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Unlocking digital competition… but locking up innovation?

Comments on the "Furman Report"

Summary

In March 2019, the Digital Competition Expert Panel led by Jason Furman delivered its report setting out far-reaching proposals to "unlock digital competition".[1] The UK government had appointed the Panel *"to consider the potential opportunities and challenges the emerging digital economy may pose for competition and pro-competition policy, and to make recommendations on any changes that may be needed."*[2] This comes at a time of growing concern with the power of the large tech companies both in terms of their impact on competition as well as a range of public policy issues.[3]

The Furman report finds that digital markets are different as they are subject to "tipping" such that a winner takes most of the market. This is driven by economies of scale (especially in data) and economies of scope through integrated services, as well as the behavioural limitations of consumers. These network effects and returns to scale are even more entrenched today, leading to highly concentrated markets where incumbents are shielded from competition and disruption.

As a result, the Furman report calls for the introduction of *ex ante* regulation in digital markets, through a dedicated Digital Markets Unit charged with (i) developing a code of competitive conduct for firms it designates as having "strategic market status", in particular for owning "gateways" the unit deems essential for competition, (ii) enabling greater personal data mobility and systems with open standards, and (iii) advancing data openness to facilitate entry. The report also recommends bolstering *ex post* regulation by lowering standards of proof to better challenge acquisitions of potential future disruptors, and reducing appeal rights so regulators can take swifter and bolder decisions.

This compares with the recommendations of another panel of special advisors appointed by the European Commission to consider similar issues, who have found similar perceived problems and proposed significant reform of antitrust rules, albeit stopping short of *ex ante* regulation.[4]

The Furman report presents itself as a sensible middle course to avoid shriller calls for the large tech platforms to be broken up, price-regulated or subjected to rewritten

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[1] Furman Report, March 2019: https://www.gov.uk/government/publications/unlocking-digital-competition-report-of-the-digital-competition-expert-panel

[2] Ibid, paragraph 1.14.

[3] Regulation to address wider public policy concerns – harmful content, fake news, privacy etc – are not the focus of the proposals. In April 2019, the UK Government published a white paper designed to address some of these wider public policy issues: https://www.gov.uk/government/consultations/online-harms-white-paper

[4] The special advisors found similar features of "extreme" returns to scale, network externalities and data essentiality in digital markets leading to large incumbent players becoming "very difficult to dislodge". Although no *ex ante* regulation is proposed, the advisors recommended widespread reform of antitrust rules, including (i) lowering the standard of proof in mergers and reversing the burden of proof for conduct (which could lead to a rebuttable duty to ensure interoperability), (ii) more focus on identifying anti-competitive conduct than defining markets (which in any event change rapidly), and (iii) a broadening of market power to include "intermediation power" and the possession of data important for competition. See report published on 4 April 2019: http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf

antitrust rules.[5] The report justifies these extra regulatory powers on the basis that because digital markets suffer from tipping points that ensure that "winners take most", and "sequential" competition *for the market* appears to have broken down. The report argues that one or two of the big 5 tech platforms (Amazon, Apple, Facebook, Google and Microsoft) dominate most key digital markets and enjoy not just market power that has endured far longer than before, but are also in pole position to dominate future innovation-rich markets (e.g. in AI and machine learning).

In our view, the report's recommendations should be considered with great caution. Many will question the robustness of the report's overarching finding that *"competition is currently insufficient with winner takes most dynamics in many markets"*, and whether such broad statements can meaningfully apply to the very different businesses and markets of the big 5. For us however, the more fundamental issue is that the proposals introduce more risk than promise for meeting *"the Panel's highest priority ... to ensure that levels of innovation are as high as they can be."*[6] In that respect, we think the proposals risk failing on their own terms.

Our concern is motivated by clear evidence the Panel has not properly considered what matters most for innovation, nor how dynamic competition might be affected by the proposals. Whilst the huge benefits of historic innovation are recognised, the proposals for *ex ante* regulation and raised appeal hurdles risk trampling over hard-won intellectual property rights with reduced due process. It is important to recognise different types of innovation and the lesson from the empirical literature is that the real long-run driver of consumer welfare is genuinely disruptive innovation, as opposed to "follow-on" innovation. The proposals to compel access to proprietary datasets and convert proprietary protocols into open standards, will no doubt promote competition in the market and provide opportunities for some follow-on innovation. However, such proposals will undermine incentives to innovate and disrupt in the first place, and therefore risk potentially inestimable long-run costs for consumers.

