



Policy Opinion

Response to "Anti-competitive Practices by Big Tech Companies"

Prepared in response to the Standing
Committee on Finance report

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The Standing Committee on Finance, under Chairperson Sh. Jayant Sinha presented its report on "Anti-competitive Practices by Big Tech Companies" to both houses of parliament on December 22, 2022. This report intends to lay the groundwork for a regulatory framework that can foster competitive, efficient digital markets in India and safeguard consumer welfare. The ideas and suggestions contained in it rest on three key claims about digital markets. These are clearly stated in the report.

1. Driven by "massively powerful" increasing returns to size and "dramatically powerful" learning and network effects, digital markets are fundamentally different from traditional markets.
2. Digital markets tend to create monopolies - these differences create conditions ripe for winner-take-all situations.
3. Monopolies get created quickly - monopoly players emerge within 3-5 years of markets coming into existence.

Based on these assumptions the report argues for a regulatory intervention

4. Digital markets need ex-ante regulations - rapid changes in the market may render ex-post remedies ineffective.

The report then identifies 10 Anti-competitive practices (ACPs), indulged in by digital companies, to be addressed by competition law and provides suggestions on what the law should disallow. This list of don'ts for players operating in digital markets draws heavily from the regulatory framework of other countries/unions with an attempt to harmonize India's regulations with other large markets. The list of ACPs is extensive and deserves careful investigation. But, such an investigation must be preceded by rigorous questioning of the basis of the proposed paradigm shift to ex-ante regulations.

There is no doubt that digital markets have some unique characteristics. But do these warrant an upturning of our understanding of the role of anti-trust regulations gleaned from traditional markets? What are the objectives of a competition policy based on an ex-ante specification of ACPs? Can they be as those for traditional markets? Such a move needs to have both a sound economic and regulatory rationale.

Perhaps more importantly, it is imperative to check if such a change can create problems that have not been explicitly explored in the report and if these can undermine the strategic requirements of the Indian digital marketplace. To investigate these and related issues, the claims made in the report needed to be supported by relevant economic logic and empirical justification. Equally importantly we need to learn from our own regulatory history. Ill designed government regulation of business often leads to worse outcomes than the ones we started with.

We do not make the claim that the identified practices cannot be anti-competitive. Unfortunately that is the best claim that the report can also make. The practices *can* be anti-competitive. This makes the evaluation of economic harm contextual and not amenable to a sweeping regulation.

There is need to bring in more economic logic, nuanced argumentation and empirical evidence to the debate before any well-meaning regulation can be designed.

The claim on the need for ex-ante regulation is self-contradictory. If rapid changes in the market increases the burden on the competition authority, then we should equip the authority to tackle the increased burden. The purpose of regulation should not be to protect regulators. The answer to this problem cannot be to introduce regulation that slows down these changes. That is harmful to consumers, innovation and the economy as a whole.

At best this approach is guided partly by an assumption that a high level of competition is necessary and sufficient for increasing consumer welfare, and partly by the belief that it would alleviate the need for increased regulatory capacity. Both these claims do not stand up to scrutiny in many different and relevant circumstances. In fact, this approach harkens back to the days of a protectionist command economy, and is not likely to serve the long-term strategic or short-term tactical interests of the country and its digital markets.

The report has overlooked some elementary current economic realities. Digital markets are not as fundamentally different to traditional markets, at least as far as the application of anti-trust regulatory action is concerned. Further, the same market dynamics that create monopolies, can, and frequently do end them. What matters for regulation is *contestability*. Is the incumbent challenged enough to keep innovating and serving consumer interests? The static understanding of fast-evolving markets that report relies on should not form the basis of a regulatory paradigm, especially in the context of a country that needs to attract investments and foster innovation.

The rest of this paper is divided into two parts – it first evaluates the premise of the report and the proposed regulatory change – ex-ante rather than ex-post regulation. It then delves deeper into the economic rationale for the principles the committee's report is based on.

Premise and approach

Competition = Consumer welfare?

