

Competition policy in the digital economy

Given the vast powers granted to the EU's competition authority by successive regulations, and in the absence of greater checks and balances, it is imperative that DG COMP's rulings be informed by sound economic analysis.

Previous digital competition probes rests on shaky economic foundations. DG COMP failed to acknowledge that market share is not a sufficient indicator of market power, and that innovation may occur outside the relevant market.

Neither vertical integration nor the own-content bias alleged in the Google case constitute anti-competitive practices in and of themselves. Market data in key EU markets also point to substantial competition between comparison shopping search engines. Google Shopping's share of the market is small and not growing.

Recommendation: In light of recent cases in the digital sector, competition policy needs to change. Market share figures tend to underestimate the prevalence of competitive forces, and recent DG COMP probes have consistently ignored the possibility of innovation coming from outside the relevant market. Without a substantive change in outlook, it is likely that competition will be harmed by intervention.

On 15 April, the European Commission formally charged Google with anti-competitive practices, as part of an investigation that was first launched in November 2010. Its statement of objections (SO) focuses only on the first of the four original allegationsⁱ in the probe, namely that Google systematically gave favourable treatment to its comparison shopping service (known as Google Shopping), at the expense of competitors.ⁱⁱ

The Commission probe underscores an increased activism by the Directorate-General for Competition (DG COMP) in recent years, not least in the digital sphere. Previous investigations against tech giants Intel and Microsoft resulted in large fines and requirements for the involved businesses to change their sales policies.ⁱⁱⁱ The amount of fines charged has increased rapidly since the turn of the century, reaching €1.69bn in 2014 from €3 million in 1996.^{iv} On its own, the 2009 penalty levied on Intel was €1.06bn.^v

While the growth in fines may raise eyebrows, the primary concern should be whether the Commission is employing sound economic analysis when deciding to bring charges against companies.

The power of EU competition bodies and the importance of good economics

Competition policy has been one of the fundamental prerogatives of the European Union since its inception. A 1962 regulation centralised anti-trust powers in the European Commission, granting it the right to probe arrangements that might obstruct trade between Member States and prevent competition in the common market. To facilitate the activity of the Commission's competition arm and reduce its workload, a 2003 regulation decentralised some of the control and supervisory functions to national competition authorities, while also strengthening DG COMP's investigative powers.^{vi}

As a result, the EU competition authority has increasingly become a para-judicial body, nominally within the EU executive but with extensive adjudicative functions on top of its investigative and enforcement powers. Because DG COMP is considered to be expert in dealing with complex economic questions, the European Court of Justice (ECJ) – charged with reviewing the Commission's decisions – is known to grant it a margin of discretion.^{vii} Coupled with the limited powers of the hearing officer, the deferential attitude of advisory committees, and the impossibility for defendants to appeal rulings to an impartial third party, this means that anti-trust authorities act as “prosecutor, judge, jury and executioner,”^{viii} with little chance for their judgments to be challenged and, in the event, reversed.

In the absence of meaningful change to the operation of DG COMP, which is unlikely in the short term, it becomes ever more urgent that competition policy be informed by sound economic analysis and that it is responsive to evidence. One may or may not agree with the OECD's view that “economic analysis could substitute for legal soundness as an anchor against politically-driven manipulation of policy outcomes,”^{ix} but without stronger checks and balances to guarantee the rule of law, good economics is more crucial than ever.

Recent anti-trust proceedings in the EU digital sector

The European Commission started its investigation of Intel in 2004. At issue were alleged ‘predatory discounts’ granted to computer manufacturers including HP and Dell in exchange for buying most or all of their CPU components from Intel.^x The Commission reasoned that such practices were aimed at driving competitors like AMD out of the market, giving Intel a dominant position that would harm consumers.

