

## **Introduction from the Expert Panel**

The United Kingdom has an opportunity to seize the full potential of the digital sector, increasing the benefits for consumers and fostering an even more vibrant ecosystem for businesses. Competition should be at the heart of this strategy, leading companies to produce better outcomes for consumers, helping new companies enter and grow, and continuing to encourage existing companies to innovate.

Some people argue that digital platforms are natural monopolies where only a small number of firms can succeed, making competition impossible. The logical conclusion of that view is utility-like regulation of the type used for electricity distributors. Others believe there is already adequate competition and no policy changes are needed to maintain it. We disagree with both views, seeing greater competition among digital platforms as not only necessary but also possible – provided the right policies are in place.

The biggest missing set of policies are ones that would actively help foster competition. Instead of just relying on traditional competition tools, the UK should take a forward-looking approach that creates and enforces a clear set of rules to limit anti-competitive actions by the most significant digital platforms while also reducing structural barriers that currently hinder effective competition. These rules should be based on generally agreed principles and developed into more specific codes of conduct with the participation of a wide range of stakeholders. Active efforts should also make it easier for consumers to move their data across digital services, to build systems around open standards, and to make data available for competitors, offering benefits to consumers and also facilitating the entry of new businesses. Implemented effectively, this approach would be more flexible, predictable and timely than the current system.

The existing competition tools also need to be updated to more effectively address the changing economy. Ensuring that competition is vibrant requires ensuring that there are competitors. Merger control has long had this role and in the context of the digital economy it needs to become more active with an approach that is more forward-looking and more focused on innovation and the overall economic impact of mergers. Even with clearer ex ante rules, ex post antitrust enforcement will remain an important backstop – but it needs to be conducted in a faster and more effective manner for the benefit of all of the parties.

Many countries are considering policy changes in this area. The United Kingdom has the opportunity to lead by example, by helping to stimulate a global discussion that is based on the shared premise that competition is beneficial, competition is possible, but that we need to update our policies to protect and expand this competition for the sake of consumers and vibrant, dynamic economies.

### **The work of the Expert Panel**

The Digital Competition Expert Panel was established in September 2018. Our terms of reference asked us 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

In particular, we were asked to examine:

- the impacts of the emergence of a small number of big players in digital markets such as social media, e-commerce, search, and online advertising
- appropriate approaches to mergers, takeovers and anticompetitive practices in digital markets
- opportunities to enhance competition, to increase business innovation and expand consumer choice
- how best to assess consumer impacts in ad-funded products and services that are ‘free’ to consumers

Underpinning our approach is the written evidence we have taken, submitted by over 60 experts and stakeholders, and gathered through 11 round tables, and further consultations with businesses, economists, lawyers, and UK and international government departments and agencies.

Within a complex and often contested field, we have sought to undertake an independent, expert-led assessment of the available evidence in order to provide government with a reasoned judgement on the best way forward.

The approach has been to review the evidence with an open mind, sift and weigh which interpretations better fit the facts, and which policy proposals provide the most convincing route to addressing the issues found. This has involved judgement and the conclusions reached will inevitably and rightly provoke further debate. The Panel has been able to develop this assessment drawing on its members’ interdisciplinary mix of expertise, drawn from economics, law, computer science and competition policy.

### **The general propositions that guide our recommendations**

Our policy recommendations are based on the following general propositions:

1. The digital economy is creating substantial benefits. The digital economy has benefited consumers by creating entirely new categories of products and services. Many of these products and services are high-quality with low prices, in many cases a monetary price of zero. It has also benefited businesses by lowering the cost of starting a business and scaling up through cloud computing, access to platforms, and digital comparison tools. In some areas this has facilitated greater competition, enabling more entry of new businesses, growth of existing businesses, and facilitating multi-homing and digital comparison tools that allow users to make better-informed choices to switch between businesses or use multiple platforms simultaneously.
2. In many cases, digital markets are subject to ‘tipping’ in which a winner will take most of the market. Digital markets vary greatly so no general rules apply to all of them. But in many cases tipping can occur once a certain scale is reached, driven by a combination of economies of scale and scope; network externalities whether on the side of the consumer or seller; integration of products, services and hardware; behavioural limitations on the part of consumers for whom defaults and prominence are very important; difficulty in raising capital; and the importance of brands.