A monopoly in a traditional market reduces consumer welfare by reducing the availability of its products and consequently charging higher prices for the products available. But in many digital markets, the value of the business is premised on the multiplier effects of more consumers accessing and using more often. In many cases, the price paid by the consumer is zero or close to it. That is not to say that consumer welfare cannot be affected in such markets, but the idea is not as straightforward to operationalize. In this regard, the report points out that lack of competition can reduce consumer choice directly in the short run and indirectly by stifling innovation in the long run.

The idea that choice, in and of itself, is a component of consumers' utility may not be as tenable as it may initially seem and is certainly far from universal. Consider a person buying a car. If the car comes without a steering wheel from the factory, the consumer can buy any steering she chooses (F1 drivers typically carry their steering wheel to the vehicle). Manufacturers of steering wheels will also benefit as they can now directly sell their

products to consumers. But is the increase in choices available to the consumer likely to increase or decrease their utility? If this example seems too far-fetched, look at the open-source operating system (for PCs), Linux. It has many different flavours and offers the user infinitely more choices than Windows or OSX. Any sufficiently skilled user can program a Linux machine to look and do exactly as they prefer. Despite the choices it offers, Linux had a 2.93% (in December 2022) share in the personal desktop computing market, revealing that choice may not be an important determinant of consumer utility and therefore, welfare.

The other concern expressed in the report on consumer welfare is of monopoly markets stifling innovation. Innovation is typically the result of a dynamic and uncertain process that cannot be willed into existence by regulations. Nonetheless, monopolies not being as innovative as firms operating in competitive markets is an old concern. However, the low cost of entry for new firms in the digital markets can, in principle, create the threat of Schumpetrian "potential competition" which would ensure that even monopolies have to continue to innovate to retain their position in the market. The large number of startups coming up in the digital markets should provide preliminary empirical evidence that all firms, even big tech, should and likely are continuing to innovate to avoid obsolescence in a fast-changing landscape.

In stating its views on the creation of monopolies, the report seems to take a static perspective implying that monopolies, once created, stay in the dominant position. For instance, it states that big tech can starve other firms of quality manpower by hiring the best and the brightest. But surprisingly, in assessing consumer welfare, it implicitly alludes to the dynamic nature of markets (that should be) driven by innovation. In such a dynamic setting, however, a firm's decisions are a function of changing market conditions and business cycles. The recent firing by Big tech of employees (who can now be hired by competing firms) in large numbers is an example of how markets can change over time. A dynamic understanding of the market, where monopolies get created and destroyed over time, may also help ensure that regulations do not crowd out markets' internal incentive mechanisms.

None of this implies that consumer welfare cannot or is not being appropriated in digital markets. But it does serve to show that the premise of the report that a higher level of competition by having more firms protects consumer welfare is not always true. The fact that the premise does not always hold, highlights the need to distinguish across different markets, products and services (a ride-hailing platform is not the same as generic e-commerce, which is not the same as a platform for pet products and services). The report though does not attempt to distinguish between different types of digital markets or the stage of evolution they are in. Such an acontextual conflation of competition with consumer welfare has three potential issues. The first, as shown in the example of car steering wheels and Linux, increased choice may not increase consumer welfare.

Second, what happens in cases where the objective of increasing competition, decreases welfare? To see that this is not a mere theoretical possibility, consider the example of a ride-hailing app. Any attempts by the app to mitigate the threat of disintermediation by limiting direct interactions between riders and drivers will be seen as an anti-competitive practice (Anti-steering). But in the absence of such practices, the app would be at risk of completely

losing revenues to an externality whereby: it is individually beneficial for a rider/driver to transact directly even though such transactions are a net loss for society as the app will invest less into addressing the problems of information asymmetry and real-time matching. The market may recess into its pre-digital state, decreasing consumer, and in this case, producer welfare.

Third, assuming that only one firm in a market harms consumer welfare, how many firms should be operational to protect consumer interests? That an exact number would be difficult to determine is not the only problem. Regulatory actions cannot (at least should not) create firms or force loss-making ones to continue to operate. How then will regulations ensure that the requisite number of firms are operating in every digital market at all times? If they cannot, then this might create the possibility that regulations may limit the actions (investments) that can be taken by monopolies, but no new firms might come up as a result of the restrictions.

The lack of a strong correlation, let alone causation, between increasing competition in digital markets and consumer welfare makes it difficult to justify the implicit acceptance of the former as the desired objective of the new paradigm of regulations.

