Regulating the Tech Titans

A DEBATE WITH THE ECONOMIST

"Regulating the Tech Titans", our discussion event with The Economist in Brussels, takes place on June 21. Ahead of the session, it's worth setting out some of the questions that will test the panel and face us all when we think about how competition law – or economic regulation in general - should be applied in the digital world. Two questions stand out above all.

Is there anything new under the sun?

Does the digital economy work differently, particularly global tech platforms? Or have we seen it all before? Take network effects. Rising participation in a platform enhances its attractiveness, but this is not a new phenomenon. Nor are multi-sided platforms. Network effects have been a feature of many markets for a long time, notably in utilities such as energy and in transport, and in two-sided markets like those found in the telecommunications and media sectors. When regulators step into these markets, there is usually a fairly clear monopoly problem. For example, the investment needed to lay down a rival electricity grid or railway network is beyond the means of a would-be entrant. This is not necessarily so for the new app developer. It is tempting to look at a combination of large incumbent market shares, bolstered by powerful network effects, and draw the conclusion that regulatory intervention is a must.

But how confident can we be that all hope of a market solution is lost when an online platform establishes a dominant position? Digital technology has advanced at a phenomenal pace since the start of the millennium. What makes online platforms so different from traditional platform markets is the fact that they can be scaled swiftly and inexpensively. New services can grow from zero to hundreds of millions of subscribers seemingly overnight. This gives these markets a strong tendency to tip. This 'tippiness' might well create a single dominant firm, but that same ability to grow rapidly and at low cost is also a big temptation for potential challengers.

So how can we be sure whether we are looking at another Microsoft or another MySpace? To intervene or not to intervene? Both options pose considerable risk to the health of competition in these markets. On the one hand, allowing unchallenged dominance of key gateways to the online world carries the danger of creating inefficiencies that slow down the pace of our digital economy and stifle its diversity. Equally, strictly regulating access to these platforms is perhaps the surest way to kill off genuine competition for good: why risk millions (or even billions) investing in The Next Big Thing when you can just buy an access product instead?

Once you've built an electricity grid, it's pretty clear that no one is ever going to duplicate it. So the case for regulation is straightforward. What sets digital platforms apart is that *We Just Don't Know*. Is competition just around the corner or not? Unlike physical markets, there isn't a ready test of whether market prices will or won't support the cost of new infrastructure. And in any case, whoever that next competitor is, its business model isn't going to look anything like the one it replaces.

Could the medicine kill the patient?

Let's suppose that we were to find a problem and conclude Something Must Be Done. More uncertainty and risk follow. In the first half of last century, a political movement built up around challenging dominant firms. Its solution was simple: break them up. The born-again converts to this antitrust religion (now taking on the moniker of the "New Brandeis" school of thought) want to take the same radical approach to the tech titans. The appeal is obvious: split a single dominant firm into two or more rivals with matching capabilities and you have a recipe for instant competition. Well, not so if you believe the source of the dominance in the first place was network effects combined with the propensity for markets to tip quickly in one direction. This drastic course of action would incur all the efficiency-destroying costs of a messy break-up, and might deliver nothing more than a temporary reprieve until customers coalesced around whichever orphan child of the regulatory process emerged victorious.

This raises the question of what the alternative remedies could be. If a particular platform has become a must-have gateway to digital commerce, then regulated access might be a logical solution. This is how telecoms regulators all over the world have overseen access to the wires that provide broadband and telephony. But such an approach is fraught with difficulty online. What exactly is the product to which access should be granted, and on what terms? How on earth could the pricing of access be set without allowing entrants a free lunch at the expense the platform owner? And, as noted above, as soon as you have a mandatory regime for access, you may provide an easy route to market for entrants that destroys their incentive to shoot for the moon and challenge the dominant platform itself.

Indeed, if the "tippiness" of digital platform markets is integral to how they work, protecting the competitive process becomes the process of protecting competitive innovation itself. Hence the focus of concerns about "self-favouring" (using a platform to favour a new service in an adjacent market) and conglomerate acquisitions. Critics see moves like this as the cynical tactics of dominant firms determined to extinguish any acorns from which the mighty oak of competition might grow – and call for tougher regulation even if such actions do not directly or obviously stifle existing competition.

But, again, the risks of intervention vs non-intervention are not one-sided. Global digital platforms are proven innovation-accelerating machines, bringing new services to a multi-billion user base in a short space of time. They can do this precisely because of their ability to leverage the platform. Force those acorns to grow by themselves and we might all be waiting a long time for them to reach the canopy and see the light of day.

We have a lot to discuss. See you on 21st June!

Register for the event

David Foster
+44 (0) 207 031 7095
david.foster@frontier-economics.com

David Parker
+44 (0) 207 031 7064
david.parker@frontier-economics.com