The Daily Dish

50 First Mistakes

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Eakinomics: 50 First Mistakes

These days everyone seems to want a piece of the tech giants Google, Facebook, Apple, Amazon, and Netflix. Recently, 50 state attorneys general (AGs) announced they were opening a sweeping investigation into Google's activities. Unfortunately, after reviewing the effort, AAF's Will Rinehart finds that "it's likely that consumers won't be much better off after the investigation has concluded."

Why? To begin, the AGs seem to have gotten off on the wrong foot. Ken Paxton of Texas, the lead AG on the case, wrote in *The Wall Street Journal*, "Each year more than 90% of Google's $117 billion in revenue comes from online advertising. For reference, the entire market for online advertising is around $130 billion annually." That percent seems to suggest a dominant position in online ads, with the investigation focusing as a result on any abuse of this near-monopoly position. Unfortunately, the statistics are misleading. $117 billion is Google's worldwide ad revenue; $130 billion is the size of the domestic market. On top of that, the actual Google market share is just under 40 percent and falling. According to eMarketer, "Google and Facebook's share of new digital ad dollars is declining…. This year, they will garner nearly 48% of new expenditures. By comparison, that figure was nearly 73% in 2016."

But measurement is not the only problem. The AGs may be making the mistake of defining the market too narrowly; it should be both advertising <u>and</u> search markets. As Rinehart explains: "…consider a business with only two sides, users and advertisers. If users experience an increase in price or a reduction in quality, then they will use the platform less or leave it completely. Advertisers see this change in users and react by reducing their demand for ad placements as well. When advertisers drop out, the total amount of content also recedes, and users react once again." In the presence of these so-called demand interdependences, focusing on ads alone gets the analysis wrong. As AAF previously pointed out:

> [T]he value of both Facebook and Google comes in creating the platform, which combines users with advertisers. Before the integration of ad networks, the search engine industry was struggling and it was simply not a major player in the Internet ecosystem. In short, the search engines, while convenient, had no economic value. As Michael Moritz, a major investor of Google, said of those early years, "We really couldn't figure out the business model. There was a period where things were looking pretty bleak." But Google didn't pave the way. Rather, Bill Gross at GoTo.com succeeded in showing everyone how advertising could work to build a business. Google founders Larry Page and Sergey Brin merely adopted the model in 2002 and by the end of the year, the company was profitable for the first time. Marrying the two sides of the platform created value. Tearing them apart will also destroy value.

Finally, there is not a lot that states can do to help consumers. They can fine Google (as the European Union has done), but that does little for consumers. Or they can try to induce changes in behavior, but in a market this difficult to characterize, those actions may ultimately hurt consumers.

An investigation by 50 state AGs will be a nuisance for any tech company, for sure. But all that nuisance may not add up to an increase in consumer welfare.