Regulating Big Tech: Factual Foundations and Policy Goals[*]

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15 February 2023

Over the past several years, we have witnessed a vigorous push to regulate the Big Tech companies, especially Amazon, Apple, Facebook and Google. In the European Union, the Digital Markets Act, a bold new regulatory regime, will soon come into force, overseen and enforced by the European Commission. In the U.K, the Competition and Markets Authority is moving ahead to regulate Big Tech in anticipation of receiving greater powers to do so.

My focus here is specifically on regulations designed to promote competition and control the market power of the Big Tech companies. These are the two stated goals of the Digital Markets Act, under the banners of "contestability" and "fairness."

In the United States, the leaders of the Federal Trade Commission and the Antitrust Division of the Department of Justice have made clear that they are on a mission to rein in Big Tech, and a number of bills have been introduced in Congress to regulate Big Tech and promote competition.

As the 118th Congress considers whether and how to regulate Big Tech, it seems prudent to pause and recall the traditional questions one asks relating to government regulation of business:

- What specific harms do the proposed regulations address?
- What is the evidence demonstrating that such harms are substantial?
- Will the proposed regulatory provisions be effective in addressing those harms?
- Will the proposed regulatory provisions themselves cause some other harms?
- What agency will promulgate and enforce these regulations?
- What resources will be needed to make the regulatory regime effective?

Watching the halting efforts in the United States to regulate Big Tech over the past several years, I have not seen Congress asking these questions or following the evidence to answer them. I am especially concerned that Congress is focused on harm to competitors, not harm to competition.

Congress, in drafting legislation, does not appear to have paid sufficient attention to the lessons we have learned from more than a century of regulation aimed at promoting competition and controlling market power. Especially relevant is the U.S. experience regulating industries experiencing significant technological change, notably telecommunications, but also financial markets, railroads, airlines, and electricity. We learn from these examples that regulation can promote competition in dynamic industries, but doing so requires an expert agency with substantial resources that is protected from regulatory capture. We also learn that regulations intended to promote competition can all too easily

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[*] Published in the Network Law Review at https://www.networklawreview.org/shapiro-big-tech/.

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become ineffective, as they are overtaken by technological advances, or downright counterproductive by stifling innovation.

In addition, Congress seems to be drafting legislation based on preconceived views about the Big Tech companies rather than following the evidence in a balanced manner. Republicans seem intent on reining in Big Tech based on their view that these companies are biased against conservative voices, not merely trying to control the spread of falsehoods. The evidence supporting that claim is thin, to say the least. Democrats, for their part, seem intent on reining in Big Tech based on their view that these companies are abusive monopolists that antitrust law is too weak to control. This view may have more merit, but it leads me to ask whether Congress is fairly evaluating the evidence so they can craft a regulatory regime that serves the public interest by promoting competition, not one that harms consumers by hobbling the Big Tech firms.

I cannot give a thorough answer to that question in a short piece such as this, but I can illustrate why I am concerned about the factual underpinnings and economic reasoning behind the Big Tech regulatory bills introduced in the 117th Congress. To that end, I focus on the report issued by the House Judiciary Committee ("HJC Report") in October 2020. That report, which describes the committee's findings regarding competition in digital markets, served as the evidentiary basis for the bills relating to competition and digital platforms that were voted out by the House Judiciary Committee. For an incisive discussion of the HJC Report written soon after it was issued, see A Missed Opportunity by Doug Melamed. Here, I illustrate my concerns using the discussion of Amazon in the HJC Report, which is found in Section V.C (pp. 207-277).

The HJC Report recognizes that Amazon has generated enormous benefits for consumers. For example: "One of the unique features about Amazon's e-commerce site is its fast and free shipping on an extremely broad selection of products. Amazon Prime Members can choose from over 100 million items that are available for free, two-day delivery in the continental United States." (p. 208) And this: "Other retailers are unable to match Amazon on its ability to provide free and fast delivery for such a large volume and inventory of products." (p. 218)

The HJC Report also recognizes that Amazon exploits economies of scale to provide highly valuable services to many third-party sellers: "As Amazon's e-commerce business has grown, it has also developed a significant logistics business providing fulfillment and delivery services to third-party sellers through its Fulfillment by Amazon (FBA) program." (p. 209)

So, what conduct by Amazon does the HJC Report identify as harming competition?

The HJC Report lists many elements of Amazon's conduct that it considers anticompetitive. Some of this conduct, such as Amazon's use of most-favored nation clauses, may well be anti-competitive. Indeed, Amazon promised to stop using those clauses in Europe in 2013 in response to pressure from the UK CMA, and the California Attorney General filed a case against Amazon in 2022 alleging that "Amazon requires merchants to enter into agreements that severely penalize them if their products are offered for a lower price off-Amazon." That lawsuit properly focuses on whether Amazon used its market power to stifle competition from *other retailers*.