In effect, the report suffers from a clear "static bias" i.e. worrying too much about the number of competitors and market shares *in the market* at the expense of the real drivers of dynamic competition *for the market*. This may be understandable—the former is more visible than the latter—but it is also unacceptable and the report lacks any real empirical assessment of dynamic competition. What is there shows that the big 5—with the two global leaders in R&D spend and annual R&D budgets over $70bn—are hardly resting on their laurels when it comes to continuing to innovate. The idea that the proposals will unlock "follow-on" innovation from access-seekers ignores the impact on the budgets of these access-givers, as well as the dulled incentives for *all* innovators if whoever succeeds risks being themselves turned on by the regulator. The promise of regulated access may also vitiate the incentives for access-seekers to engage in disruptive innovation completely. These risks are somewhat intangible but were neatly illustrated by a salutary lesson from the UK courts where "regulatory gaming" was found to have held back genuine competition and innovation.

This arose in a sector (pay-TV) where the regulator arguably had a good handle on the market. By contrast, the Panel has wisely acknowledged that *"it is impossible to predict how digital markets will change"*.[7] That is certainly an unpromising position from which to

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[5] The Furman report pulls no punches here: *"These pro-competition tools offer a better, more targeted, more pro-business and pro-consumer solution to fostering competition in digital markets than one based upon changing antitrust law to drive breakup or structural separation of dominant businesses … there is good reason for digital platforms to recognise the benefits of this approach."* Furman report, paragraph 2.100, see also paragraphs 5.9 and 5.13.

[6] Ibid paragraph 3.31.

[7] Ibid, paragraph 5.2.

argue for reduced appeal rights, and the pay-TV case (and others) illustrates the risks of eroding these rights for the quality of decision-making. Indeed, for us the report represents a missed opportunity to rely more on the UK courts to protect the competitive process through both appeals and private enforcement.

Given how highly prized genuine disruptive innovation should be, we do think there is some sense in the proposals for reviewing the standard of proof in mergers. However, consistency is imperative. If the lens is widened to include potential competitors in adjacent areas then that should be the case too in conduct inquiries, and indeed in any *ex ante* designation of market power (for example, we note that Google comfortably lags Amazon when it comes to product search).

In what follows we first consider what type of competition we should really care about in digital markets. We then consider the potentially distorting effect of introducing incentives for regulatory gaming. We then set out more detailed comments on the key proposals for a dedicated regulator with reduced appeal rights, lower intervention standards on mergers, and powers for *ex ante* regulation of data access. We close with remarks on how these recommendations compare to US and emerging EU thinking (in light of the special advisors report) and how the UK government should treat the Panel's recommendations.

What type of competition do we want to "unlock"?

Before assessing whether anything needs to be unlocked, it is worth considering what type of competition we really care about. The key distinction is between static and dynamic competition. Static competition ensures prices are close to costs and lower cost (quality-adjusted) suppliers get more market share.[8] Dynamic competition promotes dynamic efficiency and requires innovation to come up with new products, services and technologies. It is widely believed that the latter delivers far more benefits to consumers in the long-run and the Panel is right to seek to prioritise this type of competition.

> *"Innovation is particularly important in the digital economy… and digital markets have been a key source of innovation which has delivered significant benefits to consumers. The Panel's highest priority is for the UK's competition system to adapt to the competitive dynamics of the digital economy in order to ensure that levels of innovation are as high as they can be."* [9]

However, there is disagreement about how to promote dynamic competition, and there is something of a transatlantic divide here.

US antitrust officials have traditionally adopted a more laissez-faire approach to intervention in order to protect incentives to innovate. To support this with hard evidence, senior US antitrust officials have repeatedly pointed to the empirical literature on the drivers of long-term economic growth. For example, in a 2008 paper Thomas Barnett referred to the work of Nobel-winning growth economist Robert Solow which concluded that *"a remarkable seven-eighths"* of long-term US growth could be ascribed to technical progress.[10] Barnett summarised this in a chart (repeated below) and concluded that *"in other words, improvements in technology—new ways of producing, rather than just old methods done more intensely—create the vast majority of*

