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On “Competition in the Digital Advertising
Ecosystem”

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Introduction

Chair Klobuchar, Ranking Member Lee, and distinguished members of the Subcommittee, thank you for inviting me to participate in today’s hearing on Competition in the Digital Advertising Ecosystem.

My name is Todd Henderson. I am the Michael J. Marks Professor of Law at the Chicago Law School. I am also a visiting fellow at the Hoover Institution at Stanford and an Academic Affiliate of the International Center for Law & Economics (ICLE). My testimony today is drawn largely from a paper I recently published with ICLE which examines the Advertising Middlemen Endangering Rigorous Internet Competition Accountability (AMERICA) Act,¹ as well as other recent scholarship my ICLE colleagues have produced looking at the law & economics of the digital advertising market.²

There are three primary points I want to share with the Subcommittee:

¹ M. Todd Henderson, *Ads Aren’t Stocks, or How Bad Analogies Make Bad Law*, INTERNATIONAL CENTER FOR LAW & ECONOMICS (Apr. 12, 2023), <https://laweconcenter.org/resources/ads-arent-stocks-or-how-bad-analogies-make-bad-law>.

² Geoffrey A. Manne & Eric Fruits, *The Antitrust Assault on Ad Tech: A Law & Economics Critique*, INTERNATIONAL CENTER FOR LAW & ECONOMICS (Nov. 3, 2022), <https://laweconcenter.org/resources/the-antitrust-assault-on-ad-tech-a-law-economics-critique>; Eric Fruits, Geoffrey A. Manne & Lazar Radic, *Relevant Market in the Google Ad Tech Case*, INTERNATIONAL CENTER FOR LAW & ECONOMICS (June 1, 2022), <https://laweconcenter.org/resources/relevant-market-in-the-google-adtech-case/>.

1. While monopolistic markets are associated with rising prices and restricted output, digital advertising has in recent years demonstrated the opposite, with ads becoming cheaper and more effective. Ranking Member Lee has said that the “big is bad philosophy is... part of a broader effort to overturn the consumer welfare standard,” and that “the purpose of antitrust is to advance the economic welfare of consumers.”³ The online display ad market is currently serving consumer welfare.
2. Ads are not stocks, and any claim that they should be regulated as stocks is based on a fundamental misunderstanding of how securities regulation works and why it exists.
3. The divestiture portion of the AMERICA Act may have perverse effects on competition and innovation. Congress should carefully consider what the open-display advertising market is likely to look like if the bill is adopted.

The State of the Digital Advertising Market

There are many kinds of digital advertising, but for our purposes today, the market that has drawn the most criticism and controversy is the open-display digital advertising business. Open display ads are also the only part of the market that the AMERICA Act would regulate.

Most display ads appear on heavily trafficked, owned-and-operated sites like TikTok, Instagram, Amazon, or YouTube, in which the company providing the advertising space is the same company that operates the platforms that place the ads. In contrast, open-display space is supplied by independent publishers and is usually facilitated by intermediaries that match advertisers and websites automatically, displaying ads to users for whom they are most relevant.

It has become common for lawmakers, regulators, and competition watchdogs to raise concerns about the open-display digital advertising market on grounds that it is dominated by a handful of firms like Google and Facebook. The claim—raised not only by the AMERICA Act but also by antitrust litigation brought against Google, both by the U.S. Justice Department and separately by the State of Texas and 14 other U.S. states—is that this dominance allows these firms to engage in anticompetitive conduct to extend their market power and to earn excess profits at the expense of advertisers, publishers, and consumers.

In determining whether the market conduct of advertising intermediaries is anticompetitive, it is important to consider that these firms are vertically integrated and operate in two-sided markets. Their overarching goal in pricing the various advertising services they provide is therefore to optimize the overall use of the platform. Indeed, pricing on one

³ Sen. Mike Lee, *The TEAM Act*, MIKE LEE U.S. SENATOR FOR UTAH (June 14, 2021), <https://www.lee.senate.gov/2021/6/the-team-act>.

side of the platform is often used to subsidize participation on another side, increasing the value to all sides combined.

It is indeed true that, when viewed in isolation, pricing and other terms of exchange on one side of the market may appear to diverge from competitive levels. One side of the market may pay superficially higher fees, but that is offset by the benefits from increased participation on the other side of the market. In this way, using subsidies to increase participation on another side of the market creates valuable network effects for the side of the market facing the higher fees.

