MAGELLAN
EXPERTS IN GLOBAL INVESTING

Big Tech's success incites a backlash

Many think the internet giants are too big for society's good. But even a rethink of competition policy along such lines is unlikely to curb the largest platforms.

Theodore Roosevelt, the 26th US president who was in office from from 1901 to 1909, is ranked among the greats.[1] Among achievements, Roosevelt won the Nobel Prize in 1906 for efforts to resolve the Russo-Japanese war and ensured the Panama Canal was built under US control. The Republican protected natural wonders such as the Grand Canyon, welcomed Oklahoma as the 46th state, founded the Department of Commerce and Labor (since split) to oversee the economy and, by expanding the navy, hastened the US's rise as a global power. And he was a 'trust buster'.

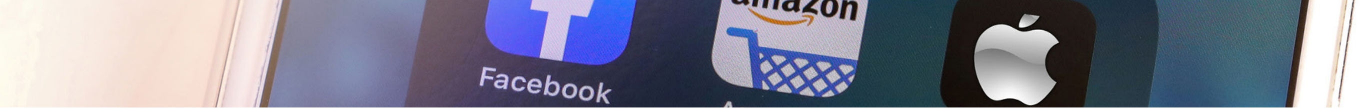
Roosevelt was president of a feeble state during a 'Gilded Age' when "the power of big business alarmed public opinion because its leaders behaved as if they were above the law", according to one biographer.[2] On assuming office in September 1901 after his predecessor was assassinated, Roosevelt challenged the business czars who sat atop trust structures. In 1902, he used the Sherman Antitrust Act of 1890 to prevent J.P. Morgan-controlled Northern Securities from establishing a western railway monopoly, the first time any president confronted a big company.[3] Northern was soon dissolved after a court battle. Moves followed against other 'bad trusts' such as the Beef Trust, the Sugar Trust and the giant Standard Oil under the control of John D Rockefeller. Such steps are recalled today as people ponder the emergence of powerful technology companies; foremost, Alphabet (owner of Google), Amazon, Apple and Facebook. Many people want to curb the influence of these billion-plus-user-strong 'net states'.[4]

The critics said the platforms enjoy monopoly powers bestowed by the 'network effect' – when each additional user makes something more valuable for other users. They say these companies were allowed to buy, imitate and crush threats. They claim the platforms are conflicted because they act as gatekeeper and competitor to rivals such as other online sellers. The overarching complaint is the internet giants have too much influence in a Gilded Age they created. They want Big Tech's power reduced, even if that means breaking up these titans.

Amid these calls, US President Joe Biden's administration is flexing against Big Tech. House Democrats have introduced six antitrust bills[5] including the Republican-supported Ending Platform Monopolies Act that seeks to ban takeovers and limit conflicts of interest.[6] Biden has appointed tech foes to head regulatory bodies and advise him. Biden named as his special assistant for competition policy Tim Wu, a law professor who has called for the dismantling of Facebook and who blames monopoly power for the rise of fascism in the 1930s.[7] He chose Jonathan Kanter, designer of the EU's antitrust case against Google, to run the Justice Department's Antitrust Division. He selected Lina Khan, an academic famous for highlighting Amazon's conflicts of interest, to head competition watchdog, the Federal Trade Commission. Already under Khan, the FTC has rescinded a 2015 policy that limited its enforcement abilities[8] and approved procedural changes to capitalise on a 1975 statute that lets it write tougher regulations.[9] Another sign of Biden's resolve is a far-reaching executive order on July 9 to promote competition across the US economy.[10]

The antitrust push comes after decades when the antitrust focus was based on the tangible goal of protecting consumers. This meant preventing price gouging. Free services such as Facebook and Google are insulated from the charge of rigging prices; so too is Amazon that is celebrated for lowering prices. For Biden's efforts to succeed Roosevelt-style, regulators need to reframe the antitrust focus to the intangible goal it had in Roosevelt's day. Back then, regulators sought to curb the political and economic power flowing from market dominance, even though economies of scale were allowing these titans to reduce prices for consumers.

