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COMMENTS OF ITIF

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PROMOTING INNOVATION IN THE ANGLOSPHERE: WHY THE DMCC IS THE WRONG PATH FORWARD

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INTRODUCTION

In September 2018, the UK government, led by then Prime Minister Theresa May, sought to proactively address concerns arising from digital markets.[1] The government commissioned an independent review by the Digital Competition Expert Panel, chaired by Professor Jason Furman, a U.S. economist and former Chair of the Council of Economic Affairs (CEA) under President Obama.[2] The Panel evaluated the potential opportunities and challenges of the emerging digital economy on competition policy, made recommendations and issued a report published in March 2019 titled "Unlocking Digital Competition: A Roadmap for Reform,"[3] which came to be known as the "Furman Report."

The Digital Markets, Competition and Consumers Bill (DMCC, the Bill)[4] is the result. The DMCC intends to create "a new regime to increase competition in digital markets by conferring powers and duties on the Competition and Markets Authority (CMA) to regulate competition in these markets; updates powers to investigate and enforce competition law; updates and enhances powers to investigate and enforce consumer protection law and resolve consumer disputes; and gives consumers protections in respect of unfair commercial practices, subscription traps and prepayments to savings schemes."[5] The Bill ambitously intends

[1] Press Release, HM Treasury and The Rt Hon Philip Hammond, *Work kicks-off to examine digital competition in UK* (19 Sept. 2018), https://www/gov.uk/government/news/works-kicks-off-to-examine-digital-competition-in-uk.

[2] Ibid.

[3] Digital Competition Expert Panel: *Unlocking Digital Competition (Furman Report)*, (London, The United Kingdom, March 2019), https://assets.publishing.service.gov.uk/media/5c88150ee5274a230219c35f/unlocking_digital_competition_furman_ review_web.pdf.

[4] Digital Markets, Competition and Consumers Bill, HL Bill 12—EN, Originated in the House of Commons, Sessions 2022-23, 2023-24.

[5] Department for Business and Trade and the Department for Science, Innovation and Technology (The United Kingdom): *Digital Markets, Competition and Consumers Bill Explanatory Notes* (The Explanatory Notes relate to the Digital Markets, Competition and Consumers Bill as brought from the House of Commons on 22 November 2023), https://bills.parliament.uk/publications/53111/documents/4050.

not just to modernize the Competition Act[6] and the Enterprise Act[7], the main sources of the post-Brexit British competition law, but specifically address perceived issues with technology markets.

The Furman Report and the broader progressive economic thinking it represents are not the only overseas influences that appear to be motivating the DMCC. Indeed, although one of the proferred reasons for Brexit was to "take back control" over governing the UK's economic, political and social issues, the DMCC is not a model of a "legislative independence" from the European Union (EU). On the contrary, notwithstanding some important differences, the Bill bears a considerable resemblance to the EU's Digital Markets Act (DMA),[8] and thus the very sort of heavy-handed regulation that will hinder Britain's ability to remain a technology leader into the 21st century.

The Schumpeter Project on Competition Policy of the Information Technology and Innovation Foundation (ITIF), the world's leading think tank for science and technology policy, appreciates the opportunity to comment on the Bill, and specifically to discuss its problems with respect to promoting innovation. ITIF's comment proceeds in five parts.

First, regulation in the digital sector should be necessary to remedy market failure, which does not appear to exist in the UK. On the contrary, its digital sector is growing. And, even though market failures may justify regulatory intervention if the latter results in outcomes superior to non-regulation, regulation should still be commensurate with the severity of the market failure and avoid resulting in unintended consequences, such as stifling the very innovation the regulation seeks to promote.

