

E.CA Economics

Gatekeepers, dominance, economic dependency, ex-ante regulation

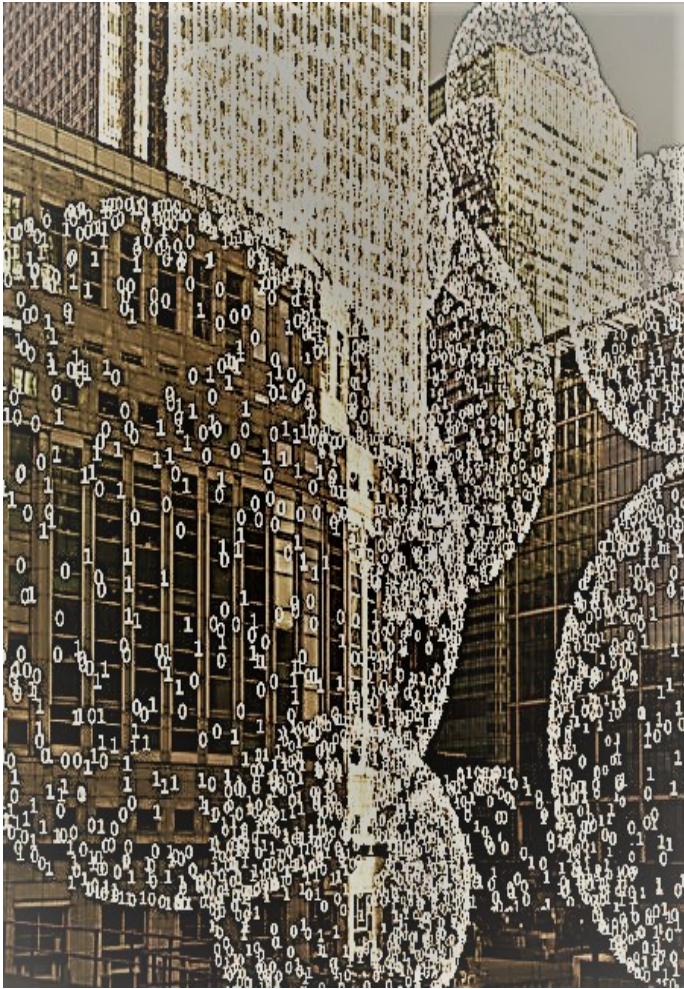
Online, 23 December 2020

117th GCLC Virtual Lunch Talk

Alexis Walckiers

1	Introduction	2
2	Sources of market power in a digital environment	4
3	Which policy instrument(s): regulation, antitrust, economic dependence or merger control?	9

Introduction



- **Conflicts?**
 - 10 years for the Belgian Competition Authority (joint memorandum Benelux)
 - My colleagues work or have worked for or against Facebook, Google, payment platforms, online travel agents, and others
- **Burning actuality**
 - in the EU: Digital Services Act and Digital Markets Act
 - ... and increasingly in the US: actions of the FTC and States against Facebook, and of the DOJ and States against Google
- **On the agenda for today:** define policy instruments that could be used to address market failures in the online world
- **Caveat:**
 - I will speak of digital or **online markets**, while I believe that many of these markets **differ in many ways**. Social networks, online retailers, OS developers, payment systems, designers of mobile devices each **face different sets of constraints**.
 - Tendency to **focus on success** and forget about failure.

1	Introduction	2
2	Sources of market power in a digital environment	4
3	Which policy instrument(s): regulation, antitrust, economic dependence or merger control?	9

The questions you want to answer are the same as in the offline world

Identifying the sources of market power:

- Which existing companies exert **competitive constraints** on the alleged dominant firm?
- What prevents **entry**?
- Or looked at from the other side: what is a user's **next best option**?
- And, what are the sources of **switching costs**?
- Is one of the parties **locked-in**, and why?
- How can market power be **quantified**?



