

Comments of ITIF

Before the

The House of Lords Internal Market Sub-Committee

of the Select Committee on the European Union

London, United Kingdom

Regarding

Online Platforms and the EU Digital Single Market

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INTRODUCTION TO THE INFORMATION TECHNOLOGY AND INNOVATION FOUNDATION

The Information Technology and Innovation Foundation (ITIF) would like to submit the attached written commentary in response to the call for evidence by the House of Lords Internal Market Sub-Committee of the Select Committee on the European Union regarding online platforms and the EU Digital Single Market. ITIF recently released a report on Internet platforms *Why Internet Platforms Don't Need Special Regulation*¹ and submitted comments in response to the public consultation by the European Union on the regulatory environment for platforms, online intermediaries, data and cloud computing and the collaborative economy.

Founded in 2006, ITIF is a 501(c)(3) nonprofit, nonpartisan research and educational institute—a think tank—focusing on a host of critical issues at the intersection of technological innovation and public policy. Its mission is to formulate and promote policy solutions that accelerate innovation and boost productivity to spur growth, opportunity, and progress.

ITIF does this in a number of ways:

- Setting the policy agenda on technology, innovation, and global competition issues by producing original research reports and analytical commentary;
- Shaping public debate by hosting events, giving speeches and presentations, providing official testimony, and serving as expert issue analysts in the news media; and
- Advising policymakers through direct interaction in Washington, DC, and other state, national, and regional capitals around the world.

On the strength and influence of this work, the University of Pennsylvania has ITIF as the top science and technology think tank in the United States, and number two in the world.

¹ Joe Kennedy, “Why Internet Platforms Don’t Need Special Regulation” (Information Technology and Innovation Foundation, October 2015), <https://itif.org/publications/2015/10/19/why-internet-platforms-don't-need-special-regulation>

ITIF is led by its president and founder, Robert D. Atkinson, an internationally recognized policy scholar and widely published author whom The New Republic has named one of the “three most important thinkers about innovation,” Washingtonian Magazine has called a “Tech Titan,” and Government Technology Magazine has judged to be one of the 25 top “Doers, Dreamers and Drivers of Information Technology.” Under Atkinson, ITIF’s team of policy analysts and fellows includes authors and recognized experts in the fields of economics, tax policy, trade, telecommunications, privacy, cybersecurity, and life sciences, among many others. ITIF also is home to the highly regarded, which develops and promotes policy ideas to capitalize on the tremendous economic and social benefits that data-driven innovation can offer.

RESPONSES TO QUESTIONS

Section 1: Online platforms, consumers, suppliers

Defining online platforms

1. Do you agree with the Commission’s definition of online platforms? What are the key common features of online platforms and how they operate? What are the main types of online platform? Are there significant differences between them?

ITIF agrees with the European Commission (EC) definition of online platforms as “software-based facilities offering two-or even multi-sided markets where providers and users of content, goods and services can meet.” Key common features are the use of Internet technology to be available to anyone, anywhere, at any time. All platforms share the same basic task of bringing different sides of a market together and making it easier for each side to achieve mutual goals. Some important distinctions are the degree to which a platform relies on advertising revenue as opposed to taking a share of the value of any economic transaction, the platform’s involvement in approving users, setting transaction prices, and handling payment, its dependence on advertising revenue, and the way in which the platform chooses to charge those who use its platform.

2. How and to what extent do online platforms shape and control the online environment and the experience of those using them?

Online platforms have complete control over the user interface that they design. However, the value of the user experience largely depends on the ability to find a suitable match. Platforms must constantly struggle to attract not only enough users on each side of the market, but also the right type of users so that successful matches can be made.

Effects on consumers, suppliers (including SMEs), competitors and society

3. What benefits have online platforms brought consumers and businesses that rely on platforms to sell their goods and services, as well as the wider economy?

Platforms have dramatically reduced the transaction cost of finding a suitable partner, negotiating a mutually beneficial agreement, and enforcing that agreement. Many platforms make it easy to exploit underutilized assets that would otherwise sit idle. Platforms have offered important income opportunities to a large number of workers, something that is especially valuable to marginal workers who lack contacts, face discrimination, or need flexibility. They have also made it much easier for businesses, especially independent businesses, to find customers and establish a reputation, an important factor as more of the economy is made up of corporate chains. Finally, platforms have dramatically reduced the cost and increased the ease of many transactions. The impact of increased quality and lower prices has been greatest for those with limited incomes.

4. What problems, if any, do online platforms cause for you or others, and how can these be addressed? If you wish to describe a particular experience, please do so here.

Like traditional businesses, there is always the possibility that problems will arise, whether from lack of capacity, misunderstanding, error, or fraud. ITIF believes experience shows that platforms do not pose special problems in this regard. In fact, the need to always be available and the use of immediate rating systems can actually work to increase service levels and weed out bad users. Online platforms do depend critically on access to broadband connections and mobile technology. This highlights the importance of policies that support the continuing evolution of communications systems.