To determine whether a vertically integrated entity in a multi-sided market is behaving in a way that harms consumers or competition, you need to look at the net effects on all sides of the market. Here, the evidence is clear: the price of digital advertising has fallen steadily, while output has risen. From 2010 to 2021, U.S. digital-ad spending grew from \$26 billion to \$189 billion, or 20% a year on average.⁴ Over the same period, the Producer Price Index for digital advertising fell by an average of 4% a year.⁵ The combination of this rising spending with falling prices means that, rather than constrained output, the number of ads bought and sold has increased by about 25% annually over the last decade.

Even in the digital advertising space, competition abounds. Over the past decade, Amazon has grown from a bit player in digital advertising to one of the biggest, last year earning \$38 billion in ad revenue. TikTok, which is a little more than six years old, saw its digital advertising revenues last year surpass Twitter and Snapchat combined, and is on track to generate over \$18 billion in ad revenue this year. Walmart had \$2.7 billion of ad revenue last year. At the same time, adtech competitors continue to expand and invest in competing technologies. Microsoft, for example, acquired the Xandr (formerly AppNexus) digital advertising platform from AT&T last year for \$1 billion. Even if Google and Facebook were trying to block competition, they are failing.⁶

These figures are consistent with a growing and increasingly competitive market. This is important context for Congress to bear in mind as it considers imposing regulatory requirements on digital advertising firms.

⁴ Megan Graham, *Digital Ad Revenue Jumped 35% in the U.S. Last Year, Biggest Gain Since 2006*, WALL STREET JOURNAL (Apr. 12, 2022), <https://www.wsj.com/articles/digital-ad-revenue-jumped-35-in-the-u-s-last-year-biggest-gain-since-2006-11649759401>.

⁵ *Producer Price Index by Commodity: Advertising Space and Time Sales: Internet Advertising Sales, Excluding Internet Advertising Sold by Print Publishers*, U.S. BUREAU OF LABOR STATISTICS, <https://fred.stlouisfed.org/series/WPU365>; *Producer Price Index, December 2009—February 2021*, U.S. BUREAU OF LABOR STATISTICS, <https://fred.stlouisfed.org/graph/?g=vtTd>.

⁶ See generally Benedict Evans, *Retail, search and Amazon's \$40bn 'advertising' business*, BENEDICT EVANS (March 6, 2023), <https://www.ben-evans.com/benedictevans/2023/3/6/ways-to-think-about-amazon-advertising>.

Considering the AMERICA Act: Ads Are Not Stocks

Like the earlier proposed Competition and Transparency in Digital Advertising Act (CTDA), the AMERICA Act would amend the Clayton Act as it applies to online advertising. The legislation proposes two major changes.

First, companies with more than \$20 billion in digital advertising revenue would be barred from owning a digital advertising exchange where online ads are bought and sold, if it also provides services to buyers and sellers of ads, or if it sells advertising space itself.

Second, companies with more than \$5 billion in digital advertising revenue that provide services to buyers and sellers of digital advertising would have a legal duty to act in a customer's "best interest" and would have to comply with various transparency requirements.

Several proponents of the legislation—both within Congress and in academic and advocacy circles—have argued for these changes on grounds that they mimic longstanding rules based in securities regulation. But if one understands the mechanics of stock markets and the reasons they are regulated as they are, the analogy completely falls apart.

Defenders of the AMERICA Act argue that Google should be barred from acting as a broker on its own ad exchange, just as Goldman Sachs is prohibited from owning the exchange on which stocks are traded.⁷ But this is factually incorrect. It is true that Goldman Sachs does not own the New York Stock Exchange, but it does own a different stock exchange, called SigmaX2, where the same stocks are bought and sold. In fact, about half of all stock trades occur on trading venues owned by brokers.⁸ The bill's insistence on the centrality of physical separation is not supported by the facts of how markets work.

There is, in fact, a "best interests" rule in securities regulation, and it appears to be the inspiration for the fiduciary duty part of the AMERICA Act. But it exists precisely because brokers may own exchanges and otherwise act on behalf of clients when there are real or potential conflicts of interest.

Even when dealing with stocks—where value is an inherent and definable thing and price is the same for everyone at a given moment—the complexity of multiple venues and individuals pursuing their own self-interest nonetheless makes enforcing a "best interests" standard extraordinarily complex. In online display-ad auctions, prices exist for a particular

⁷ Sen. Mike Lee, *The AMERICA Act: Lee Introduces Bill to Protect Digital Advertising Competition*, MIKE LEE U.S. SENATOR FOR UTAH (March 30, 2023), <https://www.lee.senate.gov/2023/3/the-america-act> ("The conflicts of interest are so glaring that one Google employee described Google's ad business as being like 'if Goldman or Citibank owned the NYSE.'").

