Insight

Will the Antitrust Investigation into Google Benefit Consumers?

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Executive Summary

- 50 state attorneys general are investigating Google for antitrust violations, and while the exact nature of the investigation and the legal arguments are not clear, the focus appears to be on Google's dominance of the online search and advertising market.
- Any investigation must take account of the complex interplay between different users of Google's services, as the Supreme Court indicated last year that it would consider some companies as multi-sided platforms, and Google fits the definition of such a platform.
- The range of possible responses the state attorneys general have to address Google is limited, and it appears that none of them will ultimately benefit the consumer.

Introduction

Last week, 50 state attorneys general (AGs) from around the United States, including those in Washington, DC, and Puerto Rico, announced they have opened a sweeping investigation into Google's activities. Front and center are concerns over competition in the advertising and search markets. As one of the state AGs explained, "Google's business practices may have undermined consumer choice, stifled innovation, violated users' privacy and put Google in control of the flow and dissemination of online information." Yet any investigation into the competitive practices of Google must reckon with the complex nature of innovation online and changes in the law. And given the options for addressing any perceived problems at the AGs' disposal, it's likely that consumers won't be much better off after the investigation has concluded.

The Scope of the Investigation: What We Know, and Initial Missteps

According to the document demands of the investigation, the state AGs are looking into Google over its "overarching control of online advertising markets and search traffic." Since there is no formal complaint, the exact legal arguments that could be wielded against the search giant are unclear.

Nevertheless, the AGs' statements provide some clues into how they are approaching the case. Ken Paxton of Texas, the lead AG on the case, said in a statement that "There is nothing wrong with a business becoming the biggest game in town if it does so through free market competition, but we have seen evidence that Google's business practices may have undermined consumer choice, stifled innovation, violated users' privacy, and put Google in control of the flow and dissemination of online information." This kind of argument is not limited to the search giant: In addition to the case against Google, New York Attorney General Letitia James recently announced an antitrust probe into Facebook, which will likely reflect a similar line of reasoning as the Google case.

Paxton also indicated the particular market of interest when he 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." As with any antitrust case, selecting the relevant market is the first step, and in trotting out these numbers, the state AGs have made it clear that their focus is on the online ad market.

These figures misrepresent the extent of Google's reach into the ad market. As Patrick Hedger of the Competitive Enterprise Institute pointed out, the Google revenue statistic is global while the online market figure is domestic. In reality, Google's share of the online advertising market in the United States is 37 percent and falling. According to industry watcher 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."

Further, fixating on the online ad space is a misstep because the truly relevant market would include all of advertising. Since digital ads are about half of the total ad market, Google's share of the total market comes to 20 percent.

The Combined Markets for Both Search and Advertising

This isn't the first time that Google has faced a serious antitrust inquiry. In 2013, the Federal Trade Commission wrapped up its investigation of Google's practice in the search market by having Google commit to a set of behaviors. This investigation will be different because the law has progressed. Last year with *Ohio v. American Express*, the Supreme Court signaled its willingness to judge enterprises such as Google, Facebook, and Twitter as multi-sided platforms that combine two or more groups of users for their mutual benefit.

To understand why it's important that the law now recognizes multi-sided platforms, 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.

Demand is tightly integrated between the two sides of the platform. Changes in user and advertiser preferences have far outsized effects on the overall platform value because each side responds to the other. Economists call these relationships demand interdependencies. The demand on one side of the market is interdependent with demand on the other. Research on magazines, newspapers, and social media sites all support this description of the dynamic.

Economists David Evans and Richard Schmalensee, who were cited extensively in *Amex*, explained the importance of the integration of these interdependencies into competition analysis: "The key point is that it is wrong as a matter of economics to ignore significant demand interdependencies among the multiple platform sides" when defining markets. If they are ignored, then the typical analytical tools will yield incorrect assessments. Understanding these relationships makes the investigation all that more difficult. AGs will have to take into account these interdependencies when analyzing Google and Facebook.

What Could Be Done?

While this investigation clearly marks a new stage of antagonism between big tech and the government, the government's range of remedies is limited. States could press for the breakup of Google, but that would be a

death warrant for the company. 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.

The state AGs might press for a large fine, a tactic preferred by Europeans. In the last two years alone, the European Commission fined Google $2.7 billion for favoring its own shopping comparison service in search results, $5 billion for pre-installing Google apps, and $1.69 billion for imposing anti-competitive contractual restrictions on third-party websites to use their ad network. A fine, however, does little to help consumers.

Last, the investigation might aim to secure behavioral changes, but these often come with a cost. In the case of pre-installing Google apps on Android, the European Commission got Google to change its practices. Because the company was ordered to stop tying the Android operating system with apps, phone and tablet manufacturers now have to pay a licensing fee in Europe if they want Google's apps and the Play Store. The pre-installation of apps is only one example of how platforms often engage in intense cross subsidization between divisions. Regulatory and legal remedies often result in those relationships being unbundled. When implicit prices become explicit prices, consumers are the one who pay.

Will Consumers Benefit?

Regardless of the end result, it is hard to see how consumers will benefit. Speaking about the investigation, Florida Attorney General Ashley Moody said, "When there is no longer a free market or competition, this increases prices, even when something is marketed as free, and harms consumers." Google search users don't experience prices, which means the antitrust analysis needs to be concerned with the quality of the search—what some have dubbed search bias.

A version of this argument was central to the European Commission's suit against Google in the shopping case, as Commissioner Margrethe Vestager noted: "Google abused its market dominance as a search engine by promoting its own comparison shopping service in its search results, and demoting those of competitors." Of course, consumers head to Google because it provides a one-stop shop for information, much as they are apt to use Amazon for product search. The state AGs face a herculean task in trying to describe this market accurately, given the interconnections and interdependencies within both consumer behaviors and company offerings.

The relationship between ad price and industry concentration is just as complicated. In the online ad market, for example, fewer platforms mean that purchasers can more efficiently target people through keywords. Because advertisers have access to superior information, research has found that more concentration leads to lower revenues for search engines.

Consumer welfare is at the core of antitrust analysis for platforms. But an early look at the state AGs' investigation suggests that consumers won't largely benefit.