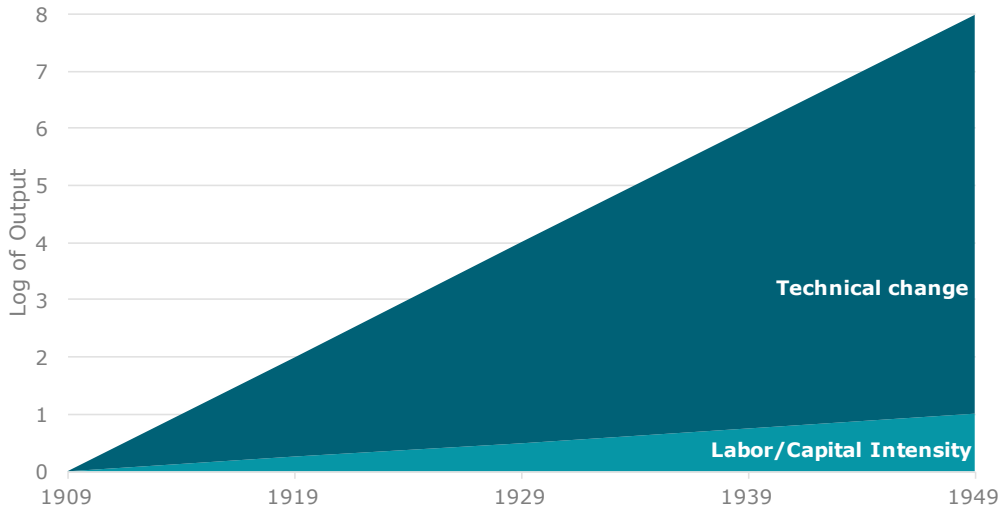
[8] Respectively these are allocative efficiency and productive efficiency. Typically, lower prices result from more players in the market, but there may be a trade-off in the presence of economies of scale.

[9] Furman report, paragraphs 3.30-3.31.

[10] Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Department of Justice (Washington, 2008): https://www.justice.gov/atr/speech/maximizing-welfare-through-technological-innovation

improvement in real societal wealth." The paper also cited much more recent work that concluded that for the United Kingdom economy, the estimated contribution of technical progress to post-war economic growth was 73%.

US GNP growth, Barnett (2008)



Crucially, the paper observes that the majority of these gains stemmed from "leapfrog innovation"—completely new products, technologies and production processes such as cars replacing horses, ipods/vinyl, email/post etc—as opposed to "incremental innovation" i.e. the squeezing of lower costs out of existing technology.[11] This disruptive leapfrog innovation lies at the heart of the Schumpeterian *"gales of creative destruction"* that really drives economic progress.[12] This moves the economy onto much higher growth paths, and benefits accumulate disproportionately over time through the "magic" of compound interest (what Einstein called the eighth wonder of the world).[13]

All this means we should be "intensely relaxed" with winners taking most and making superior profits—as long as the dynamic process of leapfrogging is not illegally frustrated. Indeed, the high market shares and prices that innovation winners enjoy are the essential signal of the value placed on their services to guide future innovation. In the words of the US Supreme Court, monopoly profits are therefore *"an important part of the free market system"*, that *"attract business acumen"* and *"induce risk taking that produces innovation and economic growth"*. [14] The message is clear: measures to just increase the number of players to improve static competition are not worth it if they

[11] *"Dynamic efficiency – particularly leapfrog dynamic efficiency – accounts for the lion's share of efficiency/welfare gains."* Ibid, page 5.

[12] *"competition from the new commodity, the new technology, the new source of supply, the new type of organization . . . competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives"*, Joseph Schumpeter (1942), *Capitalism, Socialism and Democracy*, Harper, p.84 (*cited in Barnett (2008)*). See also: Alan Greenspan and Adrian Wooldridge (2018), *Capitalism in America: a history*, Penguin, p.389. *"This book has repeatedly shown that America's greatest comparative advantage has been its talent for creative destruction."*

[13] For example, the difference between a 1% and 3% growth rate leads to an economy 4 times as large after 78 years. Many argue that this understates the benefit, as GDP figures do not capture the consumer surplus of new products. See for example: http://bruegel.org/2014/02/blogs-review-gdp-welfare-and-the-rise-of-data-driven-activities/

[14] *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 407 (2004)

erode the incentive to innovate and compete dynamically. Giving rivals a leg-up disrespects property rights, expropriates hard-earned profits and threatens to kill the "golden goose" of genuine leapfrog innovation.