However, the selective use of evidence and the flawed analysis that permeate the HJC Report do not inspire confidence that the report's many assertions regarding Amazon's conduct are well founded, either factually or analytically. Let me illustrate using Amazon Prime and predatory pricing as an example. See especially pp. 249-254.

The HJC Report alleges that Amazon has engaged in predatory pricing. The section on predatory pricing starts with this statement: "As part of its business strategy, Amazon has historically placed a higher premium on long-term growth at the expense of short-term profitability."

Right off the bat, I find it odd that the HJC Report criticizes Amazon for taking a long-term perspective. Typically, large companies are criticized (with some justification, in my view) for focusing too much on quarterly earnings rather than long-run growth and sustainability. Moreover, if one wants to promote competition, surely one should *welcome* corporate investments that build capabilities to better serve customers and that enable expansion into new markets to challenge other suppliers.

The report then states: "The most prominent example of Amazon's use of strategic losses to lock customers into the platform's ecosystem is its popular membership program, Amazon Prime."

What does the HJC Report mean what it says that Amazon Prime locks customers into the Amazon ecosystem? So far as I can tell, it means that Amazon Prime provides a compelling experience for consumers, which is why tens of millions of households have signed up for Prime, renew, and use it often. (Technically, Amazon Prime involves a two-part tariff, under which consumers pay a fixed annual fee and then get lower prices for each order they place. This pricing structure clearly is very attractive to consumers and efficiently increases output.) This is not "lock in," which can arise when it is very costly for consumers to switch to a new supplier.

Here as elsewhere, the HJC Report takes a negative view of conduct that generates consumer benefits, evidently because that conduct puts competitive pressure on rivals. I thought we learned 50 years ago that such conduct is pro-competitive. Has that basic lesson been forgotten?

Of course, we recognize that aggressive pricing by a dominant firm can go too far and become predatory. Normally, to avoid stifling legitimate price competition, we do not condemn low prices as predatory unless they are below cost. The HJC Report takes this approach, claiming that Amazon Prime "is a loss-leader for the company." (p. 250) Sadly, however, the report's claim that Amazon loses money on Amazon Prime is based on transparently flawed reasoning.

The HJC Report supports its claim that Amazon Prime is a "loss-leader" with two citations. The first is to a *Wall Street Journal* article from 2011 which estimates that Prime costs Amazon $90 per year per member, based on $55 of foregone shipping charges and $35 in royalties for video content. That is said to involve an $11 loss per Prime member, given the annual charge then of $79. But that calculation does not include the additional purchases generated by Prime – which is the whole point of the program! That very article says that "Amazon is unlikely to raise the price of Prime because it drives business to the retailer" and cites an estimate that "after joining Prime, members tripled the amount of money they spent on Amazon to $1,500 a year." The second citation is no better. It refers to a 2016 study showing that free shipping on Prime costs Amazon $1 billion per year. Again, this figure does not account for the additional purchases that Prime generates. Indeed, that same very short article says that Prime "members spend more than the typical Amazon browser—on average $1,200 per year, compared to $500 per year for nonmembers." The title of this article? "How Amazon Loses on Prime and Still Wins."

Amazingly, the HJC Report itself emphasizes this very point, citing a 2020 study for this finding: "While the average Amazon customer spends about $600 per year on Amazon.com, Prime members reportedly spend more than double that—an average of $1400 per year." The HJC Report even appears to take the view that Prime is especially worrisome *because* it drives additional purchases at Amazon. Increases in output driven by marketing innovation and low but above-cost pricing should be seen as pro-competitive. Period. I regret to say that the reasoning used in the HJC Report in support of its claim that Amazon has engaged in below-cost pricing involves basic errors of economics that would earn a failing grade in my MBA classes.

Let's turn next to Amazon's acquisitions. See pp. 219-224. The HJC Report describes various efficiencies resulting from Amazon's acquisitions, but then criticizes those acquisitions precisely because of those efficiencies. For example: "Amazon's expansion into a diverse array of business lines—from brick-and-mortar supermarkets to home security—has reinforced its significant stockpile of consumer data. With more data about online and offline consumer behavior, Amazon's acquisitions set in motion a self-reinforcing cycle, creating an ever-widening gap between the platform and its competitors." (p. 219). Here and elsewhere, the HJC Report seems more interested in protecting Amazon's rivals from competition than in promoting or protecting competition.

The HJC Report likewise expresses concern about a number individual acquisitions that are described as enabling Amazon to better serve customers.