5. In addition to concerns for consumers and businesses, do online platforms raise wider social and political concerns?

ITIF believes that the social and political concerns raised by online platforms do not differ in any material degree from those raised by traditional businesses. One concern that has been raised is that online platforms pose a disruptive challenge to many traditional industries. To the extent that this disruption occurs, it is often made possible by inefficient regulation of the traditional industry that serves to limit supply and raise prices. Disruption, whether in the form of deregulation of traditional suppliers, or their replacement by new ones, increases social welfare and should be welcomed.

Platforms as part of the Digital Single Market Strategy

6. Is the European Commission right to be concerned about online platforms? Will other initiatives in the Digital Single Market Strategy have a positive or negative impact on online platforms?

ITIF strongly believes that the degree of concern regarding online platforms is overdone. Regulators already have sufficient powers to deal with any actual problems that arise regarding market competition and data practices. Although platforms often highlight the need to update labor laws for the modern economy, this need goes well beyond Internet companies: the workplace of the future will have to be more flexible, more diversified, and more unstructured. The EC is correct to wonder why a large portion of platforms are American, but this points to problems in the European Union's (EU) approach to the Internet, and economic disruption and its lack of a more integrated digital market. ITIF also questions that the general assumption

that online platforms will capture most of the value created by their use. Although many platforms have high market valuations, we think it is more likely that much of the value will go to consumers or to suppliers that offer exceptional value at low prices. Because of their need to balance different sides of a market, in the medium-run many platforms are likely to have difficulty generating above average returns on capital.

Section 2: Competition, data, collaborative economy

Competition and dominance

7. Is there evidence that some online platforms have excessive market power? Do they abuse this power? If so, how does this happen and how does it affect you or others?

There is little evidence that online platforms have excessive market power. Some are growing very rapidly, but this is because they offer a unique service that users find valuable. Platforms are attracting an increasing amount of academic interest. The consensus so far is that platforms pose unique problems for traditional antitrust analysis. Although regulators have sufficient power to deal with any actual threats to competition, traditional antitrust analysis does not always point to the right answers. In particular, pricing below marginal cost, tying arrangements, and high profit margins on some users, all of which normally signal possible abuse of market power, can often increase the social value generated by a platform. Regulators need to look carefully at how the specific market works and the platform's role in it. They also need to consider the costs and benefits posed to all sides of the market, not just the side directly affected by a company's actions. And finally regulators should be focused on end results of innovation, productivity and consumer welfare, not on the welfare of intermediate businesses.

ITIF thinks that platforms usually face significant competition. Although few companies might duplicate a platform's specific market role, many platforms differentiate their offerings in order to compete in specific parts of a market. Platforms that rely on advertising for a significant portion of their revenues compete not only with each other but also with offline media such as television and direct mail. The advertisers using them often use sophisticated software to allocate spending over a broad range of outlets. Traditional industries continue to compete. Finally, due to the dynamic nature of computer and telecommunications technology, platforms always face the threat of disruptive competition. This forces them to constantly innovate.

8. Online platforms often provide free services to consumers, operate in two- or multisided markets, and can operate in many different markets and across geographic borders. Is European competition law able adequately to address abuse by online platforms? What changes, if any, are required?

European competition law is more than adequate to address any specific cases of actual (as opposed to theoretical) abuse by online platforms. The unique nature of online platforms will require regulators to change how they analyze potential problems, however. Standard measurements such as market size are less valuable for scale is incredibly valuable for most platform users (both sellers and buyers). Therefore a more comprehensive market analysis is usually needed.

Collection and use of data

9. What role do data play in the business model of online platforms? How are data gathered, stored and used by online platforms and what control and access do consumers have to data concerning them? Data can play a large role in the value that a platform generates. Data can help the platform do a better job of matching users on different sides of the market, reducing searching times. The collection and storage of data can also save repeat users a great deal of time by eliminating the need to reenter information each time the service is used.

To date consumers often have little control or access to the data that concern them, other than the decision to use the platform and to enter the data in the first place. Usage is often governed by Terms of Use that all users agree to, few read, and none understand. ITIF believes that most users are not concerned about what data platforms have about them. They are concerned about how this data will be used, and they get very concerned whenever it is abused or made public. But platforms have very strong motivations to not abuse the trust their users place on them, for doing so can result in quite rapid loss of customers. Moreover, virtually all major platform companies already have very detailed privacy rules that govern their own actions, and a violation of those policies is something governments can use to bring action against any particular company. Finally it is important to remember that data has an economic value that accrues not just to the company but its users and to society as a whole and that overly stringent rules governing the collection and use of that data, however, appealing they are to certain privacy groups, will reduce overall economic welfare.

