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Flawed Competition Laws: The Case of Google

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In May 2012, after a two-year investigation, the president of the European Competition Commission (ECC), Mr. Joaquim Almunia, told Google to modify the operation of its search engine, under penalty of law. According to the ECC, Google is abusing its position in the Internet search engine and online advertising markets.[1]

Elsewhere in the world, the Federal Trade Commission (FTC) in the United States is also studying the possibility of suing Google for abusing its market position. Other countries like South Korea, Australia and India are investigating on the same grounds.

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Beyond the question of whether or not Google is violating competition laws, these potential legal proceedings raise a number of economic questions: Can we really apply the concept of abuse of market power rationally? How can we precisely define a market in a high tech sector where everything evolves so quickly? And in particular, do such proceedings really have the effect of protecting Internet users and consumers?

The contested foundations of competition laws

Before delving into Google's specific case in more detail, a historical and theoretical overview of competition law itself is called for.

The central hypothesis that underlies the existence of competition laws is that above a certain level, market concentration has harmful effects for consumers. According to this logic, if the market share of a company in a particular sector is too large, that company has "market power," namely the ability to impose higher prices than would prevail in situations with healthy competition and the ability to displace its competitors unfairly. These practices become illegal when a company abuses its market power.[2] The same logic applies in the case of collusion when a few companies making up a large share of the market join forces to fix prices or limit production.[3]

This static vision of competition is more and more contested by economists. Indeed, competition is not measured simply by market share or by the number of companies in a market. It is rather the number of *potential* competitors that counts, in a context in which there are no barriers to entry. Such barriers sometimes exist due to restrictions imposed by government or because of a specific technological context, but their presence must not be overestimated. In general, the threat of the arrival of new players on a market is very real and exerts competitive pressure.[4]

These competitors can even come from outside the sector in question. The invention of a new substitute product (email that replaces the sending of letters by mail, for example) can create external pressure on a dominant company. It therefore becomes very difficult to define the precise limits of a market.

This is why many economists who have taken the trouble of digging through the numerous historical cases of "antitrust" proceedings have remarked that the companies targeted – even if they were alone in their markets – were not behaving like monopolies, as we shall see in the following section.

In practice, competition laws often have unintended consequences. First, they

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Table 1 A few historical cases of antitrust proceedings

Company (date of proceedings) / Allegations	**Historical facts**
Standard Oil (1911) Monopolization of the gas market; questionable business practices with suppliers and consumers; reduction of supply and increase in prices.	- The price of gas fell from 30 cents when Standard Oil was founded in 1870 to 5.9 cents in 1897. - Standard Oil's market share fell from 85% in 1890 to 64% in 1911, while 147 companies were competing with it. - The courts never proved the allegations but the Supreme Court nonetheless ordered the dismantling of Standard Oil in 1911.
ALCOA (1937) 100 violations of competition law; monopolization of the aluminum market.	- The price of aluminum fell from $5/pound when Alcoa was founded in 1887 to $0.22/pound when proceedings were brought in 1937. - Alcoa's market share fell from 90% in 1890 to 66% in 1937 and to 33% in 1945. - In 1945, a court declared on appeal that Alcoa's "skill, energy and initiative" was preventing competition.
IBM (1969) Monopolization of the computer market.	- IBM's market share fell from 78% in 1952 to 33% in 1972. - Start of proceedings in 1969, trial in 1975 and withdrawal of charges in 1982 due to lack of evidence.
Microsoft (1998) Monopolization of the computer operating systems market (Windows); bundling of Explorer and Windows Media Player programs with Windows.	- The inflation-adjusted price of the Windows program provided to computer manufacturers fell by 18% during the six years leading up to the proceedings (not including quality improvements). - Microsoft has competitors: Mac OS, Unix, Linux, OS/2. Computer manufacturers can bundle other browsers. - In 2004, the United States Court of Appeal rejects the final suit brought by the Massachusetts prosecutor.

Source: Dominick T. Armentano, *Antitrust – The Case for Repeal*, 2nd edition, Ludwig von Mises Institute, 2007; Burton Fulsom, *The Myth of the Robber Barons*, Young America's Foundation, 2007, pp. 25-37; Robert Crandall and Clifford Winston, "Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence," *Journal of Economic Perspectives*, Vol. 17 (2003), No. 4, pp. 7-8; Richard B. McKenzie and William Shughart II, "Is Microsoft a Monopolist?" *Independent Review*, Vol. 3 (1998), No. 2, pp. 176-177.

modify the behaviour of businesses, which divert energy into protecting themselves and minimizing the risks of lawsuits instead of concentrating on efficient economic decisions. As a result, many mergers or acquisitions that could be beneficial for all do not occur for fear of long disputes with the government.[5]

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Second, to prove a violation of competition law, it must be shown that there is "restriction of commerce" or "monopolization of a market." These terms, however, are defined arbitrarily, and the definitions differ from one sector to another. It is therefore possible for a decision by the concerned authorities to have the effect of restraining innovation and discouraging practices that would benefit consumers. Unfortunately, the costs of these errors are not adequately recognized by decision makers.[6]

This problem is even more acute in high tech sectors, which evolve much more rapidly than other traditional industrial sectors. A player can dominate a market for a few years and then be knocked off its pedestal in quite a short amount of time.[7] This is what happened to companies like IBM, AltaVista, AOL, RIM, Palm, Nortel, Polaroid, Sony (Walkman), and many others. At the moment when a judgment is handed down, there is a good chance that the company's position is no longer dominant.