Second, even if the Bill could be facially justified as a response to market failure, the DMCC targets corporations with Strategic Market Status (SMS) in an unsatisfactory way. It also contemplates an *ad hoc* regime for individualized obligations by empowering the CMA to adopt codes of conduct for SMS-firms that—like the EU's DMA—are substantially out of step with sound legal and economic principles for promoting innovation and are likely to chill procompetitive behavior.[9] Complementing this *ex-ante* regime, the DMCC also introduces a wide range of *ex post* Pro-Competitive Interventions (PCIs) enforced by the CMA that are also likely to prove highly challenging in practice.

Third, the Bill not only risks serious procedural overreaches by blending regulatory and enforcement powers in the CMA with seemingly little checks on its power, but appears to stand in tension with Britain's larger post-Brexit strategy.

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[6] Competition Act of 1998, The United Kingdom (1998), https://www.legislation.gov.uk/ukpga/1998/41/contents.

[7] Enterprise Act 2002, The United Kingdom (2002), https://www.legislation.gov.uk/ukpga/2002/40/contents.

[8] Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act), Official Journal (OJ), L 265/1., L_2022265EN.01000101.xml (europa.eu).

[9] Aurelien Portuese: The Digital Markets Act Is "Bad Economics and Bad Law," news release, September 14, 2022, https://itif.org/publications/2022/09/14/the-digital-markets-act-is-bad-economics-and-bad-law-says-itif/.

Fourth, ITIF recommends that the UK Parliament consider stepping back from following both a cadre of progressive economists in the U.S. and the EU's experimental DMA regime and, assess the latter's effects, and allow its own digital markets to prosper.[10]

A brief conclusion follows.

THE DMCC IS UNNECESSARY

As a general matter, *ex ante* regulation should be a response to market failure. But the UK's digital ecosystem does not appear to currently exhibit any such signs. On the contrary, its digital market is a vibrant and rapidly growing sector. The digital economy (narrowly defined) and digital products affected by digitisation (a broader definition) have constituted approximately 4.7% and 21.2% of the UK economy since 2016, respectively.[11] The most core segments of the digital sector are: Artificial Intelligence (AI), Robotics and Autonomous Systems (RAS), Fintech and Cyber Security. AI is of course particularly crucial going forward, with the UK home to over a third of Europe's AI startups and research citations per capita that soar above global benchmarks.[12] RAS promises a £3.5 billion economic impact by 2030, and £6.5 billion by 2035.[13] Cyber Security is even more substantial, generating £8.9 billion in 2020.[14] Fintech also flourishes in the UK, which ranks third worldwide for investment in this space, with over 1,600 firms generating £7 billion annually amidst a backdrop of 71% consumer adoption.[15] Moreover, the UK is also Europe's largest[16] data market, with many American companies playing significant roles.

These sectors intertwine to form a tapestry of innovation, solidifying the UK's position at the vandguard of global technology leadership.[17] Importantly, the UK's booming digital market is not just for tech giants: small and medium sized companies are also thriving on its open playing field. The growing digital sector is also a significant source of employment. Currently, the combined share of employment directly and indirectly

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[10] Aurelien Portuese: "The Digital Markets Act: A Triumph of Regulation Over Innovation", ITIF, 2022, https://itif.org/publications/2022/08/24/digital-markets-act-a-triumph-of-regulation-over-innovation/#_edn7.

Lilla Nora Kiss, "The United States' Tech Regulatory Dilemma—Through a Foreigner's Eyes", Digital Platforms and American Life: A Project by the American Enterprise Institute, 2023, https://platforms.aei.org/the-united-states-tech-regulatory-dilemma-through-a-foreigners-eyes/.

Aurelien Portuese, "*The Digital Markets Act: European Precautionary Antitrust*", ITIF, 2021, https://itif.org/publications/2021/05/24/digital-markets-act-european-precautionary-antitrust/.

[11] Office for National Statistics, UK Digital Economic Research, Overview of the digital economy, 2020, https://www.ons.gov.uk/economy/economicoutputandproductivity/output/articles/ukdigitaleconomicresearch/2020.

[12] Department of Business and Trade (The United Kingdom): Technology, https://www.great.gov.uk/international/content/investment/sectors/technology/.