Pressing need for ex-ante regulations?

In traditional markets, competition policy has the well-defined objective of protecting consumer welfare. This implies that the policy typically addresses the abuse of monopoly power with the mere existence or creation of a monopoly not enough to trigger regulatory action. As abuse cannot be pre-empted, this allows for a rule of reason approach where those making accusations of abuse can be relied on to collect information (in an adversarial system), reducing the load on the regulators adjudicating on a case-by-case basis.

With this approach regulations creep into the realm of business strategy. And the approach actually *increases the regulatory burden rather than decrease it*. Regulators will need extraordinary in-house capacity to map rapidly changing digital markets to ensure that regulations keep up with the latest developments.

The implication of the use of ex-ante in the report seems to be to specify that actions taken by the players can trigger regulatory action *irrespective* of the outcomes they produce. The report mentions that this is because ex-post remedies are not helpful in digital markets. It implies that as regulators cannot wait to assess the impact of any decision, they must take a deontological position that relies on specifying the acceptability or lack thereof of business strategies. So the strategy space of a firm will be divided into acceptable and unacceptable where the exercise of the latter will be punished even if it has benign (or beneficial as in the case of the ride-hailing app) effects on consumer welfare.

In India, we have had a long history of what has been called the license permit raj. The details and logistics differ, but the proposed approach will create a similar 'digital' compliance enforcement raj which would require that regulators be appraised of the day-to-day operations of firms. Firms may not have to seek permission to formulate a strategy, but their resulting actions would have to be under constant scrutiny, with all the associated ill

effects on industry efficiency and ability to innovate. Digital markets and their ability to generate value and surplus is what is likely to drive India in its quest to join the comity of developed nations, do we want to be subject to the type of restrictions that hampered the growth of our manufacturing sector?

We have spent the last few decades slowly dismantling the bureaucratic infrastructure that enforced the license permit raj. The pace of this process has been slow due to significant pushback from the bureaucracy that had come up around it. In almost all cases, once a regulatory and bureaucratic infrastructure is created, it follows the logic of survival and hampers any attempts to limit its ability to influence outcomes (and charge rent). The formulation and enforcement of ex-ante regulations that can keep up with changes in digital markets will require large upfront investments in a regulatory capacity. And once it is set up, it will be as resistant to change as the old one. This would create the possibility that once enacted, even if it becomes obvious that ex-ante regulations are not the best way forward, it will not be easy to change track. This stickiness of the proposed regulatory structure should give us pause.

Besides the issues that this paradigm change might create, it is useful to emphasize that at least in India, we do not seem to have reached the limits of the traditional approach to regulating firms. The existing institutions and regulatory structure have been working and reprimanding firms when they abuse their position in the market. Even in cases where the harm caused is not economic, like in the case of TikTok, the Indian state was able to impose punitive sanctions without causing any significant disruption or harming consumers. The government has also created players like the Government e-Marketplace that crowd out non-state platforms, underlining the ability of the sovereign to direct markets, if and when the need arises, by non-regulatory means. In this sense, the report's proposal should perhaps be seen as an attempt to pre-empt the future, with all the concomitant problems of such an endeavour.

Digital Infant industry?

The report states that India is expected to have "907 million internet users by 2023". While the number is large and impressive, its economic potential can only be realised by firms with profitable business models. In and of itself this is an empty number. The scale of the market is such that it can accommodate and potentially needs both international and domestic players. With many users still to be plugged into digital markets, there is already fierce competition to access them as quickly as possible. This process does and will continue to require additional resources that will only flow in if the regulatory framework accounts for the risks that accompany such investments and allow successful players to make returns on these investments.

In this regard, while the committee received representations from both Indian and International firms, its recommendations, at least in the short run, seem to be more relevant for the international ones. This reflects another old reflex in Indian policy-making circles of protecting domestic industry. Many homegrown firms are of a size such that they may have to compete with big tech but are not as big themselves. They may, like others

before them, come up with new ideas, products and services that will enable them to carve out a niche for themselves (or be driven into technological obsolescence).

