Yale SCHOOL OF MANAGEMENT

The New Economy: Is competition enforcement meeting the challenge?

Fiona Scott Morton

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40 years of regressing

- Due to the Chicago School non-interventionist movement, the US has spent the last 40 years steadily regressing in enforcement and allowing more and more anticompetitive conduct
- Monopolization cases that weakened enforcement: Trinko, Novell, American Express, Brooke Group
- Mergers: sugar, airlines, mobile phones
- Vertical contracts/acquisitions: Ticketmaster, AT&T-Time Warner, United-Change

$\Rightarrow$ Share of corporate profits in the economy has been rising

$\Rightarrow$ Markups have been rising

Bad luck

- In the midst of this backward movement, the economy leaped forward
- Moved from “industrial economy” to the “new economy”
  - No longer steel factories with
    - High variable costs
    - A 'vertical' chain of production
  - Now software, digital platforms, pharmaceuticals, digital media, financial services
    - Fixed cost of innovation and product creation
    - An ecosystem of 'related markets'

Economic analysis for the New Economy

- The economics literature has studied this for some time, and what I have to say today is not new
- Characteristics
  - Low / zero marginal cost
  - Network effects
  - High fixed costs
  - High differentiation
  - Innovation competition is a main source of competition
  - Potential and nascent competition is important
  - Users create data which creates quality and/or entry barriers

Environment

- The new economy is a tricky place for competition enforcement
- Differentiation among products is critical
  - Strong differentiation comes from network effects
- Entrenchment and market power is significant
  - Network effects and data are hard for entrants to overcome
- Markups are huge (marginal cost is zero)
  - Substitutes are few, markets are concentrated, UPP is high
- Competition is often dynamic and disruptive:
  - Rather than calculate a % increase in price, must predict
  - Innovation, entry, rivals who displace or disrupt incumbents

The New Economy requires better and more vigorous competition enforcement

- Competition is naturally weaker in the new economy
  - High markups
  - More differentiation
  - More barriers to entry
- Need competition enforcement to be stricter
  - Naturally more concentrated markets mean head to head competition is lessened
- Need competition enforcement to be more accurate and focused
  - Nascent entrants are particularly valuable because have innovation or a way to overcome network effects

The New Economy requires advances in regulation

- Innovation is the main source of competition
  - Hard to regulate product quality, entry, etc
  - Evaluation of welfare difficult when uncertain outcomes and unknown products
- Margins
  - Large margins needed to pay for fixed costs and innovation
  - How to determine risk and returns?
- Access conditions
  - APIs to connect available under what conditions? To whom?
  - Access pricing when MC = 0
- Huge rents make regulatory capture a bigger risk

The New Economy requires stronger consumer protection

- There are more entrenched firms with market power
  - Consumers can’t move their business to rivals so voting with feet doesn’t work well to discipline firms
  - Government must defend against exploitation
- More opportunities for consumers to make mistakes
  - Digital environment A/B testing to find and exploit consumers
  - Innovation means claims harder to evaluate and test, consumers not experienced
  - The financial offer from the firm may be hard for consumers to understand
    - Digital ads are hard to evaluate
    - Financial services tricky
    - Media subscriptions complex

Whiplash

- WE NEEDED enforcers and courts to take a ***leap forward*** to keep up with the changes in the economy
- WE GOT enforcers and courts moving backwards in terms of the conduct they were willing to condemn
- And being conservative (small c) in refusing to adopt any new theories of harm when new competitive strategies were blossoming (e.g. Facebook motion to dismiss discussion of the "free" product)

Acute problem

- This combination of enforcement moving backwards while the economy moved forward created a huge mismatch in the US
- Much less problem in the UK and the EU
- Still the case that enforcement is behind in all jurisdictions
- Enormous amount of catching up needed
  - Embrace new models and understand new market realities
  - Combat established market power by protecting entry
- Courts may not be ready for this

Enforcement response

- Need new models and new evidence from economists (this is happening)
- Need risk-taking from agencies (already see this from DOJ in the US)
- Need courts to understand the models are responding to a different economic reality on the ground
- Need courts not to be simplistic, ie stop accepting:
  - innovation is “2 guys in a garage”
  - a monopolist with network effects can be easily displaced
  - anything a user does on the internet is a substitute for anything else
- More generally, enforcement of competition law is not anti-technology

Example: Amazon MFNs

(Disclosures)

California has a new complaint

Economic analysis has a lot to say about Amazon MFNs

- What would equilibrium prices be if MFNs were banned?
  - Old literature: lower prices
- What entrant would come in if it could discount its fees?
  - New literature: lower cost entrants
- The notion of equilibrium is profound in this setting.
- The new entrant or different prices NOT VISIBLE because we are in the wrong eqbm. Courts have a hard time with that. Agencies cannot show evidence.

Example: App stores

(Disclosures)

App Stores on iOS and Android

Distribution monopoly: block alternative distribution of content consumed on the handset (app store and browser engine)

How to use economic analysis to evaluate the impact on *competition*?

- What quality and price would competition generate?
  - Curation, fees
- What innovation would result if there were competing stores?
  - Cross-platform apps could arise. E.g. WeChat
- Would those cross platform apps be middleware like java in the Microsoft case?

- Middleware would lower switching costs and stimulate entry in mobile operating systems

Google search

- Google search cases in US and EU: exclude rivals using
  - defaults, exclusive defaults (rival general search)
  - page design, VI content, ad purchase (specialized vertical search)

Economists can answer questions like:

If quality is high, shouldn’t Google have high share?

  - Quality depends on usage which can be manufactured with a default
- Will prohibiting exclusive defaults raise cost of handsets?
  - An OEM that can bargain with multiple search engines for the default position will get a large revenue share
  - That rev share will benefit consumers in lower handset prices
- Understanding equilibrium comes back

Regulation as well as Antitrust

- The DMA begins in 2 months!
  - First designation of Core Platform Services
  - Then enforcement of conduct rules
- Rival App stores must be allowed
  - FRAND, side-loading, communication, reader apps
- No bias in search rankings, no tying of Google search and browser or search and OS
  - Will we see entry by rival search engines?

Regulation as well as Antitrust

- Google adtech
  - Transparency, tools for advertisers and publishers
  - tying, use of data
- Messaging interoperability for Whats App, Facebook Messenger
  - Required publishing of APIs
- Leveraging
  - Amazon: no use of data to advantage v business users

Role for economics

- Economics is a great tool!
- Not used only by those against enforcement, but by those trying to get the right answer
- Creates tremendous clarity and discipline
- Can respond to the need:
  - Empirical evidence in many settings
  - More relevant theory
  - More crossover work into law
- Don't let progress on empirical methods define importance of any topic