10. Is consumer and government understanding and oversight of the collection and use of data by online platforms sufficient? If not, why not? Will the proposed General Data Protection Regulation adequately address these concerns? Are further changes required and what should they be?

It is likely that the proposed General Data Protection Regulation will, if enacted and implemented, dramatically further reduce the competitiveness of the European digital economy (including the emerging and still contestable data innovation “industry”). For the proposed regulation will dramatically limit the ability of firms in Europe to use data to create value, including in areas of deep public concern like health care. There are clear ways to protect privacy and enable data innovation, but the proposed regulation does not find that balance.

11. Should online platforms have to explain the inferences of their data-driven algorithms, and should they be made accountable for them? If so, how?

Online platforms should not be held responsible for the indirect or unanticipated effects of their algorithms, especially when they do not use data regarding protected categories such as race or religion. In many cases platforms themselves do not know how the algorithms work. Rather the algorithms are designed to self-adapt in order to optimize certain criteria given data inputs that constantly change. Holding platforms responsible for unintended effects, measured after the fact would deter innovation and hurt users by making it harder to find good matches. Again, like privacy, platforms have significant motivations from consumers and users to ensure that algorithms are generally fair. However, it is important to note that the quest of “algorithmic

neutrality” is an impossible one. The very nature of algorithms means that some information will be included and other information not. But compared to the inherent and often hidden biases of human decision making, policy makers should look to algorithmic decision making with relief and hope.

The collaborative economy

12. Can you describe the challenges that the collaborative economy brings? What possible solutions, regulatory or otherwise, do you propose?

The most important challenge is the fact that most users in the collaborative and sharing economy are initially strangers to each other and usually anticipate only dealing with each other once. This creates problems regarding security, reliability, and enforcement. Most platforms have successfully dealt with these problems through a combination of screening users and allowing users to rate each other. The later has created a real-time system of monitoring reputation and behavior that is often more effective than regulatory supervision.

The current regulatory environment and possible interventions

13. How are online platforms regulated at present? What are the main barriers to their growth in the UK and EU, compared to other countries?

Platforms are already regulated by market competition and public reputation as well as by existing regulations and laws governing all businesses (e.g. competition policy, privacy regulations, etc.). It is appropriate that online platforms currently face little additional targeted regulation. There are four main barriers to platform growth, especially in the EU. The first is technological sophistication. Platforms use new technology and involve users in new ways of doing things. This can often present a psychological hurdle, especially for older citizens. Younger generations seem to adopt the technology rapidly, however. Second, European governments have often been much more hostile to platforms, especially when they threaten to disrupt the regulation of traditional industries. Regulators also seem to be much more concerned about the anticompetitive effects of American platforms, operating on the belief that they will end up capturing most of the value from market transactions. Third, European labor laws do not always support the flexible nature of much platform work. Finally, the platform economy is a manifestation of a deeper and more profound change in advanced economies – a shift from firms to networks as the primary generators of wealth and progress. As such Europe with its still dominant focus on firms, rather than networks, has shown a suspicion of platform networks as challenging to the current firm-based system.

14. Should online platforms be more transparent about how they work? If so, how?

Some platforms should be more transparent about how they use and protect sensitive data. They should also be required to immediately notify users of any breach of sensitive data. But platforms should not be required to disclose their algorithms. Platforms already face the constant threat of technological obsolescence from new innovations. The disclosure of algorithms would expose a platform’s most sensitive trade secrets, allowing others to copy it. This in turn would deter companies from constantly trying to improve their performance.

15. What regulatory changes, if any, do you suggest in relation to online platforms? Why are they required and how would they work in practice? What would be the risks and benefits of these changes? Would the changes apply equally to all online platforms, regardless of type or size?

At the moment, ITIF does not advocate any additional regulation with the possible exception of modernizing labor laws to allow an increased use of part-time workers on flexible schedules. Any new regulations should be narrowly tailored to deal with specific problems as they occur.

16. Are these issues best dealt with at EU or member state level?

Most Internet policy should be at higher levels of government since the Internet is by its very nature cross border. This means that the EU should increasingly preempt national governments, especially in areas of wireless policy, consumer protection and other areas. The Union's promise as a large market that attracts constant investment and innovation is closely linked to the absence of transactions costs imposed by crossing national boundaries. The presence of several different, and possibly conflicting, regulatory regimes would add unnecessary cost by reducing competition between platforms in different countries, reducing economies of scale, and increasing the cost of compliance. Of course, these benefits of a harmonized EU-wide regulatory system will only be welfare maximizing if the EU crafts the right regulatory system. Its proposed General Data Privacy regulation points to the risk of how Europe could get it wrong, by getting uniform regulation, but regulation that would be extremely damaging to European productivity and innovation.

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