[13] Ibid.

[14] Ibid.

[15] Ibid.

[16] Department for Digital, Culture, Media and Sport (The United Kingdom): "Policy Paper – National Data Strategy", December 9, 2020, https://www.gov.uk/government/publications/uk-national-data-strategy/national-data-strategy.

[17] Department of Business and Trade (The United Kingdom): Technology, https://www.great.gov.uk/international/content/investment/sectors/technology/.

related to the digital economy is about 1 in 8 jobs.[18] Moreover, by 2025, it is estimated that there would be 678,100 jobs in the United Kingdom's digital sector.[19]

To be sure, the "Explanatory Notes" to the DMCC Bill allege "the unprecedented market power, in relation to certain digital activities, of a small number of businesses, is holding back innovation and growth."[20] However, the growth figures noted above strongly suggest an alternative explanation to market failure, indicating that the Bill is likely addressing a non-existent problem and risks creating a regulatory regime littered with false positives that could significantly harm not just large tech players, but smaller businesses, in part by disrupting the crucial complementarities that currently exist between them and larger players.

Importantly, the existence of market power does not by itself indicate that market failure exists. Since the groundbreaking work of Joseph Schumpeter in the 1940s, it has long been understood that competition is not merely, as neoclassical economics holds, an equilibrium where price equals marginal cost. Nor is it simply, as Adam Smith imagined, a rivalry between many sellers in a market. Rather, as Schumpeter explained, innovation or dynamic competition occurs through "gales of creative destruction"[21] whereby firms compete *for* the market by creating a new product, only to be challenged by additional "leapfrog competition" that supplants the formerly dominant firm with a still newer product that not just dazzles consumers but allows for the firm to recoup the costs of its innovation.

Moreover, even if market failure exists, regulation is not necessarily a preferable solution relative to non-regulation and the enforcement of the UK's robust competition laws. The digital market in the UK is already policed by a variety of actors, including a Digital Markets Unit (DMU) established within the CMA to operationalise the future pro-competition regime for digital markets. Of course, the Explanatory Notes declare that "[e]xisting competition and consumer laws are not designed to address the unique barriers to competition in digital markets. In response, this Bill establishes a new regime that is designed to boost competition in digital markets."[22] However, issues with existing competition laws does not imply that broad, preemptive regulations will be superior, and may instead chill the very innovation, Schumpeterian "creative destruction," and dynamic competition that are typically the best remedy for market failure.

SUBSTANTIVE ISSUES

Even if regulation was justified as a response to market failure, the specific regulatory regime proposed by the DMCC raises several core substantive concerns.

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[18] Scott Corfe and Jonathan Dupont (CCIA Research Center): "State of the UK Digital Economy", 2024, https://research.ccianet.org/wp-content/uploads/2024/01/CCIA_State-of-the-UK-Digital-Economy.pdf#:~:text=The%20combined%20share%20of%20employment%20directly%20and%20indirectly,data%20from%20the%20Business%20Register%20and%20Employment%20Survey.

[19] Statista Research Department: "Number of additional jobs in the digital sector in the United Kingdom in 2025, by region (in 1,000s)", October 11, 2023, https://www.statista.com/statistics/1295643/number-of-jobs-in-digital-sector-by-region-uk/.

[20] DMCC Explanatory Notes, ibid., p. 14.

[21] Joseph A. Schumpeter: *Capitalism, Socialism, and Democracy,* 81 (1942), Routledge.

[22] DMCC Explanatory Notes, p.13., point 4.

Strategic Market Status

First, aspects of the Bill's criteria for determing Strategic Market Status (SMS) could be improved. To fall under the DMCC, a firm must have "substantial and entrenched market power" and a position of "strategic significance." But the criteria for "substantial and entrenched market power" and "strategic significance" are only weakly defined in the DMCC—leaving room for subjective interpretation by the CMA and ultimately inconsistent application. This comes at the expense of the legal certainty firms need to evaluate the legal risk associated with their activities and engage in sound regulatory compliance.

