

FIRST PRINCIPLES FOR COMPETITION REGULATION IN THE DIGITAL ECONOMY

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This document takes inputs from a roundtable convened by the Esya Centre, the Jindal Global University, and the Jindal Digest for Competition and Innovation Laws (JDCIL) on 20 August 2021 to deliberate on the topic “First Principles for the Governance of Competition in Digital Markets”.

Participants for the two-hour roundtable session included (in alphabetical order): Meghna Bal, Fellow, Esya Centre; Dr. Shilpi Bhattacharya, Professor, Jindal Global Law School; Mohit Chawdhry, Junior Fellow, Esya Centre; Hemangini Dadwal, Partner, AZB & Partners; Gopal Jain, Senior Advocate, Supreme Court of India; Vikas Kathuria, Fellow, Observer Research Foundation; John Khiangte, Vice President, Public Policy, Disney India; Dr. Tanvi Nandan, Assistant Dean, Jindal Global Law School; Dr. Derek Ritzmann, Adjunct Professor— Competition, Regulation, Arbitration, University of Hong Kong; Vivan Sharan, Secretary, Esya Centre; Dr. Aruna Sharma, Member, Digitisation Committee, Reserve Bank of India and Former Secretary, Government of India; Justice AK Sikri, Former Justice, Supreme Court of India.

ABOUT THE ESYA CENTRE

The Esya Centre is a New Delhi based technology policy think tank. The Centre’s mission is to generate empirical research and inform thought leadership to catalyse new policy constructs for the future. It aims to build institutional capacities for generating ideas that will connect the triad of people, innovation, and value to help reimagine the public policy discourse in India. More details can be found at www.esyacentre.org.

CONTENTS

PROBLEM STATEMENT: A DIGITAL COMPETITION POLICY IN FLUX	4
THE NEED FOR FIRST PRINCIPLES	6
INNOVATION AS THE FULCRUM FOR FIRST PRINCIPLES IN DIGITAL ANTITRUST	7
CONCLUSION	11
ENDNOTES	12

PROBLEM STATEMENT: A DIGITAL COMPETITION POLICY IN FLUX

Digital markets are not vastly dissimilar from traditional markets. Like traditional markets, digital markets host interactions between people for trade and exchange. Therefore, the fundamental principles of economics still apply. However, there are certain peculiarities in digital markets which raise some concerns for competition regulators as network effects. Technology enables digital businesses to leverage network effects across demand and supply chains to effectively create a multi-sided market where one customer base services the other. But, none of these aspects are new. For instance, there are several legacy businesses that are two-sided such as credit cards, newspapers, and broadcasting.

The presence of network effects and the ability to leverage them across the different sides of a market, nevertheless, gives digital businesses both the impetus and the ability to scale quickly. The last decade witnessed the practical realisation of such a theoretical construct. Four out of the five largest companies in the world today are digital.¹

THERE IS NOW A STRONG IMPULSE TO SHIFT THE LOCUS OF COMPETITION ENFORCEMENT FROM REMEDIAL JUDICIAL DETERMINATIONS TO PROPHYLACTIC REGULATION.

The ability of digital businesses to scale effectively, coupled with their ability to shape and guide socio-political discourse raised concerns amidst decisionmakers around the globe about the extent of concentration in digital markets. As such, the past two years saw most nations introduce stricter competition policy to guard against the possible deleterious effects from the presence of large digital businesses in their information societies. Specifically, there is now a strong impulse to shift the locus of competition enforcement from remedial judicial determinations to prophylactic regulation.

Examples of the new approach to competition governance include the United States Executive Order on the Promotion of Competition in the American Economy which enables the Federal Trade Commission, the nodal competition authority in the country, to establish rules prohibiting “unfair methods of competition” in online markets.² There is also the European

Rank	Company	Country	Sector	(\$ billion)
1	Apple	U.S.	Technology	2,406
2	Microsoft	U.S.	Technology	2,140
3	Saudi Aramco	Saudi Arabia	Energy	1,865
4	Alphabet	U.S.	Technology	1,806
5	Amazon	U.S.	Technology	1,680

TABLE 1: TOP 5 LARGEST COMPANIES BY MARKET CAPITALIZATION
SOURCE: [GLOBAL FINANCE](#)

Union's Digital Markets Act which proposes to classify certain large online platforms as gatekeepers that are required to adhere to obligations which include enabling third-party interoperability with their platforms.³ Finally, elements of the new approach have emerged in India as well. Illustratively, the proposed amendments to the Consumer Protection (E-commerce) Rules, 2020 include a provision that prohibits e-commerce entities from hosting unannounced sales.