3. Concentration in digital markets can have benefits but also can give rise to substantial costs. A large part of the reason for the emergence of one or a small number of dominant firms is that it is more efficient and thus better for consumers or businesses. That may be because a firm grows because it offers better, more innovative products or provides integration that benefits consumers. It also may be because it is more efficient to have one firm with substantial scope of network benefits instead of many firms. But concentration can have substantial downsides as well. It can raise effective prices for consumers, reduce choice, or impact quality. Even when consumers do not have to pay anything for the service, it might have been that with more competition consumers would have given up less in terms of privacy or might even have been paid for their data. It can be harder for new companies to enter or scale up. Most concerning, it could impede innovation as larger companies have less to fear from new entrants and new entrants have a harder time bringing their products to market – creating a trade-off where the potential dynamic costs of concentration outweigh any static benefits.
4. Competition for the market cannot be counted on, by itself, to solve the problems associated with market tipping and ‘winner-takes-most’. Many of the dominant technology companies of the past seemed unassailable but then faced unexpected competition due to technological changes that created new markets and new companies. 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. Today, network effects and returns to scale of data appear to be even more entrenched and the market seems to have stabilised quickly compared to the much larger degree of churn in the early days of the World Wide Web. Moreover, to the degree that the next technological revolution centres around artificial intelligence and machine learning, then the companies most able to take advantage of it may well be the existing large companies because of the importance of data for the successful use of these tools. New entry may still be possible in some markets, but to the degree that entrants are acquired by the largest companies – with little or no scrutiny – that channel is also not operative.
5. Government policy and regulation also has limitations. Policy change and enforcement can be slow and unpredictable, which is even more costly than normal in rapidly evolving technology markets. Government and regulators are at an enormous informational disadvantage relative to technology companies. Like consumers, they can also be subject to behavioural biases. Regulators may be captured by the companies they are regulating. Any approach to policy needs to be mindful of these downsides and make sure that it is designed to encourage competition, while increasing the speed and predictability of enforcement.

The Panel believes that competition policy should be given the tools to tackle new challenges, not radically shifted away from its established basis. In particular, policy should remain based on careful weighing of economic evidence and models. Consumer welfare is the appropriate perspective to motivate competition policy and a completely new approach is not needed. This approach is flexible and can take into account broader considerations than price, narrowly

defined, and also include choice, quality and innovation, among other areas. We have developed a set of policy, legal and regulatory proposals that would help achieve these goals.

### **Our proposals**

Our central conclusion is that digital markets will only work well if they are supported with strong pro-competition policies that open up opportunities for innovation, and counter the forces that can lead to high concentration and a single winner.

Solely relying on merger and antitrust enforcement can create delays and uncertainty that can be bad for large incumbents and small entrants alike. Neither is well designed for the intensive and ongoing work that needs to be done to facilitate competition and entry through making it easier for consumers to move and control their data, and for new digital businesses to interoperate with established platforms. An approach that uses these pro-competition tools can make it easier for new businesses to enter digital markets, give more predictability to all companies about the rules and standards that apply, spur innovation and provide consumers with higher quality and greater choice.

This is why the Panel is recommending the establishment of a digital markets unit, given a remit to use tools and frameworks that will support greater competition and consumer choice in digital markets, and backed by new powers in legislation to ensure they are effective.

This unit would have three functions. **First**, it would develop a code of competitive conduct, with the participation of stakeholders. This would be applied only to particularly powerful companies, those deemed to have ‘strategic market status’, in order to avoid creating new burdens or barriers for smaller firms.