Economies of scale and economies of scope

- Serious **economies of scale** usually favour large companies in the digital environment
 - **Significant fixed costs**: for the development of an OS system, a search engine, or a social network.
 - In many cases, close to **zero costs of serving an additional client**
- Also notable **economies of scope**
 - Easier for a dominant firm to enter in an adjacent market (the so-called **envelopment** theory of harm; see for instance Condorelli & Padilla, JCLE, 2020)
 - Access to competent and motivated **staff** (coding, but also marketing, design, and data management)
 - **Monetization** of insights from the new market by existing business units (eg, online advertising)
 - Additional options of large platforms can generate competitive advantages or additional sources of revenue for their **ecosystems**

Direct and indirect network effects

- **Direct network effects** reinforce companies with market power
 - Users benefit from the **presence of other users**: Word, WhatsApp, Facebook
 - Users are unlikely to switch to an alternative provider, if other users do not switch
 - Possibility to target specific group of users?
- **Indirect network effects** make it even more difficult for entrants
 - Users benefit from the **presence of other categories of users**: payment cards, game developers, advertisers
 - Users are unlikely to switch to an alternative provider, if the other category of users does not switch
 - So-called single homers are better treated
- Counter-intuitive economic insights?
 - Exclusive agreements may over-compensate single-homers
 - Exact model set-up is sometimes crucial (eg, user externality derives from membership Vs interaction?)

Data

- **Access to data plays** a remarkable role in online markets
 - Ability to target specific customer groups, which is crucial for marketers
 - Ability to price discriminate
 - Intra-group data sharing is easier than cross-group data-sharing, through tying of privacy policy
- **Who generates data?**
 - Who generates insights when a producer of sports equipment organizes an online marketing campaign through one or more channels to identify potential clients?
 - Social platforms and online market places are difficult to by-pass to access (existing) customers
- **Decreasing or increasing returns to data?**
 - Very little is known on returns to data: it is often valuable to connect different aspects of a profile, which suggests that there is virtually **no limit to data richness** (some information is quickly outdated)
 - Not easy to organize data-sharing to favour entry, in a privacy compliant manner

1	Introduction	2
2	Sources of market power in a digital environment	4
3	Which policy instrument(s): regulation, antitrust, economic dependence or merger control?	9

Policy instrument: comparing two main sources of errors

- As has been seen, there are **many sources of market power** in online markets
 - They reinforce each other
 - Online markets are prone to **tipping**
- How should the **appropriate policy instrument** be selected?
 - For each candidate policy instrument, try and **minimize the expected cost of error**
 - Besides minimizing error cost, enforcement must be **predictable and timely**
 - Instruments are **not necessarily mutually exclusive**; if well-designed they complement each other
- **Overenforcement (type I error)**
 - Enforcement, when non-enforcement would have been preferable
 - Cost of error: reduced user benefit? reduced innovation? reduced incentives to invest?
- **Underenforcement (type II error)**
 - Non-enforcement, when enforcement would have been preferable
 - Cost of error: effect on competitors? on entry? on innovation?

Regulation

- **Platform-to-business (P2B) regulation**
 - Entry into force in July 2019
 - Objective: create a fairer, more transparent and predictable business environment for smaller businesses and traders on online platforms
- **Digital Services Act**
 - Revision and extension of the 2000 e-Commerce Directive that harmonized the cross-border provision of online services in the EU
 - Increased obligations on transparency, user empowerment, risk management and industry cooperation
 - Enforcement by a Digital Services Coordinator with significant investigation powers, including ability to carry out on-site inspections, interview staff members and require the production of documents and information
- **Digital Markets Act**
 - Introduces rules for platforms that act as **gatekeepers** in the digital sector
 - Gatekeeper: “core platform service” in at least three EEA Member States, €6.5 Bn turnover in the EEA, and other criteria on market capitalization (€65 Bn), and number of users (45m active users)
 - Obligations such as: inter-operability with third parties, interdiction to use business data to compete against them, access to data generated by activities on the platform

Competition tools

- **Abuse of dominance**
 - Many cases in the EU, in Member States, and also, more recently, in the US
 - Difficult to summarise all theories of harm
- **Abuse of economic dependence**
 - New law on economic dependence in Belgium, which joins a long list of countries with similar provisions
 - French and German NCAs have made clear that there should be a role for such provisions in online markets
 - Lower intervention thresholds?
 - Raises a number of questions, especially in two-sided markets, where singlehomers often benefit from exclusivity
 - Entry often requires targeting specific groups (divide and conquer strategy)
 - German online travel agents case: does multihoming mean that access to all platforms is necessary?
- **Merger control**
 - Killer acquisition (or reverse killer acquisition), acquisition of nascent competitors and envelopment theory of harm
 - Merger control requires to be able to predict market evolution, which is especially difficult in disrupting markets such as online markets
 - Would there be a way to hold the acquired firm separate, or at least to ensure that it could be divested, after a review?