Even without much of a pivot, Biden's actions will likely help consumers. The 'right to repair' is being enforced, which means tech companies will need to make models that can be repaired and supply relevant parts. Amazon in July gave complainants the right to take court action against the company, a move that exposes the e-retailer to liability.[11] Regulators will impose fines on platforms for even minor competition breaches and target conflicts of interest. Amazon could be forced to shed AmazonBasics that sells Amazon-branded goods and might be forced to allow rival sellers to offer wares at lower prices on other



sites. Ditto for Google when promoting search results that benefit the Alphabet group. Apple faces scrutiny about pre-installed apps for Apple services on iPhones. Regulators will take a harsher view of takeovers, especially by Big Tech. Government antitrust action in June that prompted Aon to abandon its US$30 billion takeover of rival insurer Willis Towers Watson showed the higher hurdle for takeovers.[12]

But even if antitrust swivels to focus on intangible threats to society, much won't change. Breaking up companies is hard because liberal democracies enshrine property rights by limiting government power. Big Tech will thus use the courts as a shield against the antitrust push. These companies have the resources to prolong and win court action. Legal moves by Amazon and Facebook in June to force Khan to recuse herself from FTC decisions revealed Tech's resolve to protect gains.[13] The FTC's failure in a federal court in June to prove Facebook is a monopoly shows how hard the legal battle will be to win. That follows a unanimous ruling of the Supreme Court in April that stripped the FTC of its long-used power to seek restitution from businesses guilty of abusive practices.[14] Away from the legal system, a polarised Congress won't toughen antitrust laws too much when unravelling the network effect would result in outsized damage to popular tech services offered free by companies. Big Tech might be crimped here and there but the internet giants will remain as dominant as ever; perhaps even too powerful for society's good.

To be sure, the internet giants reject accusations they are 'robber barons', claiming they have succeeded through ingenuity and effort, not by rigging markets. The antitrust pursuit precedes Biden by years – the FTC action that seeks to reverse Facebook's purchases of Instagram and WhatsApp, for instance, began under the administration of Donald Trump.[15] The issue of monopoly or oligopoly power extends beyond tech.[16] Even the internet giants deserve protection from capricious politicians – Trump's attempt to block AT&T's takeover of Time Warner in 2018 was seen as politically motivated.[17]

Truth be told, Western politicians and regulators are flummoxed on how to regulate such complex creations as platforms. While that could result in poorly designed regulation, the more likely result is that authorities refrain from mounting an aggressive tilt against the internet titans that would be hard to beat in court anyway. The upshot is that the tech superstars are likely to retain, if not extend, their dominance in coming years. Their critics will keep longing for another Roosevelt for a while yet.

UNWINDING THE CHICAGO TWIST

John Sherman (1823 to 1900) was a Republican senator from Ohio who gave his name to the act that is regarded as the foundation of attempts to regulate competition. At its core, the act, which Sherman described as "a bill of rights, a charter of liberty"[18] made it illegal for competitors to collude on prices, to divide markets, and outlawed monopolies if they relied on unfair competition.[19] The act's significance was to consider the interests of workers, smaller competitors and wider society over the long term.

US Congress soon passed two more laws to strengthen the Sherman Act. As trusts were dismantled and companies formed, the Clayton Act of 1914 was designed to block mergers and takeovers that would have cemented control over prices. The other was the Federal Trade Commission Act of 1914 that created an agency to scrutinise businesses. The intent of these three acts and subsequent amendments[20] spread to US states and other countries such that it forms the basis of government control over business around the world today.

In the US, the efforts to police competition peaked in the 1950s and 1960s. After World War II, Congress and the Supreme Court introduced and enforced antitrust measures that protected smaller businesses against larger ones by cracking down on predatory pricing, looked askance at 'vertical integration' and consistently considered social and political issues, not just economic ones.

The focus, however, changed from the 1970s when University of Chicago professors (dubbed the Chicago School) argued that antitrust laws should focus only on what mattered to consumers; namely, prices, output and efficiency. The Chicago School argued that firms survived only if they pleased consumers so there was no need for the government to protect firms from more dominant competitors or take a wider view of their influence in society.

