platforms and Digital Advertising Market Study: Final Report, 231 (July 1, 2020).

[14] U.S. Bureau of Labor Statistics, *Producer Price Index by Commodity for Advertising Space and Time Sales: Broadcast and Network Television Advertising Time Sales [WPS362101]*, https://fred.stlouisfed.org/series/WPS362101 (last visited July 30, 2020).

higher advertising prices, rather than an alternative view that this is about dividing up rents between different players in the market.[15]



The CMA does show that Google's search revenues are higher prices are higher than Bing's – which it says could be caused by market power in search,[16] but could just as easily be because Google has a more lucrative user base or targets / converts adverts better (i.e., that it has a higher quality product). Other data in Appendix C shows significant differences in user behaviour between Google and Bing users for the same search terms, which would be reason to question whether you can assume that the value of click-throughs is the same for each company.

[15] Michael Mandel, The UK Online AD Market, Progressive Police Institute (July 1, 2020), https://www.progressivepolicy.org/blogs/the-uk-online-ad-market/.

[16] Competition and Markets Authority, *supra*, note **Error! Bookmark not defined.** at 231.

The CMA also does not mention the benefits that targeted ads have given to small and medium businesses that can now compete with larger corporations, thanks to much lower fixed costs of advertising.

When the report does try some economic analysis, it is crude. Comparing the 'cost of capital' — what companies must pay to raise funds for investment — with profitability may be appropriate for things like the electricity or water networks, where returns are predictable in advance. But to do so in digital markets completely misunderstands the economics of these markets, where businesses spend tens of billions a year on research and development (which itself may be a sign that these companies face strong competition) and where the launch of any new product is a gamble. The reliance on this analysis is telling: it is an approach that may be appropriate in static markets where tangible capital dominates, but not in dynamic ones where intangibles are the most valuable capital assets owned by companies.

The CMA rules out of its analysis potential competitors such as TikTok, because TikTok's current share of the advertising market is small, even though its growth and share of user attention are signs that it may be an important player in the near future (young people spend more time watching TikTok than YouTube, for example).[17] Amazon is ruled out of consideration on *ad hoc* grounds,[18] despite accounting for nearly a tenth of the overall digital advertising market and being the third largest advertising company overall.[19]

Finally, the analysis never gets to grips with the incentives that tech companies have to invest in products that don't make them much money directly. Google invests in Android precisely because it can make money from it by being the default search engine. That may be bad for other search engines, but without it, Google would have much less reason to invest in Android, and competition in the smartphone market between iPhones and Android devices would dry up.

The CMA also plays fast and loose with supposed harms such as targeted advertising, which may seem intrusive to some users, but also helps keep them from seeing annoying, irrelevant adverts. If digital platforms were forced to stop targeting ads, as the CMA has suggested, Facebook would have much less incentive to invest in the things about its products that benefit consumers.

The CMA's remedies are similar to those of the Furman Report, likely by design. But it proposes one additional remedy that should be dismissed out of hand. Although the language it uses is ambiguous, since the CMA already does have the power to break up businesses at the conclusion of a Market Investigation if it has found evidence that this would benefit consumers, the request that the Digital Markets Unit have the power to break up businesses can only be read as wanting to be

17 Competition and Markets Authority, *supra*, note **Error! Bookmark not defined.** at 134.

18 *Id.* at 88-89.

19 Nicole Perrin, *Amazon Advertising 2019*, EMARKETER (November 7, 2019), https://www.emarketer.com/content/amazon-advertising-2019.

able to have structural remedy powers *without the legal protections currently given by the Market Investigation Reference process.*

Here, the CMA is proposing to give itself essentially dictatorial powers to break up digital businesses whenever it likes. This would be contrary to the rule of law, and would cut against Britain's post-Brexit ambitions to be a haven for international investment. It is shocking that the CMA felt it was appropriate to request such extralegal powers.

IV. Conclusion

The process since the conclusion of the Furman Report has focused first on the digital advertising market study and then on the Digital Markets Taskforce, with the potential *costs* of the interventions recommended by the Furman Report never given any serious consideration. This is a grave mistake. As this submission has demonstrated, the evidence in favour of the Furman Report's recommendations is thin, and the CMA's report is a poor basis for interventions in the *digital advertising* market, let alone in other markets such as online retail or app stores that would be affected by the remedies being considered.

The costs of the interventions proposed could be significant. Economic regulation comes with significant costs, especially in innovative markets, and to regulate digital markets as is being proposed could seriously weaken the UK's productivity growth and long-run prosperity. There is good economic evidence that regulation reduces innovation, and size-dependent regulation (as proposed by the Furman Report and the CMA) reduce *radical* innovation in particular.[20] The government should set up an independent review to consider the potential costs to innovation, company formation, investment, competition and productivity growth of any of the Digital Markets Taskforce's recommendations before it makes any further moves to regulate Britain's technology sector.

[20] Philippe Aghion, Antonin Bergeaud and John van Reenen, *The Impact of Regulation on Innovation* (2019), *available at* https://scholar.harvard.edu/files/aghion/files/impact_of_regulation_on_innovation.pdf.