This is a costly, difficult, and uncertain process. A potentially simpler way is to seek protection under a regulatory umbrella based on a modern version of the infant industry argument or ask for state-protected licensed monopoly markets in a take on the post-independence Bombay plan. As in the past, this may seem lucrative in the short run. But it will stunt the development of the digital markets in India, the way it did for the manufacturing sector in traditional markets.

Another lesson to be taken from the history of manufacturing in India is how the size distribution of firms is heavily skewed, with most of the firms being very small. The regulatory compliance required of larger companies was seen as being so onerous and expensive that it disincentivized firms from growing in size. In addition, a high regulatory burden created the possibility that success was dependent on a firm's ability to engage with regulators rather than generate value in market interactions. This reduced efficiency, with valuable resources being directed away from economically productive activities.

In digital markets, the reflex to protect domestic industry, of any size, is at odds with the policy to encourage foreign investments that makes distinguishing between domestic and foreign firms a non-trivial endeavour. In such markets, value can, and frequently is, generated by cross-border transactions that cannot be neatly segregated into national jurisdictions. The report attempts to address this issue by emphasizing the need to synchronize India's regulatory regime with the regulatory regimes in other large economies. But, these other economies are at a different stage of economic evolution. The Indian ecosystem is still in its nascency, and the new platforms, products or services that will come up to address the frictions here will likely engage in practices that are tough to foresee and therefore, almost impossible to categorize as being undesirable today. So, while markets like the EU can and do take well-defined ex-ante positions to protect consumer interest, India cannot and should not.

Ex-ante regulations targeted at maintaining competition in the market are difficult to implement and undesirable, both from a market and a strategic perspective. As the need for such regulations is the inference drawn by the report based on its reading of digital markets, it would be instructive to evaluate the underlying economic premises on which this inference is based.

Economic assumptions made in the report

How fundamentally different are digital markets?

The claim of being fundamentally different has to be evaluated in the context of competition law and its application. As long as anti-trust action is able to address abusive practices similar to ones employed by digital firms, and there exists precedence for this, differences between sectors – fundamental or otherwise – are immaterial.

More than a hundred years before Big Tech, there was Big Oil. In 1904 Standard oil "controlled 91% of the U.S. oil market and 85% of final sales". It was founded in 1863 by John D. Rockefeller, whose personal fortune peaked at around \$900 million, about 3% of the GDP of the USA at the time. In 1911 it was broken up into 34 companies as one of the first high-profile targets of modern anti-trust (competition) law. It is tough to ascertain without deeper empirical investigation if the economies of scale and scope that favoured Big Oil were as massively powerful as those that exist in digital markets today. But, certainly, digital markets are not the only ones where firms have downward-sloping cost curves and benefit from learning and network effects.

In fact, most of the ACPs identified in the report have (less extreme) analogues in traditional markets. Super and hypermarkets engage in self-preference with home brands. Malls have sales-based rental arrangements, an anti-steering provision. Car companies bundle services and restrict third-party fitments etc. These have a long history of being studied by economists (and in almost all cases, the welfare effects of any of these can only truly be evaluated ex-post). A consequence of the similarities outlined here is that any regulatory precedent set for digital markets will likely also be relevant in traditional markets.

Winner-take-all: An investor pipe dream?

Standard economic theory states that monopolies can make large profits. It is no surprise then that, smart investors want to invest in companies that have the potential to be monopolies. It is also reasonable to expect that most companies seeking investment would do so by claiming that they can become (something close to) a monopolist and employing strategies to this end. But just because they make such claims or formulate such strategies, and even if investments are made in the expectation of monopoly profits, does not mean that they will make monopoly profits. Now, of course, in some cases, their ability to monopolize a market would and should be limited by competition policy. But in many, many others, winner-take-all is a carrot for investors to inject large amounts of capital into companies trying to build a business, not a market truism.

Perhaps an argument can be made that such claims seem more plausible in digital markets, and hence the large investments into firms that operate in them. But similar claims came to nought in the 1990s, the early days of digital. Further, the success of a few players has not starved new ventures of funding in more recent times. This seems to suggest that even if it is a winner-take-all market, investors believe that winners can change over time.

