



06/2018 DIGITAL CAPITALISM – HOW TO TAME THE PLATFORM JUGGERNAUTS

AT A GLANCE

Large digital platforms have become so powerful and pervasive that governments face a stark choice: they can either assert sovereignty in the digital sphere, or cede it to powerful corporate executives. These platforms are no longer mere market participants, but are defining how markets operate. Left unchecked, they will be the de facto sovereigns of the 21st century. Properly regulated or broken up, they can help spur inclusive prosperity.

What new challenges to governance are posed by digital capitalism? The strategies of its largest, most successful firms suggest one answer. They tend to serve as platforms, ranking and rating other entities rather than directly providing goods and services. This strategy enables the platform to outsource risk to vendors and consumers, while it reliably collects a cut from each transaction. Just as a financial intermediary may profit from transaction fees, regardless of whether particular investments soar or sour, the platform pockets revenues on the front end, regardless of the quality of the relationships it brokers.

FROM PARTICIPATING TO RULING THE MARKET

This intermediary role creates numerous opportunities for platforms. For example, they police transactions and adjudicate disputes that used to be the preserve of governments. I call this powerful new role of platforms “functional sovereignty,” to denote the level of power a private firm reaches when it is no longer one of many market participants, but instead, the main supervisor and organizer of actual market participants.

Platforms have an interest in intensively monitoring and shaping certain digital spheres in order to maximize their profits (and, secondarily, to maintain their own reputations). However, in their ceaseless quest to annex ever more sectors into their own ecosystems, they all too often bite off more

than they can chew. They tend to overestimate the power of automation to process all the demands that modern marketplaces generate. This has led to another problem, familiar from the history of monopolistic enterprise: absentee ownership. When a massive firm buys a store thousands of miles away from its headquarters, it owns the store, and will seek profit from it, but it may only assess its performance in crude terms, with little interest in the community in which the store is embedded. The store may neglect traditional functions it served, simply in order to maximize the revenues that its absentee owner demands. A present owner, resident in the community, is more likely to run the store in a way that comports with community interests and values, since the present owner will itself experience any improvement or deterioration the store causes in its community. The same dynamics emerge online. Google owns the largest collection of videos online, but its YouTube subsidiary’s profitability depends on calculated neglect of many aspects of the platform.

There is ongoing struggle over what responsibilities the domination of an online space should entail. At the very least, a de facto sovereign entity should observe certain basic types of responsibility. This tension between functional sovereignty and absentee ownership clarifies key political struggles over the degree to which internet firms should organize online life. Investors demand a fantasy of monopolization: their firm not merely occupying a field, but developing “moats” against entrants, to guarantee both present returns and future growth. However, the day-to-day reality of operational budget constraints pushes the same firms toward the pathologies of absentee ownership.

Law can help resolve these tensions. Competition laws take aim at functional sovereignty, reducing the stakes of a firm’s domination of a field. Utility-style regulation mitigates

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the worst failures of absentee owners. Each counters the untrammelled aspirations (and disappointing quotidian reality) of these stalwarts of digital capitalism.

CREATING AND EXPLOITING A GOVERNANCE VACUUM

Economists tend to characterize the scope of regulation as a simple matter of expanding or contracting state power. But a political economy perspective emphasizes that social relations abhor a power vacuum. When state authority contracts, private parties fill the gap. That power can feel just as oppressive, and have effects just as pervasive, as garden variety administrative agency enforcement of civil law. As the great legal realist Robert Lee Hale stated, “There is government whenever one person or group can tell others what they must do and when those others have to obey or suffer a penalty.” (Hale 1952)

We are familiar with that power in employer-employee relationships, or when a massive firm extracts concessions from suppliers (Anderson 2017). But what about when a firm presumes to exercise juridical power, not as a party to a conflict, but the authority deciding it? I worry that such scenarios will become common as massive digital platforms exercise more power over our commercial lives (Srnicek 2017; Scholz/Schneider 2017). They are no longer merely one of many market participants. Rather, in their fields, they are market makers, able to exert regulatory control over the terms on which others can sell goods and services. Moreover, they aspire to displace more government roles over time, replacing the logic of territorial sovereignty with functional sovereignty. In functional arenas from room-letting to transportation to commerce, persons will be increasingly subject to corporate, rather than democratic, control.