Europe has hitherto taken a different path. This can be seen in the very different approach to the Google and, to a lesser extent, Microsoft antitrust cases, lower thresholds for dominance, a lower standard for compulsory licensing to compel interoperability, a lower standard of proof for consumer harm[15], and (in sharp contrast to the US) an ability to sanction "excessive" pricing. Although the excessive pricing tool is rarely deployed, only very recently the French antitrust chief commented that excessive pricing powers should be used "broadly" for tech platforms, and Spotify has just launched an antitrust complaint to the Commission against Apple's 30% commission which it characterises as an excessive "tax".[16]

EU officials argue that you need competition for innovation and are more resistant to the idea of winners taking most if that snuffs out static competition. This thinking has for a long time been influenced by an ordo-liberal philosophy that values the "freedom to compete" separately to the value placed on the competitive process. For example, this lay behind the European Commission's somewhat reluctant abandonment of the "not (yet) as efficient competitor" test in its proposals to revamp the abuse of dominance toolkit. From a competition perspective, the clear difficulty of such a philosophy is that it risks allowing not just survival of the fittest but also the fattest. When concerns about high market shares and prices translate into assisting less efficient or less innovative competitors, dynamic competition gets distorted and incentives to innovate eroded. If the idea is that supporting entry will lead to more innovators, then we still cannot escape the fact that each will face reduced incentives from the risk of themselves being turned upon by the regulator should they succeed.[17]

In our view, the report's "static bias" has led to some of these basic tenets of dynamic competition being simply overlooked. The overarching finding is that *"competition is currently insufficient with winner takes most dynamics in many markets"*. That may work if we refer only to static competition; but it is very misleading when we broaden to include dynamic competition, because there is no real evaluation of the effectiveness of *dynamic* competition.[18] In spite of recognising that the large tech companies deliver

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[15] *"in the EU it is enough to show harm to the competitive process as a proxy to consumer harm, whereas in the US you need to show harm to consumers."* Comments of Thomas Kramler of DG Competition, at Bruegel conference, March 2019: "Panel II: Competition policy for the digital age"

[16] *"Tech platforms could in theory draw excessive pricing scrutiny, French antitrust chief says"*, mlex, 28 March 2019. *"Spotify escalates Apple dispute with formal EU antitrust complaint"*, mlex, 13 March 2019.

[17] The Panel suggests that regulatory intervention can be good for disruptive innovation because for example, *"IBM's dominance of hardware in the 1960s and early 1970s was rendered less important by the emergence of the PC and software. Microsoft's dominance of operating systems and browsers gave way to a shift to the internet and an expansion of choice. But these changes were facilitated, in part, by government policy – in particular antitrust cases against these companies, without which the changes may never have happened".* Furman report, p.4. Debates about both the correlation and implied causality of these examples will no doubt continue (we note that Microsoft signed its seminal deal with IBM in 1974 whereas the DoJ abandoned its 13-year case against IBM's dominance of the hardware market in 1982). In any event, of course effective enforcement of antitrust rules is essential; the question for the Panel is whether the proposals to go way beyond these rules will do more harm than good.

[18] There are passing references e.g. *"Facebook's strong position in the attention market has enabled it to grow its share of the digital advertising market to challenge Google"; "Amazon's position as an online marketplace has been achieved through offering a fast, efficient and low-cost service that consumers value highly"; "Google took over from rivals such as Lycos, AltaVista, and Yahoo as the leading search engine because it offered users faster and more relevant search results"; "Nokia appeared to have an unassailable position in the mobile phone handset market in the late 1990s, until it was left behind by the smart phone revolution a decade later."* Ibid, paragraphs 1.93-1.98.

enormous consumer benefits (often for free[19]) and their market-leading levels of global R&D, the Panel seems to see market power and concentration as a bad thing. Nowhere is concentration described as the essential carrot to spur innovation, or as a hallmark of successful innovation giving advantages to be pressed home to both create markets and win market share (in particular from offline suppliers). Rather, as far as *dynamic* competition is concerned, concentration is seen only as a cost: *"concentration... creat[es] a trade-off where the potential dynamic costs of concentration outweigh any static benefits".*[20] This completely ignores the benefits of concentration for *dynamic* competition: the promise of the reward of reduced *static* competition in return for the risky investments that are the pre-requisites of innovation.

The following statement is telling:

> *"A small number of large digital companies occupy strategically important gateway positions in digital markets, wielding significant bargaining power over their business users as a result. Whether a result of a conscious anticompetitive strategy or not,* ***these market dynamics will lead to business users of platforms accepting worse terms than they would face if multiple platforms were competing with one another in each market.*** *The consequences of these terms will ultimately feed through to consumers in the prices they pay, the quality they receive, and the range of innovative new products and services they are able to choose from."* (emphasis added) [21]

The Panel wants the innovation to build the now-valuable gateways, but it also wants more static competition and choice. Alas, the hard fact is that there is a trade-off and we cannot have our cake and eat it.