The move to an ex-ante approach to competition regulation is driven by the two concomitant considerations. One, a political exigency to “do something” about big technology firms. Two, a belief that traditional approaches take too long and rely on dated metrics such as consumer welfare and economic efficiency to gauge the harms of anti-competitive behaviour. The concern behind this consideration is that it can always be argued that digital businesses enhance consumer welfare as they reduce information asymmetries and provide many services low to no cost. Additionally, the inherency of information to the operations of a digital business means efficiency is a central part of its value proposition. As such, newer litmus tests must be developed to understand anti-competitive harms unique to the digital realm.

These global changes are taking place at a time when the Competition Commission of India, the nodal competition authority in the country, is beginning to pay greater attention to digital markets. To its credit, the CCI has accommodated the uniqueness of digital business models in its assessments. For instance, in a case pertaining to zero rating on communications over-the-top service Whatsapp, the Commission noted that providing free services appear to be standard industry practice, as other players (like Hike, Viber etc.) were also not charging for their services.⁴

However, the CCI is an ex-post regulator. Its approach lies in stark contrast to the new ex-ante approaches taken by the US, the EU, and the Indian executive, towards competition regulation. For instance, while the CCI relies on evidence and considers objective justifications for anti-competitive behaviour such as improved consumer well-being, the new approach advocates an increasingly inference-based and, consequently, less data-driven, method to understand competitive harm.

COMPETITION POLICY IS, THEN, IN FLUX. THE CONTRADICTION BETWEEN THE OLD AND NEW APPROACHES TO COMPETITION BREEDS UNCERTAINTY IN DIGITAL MARKETS, WHICH COULD IN THE LONG RUN, DAMPEN INVESTMENT AND INNOVATION IN THESE ECOSYSTEMS.

Competition policy is, then, in flux. The contradiction between the old and new approaches to competition breeds uncertainty in digital markets, which could in the long run, dampen investment and innovation in these ecosystems.

It is in this broad context that the Esya Centre convened with Jindal Global University and the Jindal Digest for Competition and Innovation Laws (JDCIL) to host a “First Principles For the Governance of Competition in Digital Markets” on 20 August 2021. The event brought together a diverse group of experts to discuss the different facets of competition regulation in the digital realm. The goal of the exercise was to carve out a set of first principles that address the need for oversight in digital markets while taking a balanced view on their nuances and preserve innovation, principles can aid competition regulators and jurists in their assessments on digital competition matters in the future.

THE NEED FOR FIRST PRINCIPLES

Digital markets are complex paradigms to regulate as they are:

TECHNICAL	Regulating digital markets effectively demands specialized knowledge of technology as well as an understanding of the nuances of different digital business models, both of which are a tall ask for most capacity constrained institutions.
UNPREDICTABLE	It is very hard to say how a particular digital business model or practice will evolve or what it will evolve into. Even top industry insiders are unable to accurately speculate about where their industries are headed. Illustratively, Samsung and HTC passed on investing in Android before the operating software company went to Google. ²¹ Another notable example is when Michael Dell, CEO of Dell Computers, once remarked that he would shut Apple down and give the money back to the shareholders. ²²
FRAGILE	Digital markets are not able to absorb the blow from adverse regulatory decisions or unfavorable legislation as easily their brick-and-mortar counterparts and are more liable to shut down as a consequence. For instance, Zebpay, which was India's largest crypto-exchange, shut down its services after the Reserve Bank of India issued a circular restricting entity regulated by it, i.e., banks, from dealing with crypto companies. ²³

First principles that account for the nuances of digital businesses can help guide regulators towards more effective middle of the road approaches that enable digital markets to function while serving the public interest. Such principles are also necessary to sensitize non-specialized decision-making bodies, such as the

Indian judiciary, to the peculiarities of digital markets, thereby mitigating arbitrary and regressive outcomes. The latter consideration is particularly relevant in the case of competition regulation in India, where appeals from CCI decisions lie before the National Company Law Appellate Tribunal and the Supreme Court.



INNOVATION AS THE FULCRUM FOR FIRST PRINCIPLES IN DIGITAL ANTITRUST

To formulate first principles that enable balanced outcomes, it is necessary to establish a normative fulcrum on which such principles can rest. Such normative guidance can be used to test the practicality of principles devised, and the possible outcomes they may or may not deliver.

THE EMERGING REGULATORY APPROACHES IN DIGITAL ANTITRUST IN THE EU, US, AND INDIA ARE GUIDED BY THE PRINCIPLE OF PRECAUTION DUE TO CONCERNS ABOUT THE PACE OF TECHNOLOGICAL DEVELOPMENT AND AN ACCEPTANCE OF THE FACT THAT REGULATORY AGENCIES ARE UNABLE TO KEEP STEP.

The emerging regulatory approaches in digital antitrust in the EU, US, and India are guided by the principle of precaution due to concerns about the pace of technological development and an acceptance of the fact that regulatory agencies are unable to keep up.