⁸ *US Equity Market Structure Analysis: Analyzing the Meaning Behind the Level of Off-Exchange Trading*, SIFMA INSIGHTS (Sep. 2021), <https://www.sifma.org/wp-content/uploads/2021/09/SIFMA-Insights-Analyzing-Off-Exchange-Trading-09-2021.pdf> (reporting 44% of trades in 2021 (through June 30) were "off-exchange").

viewer for a particular location at a particular time. These multiple factors and the lack of an objective valuation make determining the “best” price, or even a reasonable price, nearly impossible.

But more importantly, we must remember why the stock market is regulated as it is. It is because of the profound social importance of accurate stock prices. Stocks are the largest source of savings and investment for individual Americans. They serve an essential function in funding projects that provide most goods and services in the economy, as well as directing almost all economic activity.

Stock markets are engaged in the constant evaluation of the intrinsic value of a single thing, which has the same value for every holder, more or less. Finding that intrinsic value is the stock market’s purpose, and the regulation of disclosure and trading activity is centrally about that purpose.

Ad markets, on the other hand, are not about finding the intrinsic value of information conveyed on a website to a particular individual, but rather just what someone is willing to pay for it in that instant. For small businesses, something less than 10% of all sales are devoted to marketing of all kinds, making it an insubstantial business expense.

One also must ask why divestiture of ad exchanges would even be necessary once a best interests standard of this type is imposed. The AMERICA Act takes a belt-and-suspenders approach that offers more extensive protection for advertisers and ad buyers than stock traders, even though the potential mischief and consequences are greater in the securities world. Ordinary Americans have their savings and their futures bet in the stock markets, not in ad markets, which are merely places where business-to-business services are bought and sold. There is no investment or speculation in ad markets.

In short, stocks are regulated as they are because they are stocks. Ads are not stocks, and regulating them as if they were makes no sense.

Predictions Are Difficult, Especially About the Future

There are real dangers that accompany any intervention in complex markets. The history of digital advertising is one of dynamic changes to satisfy the demands of advertisers, publishers, and consumers. It would be a mistake to conclude that the days before vertically integrated digital advertising stacks were a golden age.

Early digital ads were poorly targeted and carried high fixed costs, much like conventional print and broadcast advertising. Over time, technological progress enabled this process to become far more automated, including the emergence of ad exchanges that sell ad space using real-time auctions. These innovations made digital advertising profitable for smaller

publishers, who would otherwise be unable to attract direct deals to sell ad space.

Bearing this in mind, Congress should carefully consider what the open-display ad tech market is likely to look like if the AMERICA Act is adopted.

Many of the competitors in open-display advertising—including some of the most important, like Amazon—started out by offering advertising on their own sites to their existing business customers. When some of these customers expressed interest in using the data and infrastructure developed on-site to advertise elsewhere, Amazon developed that capacity, leveraging its on-site advertising expertise to provide ads for Amazon merchants elsewhere on the Internet. That business then expanded further to connect other, non-Amazon-merchant advertisers to publishers on the Internet.

This has been one of the most significant sources of competition to Google and Meta in the open-display ad tech market. Indeed, in 2018, Amazon stopped buying product listings from Google, and soon rolled out its own competing product. Just a few days ago, Amazon entered into a deal with Pinterest to provide third-party ads on the platform for its almost 500 million users, enabling Pinterest users to readily convert their interests into purchases.⁹

The AMERICA Act would prohibit Amazon from offering these third-party advertising products, presumably forcing Amazon and all its independent sellers to revert to paying Google for off-site advertising. Other companies with advertising inventory that have developed their own third-party advertising networks, such as Walmart and Target, would also likely stop investing in them. It is hard to see how this result benefits advertisers, publishers, or users.

And while Google would be forced to divest its open-display advertising operations, those operations would remain intact and likely, to the extent allowed under the law, still vertically integrated. The net effect, as emerging and innovative competitors exit the market, would arguably be worse than the status quo. The vertical divestiture portion of the bill, in other words, may have perverse effects on competition and innovation.

⁹ *Amazon to bring third-party ad demand to the platform*, PINTEREST (April 27, 2023), <https://newsroom.pinterest.com/en/post/pinterest-announces-partnership-with-amazon-to-bring-third-party-ad-demand-to-the-platform>.