Yet, on any possible measure, competition in the chip market was fierce while the supposed anti-competitive conduct was taking place. Chip prices declined by 66% to 75% in the ten years prior to 2008, while performance grew tenfold.^{xi} Far from increasing inexorably, Intel's share of the microchip market remained stable in that ten-year period, at circa 80%, while AMD's rose slightly to just under 20%. Crucially, fluctuations in market share for both companies correlate

with new product launches, highlighting the continued impact of innovation. Finally, the stock market performance of Intel and AMD shares bears no indication of significant abnormal stock returns (positive and negative, respectively) during the period of Intel's alleged anti-competitive conduct, suggesting that no monopoly rents resulted from the latter.^{xii}

In the case of Microsoft, it is not so much developments *within* as those *outside* the PC market which are interesting. When the Commission concluded its investigation in 2004, which resulted in a €497 million fine (the first of several), Microsoft's worldwide share of the operating-system market stood at 95 per cent.^{xiii} As with Intel, Microsoft's dominant status raised concerns with the EU competition watchdog, which feared that it was abusing its position by 'bundling' other Microsoft products with its Windows operating system, to the detriment of its specialised competitors.^{xiv} The DG COMP ruling required it to stop such bundling, as well as disclosing information on its operating system to rivals.^{xv}

A decade later, the picture has changed dramatically: Microsoft's share of all operating systems had plunged to 20 per cent by 2012, making it the third-largest software provider worldwide, behind Apple and Google. Yet this transformation did not occur in the PC market, where Windows still prevails. It happened as a result of the rise of smartphones, where Google's Android and Apple's iOS dominate and to which Microsoft was slow to respond.^{xvi} Competition officials may have been worried about Windows' hegemony in the PC market, but it was innovation outside that market – which no one could have foreseen in 2004 – which ended Microsoft's dominance.^{xvii}

Lessons from the past and implications for the Google case

There are two key lessons to be learnt from the Intel and Microsoft investigations:

- 1) **Market share is not a sufficient indicator of market power.** Intel's share of the chip market may have been large – particularly when compared to non-digital industries – yet competition in that market remained aggressive even as it offered loyalty discounts to computer manufacturers.
- 2) A focus on a company's share of a particular market will necessarily underestimate competitive conditions, as **innovation may occur outside the relevant market.** Yet, it is difficult for competition authorities to pre-empt this bias, as the future paths that innovation may take are – by definition – unpredictable.

The allegations currently made against Google mirror claims previously heard against Microsoft and Intel. As in the latter probes, the company involved holds close to 90% of the worldwide search engine market, and more than 92% in Europe.^{xviii} And as with Microsoft, the Commission fears it may be using its pre-eminence to promote other Google products, most saliently its vertical search engines.^{xix}

Studies of vertical integration of the sort practiced by Google with its horizontal search engine and its specialised vertical ones have generally found that such integration benefits consumers.^{xx} Similarly, the own-content bias of which it is accused in the specific case of Google Shopping can have a positive or negative impact on consumer welfare, so it does not constitute sufficient justification for regulatory intervention.^{xxi} There is also a market-definition problem: Google may appear to be competing for market share with other search engines (vertical and horizontal), but it really is vying for users' attention, information and future actions, which generate data and purchases that make its advertising services valuable.^{xxii} The relevant market in which Google operates is therefore much broader than horizontal search, which makes concerns about its dominance of that particular segment even less pertinent.

Moreover, evidence hardly suggests that competition in the online search market has been stifled in recent years. Not only has Google's global market share declined slightly in the last five years,^{xxiii} but new players have emerged in the specialised search market.^{xxiv} Moreover, from the available traffic figures, it does not seem that Google Shopping has been steadily growing its user base thanks to Google's preferential ranking: In key EU markets like Germany, France and the UK, Amazon and eBay (alongside national comparison websites) boast up to 25 times more unique visitors than Google Shopping – and the gap does not appear to be closing.^{xxv}

The perils of Commission activism in digital competition

There is little economic justification for anti-trust intervention in the case of Google's preferential ranking of its own comparison shopping search engine. Data reveal a vibrantly competitive search engine market. Furthermore, it is questionable that Google's practices harm the competitive process. They may have harmed competitors, but this does not offer grounds for intervention – indeed, it is a critical sign of market forces at work to the benefit of consumers.^{xxvi}

In light of the questionable economic arguments on which previous and current investigations are founded, it would seem that EU competition policy in the digital sector needs to change. Specifically, DG COMP must recognise that a company's market share, in a sector as volatile and dynamic as information technology, is no proxy for the presence or absence of competition. A better understanding of the nature and sources of innovation in digital markets is also critical, considering that tech giants have been shown to be more vulnerable to newcomers than statistics might suggest.^{xxvii} Misguided intervention is likely to stifle, rather than promote, competition, and as with any regulation it is vulnerable to capture by incumbents. This means that intervention could end up enhancing Google's power.