The precautionary approach to regulation traces its roots to Article 191 of the Treaty on the Functioning of the European Union.⁵ Broadly, the provision sought to preserve and protect the environment from future harm through preventive action. The principle is to be invoked after scientifically evaluating whether a process or phenomenon may have a “dangerous effect”, if such a scientific evaluation is inconclusive. The consequences of human action for the environment are relatively linear, meaning there is a fair chance of correctly speculating about possible future degradation. As such, precaution and prevention are useful guiding principles to create environmental safeguards.

More recently, the principle has been brought in to other areas where there is regulatory uncertainty such as digital competition regulation. Such a move is questionable,

however, as evolutionary trajectories in digital markets are much harder to predict and understand. In such a context, it is hard to rationalize the induction of a regulatory principle that relies on an indeterminate standard of possible future harms, drives emergency-based regulation and reverses the burden of proof so the private entity must establish how its business has no negative effects and/or enhances efficiency, as none of these make for good law.⁶

In this context, safeguarding innovation can serve as a more practical guiding principle for competition regulation in the digital realm. There are three practical reasons supporting such a position:

Innovation is a strong countervailing force to market power. Monopolies in digital markets are not as entrenched as rhetoric makes them out to be. Consumers in digital markets are discerning and if a better service comes along or quality of service of a particular product decline, they will switch. Digital consumers also multi-home, meaning they use different platforms simultaneously for different things. Illustratively, while Google, Apple, and Microsoft each have their own virtual meeting products, our roundtable was held on Zoom.

Innovation boosts consumer welfare. Before the arrival of Uber and Ola, for instance, the Indian personal transit market was rife with information asymmetries and poor service standards. Instances of refusal to use fare meters and denial of service were common and availability highly variable. After taxi aggregators entered the market several incumbent service providers began relying on technology to compete. Now, even the Mumbai Kaali-Peeli taxis have an application called “Aamchi Drive”.

Innovation drives value: The United States has broadly let innovation guide its hand in competition regulation in the digital sphere. As Table 1 indicates, the strategy has been effective in building successful technology platforms. Conversely, the EU, which is known for heavy handed and conservative competition regulation lags far behind.

With the preservation of innovation as a guiding principle, regulators can effectively rely on first principles to navigate three common digital competition conundrums:

- i. Understanding competitive harm in the digital sphere
- ii. The need to create a level playing field
- iii. Maintaining a healthy balance between incentives and public interest. These are discussed in greater detail below.

First principles to understand competitive harm in digital markets

- **Interventions are only necessary if there is an enduring monopoly in a digital market with no incentive to provide high quality service and/or improve the quality of its services or keep prices low⁷:** As pointed out earlier, there are several qualities of digital businesses that operate as a recipe for accumulating market power. Network effects, the phenomenon where the value of a business is synonymous with the number of users it has, is generally the most cited as a reason to regulate. The contention is that network effects, coupled with market power, create considerable barriers to entry in a digital market. However, these constructs cannot be considered in isolation. Other considerations include costs of starting a similar line of business and switching costs to consumers, i.e. how difficult is it for a consumer to switch from one product to another. When considering arguments around network effects and a large firm, regulators must establish whether indeed that firm is dominant in a market. And if dominant, whether there is a constant effort on the part of such a firm to retain customers through better quality of service and/or competitive pricing.

U.S.		EU	
Apple	2.49 trillion	ASML	295.47 billion
Microsoft	2.12 trillion	SAP	175.08 billion
Amazon	1.86 trillion	NXP Semiconductors	53.68 billion
Alphabet	1.74 trillion	Infineon	50.26 billion
Facebook	974.83 billion	Yandex	25.11 billion
Tesla	636.78 billion	Seagate Technnologies	20.06 billion

TABLE 2: COMPARISON OF LARGEST TECHNOLOGY COMPANIES IN THE U.S. AND THE EU BY MARKET CAPITALIZATION (USD).

SOURCE: [COMPANIESMARKETCAP.COM](https://companiesmarketcap.com)

- **Weigh potential or real anti-competitive effects against possible or actual pro-competitive effects:** It is often the case that digital business models or activities that seem anti-competitive on the surface entail several pro-competitive benefits. For instance, in the matter of Philadelphia Taxi Association, Inc vs Uber Technologies, Inc., the complainant taxi association and its 80 members of traditional taxi companies⁸, were aggrieved with Uber because it “flooded” the market with non-traditional taxis and ate into the complainant companies’ profits.⁹ The complainants indicated that such behaviour was predatory and anti-competitive. The judge, however, noted that Uber’s entry into the market increased taxi availability for consumers, and brought down prices. The judge concluded that even if such behaviour “served to eliminate competition”, it was not anti-competitive because it had several beneficial effects associated with a competitive market.¹⁰ Decisionmakers must, then, take a holistic view of a particular type of conduct and see if the pro-competitive effects outweigh the anticompetitive ones.

