Insight

Facebook, Market Definitions, and the Goldilocks Problem

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Executive Summary

- The Federal Trade Commission refiled an antitrust claim against Facebook seeking to improve its definition of the relevant market.
- Defining the relevant market either too narrowly or too broadly can have damaging economic impacts by missing relevant competitors or failing to protect consumers.
- As Congress considers possible antitrust reforms including potential changes to the standards for enforcers to define the relevant market, it is important to consider the impact such changes could have on consumer-benefitting actions.

Introduction

In July 2021, a federal judge dismissed the Federal Trade Commission's (FTC) antitrust complaint against Facebook in part due to its inability to establish a concrete claim of market power in a properly defined antitrust market. On August 19, the FTC refiled its antitrust claims against Facebook, this time seeking to more clearly define the market it accuses Facebook of dominating and the claims that it had maintained that dominance through "buying and burying" potential rivals in its acquisitions of companies such as Instagram and WhatsApp.

While this revised complaint is more specific than the prior complaint, there is already debate about if the proposed market definition is accurate. Market definition for today's Big Tech players as well as the technology industry in general is a key point of dispute in debates around antitrust. In order to succeed with its case, the FTC will need to show Facebook's dominance in the market it has defined, and the court will need to accept its arguments justifying the relevant market. The current proposed market definition is narrow and, even if successful, could have consequences for consumer welfare due to the innovation and changes involved in such a dynamic market. At the same time, defenders of tech companies should be careful to avoid hyperbolic and overly expansive definitions of markets that would allow behaviors that truly are harmful to consumers. As Congress considers the potential for additional FTC powers regarding antitrust and even proposals that would lower the standards for proving the relevant market, it is important to examine the impact that misguided market definitions could have on consumer-benefitting actions.

Antitrust Law and Identifying the Relevant Market

The relevant market for the purposes of competition law considers both the product market and the geographic market for the company in question. While there are ongoing debates over whether Big Tech companies compete on a national or international level, for the purposes of an antitrust case the geographic market is less debated: A court is likely to consider the range of competitors and substitutes available in the United States. (There is a more complicated debate regarding the relevant geographic market for retail and e-commerce that this piece will not address.) The question of the relevant product market for various technology services such as

Facebook or Google remains an intensely debated issue.

There are a series of tools courts use when determining if the proposed market constitutes the relevant product market. These include an examination of demand substitutes, supply substitutes, and additional competitors. In general, when determining if demand-side substitutes exist, the analysis looks at the ability of consumers to switch to other products were a price increase to occur. Some argue that given the fact that many technology services are free, it is difficult to conduct such analysis for these products and services; economists, however, have pointed to other objective tools that can be used for similar analysis. In other scenarios, the market may be better defined by the effect of such changes on suppliers rather than on consumers, and therefore a similar analysis of relevant price changes can be conducted. These tools are used to determine an appropriate relevant market that reflects the relevant constraints of competition and geography on a product or service.

Issues with Overly Narrow Market Definitions

The FTC has succeeded in past antitrust enforcement actions with narrower definitions of the relevant market than some consumers would expect. This success, however, may be less beneficial to consumers and stifle the ability of a business to adapt to a rapidly changing industry. Two notable examples of this dynamic are past FTC actions concerning office supply stores and video rentals. These examples help illustrate the potential negative impact on consumers of narrow market definitions.

In 1997, the FTC blocked the merger of office supply stores Staples and Office Depot. In this case, the agency used a definition that limited the relevant market to only the "sale of office supplies through office superstores" as opposed to the "sale of office supplies." This distinction limited the market to three major players at the time (Staples, Office Depot, and Office Max) and ignored the competition from smaller local suppliers, general retailers such as Walmart and Costco, and the potential for online retail to emerge as a competitive force. To support this narrow definition, the FTC provided evidence that these office supply retailers viewed each other, and not general retailers, as their primary competition and that market concentration from the merger would likely increase prices in this market. The judge accepted the FTC's theory of the case and blocked the merger. The retail market, however, continued to evolve, but these still separate supply stores struggled to remain relevant and compete. In 2013, when OfficeMax and Office Depot sought to merge, the changes in the retail landscape including the emergence of online retail led to a broader market definition that allowed the merger to proceed.