The danger is that such "static bias" quickly descends into an instinct to intervene to increase the number of players at the expense of incentives to innovate. The discussion of compelling open standards for IOT products even suggests regulators can identify *"optimal market outcomes"* (see below). This is simply not credible and gives great concern that regulation will consist of attempts to "market design" precisely in those markets where, by the Panel's own admission, the consequences are least predictable. In such circumstances, we would do well to heed another Nobel-winner's call for humility in the face of unintended consequences: *"The curious task of economics is to demonstrate to us how little we really know about what we imagine we can design."* [22]

As the economic growth literature suggests, the costs of reduced innovation for consumers could dwarf the benefits of any enhanced static competition. A key problem is that such unintended consequences are also hidden from view. However, one seminal UK case did shine a light on them.

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[19] *"the average adult values free services at several thousands of dollars a year",* Ibid, paragraph 1.14.

[20] Furman report, page 4.

[21] Furman report, paragraph 1.161. See also "*Markets based upon digital platforms, with network-based and data-driven business models, show a tendency to tip towards a single winner. That dominance can be abused in a way that antitrust can seek to address. But even where conscious abuse does not occur, markets can produce better outcomes if they are less concentrated, more contested and more dynamic*" Furman report, paragraph 2.13.

[22] Friedrich Hayek (1988), *The Fatal Conceit*, University of Chicago Press, p.76.

The Competition Appeal Tribunal's finding of "regulatory gaming" in the pay-TV appeal[23]

Briefly, the sector regulator Ofcom had concluded that the leading satellite broadcaster Sky was abusing an alleged dominant position in the retail pay-TV market by refusing to supply wholesale premium sports content to downstream rivals including cable companies, BT and internet operators, at a competitive price. Ofcom found that negotiations had stalled because Sky was acting on a strategic incentive to forgo incremental wholesale revenues in order to suppress downstream competition. The proposed remedy was to compel Sky to licence the premium sports content at a regulated wholesale price. This was in spite of the fact that Sky had by that point spent £6bn in competitive auctions to secure the rights to the Football Premier League (the jewel in the crown of its premium sports product) and had for many years innovated and invested heavily to refine its overall sports coverage.

The Competition Appeal Tribunal (CAT) rejected Ofcom's analysis and concluded that Sky had negotiated in good faith, and that BT in particular had engaged in "regulatory gaming"—namely *"the conditioning of a party's conduct in commercial negotiations by reason of an ongoing regulatory review by Ofcom, and its hope and expectation that this review would produce a favourable outcome."* [24]

The CAT concluded *"in the light of all the evidence, including in particular the conduct of the parties, that a major reason for the breakdown of the negotiations in 2007/8 was the impact of the regulatory process upon BT's incentives to reach a wholesale deal with Sky at that stage and thereby upon BT's negotiating position."* [25] In view of these findings[26], the CAT concluded that the compulsory licensing intervention was unwarranted.

In addition to the obvious incentive problems of a remedy that expropriates Sky's large investments in proprietary content, the subsequent events give an insight into what was missed in terms of competition and innovation from Sky's rivals as a result of the distraction of a regulatory short-cut. Since the CAT's judgment, the sector witnessed a marked intensifying of commercial negotiations, competitive bidding for rights, and wider innovation and competition. Specifically, deprived of any regulated access to Sky's premium sports content, BT entered the auctions for the underlying football rights and has since spent £2.6bn to successfully secure certain football packages. This has also forced Sky to increase its bids markedly: Sky spent a further £10bn at an average cost per game of £9m compared to £3m before BT's participation in the auctions.[27] BT and Sky also went on to successfully negotiate a commercial wholesale deal.

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[23] Case no. 1158/8/3/10, *British Sky Broadcasting versus Ofcom,* Competition Appeal Tribunal (August 2012). In the interests of disclosure, we acted as Sky's independent experts before the CAT on this matter. Note that the Court of Appeal subsequently ruled that, in addition to overturning Ofcom's finding of fact that Sky had deliberately withheld wholesale supply of its premium channels, the CAT shoud also address Ofcom's concern regarding whether the price (and discounts) offered to BT nonetheless impaired effective competition (in spite of having found that Virgin Media was able to compete effectively with Sky on the basis of undiscounted rate-card prices). This question was therefore further remitted to the CAT by the Court of Appeal, before all appeals were withdrawn in 2015. See https://www.catribunal.org.uk/cases/11588310-british-sky-broadcasting-limited

[24] Ibid, footnote 15.