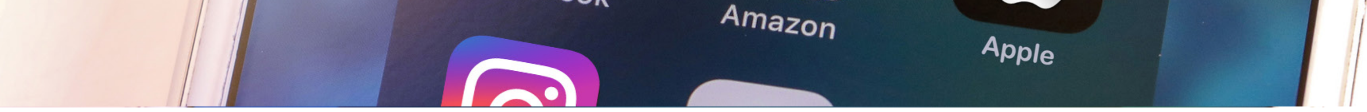
The Chicago view was encapsulated in the paradox named after Yale professor Robert Bork who said in his book of 1978 The antitrust paradox that efforts to protect consumers only lead to higher prices by protecting inefficient firms.[21] The Bork paradox, which essentially said government regulation of competition did more harm than good, took hold and antitrust enforcement largely lapsed during the 1980s and has been patchy since.[22]

As the rise of the digital platforms revived interest in antitrust efforts, Amazon became the prime antitrust focus because a company that started selling books online in 1995 now has interests that extend beyond ecommerce to advertising, artificial intelligence assistants, book publishing, bookstores, cloud services, delivery, electronics, express post, entertainment, gaming, groceries, logistics, money lending, music, publishing, streaming, videos and warehousing. This issue is not just Amazon's power within an industry but the company's influence across the economy and society.

Khan, when at Yale University in 2017, wrote perhaps the most influential paper that has argued that today's narrow approach to antitrust allows Amazon's unfettered rise to the detriment of wider consumer welfare. In Amazon's antitrust paradox Khan said measuring Amazon's dominance on short-term benefits to consumers misses the potential longer-term harm to market structures and competition and underappreciates the risk of predatory pricing.

Khan said the narrow antitrust focus misjudges how integration across distinct business lines may prove anticompetitive because the platforms serve as infrastructure for rivals and the economics of platforms promotes growth over profits. Thus predatory pricing is rational, she said, when today's narrow antitrust doctrine treats it as irrational and implausible. Another consequence is that platforms can exploit information collected on companies using their services to undermine them as rivals.[23]

Her solution was to restore the traditional broader antitrust and competition policy principles or apply common carrier obligations and duties on the platforms, proposals Khan and others of her ilk now have the regulatory power to pursue.



FLAWED SOLUTIONS

In 2012, Facebook paid US$1 billion for Instagram when the photo-sharing app employed just 13 people, had only 30 million users and earned no revenue.[24] The US regulator voted 5-0 to allow the deal[25] while the UK supervisor approved the purchase because Instagram was in no position to compete against Facebook "as a potential social network or as a provider of advertising space".[26]

Regulators missed that Facebook was buying a rival that might divert people from its platform, the same motive that prompted Facebook in 2013 to bid unsuccessfully for Snapchat[27] and in 2014 to buy WhatsApp for US$19 billion with regulatory approval.[28] Alphabet, Amazon, Apple and Facebook, by the count of The Washington Post owned by Amazon's Jeff Bezos, have bought at least 607 companies in their rise to monopolistic or oligopolistic control over their tech spheres that have become central to daily life.[29]

Suggestions for curbing Big Tech are plentiful. Their implementation, however, often looks problematic.

Some have argued, for instance, that Amazon should be subject to common carrier obligations (ensure other businesses have equal and fair access to the platform) to curb its power in retail and be prevented from favouring its products. But why would Amazon be treated like a utility when it only accounted for just below 5% of US retail sales in 2020, hardly monopoly control? Why would online and offline competitors be able to favour their products and not Amazon?

For those who suggest that the platforms be regulated like utilities, many propose the 'regulated asset base' model of oversight. Under this model, utilities earn a return akin to what they would earn competing against an imaginary competitor that was meeting its cost of capital. Valuing the intellectual capital of the platforms would be just one hurdle.[30]

Others propose that users own their behavioural data, connections or search history. But apathy might prevent much changing. Stronger privacy laws would dim Big Tech's sway but this would inhibit innovation.

Some say Facebook should be made interoperable – when data can be shared with other sites – akin to how AOL was forced to make its Instant Messenger interoperable in 2001.[31] Would people bother switching? Others suggest that Facebook be forced to become a subscription service.[32] But politicians might baulk at making users pay for something a company is offering at no charge. Another solution is tougher regulations on how algorithms target and sort information and people and steep penalties for their misuse.[33]

A more-radical proposal would be for governments to set up publicly owned platforms to compete against the established privately owned platforms. But no one in the US is serious about this path.

Another radical proposal is to dismantle the platforms. But that would diminish the network effect for users, nullify economies of scale, Amazon A might eventually dominate Amazon B, C, D and E anyway, and such a path presages years of court battles with no guarantee of success for antitrust forces.