> **Zappos** (2009, $1.2 billion): "Acquiring Zappos provided Amazon with two important advantages. First, it enabled Amazon to add significant selection to its category of shoes and other fashion-related items at a time when expanding its selection was critical to the company's success…. Second, Zappos' unique approach to customer service, marked by 'a deeply felt connection with customers,' added an emotional and psychological element to Amazon's relationship with consumers." (p. 220)
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> **Kiva Systems** (2012, $775 million): This acquisition "provided Amazon with a robotics company that accelerated its ability to streamline picking, packing, and shipping e-commerce." (p. 223)
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> **Pillpack** (2018, $750 million): This acquisition "equips Amazon with an online pharmacy and marks its entry into the pharmaceutical market" (p. 223)
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> **Ring** (2018, $1.2 billion): "Ring's 'eyes and ears' add significant value to Amazon's smart home, allowing customers to virtually interact with Amazon delivery personnel and instruct them on where to drop off Amazon packages." (p. 222)

The report concludes its section on Amazon's acquisitions with this statement: "The company's significant expansion into new markets, paired with Amazon's wealth of data from its retail business, has fueled the platform's increasing market power." (p. 224) This is peculiar way to describe acquisitions that, on the face of it, enabled Amazon to compete more effectively in more markets, to the benefit of consumers. Beyond that, the HJC Report seems to fundamentally misunderstand how startups and large platforms together achieve innovation in the tech sector.

More generally, I am concerned that the HJC Report takes a negative view of actions by the Big Tech firms that enable them to gain or extend their competitive advantage over their rivals by lowering their costs or expanding their product offerings. Stopping market leaders from better serving customers does not promote competition; it reduces competition and harms consumers.

Where does all of this leave us?

I am writing to warn readers that the 2020 House Judiciary Committee Report is a badly flawed document that does not provide a reliable basis for regulating the Big Tech firms. However, I am *not* opposed to targeted regulations designed to promote contestability, by removing barriers that impede those who would challenge the leading digital platforms, and to protect business users from abusive conduct by platform owners, a real harm described at length in the HJC Report.

My focus is squarely on competition. I do not address privacy regulations. For the record, I support well-crafted rules to protect the privacy of end users, primarily by giving people strong and clear control over how the data generated by their online activities is collected, stored, and shared. Nor do I address rules relating to content moderation. For the record, I support a legal regime under which platforms have broad scope to decide what content appears on their platforms without incurring liability for those decisions, but under which speakers responsible for disinformation and misinformation can be held liable for harms caused by their speech.

Let me close by giving a few examples of the type of targeted regulations I support. An expert agency would designate the digital platforms subject to these regulations, subject to specified criteria. The examples given below are not intended to constitute a complete list. Similar provisions, and much more, can be found in the EU's Digital Markets Act.

Transparency: Some of the most powerful evidence presented in the HJC Report relates to small businesses that are heavily reliant on the leading digital platforms to reach their customers. Many sad stories are reported of such businesses being gravely harmed when platforms abruptly change their policies. I support rules requiring designated platforms to clearly explain their policies regarding business users and giving business users advance notice when changes are made that might disrupt their ability to reach end users.

To illustrate, the HJC Report is critical of the changes Amazon announced in August 2020 to its Seller Fulfilled Prime ("SFP") program. These changes required SFP shippers to support Saturday pickup and delivery to "provide customers with a more consistent delivery experience throughout the week." They also required SFP shippers to "meet targets for one- and two-day delivery promises." (p. 286) Under my approach, Amazon would be allowed to place demanding requirements such as these on business users, so long as they are communicated clearly and implemented in a non-discriminatory manner.

Procedural Fairness: Designated platforms should be required to respond promptly to queries by business users about changes that have reduced their access to end users. Business users should be awarded damages for errors that are not promptly fixed.

Use of Confidential Business Information: A designated platform cannot require business users, as a condition for appearing on its platform, to share confidential information with that platform, above and beyond the information the platform needs to directly serve end users. Moreover, the platform may use such mandated information only for that purpose. As an example, in Amazon recently entered into an agreement with the European Commission "not to use non-public data relating to, or derived from, the independent sellers' activities on its marketplace, for its retail business."

No Penalties for Appearing on or Using Rival Platforms: A designated platform may not treat business users or end users that appear on or use other platforms less favorably than those that do not. Nor may a designated platform, as a condition for appearing on its platform, require a business user or end user to appear exclusively on its platform.

Additional rules could be implemented to address the conflicts of interest that arise when platform owners compete against business users on their platforms, including various non-discrimination rules. Such rules warrant detailed analysis that is beyond the scope of this note.

Well-designed rules can promote competition and protect business users and end users from abusive conduct without hindering the large platforms themselves from competing. Misguided regulatory interventions may do the opposite, harming end users and stifling innovation.