[25] Ibid, paragraph 323.

[26] See also ibid paragraphs 29, 338, 403 and 404.

[27] Sources: https://www.ofcom.org.uk/__data/assets/pdf_file/0021/55470/paytv_statement.pdf, paragraph 5.432, and https://www.independent.co.uk/sport/football/premier-league/163178bn-record-premier-league-tv-deal-defies-economic-slump-1569576.html

This stark illustration of regulatory gaming[28] shows that the risks of regulatory intervention for the dynamically competitive process are very real, even if they are intangible. Accordingly, even if market failures can be identified, thought needs to be given to the risk of *regulatory failure* undermining the very innovation the regulation is trying to promote.

Comments on specific proposals

a) The creation of a dedicated Digital Markets Unit with reduced appeal rights for parties

Whilst it may be sensible for the CMA to conduct a market study into digital advertising, it is not at all clear that the Furman report has made the case for a new digital regulator, let alone one that should enjoy reduced appeal rights for parties.

The assertion that digital markets are "different" is at the very least contentious. Many markets are characterised by tipping points due to some combination of economies of scale, network effects, two-sided dynamics and behavioural biases. Arguably, the same could have been said of the now bankrupt Kodak's multi-decade dominance of the photography market.[29] Technology consistently shows there is more often a failure of imagination than market failure. The last UK regulatory review in telephone directories saw the imposition of a utility-like price cap on the now obsolete Yellow Pages. The emergence of digital assistants (including speakers that give you access to multiple providers including Siri, Alexa and Google Assistant[30]) will probably change the game further: moving competition from being "1-click away" to "one shout away".

We therefore do not think the report has made the case that market failures arising from market power in digital markets are inevitable and need addressing through regulation. In any event, concerns over market failure need to be balanced with the risks of *regulatory* failure. In our view, these latter risks may well dominate and the consequences for innovation and consumer welfare could be profound—not least as the proposed *ex ante* regulatory framework is inspired by a telecommunications regime where many positions of market power have been inherited, as opposed to created through innovation and dynamic competition.

The Panel's recognition that digital markets are impossible to predict, and the fact that the Panel itself appears to display a "static bias", reinforces the need to have any regulatory intervention robustly tested by independent courts with appropriate appeal standards. In addition to the pay-TV example, the CAT's recent rejection of the CMA's decision in *Pfizer/Flynn* illustrates the need for such standards. Had the CMA's decision been allowed to stand, it would have had a deleterious effect on investment and innovation incentives (and to be clear, not just in the pharmaceutical sector), as it sought to set the threshold for excessive prices based on a cost-plus methodology. The CAT rightly rejected the CMA's analysis.[31]

The Panel's proposals would be a wrong step and are a missed opportunity to embrace private enforcement, which also does not carry the same risks of regulatory gaming as setting up an *ex ante* regulator. Indeed, the UK courts have been active in the digital

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[28] Ayn Rand described this as relying on "pull" with the regulators instead of competing on "competence". Ayn Rand (1957), *Atlas shrugged*, Random House.

[29] For example, in the 70s the company sold 90% of the photographic film in the US along with 85% of the cameras. In 1976 Kodak then also invented the digital camera—a "pole position" advantage that clearly did not last.

[30] https://www.techadvisor.co.uk/test-centre/digital-home/best-smart-speakers-3666845/

[31] Case No: 1276/1/12/17. *Pfizer v Competition and Markets Authority*. See paragraphs 311-325.

space (e.g. *Streetmap v Google, Unwired Planet* etc) and, with the fast-track regime and an increasingly vibrant class action regime (including for stand-alone abuse of dominance cases), look set to become more so.

b) Lower standards of proof in mergers

Given the value of disruptive competition, it does seem sensible in principle to ensure that impairment to dynamic competition by the acquisition of potential future disruptors is challenged. The point is that an adverse effect on potential competition could be material but reflect a high impact with a low probability of arising. If such potential impacts are currently precluded from carrying weight by a balance of probabilities threshold, then that is clearly worth addressing. Expected value analysis, involving valuing lower than 50% chances, is routinely used in business and indeed the courts (in loss of chance cases).

However, many have cited the dangers of over-enforcement, in particular on the incentives to finance innovation whose highest and best uses (whether as a complement to, or potential usurper of, existing technology) will be unclear at the outset.