The digital landscape as we see it today has emerged over the last two decades or so, and it is continuing to expand. This relentless expansion has been and will continue to be driven by the ingenuity of entrepreneurs coming up with new products and services. Many of the businesses that can today seem to be monopolies are in this position because they created the market they operate in. Google, a firm started by two graduate students, was the first to crowdsource internet search and take it beyond the digital yellow pages model of the early search engines. Apple, for all its celebrated history, was a bit player in the personal computer market when it created the market for smartphones with an app ecosystem and ended Microsoft's monopoly on personal computing. This is of course, not true for every big tech firm and every product offering they have. But in the cases that it is, it is pertinent to

recall that in traditional industries we offer legal protection in the form of patents and copyright to ensure that pioneers are adequately rewarded for their risk and enterprise.

It would be prudent, therefore, to not take a static view of digital markets and evaluate them based on how the landscape looks today. To develop a more dynamic view of digital markets it is important to acknowledge another characteristic it has - low cost of entry. Most big tech firms operating today were founded in garages and university dorms. Further, a new digital market tends to create the possibility for new ones. New firms routinely enter these adjacent markets (e.g. from PCs to smartphones) and generate competition for returns. Different models will emerge on how to split the pie and consumer preferences will determine which ones are successful.

Consider the case of Alexa and Siri: Apple adopted a closed model for the development of Siri whereby other market players had little to no ability to build functionality into Siri or related hardware. Amazon, on the other hand, created a more open ecosystem where others could contribute (with low access charge) and link their products to Siri. Alexa is the market leader, for now. But if Amazon raises its access charges, it won't be long before a completely new way of interacting with appliances comes up.

The market has and will continue to evolve. Digital markets, as the report mentions, evolve faster than most. Facebook, a new upstart then, decimated Orkut and paved the way for Tik Tok. Some winners may emerge in the 3-5 year timeline specified in the report, but they are not likely to continue being winners forever. There is an entire army of a new generation of tech startups and their founders who will make sure of this.

Consumer and company strategies co-evolve?

It is not just new ideas, technology and firms that threaten the rein of monopolies in digital markets. Their customers are also strategic, and their strategies also evolve in response to changing circumstances.

Consider the case of the ride-hailing app referred to earlier. The value added by the app is that it connects people with transportation to people who need to be transported. When the service starts, it is reasonable to assume that the charges of the platform would be low to attract both riders and drivers. In fact, as the availability of drivers is likely to create strong incentives for riders to use the app (cross-group network effects), the business is even likely to subsidize them. With low prices for riders and subsidies for drivers, this new business may get a monopoly over the market. How will the service use its monopoly power? Increasing service charges from both sides would be a reasonable guess. But if that is the case, riders and drivers would start sharing phone numbers when they meet, cutting out the app. The threat of the resulting decrease in business will keep the charges in check (and create incentives for the app to ensure that the two sides of the market do not meet very often and avoid disintermediation - tough for a ride-hailing service).

Now, this type of co-evolution takes time to emerge. The 3-5 year timeline outlined in the report may not be enough to start observing these strategies. The resulting penalty on platforms will disincentivize the creation of new platforms desperately needed in India, an

economy rife with information asymmetries. This is but an example of the incentive problems that anticipatory ex-ante regulations can create.

Conclusions and recommendations

India's tryst with digital markets is at a critical stage. Firms in these markets will not only play a part in creating new avenues for value creation in the digital space but can also provide the impetus required for large parts of the traditional economy in India to enter the global marketplace. Building up an ecosystem that can leverage the 907 million strong customer base will require a mix of prudent regulations, large amounts of capital, and skilled and motivated entrepreneurs.

It is important to remember that the big tech players of today attained the scale that they did in an environment where digital markets all across the world were lightly regulated, if at all. We are still in the process of building our homegrown big tech firms. A message that the regulatory regime in India frowns upon large (monopoly) profits, and is willing to set up and empower a large bureaucracy to ensure desired level of market competition will be a message to investors and entrepreneurs to take their capital and ideas elsewhere.

There may well be a need for targeted and well-designed regulation to improve the levels of competition and innovation in the digital economy. However, designing such a regulation needs more economic logic, empirical evidence, debate and discussion. The purpose of competition regulation is not to protect competition per se, but to improve consumer welfare. The purpose certainly is not to protect competitors. The standing committee report certainly kick-starts an important discussion. But to frame any regulation based on the current level of understanding would be counter-productive.