Third, the fact that the terms are not well defined, that proof is difficult to establish and that many markets are very fluid increases the chance that competition law will be diverted to ends other than the protection of consumers. This process, known as "regulatory capture," occurs when less competitive players try to beat the dominant firms by political and legal means instead of doing so by reducing their costs and improving their products.[8] An indication of this reality is that over 90% of all proceedings under competition law in the United States are instituted by private parties, while the rest are instituted by the government.[9]

Historical cases that contradict the theory

One of the historical examples of monopolistic companies most often mentioned is that of the American oil company Standard Oil. According to its detractors, Standard Oil tried to exclude several producers from the American market by using unfair competitive practices to capture a market share of over 90% at the end of the 19th century.[10]

It can be argued, however, that it is by virtue of over thirty years of systematic innovation that the company succeeded in capturing such an impressive market share. It created dozens of petroleum by-products as well as new, more efficient refining and extraction techniques.[11]

It is thanks to this superior efficiency that the price of oil in the United States fell continually over the final decades of the 19th century.[12] Despite this superior efficiency, the decline of Standard Oil's dominance was underway well before the 1911 governmental decision to break up the company. In fact, following the intervention of the government, prices stopped falling and even rose appreciably.[13]

There are numerous cases of antitrust proceedings similar to the Standard Oil case in which we see a reduction in prices and market shares of the presumably monopolistic company in the years leading up to the proceedings, which should logically call into question the whole point of such proceedings (see Table 1).

The economics of the Internet

While it is difficult to determine the exact limits of a market in a traditional industry, it is even more perilous to try to do so and to prove that a company has a monopoly in that market in the world of the Internet, where technological changes abound. And even then, this is not sufficient, since the government must prove that the company under investigation is abusing its monopoly position and that consumers are being harmed. This extremely complex task requires more and more economic understanding on the part of the entities responsible for regulation as well as the judges who must decide the cases.[14] It is in light of these flaws in competition laws that we must analyze the case of Google.

The allegations brought against Google, both in the United States and in Europe, are primarily concerned with search results on its search engine. Google apparently modified its search algorithm so that the results would emphasize its own products and provide less visibility to the sites of its competitors (like Microsoft). It is not even necessary to take a position on the truth of these allegations to see that it would not be in the interests of consumers to add Google to the long list of antitrust lawsuits.

A player can dominate a market for a few years and then be knocked off its pedestal in quite a short amount of time.

First of all, no one can deny that it is by innovating and offering an efficient and user-friendly search engine that Google won its advantageous market position in under a decade. Considering the fact that search engine services are free and the ease of accessing alternate sites, consumers are very sensitive to changes in the quality of the service they receive. Users can change browsers with the click of a mouse if they are not satisfied. It is therefore on the basis of quality that companies compete in order to attract web users and increase their advertising sales.[15]

Even though Google enjoys considerable market share in the United States and Europe if we look exclusively at search engines,[16] as in other areas, competition can also come from a substitute product that better satisfies consumers. For example, according to a former commissioner of the FTC in the United States, social media like Twitter and Facebook are leading a growing proportion of web users to get their news from these platforms. Web users are therefore abandoning news platforms produced by Google, Bing and Yahoo!.[17]

Web users spend an average of 27 minutes a month on search engines, which represents 3.4% of the total time spent on the Internet.[18] This means they spend the vast majority of their time navigating other websites, several of which offer an alternative to search engines for a multitude of services, including advertising. Is it really possible, in this context, to speak of the abuse of position in a specific market?

Furthermore, we need to consider the fluid nature of markets on the Internet, where companies can dominate at a certain moment only to be displaced a few years later. For example, MySpace was the dominant player in the social media market between 2005 and 2008 before being displaced by Facebook.[19] The same thing happened in the field of multimedia players. Between 2003 and 2005, the main player in this market was Windows Media Player, with some significant competition from RealPlayer. Since then, both Windows Media Player and RealPlayer have lost the loyalty of many consumers, to the benefit of Apple's products.[20]

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Not so long ago, Apple was mass producing electronics, Google had its search engine, Amazon its online store and Facebook its social network. Today, Amazon's Kindle Fire is challenging Apple's iPad on its home turf; Apple's iTunes store is competing with Amazon's online store; and Google+ is hot on the heels of Facebook.

More than other traditional businesses, high tech companies have no problem playing in each other's backyards, to the great benefit of consumers. But to succeed and maintain consumer loyalty, they constantly have to show ingenuity. They should not be punished for doing so.

Conclusion

The logic of market abuse that underlies the lawsuits brought by competition authorities against companies that are successful, like Google, is flawed. Moreover, these lawsuits too often have negative consequences for consumers and for the economy as a whole.

Indeed, they distract innovative companies and force them to spend considerable sums defending themselves for years on end before courts in several countries, not to mention the heavy fines that can be demanded without justification.[21] These legal proceedings can also make it impossible for a company to make a return on its development costs, and lead it to scale down its innovative activities.[22] The main losers of such a slowdown in innovation are the very consumers the laws were meant to serve.

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