More fundamentally, it will also be important for the authorities to be consistent. The more weight we attach to a potentially usurping innovator, the more we acknowledge the contestability of the acquiror's current market position. Similarly, the more these potential competitors are worth preserving to prevent a "killer acquisition", the more they may discipline other acquisitions. We would recommend that in its *ex post* review of mergers the CMA also looks at Project Kangaroo (where the potential competition from the likes of Netflix was discounted).

It would also be inconsistent to attach weight to speculative potential competition from certain players and not direct competition from actual rivals due to an overly narrow market definition. For example, it is argued that in *Facebook/Instagram* the authorities should have widened the market from beyond camera-apps to capture the potential competition of Instagram as a social network that could rival Facebook. A perhaps more modest widening of the market in online search would allow the Commission, currently implementing what some see as an essential facility remedy on Google, to take account of the fact that Google comfortably lags Amazon in product search.[32]

c) Ex ante regulation and data access

The Panel clearly sees access to data as a central issue.

> *"Large data holdings are at the heart of the potential for some platform markets to be dominated by single players and for that dominance to be entrenched in a way that lessens the potential for competition for the market."* [33]

> *"Data can act as a barrier to entry in digital markets. A data rich incumbent is able to cement its position by improving its service and making it more targeted for users."* [34]

[32] https://internetretailing.net/irbx/irbx/amazon-beats-google-and-brand-sites-as-first-stop-for-product-searches

[33] Furman report, paragraph 2.89

[34] Ibid, paragraph 1.73

This somewhat ignores that superior innovation and performance by the likes of Amazon, Google and Facebook may also play a role in their market "entrenchment". But the broader perspective is that for dynamic competition it also demonstrates to a wider audience the value of holding such data. As such, dynamic competition may be relied upon to keep the incumbents honest. No doubt the big 5 direct their annual R&D spend of $70bn to try and stay one step ahead of not just each other but also future disruptors and entrants.

The Panel also suggests that the incumbents' use of large datasets somehow compromises innovation using emerging technologies: *"it is impossible to assess and predict future technologies and how they might affect the current incumbents but large incumbents are in the best position to lead the next wave of ML and AI powered by data sets."*[35] Even ignoring other players, it is by no means clear why having 5 aggressively innovating large players should be a cause of concern. Unless of course, the Panel is fast forwarding to a position where one or two of them pull away from the others.

More fundamentally, even ignoring competition *between* the big 5, the Panel has not considered wider datasets that could compete in any event. In particular, no attention has been paid to the retail banks and payments companies who hold vast datasets that contain, with actual transaction data, far richer information on consumers than mere searches and likes.

The report sets out far-reaching proposals to address this putative dataset incumbency. These include relatively benign proposals for data mobility to make it easier for customers to switch and multi-home. Such measures may be beneficial in the right circumstances where they do not materially impinge intellectual property rights (e.g. mobile number portability). However, the proposals also envisage compelling access to proprietary data including *"inferred data"* where *"businesses combine input and observed data to infer other information about the consumer."* [36] The report gives the example of age and gender but clearly inferred data could include all manner of commercially valuable information such as insurance or credit risk or the likelihood of purchasing certain products. The report acknowledges the risks of undermining *"incentives for investment in future data collection and management"* but this probably understates the risks for incentives to compete and innovate.[37] The report also envisages further data openness remedies that go beyond personal data mobility.[38]

The bar for being caught by such remedies also seems worryingly low and the danger is that the unit is quick to designate gateways as essential: *"the digital markets unit should be able to impose measures where a company holds a strategic market status – with enduring market power over a strategic bottleneck market."*[39] The definitions here also fall far short of traditional thresholds for essentiality to include much vaguer concepts: "*aspects of market power particularly relevant to platforms and their potential to act as a*

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[35] Ibid, paragraph 1.115

[36] "*i.e. input data – data consumers input about themselves; observed data – data businesses observe about consumers (for example what they read or watch online); and inferred data – where businesses combine input and observed data to infer other information about the consumer (for example their age group or gender)".* Ibid, paragraph 2.54

[37] Ibid, paragraph 2.87

[38] *"Enabling personal data mobility may provide a consumer-led tool that will increase use for new digital services, providing companies with an easier way to compete and grow in data-driven markets. However, in some markets, the key to effective competition may be to* ***grant potential competitors access to privately-held data****."* Ibid, paragraph 2.81

[39] Ibid, page 10

bottleneck should also be considered for incorporation: economic dependence, relative market power and access to markets."[40]

