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Topic 3: The identification and measurement of market power and entry barriers, and the evaluation of collusive, exclusionary, or predatory conduct or conduct that violates the consumer protection statutes enforced by the FTC, in markets featuring "platform" businesses

Comments of Mark A. Jamison

Following are the comments of Mark A. Jamison, Ph.D., on the topic of market power and entry barriers in markets featuring platform businesses. I am a Visiting Scholar with the American Enterprise Institute and Director and Gunter Professor at the Public Utility Research Center, Warrington College of Business, University of Florida. While I am honored to have these affiliations, my comments are my own and may not reflect the views of the American Enterprise Institute, the Public Utility Research Center, or the University of Florida.

Disclosure statement: I provided consulting for Google in 2012 regarding whether Google should be considered a public utility.

Introduction

The presence of platform businesses in a market changes how regulators should identify and measure market power and entry barriers, and how they consider other traditional concepts of anticompetitive conduct. Most of these changes extend from the nature of multisided markets, which is an area that has been well researched in economics. I limit my comments to areas that I believe are under researched. In particular I address refocusing the methods used to identify market power. I begin by describing how network effects extending across markets and across generations of products affect the conventional wisdom regarding firms having large market shares. I then discuss how a large market share should be distinguished from the idea of market power and how these considerations, plus the rapidly changing nature of digital markets that I describe in my comments on Topic 2, lead to conclusion that regulators should focus on factors that lead to market power rather than attempting to measure market power itself.

Intertemporal and cross-market network effects

Historically antitrust has analyzed competition based on analyses of markets (Baker 2007), although there have been situations where regulators have been concerned that a firm with market power in one market might leverage that power to limit competition in another, such as in the case of the breakup of AT&T. Often such considerations ignore the positive impacts that larger market shares in one market may have on service expansion in another.

Consider, for example, theoretical models that suggest a firm with a large market share can sometimes leverage that market share to advantage itself in other markets. Cremer et al. (2000) draw this conclusion in the case of the internet backbone, and Carlton and Waldman (2002) do so in the case of software. The essence of these models is that complementarities across markets or time help a firm with a larger market share in one market to gain market share in other markets.

Missing from Cremer et al. (2000) and Carlton and Waldman (2002) is an analysis of how opportunities for future markets impact investments in today's markets and impacted investments leading to today's markets. Jamison (2001) demonstrates that the opportunity to leverage complementarities across markets stimulates investment. The logic is fairly straightforward. First consider intertemporal markets. To illustrate, assume a search engine provider attracts users today and then leverages that customer favor later by highlighting in organic search results a newly developed shopping service. When the provider is deciding how much to invest in improved search features, it considers the expected profits from selling more advertising and expected profits from future shopping services made possible by the attractiveness of the search engine. Assume that this results in a current investment level of $Y. Now suppose that if the provider expects that achieving a large market share in search would trigger regulators to not allow the firm to leverage its success in launching shopping services, the firm would no longer consider the shopping profits in its analysis. The result of this restriction would be an investment

level of $X that is necessarily less than $Y. This would be a loss for consumers as they would receive less beneficial search results, a potentially less valuable or even no shopping experience from the search provider, and possibly less investment by the search provider's shopping rivals. This analysis was missing from the European Union's decisions to fine Google for biasing search results. (Jamison 2015)

Now consider a situation where a firm in one market seeks to merge with a firm in another market where there are positive network effects between the two markets. This might have been the case, for example, in the MCI and Worldcom merger where the companies were in different internet backbone markets, but also some of the same backbone markets. Back to our hypothetical, prior to the merger, the network effects between the two countries were an externality and so neither pre-merger firm made greater investments because of them. But when one firm served both countries, it could internalize the network effects, leading to greater investment in both countries. This conclusion may hold even if the merging firms already serve both markets since larger service footprints incentivize more cross-market investment.

The cross-country analysis has implications for services that are imperfect substitutes. In some situations, a merger of two firms can increase investment even if their products are rivals. Consider, for example, a situation where two social media firms seek to merge. One of the firm's pre-merger service focuses on personal information sharing and the other firm's focuses on business content. Pre-merger, the synergies between the two services are externalities and so do not affect investment decisions. Post-merger, the merged firm can internalize complementarities across the platforms, which would benefit customers and might increase investment if the synergy effect outweighs the weaker competition effect. In addition to the internalization of a network effect, the merged firm has more information about customers and can use that to better market advertising, develop new features, and encourage customers to try features that are suited to them. In net, if the effect of the loss of rivalry between the two pre-merger firms is less than the benefits created by internalizing network effects, developing new features, improving advertising, and better marketing of features, customers can be made better off by the merger.

Market share is not market power

Pundits and European regulators often equate market share with market power. I addressed this in Jamison (2017 and 2018). In these blogs I cite journalists, rivals to leading tech companies, and academics that equate size with power. Their analyses are flawed.

As I explain in Jamison (2017), customers are in charge of market share in the information technology space.