**Second**, the digital markets unit would be charged with enabling greater personal data mobility and systems with open standards where these tools will increase competition and consumer choice. Some companies are already making substantial efforts in this regard, like the Data Transfer Project that includes Microsoft, Google, Facebook and Twitter. In some cases the obstacles to interoperability are technical, in some cases due to lack of co-ordination; but in other cases the obstacles are due to misaligned incentives as such interoperability might have broader benefits but to the cost of the dominant companies. Email standards emerged due to co-operation but phone number portability only came about when it was required by regulators. Private efforts by digital platforms will be similarly hampered by misaligned incentives. Open Banking provides an instructive example of how policy intervention can overcome technical and co-ordination challenges and misaligned incentives by creating an adequately funded body with the teeth to drive development and implementation by the nine largest financial institutions.

**Third**, the digital markets unit would be able to advance data openness where access to non-personal or anonymised data will tackle the key barrier to entry in a digital market, while protecting privacy.

Our recommendations also update merger policy to protect consumers and innovation, preserving competition for the market. Central to updating merger policy is ensuring that it can be more forward-looking and take better account of technological developments. This will

require updated guidance about how to conduct these assessments based on the latest economic understanding, and updated legislation clarifying the standards for blocking or conditioning a merger. We believe that the correct application of economic analysis would result in more merger enforcement. This would be welcome given that historically there has been little scrutiny and no blocking of an acquisition by the major digital platforms. This suggests that previous practice has not had any ‘false positives’, blocking mergers that should have been allowed, while it may well have had ‘false negatives’, approving mergers that should not have been allowed.

Merger control can only address the use of acquisitions to expand the scale and scope of the incumbent digital companies but cannot address their existing scale and scope. Doing this requires antitrust policy. There is nothing inherently wrong about being a large company or a monopoly and, in fact, in many cases this may reflect efficiencies and benefits for consumers or businesses. But dominant companies have a particular responsibility not to abuse their position by unfairly protecting, extending or exploiting it. Existing antitrust enforcement, however, can often be slow, cumbersome, and unpredictable. This can be especially problematic in the fast-moving digital sector. That is why we are recommending changes that would enable more use of interim measures to prevent damage to competition while a case is ongoing, and adjusting appeal standards to balance protecting parties’ interests with the need for the competition authority to have usable tools and an appropriate margin of judgement. The goal is to place less reliance on large fines and drawn-out procedures, instead enabling faster action that more directly targets and remedies the problematic behavior.

As a Panel we have not been asked to consider wider social questions around digital markets and our recommendations do not specifically address privacy, harmful online content and other issues. However, it is clear that well-functioning competitive digital markets have the potential to develop new solutions and increased choice for consumers, where privacy and quality of service can be differentiating factors. The digital markets unit could also work with others to secure wider policy goals, using its technical expertise, engagement with markets and competition-first approach to solve problems.

Clearer principles, rules and standards can support and enhance competitiveness and success in the global economic arena. For example, the UK is a leader in global banking in part thanks to its regulatory environment. The UK is a great place to start a FinTech company in part because of Open Banking, and the approach of the Financial Conduct Authority and the Payment Systems Regulator. Applying similar regulatory principles can improve the economic environment in the UK for digital start-ups and scale-ups while creating more predictability for large incumbent firms.

Many digital policies would ideally be globally co-ordinated and enforced. In practice this is often not feasible. If policy cannot be fully co-ordinated, then countries can at least learn from each other to work out how best to preserve and expand the enormous benefits economies around the world have gained from the digital sector and take advantage of the great additional potential that it still has. Global dialogue and sharing of ideas and co-ordinating on merger enforcement and other policy actions would help. Global leadership can also play an important role by developing and demonstrating improved models to approach policy. The UK’s long tradition of rule of law, a business-friendly environment, and expert independent enforcers and regulators

give it the potential to play this global leadership role by adopting the recommended strategic approaches and specific actions put forward by the Panel.