Similarly, in spite of acknowledging a long list of the benefits of closed standards[41], the Panel appears very confident of the ability to regulate to a better market outcome by compelling open standards:

> *"All the same the private incentives for decisions on adopting open or closed systems may not always lead to* ***optimal competitive outcomes****. It is for this reason that the government should provide the digital markets unit with powers to require systems be built on open standards, if it determines that approach to be the best, proportionate tool to enable effective competition* ***in that market****."* (emphasis added)[42]

Again, with the focus on competition in the market, the static bias is on display. This statement also reveals a remarkable regulatory optimism: the Panel clearly believes that the unit can identify the "optimal competitive outcome". For a regulator to do that in a way that properly embraces both dynamic and static competition is nigh on impossible, and this should simply be best left up to the market.

All in all, these proposals amount to a significant departure from current competition law standards in relation to regulatory remedies, thresholds for dominance and essentiality, and the definition of what constitutes anti-competitive behaviour.[43] We think that the report has not established the evidential justification for this, and that the proposals carry serious risks to dynamic competition and consumer welfare.

Closing remarks

The report has rightly prioritised the need to promote innovation and dynamic competition. However, the report displays a clear "static bias" in how it evaluates competition—to the detriment of properly evaluating the dynamically competitive process. As a result, the report suffers from a Nirvana fallacy of wanting dynamic competition for the market and diverse choice and competition in the market. It also displays remarkable optimism that regulators can identify optimal competitive outcomes, in spite of (rightly) observing that future developments in digital markets are impossible to predict. The prospect of such a regulatory mindset attempting to "police the tipping point" and generally being in charge of the future direction of these markets is deeply worrying for long-term consumer welfare.

In general, the best way to promote innovation is to allow the market and the profit signal to do its work and not to introduce the dead-hand of regulation and incentives to game the regulator instead of competing and innovating. This does rely on effective enforcement of antitrust rules, but stronger not weaker rights of appeal underpin that. We also think that more reliance on the courts for first instance reviews is the best way forward too (in particular as the jurisdiction of the European Commission over UK antitrust recedes).

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[40] Ibid, paragraph 2.117

[41] *"However, there can also be advantages for businesses and consumers in systems built on standards that are – to a greater or lesser degree – closed. For example, proprietary systems can provide a more secure business proposition for investment in innovative services. They can help ensure technical consistency. They can be part of a proposition that protects user privacy and guarantees the standards and reputation of all services offered. They can protect the intellectual property of new businesses whose innovations would be apparent from an open standard. And proprietary systems are more easily updated and developed where they need to develop rapidly."* Ibid, paragraph 2.74

[42] Ibid, paragraph 2.75. See also paragraph 2.72, box 2G.

[43] See also ibid paragraph 2.45

In our view, the stakes for consumer welfare are high. From a UK plc perspective, we hope that the UK government thinks about these proposals very carefully and the signals they send for inward investment in innovation-rich sectors. The Economist has even suggested that the lack of European tech champions is down to a regulatory culture that is less innovation friendly.

> *"Europe is not an impressive performer when it comes to creating tech behemoths: there is just one (SAP, a business software company) in the top 20. In the top 200 internet companies there are just eight. But in regulatory heft the EU punches far above its members' business weight. [One] way of explaining this … is that Europe's keenness to regulate stops its tech firms from growing in the way that hands-off America encourages"* [44]

The Furman report has been described as "mid-Atlantic" and striking a balance between EU and US approaches.[45] We are not so sure. The proposals seem similar to views expressed by EU officials and, although not a reflection of official European Commission policy, the Commission's special advisors report has stopped short of recommending *ex ante* regulation.[46]

In our view, the Furman proposals carry very significant long-term risks to innovation and are a missed opportunity to chart a more innovation-friendly course for the UK. They may "unlock" some static competition, but they risk "locking away" the far more important disruptive innovation. And it is in the nature of dynamic incentives, that it may then be very difficult to re-find the key.

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[44] "Big tech faces competition and privacy concerns in Brussels", *The Economist,* March 2019 (available at: https://www.economist.com/briefing/2019/03/23/big-tech-faces-competition-and-privacy-concerns-in-brussels

[45] Comments of Professor Carl Shapiro at ABA Antitrust Conference Washington 2019

[46] See footnote 3 above. The DG COMP chief economist Tomasso Valletti has emphasised the special advisors report is not official EC policy. In reality some of the proposals to reform antitrust rules may come close to effective ex ante regulation.