- **Look for direct economic evidence on harms to the competitive process¹¹:** Regulatory and judicial decisionmakers must judge a firm’s conduct to see whether it is hampering the competitive process by thwarting other firms from making attractive offers to users or amalgamating with competitors.¹² The competitive process means the struggle between firms to retain or attract customers/users. Regulators must look for direct economic evidence of the disruption of such activity.¹³

First principles for a level playing field

- **Follow a standard of economic progress:** Calls for a level playing are most often agitated by well-entrenched incumbents that have had no incentive to innovate and are suddenly threatened by a high-technology competitor. If a service raises the standard of technology use in

an industry or offers customers a technological alternative to a particular transactional activity, it should be allowed. Level-playing fields should not be brought in to derail the march of economic progress and stymie technological advancement in an industry. The standard of economic progress is in line with the goal of the Competition Act, 2002, which is to promote economic development.

- **Deregulate:** Incumbents are also wont to have regulators impose legacy regulation on new technology businesses because the cost of complying with such frameworks is high. High compliance costs make it difficult for incumbents to compete. As such, they advocate creating parity through the application of the same rules to similar service providers, namely applying outdated regulation to new businesses. The most progressive way forward, however, is to reform sectors demanding a level playing field through by deregulation. For example, instead of considering regulations for Video-on-Demand, regulators must revisit broadcasting regulations is governed and consider streamlining them to make legacy players more competitive.

- **Novel business practices should not be treated as per-se anticompetitive or illegal¹⁴:** Regulators are tempted to follow the level-playing field argument because they often conflate service innovation with regulatory arbitrage. The primary reason for such conclusions is a lack of technical understanding on how to deal with the challenges raised by the novel business practice coupled with a dearth of resources to develop such capacity. Decisionmakers must resist being swayed to deem novel business practices illegal and/or anti-competitive solely because they proffer new way of offering a previously regulated service, especially if the former is a more efficient and convenient alternative to what is available in the market.

Balancing incentives with access

- **Incentives to innovate only exist where businesses can capture the benefits of their innovation**⁵: Regulators must only intervene if there is a market failure which precludes widespread access to an innovation. Calls for access to proprietary information or networks by competitors are often expropriative in nature. They are generally in pursuit of a form of rent-seeking on the back of another entity's labour and investment, rather than a legitimate public interest concern. Forcing access in such circumstances sets bad precedent and operates as an overall disincentive to innovation as it reduces the value of proprietary creations and foments concerns about future risks of appropriation of intellectual property. In such cases, regulators must evaluate whether Fair Reasonable and Non-Discriminatory terms manage transactions within a particular ecosystem.

- **Digital platforms are not utilities**: Calls for access to platform data or networks often rest on the contention that digital platforms are

utilities and must be treated as such. However, there are some strong distinguishing features. For instance, platforms rely on the availability of actual utilities, i.e., telecom services, to operate. In areas that have no connectivity, for instance, it is moot arguing that Google Play is a utility because it will not work. In such contexts, universal service obligations, which utilities are beholden to fulfill, cannot be met by platforms. Deeming platforms utilities is also dangerous because it gives them far-reaching powers such as right-of-way, which enables a utility to enter any property, for maintenance of their service. If a search engine was deemed a utility, for instance, it could argue that ad blockers or tracking blockers, which are useful tools for privacy against tracking carried out by most search websites, impede its service delivery.

- **Digital platforms provide a means of access to all kinds of markets and infrastructure**: Digital platforms open up new markets not only domestically but internationally as well. They give traditional businesses access to a wider range of customers than ever before and vice versa. As such, interventions should only be made when they stop acting as facilitators and start erecting barriers to entry or trade.



CONCLUSION

Digital markets are hotbeds of innovation. Innovation, in turn, drives progress that benefits consumers, businesses and the economy. In 1500, China was the most powerful economy in the world.¹⁶ But by the 19th century, the economies of the U.S., Western Europe, and Japan surged ahead of China by producing mass quantities of goods, while the latter stagnated.¹⁷ Innovation was the key differentiator.

DIGITAL MARKETS ARE HOTBEDS OF INNOVATION. INNOVATION, IN TURN, DRIVES PROGRESS THAT BENEFITS CONSUMERS, BUSINESSES AND THE ECONOMY.

Advancements in chemistry, transport, and engineering as well as the strengthening and modernizing public institutions that are key to sustaining and safeguarding innovation in markets by providing certainty and confidence to market players helped China's competitors move ahead.¹⁸ Historically, in places such as the United States that enabled the freedom to test new ideas and concomitantly "compete and cooperate through a market", innovation flourished.¹⁹

Threats to development and progress come from people who believe they are serving the public interest by wielding state power to decide which inventions are beneficial and which are not.²⁰ It is, then, incumbent on decisionmakers to bring an innovation-friendly competition policy in India.



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