Additionally, the CMA is expected to carry out a "forward-looking assessment" to foresee future developments which could stifle innovation—all while allocating unprecedented power to the CMA. In particular, focusing on the designated company rather than the wider market can further discourage potential market actors from procompetitive entry. To make matters worse, relying mainly on market share as the key metric to determine market power is bound to be overly inclusive: firms with a high digital market share may ultimately lack market power.[23] Indeed, an overly broad application of the SMS concept risks discouraging competition by imposing unnecessary regulation on non-dominant players, and as a consequence, stifling innovation on the UK's digital market and beyond.

The SMS's "turnover condition" is clearly designed to limit the application of DMCC, but unfortunately does little to remedy the problem of conflating size with market power. According to this criterion, firms with a global turnover exceeding £25 billion or a UK turnover exceeding £1 billion fall within the scope of the SMS designation. However, whereas the EU designed six corporations (Alphabet, Amazon, Apple, ByteDance, Meta, Microsoft) as gatekeepers,[24] there will still likely be many more firms falling under, and thus subject to the costs of, the DMCC. Indeed, the Bill's turnover condition allows for expansion of the designated firms during enforcement, as the CMA can revisit the threshold and apply it to additional companies based on its own discretion, creating uncertainty for businesses. In fact, unlike the DMCC, the DMA at least has the virtue of providing a definition of the firms it applies to that cannot be so flexibly opened expanded.

General Conduct Requirements and Codes of Conducts

While both the DMCC and the EU's DMA aim to tackle the dominance of large tech platforms, their approaches to regulating conduct differ significantly. Whereas the EU sets forth a clear list of *per se* bans for designated gatekeepers (self-preferencing, bundling, profiling, etc.), the DMCC takes a more "discretionary" approach, requiring the CMA's Digital Markets Unit (DMU) to craft individual "codes of conduct" for each and every SMS firm.

To be sure, the DMA's *per se* bans are generally bad and prohibit conduct that is usually pro-competitive. As digital markets are dynamic and rapidly evolving, an *ex ante*, one-size-fits-all approach of *per se* bans will

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[23] *See, e.g.*, Nicolas Petit: *Big Tech and the Digital Economy: The Moligopoly Scenario*, (Oxford: Oxford Academic, 2020), November 19, 2020, https://doi.org/10.1093/oso/9780198837701.001.0001, accessed 18 Jan. 2024.

[24] European Commission, list of designated gatekeepers, September 6, 2023, https://digital-markets-act.ec.europa.eu/gatekeepers_en#:~:text=Gatekeepers%20On%206%20September%202023%20the%20European%20Commission,services%20provided%20by%20those%20gatekeepers%20have%20been%20designated.

hinder efficient market mechanisms. Self-preferencing is a good example. Platforms widely use self-preferencing not just to integrate their products in a way that adds value for consumers, but to recoup investments in research and development.[25] It is widespread in the digital economy. Another example is "gatekeeping," which can prevent substandard products or services from entering an ecosystem, benefiting consumers and protecting the products meeting the standards. For example, app stores like Google Play and Apple's App Store vet apps to ensure they meet certain security and functionality requirements, such that prohibiting these activities would undermine core platform functionalities that protect and serve consumers.

Although the UK's individualized approach might seem more flexible and tailored compared to the DMA, there is of course no guarantee that regulation will not involve the sort of *per se* bans in the DMA which limit the very innovation that drives long-run consumer welfare and productivity growth. But there is also another fundamental issue: regulation should be of markets, not firms. Having firms face different obligations makes a regulatory regime unpredictable and comes at the expense of legal certainty and transparency. Invariably, the codes of conduct will be seen as discriminatory and picking winners and losers. Indeed, this concern may be further amplified by the CMA's already stretched capacity: with its workload constantly increasing under existing laws following Brexit, overextending itself through individualized regulation is a recipe for a discretionary, ineffective approach. A clear framework grounded in market-wide evidence is crucial to avoid regulatory overreach and ensure both fairness and predictability.