Perhaps pertinent for those intent on breaking up Big Platforms are the unintended consequences of Roosevelt's successful battle to dissolve Rockefeller's Standard Oil.

In 1911, Rockefeller was playing golf when he was given the news the Supreme Court had ordered Standard Oil to be split into 34 companies. He asked his golf partner, a Catholic priest, if he had any money. The priest said no and asked why. "Buy Standard Oil," was Rockefeller's response. It was sound advice for, in one biographer's view, "it was the luckiest stroke of his career". Only three years after Henry Ford produced his first Ford Model T, Rockefeller now owned about 25% in 34 oil companies that soared in value when investors could glimpse the assets in listed companies that had previously been largely privately held. [34]

And didn't Roosevelt know he had made Rockefeller the world's richest person. In 1912, Roosevelt re-entered presidential politics by creating the Bull Moose party. At one stop during his failed campaign, Roosevelt roared: "Rockefeller and his associates have actually seen their fortunes doubled. No wonder that Wall Street's prayer now is: Oh Merciful Providence, give us another dissolution."[35]A more-radical proposal would be for governments to set up publicly owned platforms to compete against the established privately owned platforms. But no one in the US is serious about this path.

Another radical proposal is to dismantle the platforms. But that would diminish the network effect for users, nullify economies of scale, Amazon A might eventually dominate Amazon B, C, D and E anyway, and such a path presages years of court battles with no guarantee of success for antitrust forces.

Perhaps pertinent for those intent on breaking up Big Platforms are the unintended consequences of Roosevelt's successful battle to dissolve Rockefeller's Standard Oil.

In 1911, Rockefeller was playing golf when he was given the news the Supreme Court had ordered Standard Oil to be split into 34 companies. He asked his golf partner, a Catholic priest, if he had any money. The priest said no and asked why. "Buy Standard Oil," was Rockefeller's response. It was sound advice for, in one biographer's view, "it was the luckiest stroke of his career". Only three years after Henry Ford produced his first Ford Model T, Rockefeller now owned about 25% in 34 oil companies that soared in value when investors could glimpse the assets in listed companies that had previously been largely privately held.

And didn't Roosevelt know he had made Rockefeller the world's richest person. In 1912, Roosevelt re-entered presidential politics by creating the Bull Moose party. At one stop during his failed campaign, Roosevelt roared: "Rockefeller and his associates have actually seen their fortunes doubled. No wonder that Wall Street's prayer now is: Oh Merciful Providence, give us another dissolution."

By Michael Collins, Investment Specialist

[1] Roosevelt has come fourth in the past four C-SPAN surveys of historians where they rank the US presidents. The past four surveys were conducted in 2021, 2017, 2009 and 2000. In the past three, Abraham Lincoln came first, George Washington second and Franklin D. Roosevelt third. c-span.org/presidentsurvey2021/?page=overall

[2] Kathleen Dalton. 'Theodore Roosevelt. A strenuous life.' Vintage Books. 2002. Page 204.

[3] Dalton. Op cit. Pages 224 to 226.

[4] WIRED. 'Net states rule the world; we need to recognise their power.' Alexis Wichowski from Columbia University's School of International and Public Affairs. 4 November 2017. wired.com/story/net-states-rule-the-world-we-need-to-recognize-their-power/

[5] House Committee of the Judiciary. 'Markups'. 23 June 2021. The six bills are H.R. 3843, the Merger Filing Fee Modernization Act of 2021; H.R. 3460, the State Antitrust Enforcement Venue Act of 2021; H.R. 3849, the Augmenting Compatibility and Competition by Enabling Service Switching Act of 2021 or the ACCESS Act of 2021; H.R. 3826, the Platform Competition and Opportunity Act of 2021; H.R. 3816, the American Choice and Innovation Online Act; and H.R. 3825, the Ending Platform Monopolies Act. judiciary.house.gov/calendar/eventsingle.aspx

[6] House of Representatives. 'H.R. 3825 – Ending Platform Monopolies Act.' Entered 11 June 2021. congress.gov/bill/117th-congress/house-bill/3825/text. See release by Congressman Lance Gooden, who introduced the bill. 'Congressman Gooden introduces the Ending Platform Monopolies Act.' 11 June 2021. gooden.house.gov/media/press-releases/congressman-gooden-introduces-ending-platform-monopolies-act