The market definition included in the refiled Facebook case may have a similar static view of the market that misses the emerging competitors that consumers actually have to choose from. In hindsight, even if the growth of online retail could not have been predicted, the narrow market definition in the Staples-Office Depot case was likely more limited than the substitutes consumers already had encountered and considered such as Walmart and Costco. In the refiled Facebook case, the FTC seeks to define Facebook's market as personal social networking services that connect friends and family. This definition eliminates not only targeted social networking services such as running app Strava or professional networks such as LinkedIn that may seek to serve a specific community or interest, but also those that are more aimed at general broadcast such as TikTok and Reddit. But when examining market definition, the question should be focused on how consumers view potential substitutes. Many users use Facebook in a variety of ways, including for the more "general broadcast" usage discussed or for their specific community or interest. The result is there are already applicable substitutes that are popular and used by many of the same consumers in the same way Costco or Walmart was for office supply stores. Additionally, as International Center for Law and Economics' Sam Bowman noted in an analysis of the FTC's original case against Facebook, such definitions could even exclude the challenged Instagram or WhatsApp from the relevant market.

Hindsight may be 20/20, but a narrow definition of the market neglects the reality of existing substitutes and the range of ways in which people use various services. Looking only at one aspect of the market may result in enforcement actions that could limit more beneficial services or unfairly prevent its ability to respond to consumer demands in an evolving market.

Another example of antitrust enforcers failing to see the impending changes to a market and instead sticking to a narrow market definition is found in the case of video rental giants Blockbuster and Hollywood Video. In 2005, the FTC blocked the merger of the two market leaders in video rental. The dynamics of the home entertainment market, however, were beginning to change with the growing popularity of new entrants such as Redbox and Netflix. In this case, regulators acted on a presumption that home entertainment would forever mean going to the video store while early indication showed a broader change in the market. The static view proposed by antitrust enforcers in a narrow market definition may miss the impact of innovative changes that are improving consumers' experience in the market.

The FTC proposed definition of "personal social media networks" may be risking a similar error. Gen Z is consuming more creator-driven content through services such as YouTube and TikTok and shifting away from social media platforms such as Facebook. These competing services continue to see rapid growth and have even begun to surpass Facebook's success by some measures. A definition of "personal social media networks" that ignores the changing landscape social media is undergoing more generally may prove misguided in hindsight, as did ignoring new trends in home entertainment in favor of only a narrow definition of video rental stores. The result is the company subject to antitrust enforcement may not be able to adapt their experience to the consumer demands and may struggle to keep up with market dynamics. Such a static snapshot of market definition may be outdated by the many years it takes for a case to conclude.

Can the Market Be Too Expansive?

While much of the issue of market definition focuses on concerns that a market may be misidentified to show market power that does not really exist, a market still must be clearly definable and not so broad as to miss potentially harmful behavior to consumers. The objective economic tests used for market definition in identifying potential substitutes and appropriate geographic areas largely serve as a balance for such concerns.

While a service such as Facebook may have many uses and compete in different markets, it is hyperbolic to claim the entire internet serves as competition

. Again, if past cases serve as an illustration, while limiting the market to only video rental stores with a large geographic footprint may seem too narrow and problematic in hindsight, there are distinctions that can be made between home entertainment and a more general entertainment category including movie theaters and amusement parks. While in some ways market definition seems to be a Goldilocks issue of too expansive, too narrow, or just right, the focus on consumer welfare and the experience of consumers coupled with existing economic analysis tools can serve well to yield a balanced approach even in dynamic and zero-price markets such as social media.

Conclusion

The FTC continues an aggressive approach to antitrust enforcement that seems to have lost its focus on consumers and their welfare in favor of achieving policy goals or "punishing" a disfavored industry with unclear evidence of harm. The dynamic nature of the technology industry makes it difficult to correctly define the market, but overly narrow definitions risk harming consumers through unnecessary interference. Congress should ensure that there remains sufficient oversight of the FTC and that its activist desires do not undermine its purpose as a consumer protection agency in favor of other policy goals.