Pro-Competitive Interventions

The Bill also proposes a broad scope for *ex post* conduct regulation in the form of specific behavioral and structural measures known as "Pro-Competitive Interventions (PCIs)." While the code of conduct is intended "to prevent SMS firms being able to take advantage of their powerful positions in the activities that give rise to their SMS designation, PCIs seek to address the root cause of market power."[26] Such an approach is troubling. First, the PCI provisions further extend the already broad authority of the CMA. Discretionary authority for the CMA to define and implement PCIs based on its own assessment of competitive effects without specifying a market to frame evidence assessment—as currently required—grants significant power to the agency, especially when taken in conjunction with its other powers.[27] Such discretionary power accompanied with a seeming lack of transparency requirements risks leading to inconsistencies in interpretation and enforcement which, in the end, undermine due process.

Secondly, the definition of "Pro-Competitive Intervention" is overly broad and appears to lack any specific thresholds for triggering PCIs. In particular, the CMA can impose a wide range of PCIs (personal data mobility, interoperability, data access, etc.) which leaves firms operating in a state of constant uncertainty—waiting for *ad hoc* adverse judgements from the CMA. Indeed, the options available to the DMU with regard

[25] Trelysa Long: "History Shows How Private Labels and Self-Preferencing Help Consumers", November 30, 2022, https://itif.org/publications/2022/11/30/history-shows-how-private-labels-and-self-preferencing-help-consumers/.

[26] UK Government Service: Appendix D: The SMS regime: pro-competitive interventions, The purpose of pro-competitive interventions, p.2. https://assets.publishing.service.gov.uk/media/5fce70118fa8f54d58640c7f/Appendix_D_-_The_pro-competition_interventions_.pdf.

[27] Stephen Dnes and Fred de Fossard: "The Digital Markets, Competition and Consumers Bill: How to protect prosperity and innovation in the digital economy", Legatum Institute, 2023., p.42, https://li.com/wp-content/uploads/2023/12/4543_LI_DMCC_Main_AW-Web.pdf.

to PCIs are practically endless, and here again the flexibility afforded by PCIs would entitle the CMA substantial freedom compared to the European Commission to engage in market interventions. As a result, PCIs not only make it difficult for firms to plan their business strategies and comply with regulations but are a formula for disproportionately burdening certain market players without any transparent upfront basis.

Thirdly, and accordingly, the PCIs impact on innovation and competitiveness is at best indeterminate, but very likely harmful. Specifically, the review procedures do not appear to include any requirement to benchmark the PCIs with respect to innovation, but only countenance consideration of competitive effects in a general sense.[28] Against such uncertainty, businesses will be dissuaded from making investments and engaging in innovative behavior, with certain practices likely to be deemed anticompetitive by the CMA *ex post* despite offering benefits in terms of dynamic efficiency and consumer choice. The chilling effect of the DMCC's vague PCI policy thus threatens to stall innovation and competition—sacrificing real consumer benefits for uncertain and unproven benefits.

STRUCTURAL CONCERNS

Another important feature of the Bill is that it supports the combination of powers instead of the separation of powers by giving the CMA unprecedented competences and discretionary authority. In so doing, the Bill greatly blurs the lines between regulation and law enforcement, creating a tension with the separation of powers principles that are essential to healthy democratic systems. This concentration of authority in the CMA's hands adds to concerns surrounding transparency and accountability, making it difficult to both understand how decisions are made as well as hold the agency responsible for its actions.

Additionally, the centralization of power in the CMA raises the spectre of regulatory capture—yet another unintended consequence of well intentioned regulation. That is, the close and dependent relationship between the CMA and regulated industries exacerbates concerns about disparate treatment, including potentially favoring established players over new entrants. For example, the Bill will allow the CMA to order regualted companies to generate information which would then be assessed by an industry-funded expert.