[7] Tim Wu. 'Be afraid of economic 'bigness'. Be very afraid.' 10 November 2018. The New York Times. nytimes.com/2018/11/10/opinion/sunday/fascism-economy-monopoly.html. See also, 'Tim Wu explains why he thinks Facebook should be broken up.' WIRED. 5 July 2019. wired.com/story/tim-wu-explains-why-facebook-broken-up/

[8] Federal Trade Commission. 'FTC rescinds 2015 policy that limited its enforcement ability under the FTC act.' 1 July 2021. ftc.gov/news-events/press-releases/2021/07/ftc-rescinds-2015-policy-limited-its-enforcement-ability-under

[9] Federal Trade Commission. 'FTC votes to update rulemaking procedures sets stage for stronger deterrence of corporate misconduct.' 1 July 2021. ftc.gov/news-events/press-releases/2021/07/ftc-votes-update-rulemaking-procedures-sets-stage-stronger

[10] The White House. 'Fact sheet: Executive order on promoting competition in the American economy.' 9 July 2021. whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/

[11] See "Amazon ends use of arbitration for customer disputes.' 22 July 2021. nytimes.com/2021/07/22/business/amazon-arbitration-customer-disputes.html

[12] See US Department of Justice Antitrust Divisions 'Complaint' filed against Aon and Willis Towers Watson. Filed to the US District Court for the District of Columbia. 16 June 2021. justice.gov/opa/press-release/file/1404951/download. The EU had approved the takeover. Berkshire Hathaway, fearing FTC pushback, in May/June abandoned the purchase of pipeline assets from Dominion Energy. See 'Wall Street and Warren Buffett miss the good old days.' 27 July 2021. Bloomberg News. bloomberg.com/opinion/articles/2021-07-26/wall-street-and-warren-buffett-miss-the-good-old-days

[13] 'Amazon seeks recusal of FTC chair Khan, a longtime company critic.' 30 June 2021. The Washington Post. The newspaper is owned by Amazon founder Jeff Bezos. washingtonpost.com/technology/2021/06/30/amazon-khan-ftc-recusal/. 'Facebook seeks recusal of FTC chair Lina Khan amid high-profile antitrust case.' 14 June 2021. The Washington Post. washingtonpost.com/technology/2021/07/14/facebook-seeks-recusal-ftc-chair-lina-khan/

[14] Supreme Court of the US. Ruling. 'AMG Capital Management, LLC et all v Federal Trade Commission.' 22 April 2021. supremecourt.gov/opinions/20pdf/19-508_l6gn.pdf. See also, Mike Davis, founder Article III Project. 'Congress must empower the FTC to fight tech's abuses.' Newsweek. 29 July 2021. newsweek.com/congress-must-empower-ftc-fight-big-techs-abuses-opinion-1614105

[15] See Axios. 'Judge dismisses FTC's antitrust complaint against Facebook.' 28 June 2021. axios.com/judge-dismisses-ftcs-antitrust-complaint-against-facebook-b4612f7a-2f82-4462-91d3-36612c56416e.html. See also Federal Trade Commission. 'FTC sues Facebook for illegal monopolisation.' 9 December 2020. ftc.gov/news-events/press-releases/2020/12/ftc-sues-facebook-illegal-monopolization. More than 40 state attorneys were involved in the case.

[16] Some parts of tech seem safe from antitrust efforts. See WIRED. 'Biden's antitrust revolution overlooks AI – at Americans' peril.' 27 July 2021. wired.com/story/opinion-bidens-antitrust-revolution-overlooks-ai-at-americans-peril/

[17] The allegation is that Trump ordered Gary Cohn, then the director of the National Economic Council, to pressure the Justice Department to block AT&T's takeover of Time Warner (now known as Warner Media) out of spite of CNN. The allegation was made by Jane Mayer in 'The making of the Fox News White House'. The New Yorker. 4 March 2019. newyorker.com/magazine/2019/03/11/the-making-of-the-fox-news-white-house

[18] Senator John Sherman speaking in the US Senate. Congressional Record. Senate 1890. Page 2,461. appliedantitrust.com/02_early_foundations/3_sherman_act/cong_rec/21_cong_rec_2455_2474.pdf

[19] US Federal Trade Commission. 'FTC fact sheet: Antitrust laws: A brief history." Undated. consumer.ftc.gov/sites/default/files/games/off-site/youarehere/pages/pdf/FTC-Competition_Antitrust-Laws.pdf. Federal Trade Commission. 'The antitrust laws.' ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws

[20] The Robinson-Patman Act of 1936 amended the Clayton Act to ban certain discriminatory prices, services, and allowances in dealings between merchants. The Clayton Act was amended again in 1976 by the Hart-Scott-Rodino Antitrust Improvements Act to require companies planning large mergers or acquisitions to notify the government of their plans in advance. See the Federal Trade Commission 'The antitrust laws.' ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws

[21] See Robert Bork. 'The antitrust paradox. A policy at war with itself.' The Free Press. 1978. The introduction, chapter 1 and epilogue can be found at: amazon.com/Antitrust-Paradox-Robert-H-Bork/dp/0029044561

[22] See Maurice E. Stucke and Ariel Ezrachi. 'The rise, fall, and rebirth of the US antitrust movement.' Harvard Business Review. 15 December 2017. hbr.org/2017/12/the-rise-fall-and-rebirth-of-the-u-s-antitrust-movement

[23] Lina M. Khan. 'Amazon's antitrust paradox.' The Yale Law Journal. Volume 126 2016-2017. Number 3. January 2017. yalelawjournal.org/note/amazons-antitrust-paradox

[24] UK Office of Fair Trading. Release. 'Anticipated acquisition by Facebook Inc of Instagram Inc.' 14 August 2012. webarchive.nationalarchives.gov.uk/20140402232639/http://www.oft.gov.uk/shared_oft/mergers_ea02/2012/facebook.pdf

[25] Federal Trade Commission. 'FTC closes its investigation into Facebook's proposed acquisition of Instagram photo-sharing program.' 22 August 2012. ftc.gov/news-events/press-releases/2012/08/ftc-closes-its-investigation-facebooks-proposed-acquisition

[26] UK Office of Fair Trading. Op cit.

[27] The Wall Street Journal. 'Messaging service Snapchat spurned $3 billion Facebook bid.' 13 November 2013. wsj.com/articles/messaging-service-snapchat-spurned-facebook-bid-1384376628

[28] See Federal Trade Commission. Release. 'FTC notifies Facebook, WhatsApp of privacy obligations in light of proposed acquisition.' 10 April 2014. ftc.gov/news-events/press-releases/2014/04/ftc-notifies-facebook-whatsapp-privacy-obligations-light-proposed. See European Commission. Press release. 'Mergers: Commission approves acquisition of WhatsApp by Facebook.' 3 October 2014. europa.eu/rapid/press-release_IP-14-1088_en.htm

[29] The Washington Post. 'How Big Tech got so big. Hundreds of acquisitions.' 21 April 2021. washingtonpost.com/technology/interactive/2021/amazon-apple-facebook-google-acquisitions/

[30] See The Economist. Schumpeter. 'What if large tech firms were regulated like sewage companies?' 23 September 2017. economist.com/business/2017/09/23/what-if-large-tech-firms-were-regulated-like-sewage-companies

[31] Mark Stoller. Fellow at the Open Markets Institute. Tweet. 'We know one way to regulate Facebook. DOJ forced AOL messenger interoperability in 2001. It worked.' 6 October 2017. twitter.com/matthewstoller/status/916316360807985153

[32] Roger McNamee, managing director of Elevation Partners. 'How to fix Facebook: Make users pay for it.' 21 February 2018. washingtonpost.com/opinions/how-to-fix-facebook-make-users-pay-for-it/2018/02/20/a22d04d6-165f-11e8-b681-2d4d462a1921_story.html

[33] See Martin Sandbu. Financial Times. 'Free Lunch' columnist. 'Civilising the digital economy. Ownership rights and algorithmic accountability.' 24 February 2018. ft.com/content/a245e882-1882-11e8-9e9c-25c814761640

[34] 'Titan. The life of John D Rockefeller Sr.' Ron Chernow. Warner Books. 1998. Page 545. By one count the largest federal antitrust suit of the day against the biggest empire of the day, it entailed 444 witnesses who delivered 11 million words of testimony. Add on 1,374 exhibits, and the proceedings filled 12,000 pages in 21 volumes. On top of that were another 21 state antitrust suits.

[35] Chernow. Op cit. Pages 556 and 557.

info@magellangroup.com.au   +61 2 9235 4888