> Successful tech companies become large because customers choose them. Facebook does not compel anyone to sign up, Google does not divert searches

> from Bing or DuckDuckGo to www.google.com, nor does Amazon block people from driving to Books-A-Million. In fact, at least two of these companies became successful by surpassing other companies that pundits once described as controlling their markets — namely Myspace and Yahoo!. And the National Retail Federation ranks Amazon as only seventh in the US in retail sales for 2017.
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> Why do people embrace the myth [that tech companies control their markets]? People think past the sale. It is hard, if not impossible, to make a substantive case that enduring tech monopolies have finally arrived. So writers and publishers leverage (perhaps unwittingly) an availability cascade by using words that trigger ominous visions, including "digital overlords," "monopolize," and "online trust," encouraging readers to simply assume that successful companies are villains and customers are victims in need of a hero — namely the government. (hyperlink omitted; bracketed content added)

In Jamison (2018), I address errors that people commit in comparing today's tech companies with well-known antitrust violators of yesteryear, namely AT&T and Standard Oil in the examples I cite. I begin by cleaning up some facts that were missed by the authors I cited, who made claims such as that Facebook, Alphabet and Amazon control their markets, that Google drives 89% of internet search, and that 95% of young adults in the US use a Facebook product:

> Google is *chosen* somewhere between 75 percent and 90 percent of the time worldwide by people using organic search. It doesn't "drive" those searches. And this is only organic search — apps such as Yelp and Travelocity provide specialized search services. Facebook products are indeed popular, but the 95 percent figure is misleading: According to Pew Research, 35 percent of US teens say they use Snapchat more than any other social media, and 32 percent say they use YouTube more than any other. Facebook and Instagram together are most used by only 25 percent of US teens. So Facebook is, at best, number three in the market. And two companies with a 63 percent market share do not make a duopoly: To constitute a duopoly, they must have 100 percent of the market. Besides, it is unclear that online advertising is a market in the sense used in antitrust legislation.
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> The analogies with Standard Oil and AT&T are incorrect. Standard Oil's market shares were indeed high during the years before final antitrust actions — 90 to 95 percent of oil production in 1880 and about 90 percent of oil production and 85 percent of final sales in 1904. However, its market dominance came from controlling resources, primarily access to railroads, which were needed to move oil to market and where regulation limited competition. AT&T served 100 percent of each of its markets, not 80 percent. Its markets happened to cover about 80 percent of the phones in the US. AT&T obtained its 100 percent market shares because of exclusive government franchises. (hyperlinks omitted)

I then explained that customers provide large market shares in tech industries, a reality ignored by the advocates of greater use of regulation and antitrust in these sectors.

> (F)or now, large tech companies have become successful by customer choice. Facebook founder Mark Zuckerberg thought that a social media platform would take off if it enabled two-way communication and allowed people to connect with others whom they want to reach but might otherwise miss. He was right in a big way. Google founders Larry Page and Sergey Brin thought that the most valuable web-pages — those which people want to find when searching — would be the ones that other web pages cite. They were right in a big way. Amazon's Jeff Bezos was right about online shopping and cloud computing. And Steve Jobs was right that people would gobble up cool technology that changes their lives.

Pleasing customers results in large market shares in information technology sectors. This happens for several reasons, including the low cost of adding customers relative to the high costs of building service, the ease of customers' learning from each other over the internet, and the internalization of network effects as services grow. None of these are about market power. They are all about improving profits by improving consumer welfare.

Competition for Time and Attention

Much of the rivalry among firms in information technology industries is a rivalry for resources. As I explain in Jamison (2018b):

> Consumer time and attention are sought-after resources. So are information, knowledge, and understanding, which today are being augmented with artificial intelligence. Companies accumulate these resources to launch what happens next. The companies that accumulate the most have an earned advantage over rivals. The advantage is earned and benefits customers because the prospect of gaining the advantages gives companies a strong incentive to compete for the future.

This rivalry exists even if products and services do not appear to be substitutes in a traditional market-by-market analysis. Firms in this space monetize user time and attention largely through selling advertising, but also by leveraging intergenerational network effects, as I explained above. The competition for time and attention can be intense as it is the space within which firms can put ads in front of users. Also, the time users spend with a service generates data that the service provider then uses to better target ads and develop next-generation services.

Focusing on the Factors that Lead to Market Power

For the reasons I state above, and those that I state in my comments on Topic 2, looking for the existence of market power can be counterproductive in digital markets. Hauge and Jamison (2016) suggest an alternative, namely:

> (F)ocusing regulatory concerns on situations where there are endowed or illicit factors that will lead multiple generations of products to be provided by monopolies…. Regulatory responses should be limited to factors that cause monopoly across generations of products because, in our context, the life of a single product is too brief to warrant regulatory action. Furthermore regulatory responses should be limited to factors either endowed or illicit because they are either costless to the firm (in the case of endowed factors) or destructive to market performance (in the case of illicit factors). All other factors must be built or acquired by a firm, and such innovations will be discouraged by regulatory practices that penalize such developments.

Hauge and Jamison (2016) find that naturally occurring monopolies are rare in economic studies. Two founders of economic thought, Smith (1776) and Mill (1852), emphasize government barriers to competition as a primary source of monopoly. They also describe how collusive agreements can allow firms to avoid competition. Mill (1852) also describes monopoly arising from situations where essential skills or supply inputs are subject to natural limits. The most common approach in economics to determining whether a firm is a natural monopoly is to examine technology. By this view, a monopoly is natural if a single firm represents the least cost arrangement for serving the entire relevant market demand because its costs are subadditive (Baumol 1977, Sharkey 1982). Jamison (1999) adds that a firm must have dominant cost subadditivity for its products to ensure that the firm's supply cannot be more economically provided by any combination of firms, including those outside of these products' markets. These conditions are so strict that natural monopoly should be rare.

Since naturally occurring monopolies should be rare, analysts should focus on whether there are government barriers to competition or illicit agreements. Absent these, any tech firm that appears to be a monopoly has likely built that capability by producing valuable services.

Conclusion

In these comments, I examine market power in industries with platforms. I find that competition regulators should move from looking for the presence of market power to endowed or illicit factors that inevitably lead to market power.

Respectfully submitted this 20th day of August, 2018.

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