THE DMCC IN GLOBAL CONTEXT

One can also examine the DMCC in the broader context of the post-Brexit strategy for Britain's political economy. The Brexit campaign promised that Britain would "take back control" of its economic future and align itself within the the vales of a broader Anglosphere, rather than those of the EU. One vision for this post-EU future was a "Silicon Valley on the Thames," whereby Britain would follow the American approach to innovation that gave rise to the large technology companies that are the envy of the world—ensuring its place as a technological leader in the 21st century. There is no reason why the UK should not aspire to drive successive waves of innovation, and the U.S. framework has proven to be markedly more successful at promoting technological growth than the EU model. As we have seen, however, the DMCC clearly follows the European model of regulation, not the American model of innovation. As such, the DMCC appears to paradoxically reflect the importation of the very sort of regulatory policies Brexit was a reation against.

[28] Ibid., pp. 42–43.

Unsurprisingly, the DMCC also appears poised to follow the EU's approach of targeting American technology companies, rather than creating a regulatory environment for developing local digital champions as part of the next wave of Schumpeterian competition. Indeed, these American firms, which have driven so much innovation and technological progress over the past several decades, are increasingly facing overbearing regulatory costs from the proliferation of DMA like policies around the world. This forces them to scale back their operations in countries that take the path of digital regulation, constituting self-inflicted harm to a local economy. There are also significant lost complementarities, such as specialization in finance in the UK serving technology businesses overseas. Moreover, in the context of the rivalry between the U.S. and China, overburdensome regulation by America's closest allies clearly sends the wrong signals, especially concerning the special relationship between the U.S. and the UK as part of a broader and united Anglosphere.

RECOMMENDATIONS

ITIF recommends the UK Parliament strongly consider stepping back from following the model set by the EU's experimental DMA regime and at least take a wait and see approach to analyze its effects before embarking on a policy that will take it into unchartered waters and, for the reasons discussed, risk doing tremendous harm to Britain's economy.

- Strategic Market Status: The current definitions of "substantial and entrenched power" and "strategic significance" lack sufficient clarity and reflect a narrow focus on the activities of the designated firms in lieu of a wholistic view of the wider market. The current turnover condition is not a corrective, but rather creates additional uncertainty.

- Conduct Requirements: The DMCC's *ad hoc* approach to conduct requirements is likely to do more harm than good. Although general *per se* bans are an errant approach, individualized rules raise other serious issues—a rulebook that applies to just one company. The result will likely be discriminatory burdens introduced arbitrarily by an overly empowered agency—sacrificing legal certainty, transparency, and a balanced regulatory environment.

- Pro-Competitive Interventions: The PCIs are also problematic. Interventions should be based on a nuanced understanding of the potential benefits of certain targeted—and perhaps most often pro-competitive—practices by requiring full assessment of consumer impact at least if it is available, as is undertaken with Enterprise Act investigations. Moreover, the CMA's interventions should be proportional and generally applicable, focusing on bad behavior and not simply large firms.

CONCLUSION

The DMCC comes at a time when the UK is at a crossroads. Westminster has a great opportunity to "take back control" over its digital market and avoid being tethered to the EU's path of punishing companies through overbearing European-style regulation. The DMCC, in its current form, unfortunately does exactly the opposite. Instead of enforcing existing competition laws and investing in its digital industries to promote innovation and healthy dynamic competition in the UK, the DMCC offers an overly broad and likely harmful solution to unproven problems. Westminster should avoid repeating the mistakes of other jurisdictions by creating a digital landscape where innovation and competition wither under the shadow of an

unchecked regulator, and instead foster a vibrant and competitive digital ecosystem that benefits both businesses and consumers—ensuring the UK remains at the forefront of the digital revolution.

Thank you for your consideration.

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