The Commission should reconsider its methodology for establishing the state of competition in relevant markets. Competition policy in the digital sphere has failed to deliver on previous occasions, and without meaningful change consumer welfare and innovation will suffer.

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- ⁱ European Commission, "Antitrust: Commission probes allegations of antitrust violations by Google" (Brussels: 2010).
- ⁱⁱ In addition to the Google Shopping probe, the Commission is investigating restrictive practices in the use of Google's Android mobile operating system. The latter investigation is outside the scope of this briefing.
- ⁱⁱⁱ "Inside the history of antitrust: special interests unleashed." IEM Economic Note (Brussels: Institut Economique Molinari, 2005), 3. In the Microsoft case, one of the requirements was to refrain from including Windows Media Player in its standard software package.
- ^{iv} Serena Sileoni, "The sphynx and the chimera: antitrust proceedings in the European Union," IBL Special Report (Milan: Istituto Bruno Leoni, 2014), 34. The 2014 figure comes from the Commission's cartel statistics: <http://ec.europa.eu/competition/cartels/statistics/statistics.pdf>.
- ^v Luca Mazzone and Alberto Mingardi, "Innovation, competition and antitrust: an examination of the Intel case," *Economic Affairs* 31.2 (London: Wiley-Blackwell, 2011), 69.
- ^{vi} Sileoni, 6-11.
- ^{vii} *Ibid.*, 2.
- ^{viii} *Ibid.*, 12-16 and 2.
- ^{ix} OECD, "European Commission – peer review of competition law and policy," (Paris, 2005), 59. Cit. in Sileoni, 21.
- ^x Mazzone and Mingardi, 69-70.
- ^{xi} *Ibid.*, 72-73.
- ^{xii} Wright, Joshua D. "Does antitrust enforcement in high tech markets benefit consumers?" (Washington, DC: Technology Policy Institute, 2010), 14-19.
- ^{xiii} "Goldman Sachs: Microsoft has gone from 97 percent share of compute [sic] market to 20 percent," *Seattle Times*, 7 December 2012.
- ^{xiv} "Does the tying and bundling of products harm consumers?," IEM Economic Note (Brussels: IEM, March 2006).
- ^{xv} Valentin Petkantchin, "Does the presence of just one producer automatically point to an absence of competition requiring anti-trust authorities to intervene?," IEM Economic Note (Brussels: Institut Economique Molinari, September 2007), 1-2.
- ^{xvi} Farhad Manjoo, "Case against Google may be undercut by rapid changes in technology," *The New York Times*, 15 April 2015.
- ^{xvii} "We've been here before in the relatively short history of high-tech antitrust. Microsoft's market position was unassailable... until it wasn't." Cf. Geoffrey A. Manne and William Rinehart, "The market realities that undermined the FTC's antitrust case against Google," *Harvard Journal of Law & Technology* (Cambridge, MA: Harvard University, 2013).
- ^{xviii} Data from www.statista.com. It is worth pointing out that Google's global market share has slightly declined since 2010. For the European figures: Matt Rosoff, "Here's how dominant Google is in Europe," *Business Insider*, 29 November 2014.
- ^{xix} FTC internal memorandum, 8th August 2012. First reported by the *Wall Street Journal*. Cf. Brody Mullins, et al., "Inside the U.S. antitrust probe of Google," 19 March 2015.
- ^{xx} Joshua D. Wright, "Defining and measuring search bias: some preliminary evidence," George Mason University Law and Economics Research Paper Series (Fairfax, VA: George Mason University, 2011), 5.
- ^{xxi} *Ibid.*, 7.
- ^{xxii} Manne and Rinehart, cit., 7-9.
- ^{xxiii} *Supra* note xix.
- ^{xxiv} Adam Vincenzini, "30 specialist (and super smart) search engines," *The Next Web*, 29 April 2012.
- ^{xxv} "The search for harm," Google Europe Blog. The data are from ComScore, a digital analytics company.
- ^{xxvi} "Conduct that harms rivals merely because it attracts consumers from rivals is the essence of competition [...]." Cf. Wright, "Defining and measuring search bias," 6.
- ^{xxvii} Manne and Rinehart, 16-17.

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