For example: Who needs city housing regulators when AirBnB can use data-driven methods to effectively regulate room-letting, then house-letting, and eventually urban planning generally? (Kuang 2.08.2016) Some vanguardists of functional sovereignty believe online rating systems could replace many forms of state occupational licensure – so rather than having government boards credential workers, a platform like LinkedIn could collect ratings on them (Vaheesan/Pasquale 2018).¹

This shift from territorial to functional sovereignty is creating a new digital political economy. Amazon’s rise is instructive, and the dilemmas it poses are likely to be re-created, albeit in smaller ways, as other platforms try to take over spheres of commerce. As Lina Khan (2017: 567) explains, Amazon “has positioned itself at the center of e-commerce and now serves as essential infrastructure for a host of other businesses that depend upon it.” The “everything store” may seem like just another service in the economy – a virtual mall. But when a firm combines tens of millions of customers with a “marketing platform, a delivery and logistics network, a payment service, a credit lender, an auction house...a hardware manufacturer, and a leading host of cloud server space,” as Khan observes, it’s not just another shopping option.

Digital political economy helps us understand how platforms accumulate power. Amazon’s dominance has exhibited how network effects can be self-reinforcing. The more merchants there are selling on (or to) Amazon, the better shoppers can be assured that they are searching all possible vendors. The more shoppers there are, the more vendors consider Amazon a “must-have” venue. As crowds build on either side of the platform, the middleman becomes ever more indispensable. Oh, sure, a new platform can enter the market – but until it gets access to the 480 million items Amazon sells (often at deep discounts), why should the median consumer defect to it? If I want garbage bags, and I am already an Amazon user, do I really want to go over to the Target website to re-enter all my credit card details, create a new log-in, read the small print about shipping, and hope that this retailer can negotiate a better deal with the manufacturer? Or do I want a predictive shopping purveyor that intimately knows my past purchase habits, with satisfaction just a click away?

PRIVATIZING JUDICIAL FUNCTIONS

As artificial intelligence improves, the tracking of shopping into the Amazon groove will tend to become ever more rational for both buyers and sellers. Like a path through a forest trod ever clearer of debris, it becomes the natural default. To examine just one of many centripetal forces sucking money, data, and commerce into online behemoths, play out game theoretically how the possibility of online conflict redounds in Amazon’s favor. If you have a problem with a merchant online, do you want to pursue it as a one-off buyer? Or as someone whose reputation has been established over dozens or hundreds of transactions – and someone who can credibly threaten to deny Amazon hundreds or thousands of dollars of revenue each year? The same goes for merchants: The more tribute they can pay to Amazon, the more likely they are to achieve visibility in search results and attention (and perhaps even favor) when disputes come up. What Bruce Schneier (26.11.2012) said about security is increasingly true of commerce online: You want to be in the good graces of one of the neo-feudal giants who bring order to a lawless realm. Yet few hesitate to think about exactly how the digital lords might use their data advantages against those they ostensibly protect (Ezrachi/Stucke 2016b).

Progressive legal thinkers are helping us grasp these dynamics. The market power of internet retailers can lead to a privatization of judicial functions. To avoid bureaucracy, it is rational for buyers to turn to Amazon rather than state agencies or courts to press their case if they feel cheated by a seller. Similarly, the more online buyers and sellers are relying on Amazon to do their bidding or settle their disputes, the less power they have relative to Amazon itself. They are less like arms-length transactors with the company, than they are like subjects of a despot, whose many roles include consumer and anti-fraud protection.

UNDERSTANDING THE BIGGER PICTURE

Solutions to Amazon's power will, no doubt, be hard to advance as a political matter – consumers like 2-day deliveries. But understanding the bigger picture here is a first step. Political economy clarifies the stakes of Amazon's increasing power over commerce. We are not simply addressing dyadic transactions of individual consumers and merchants. Data access asymmetries will disadvantage each of them (and advantage Amazon as the middleman) for years to come (Stucke/Grunes 29.05.2015). Nor can we consider that power imbalance in isolation from the way Amazon uses its lobbying power to avoid taxes and to pit cities against one another, as in the recent Amazon HQ2 competition. Mastery of political dynamics is just as important to the firm's success as any technical or business acumen. And only political organization can stop its functional sovereignties from further undermining the territorial governance at the heart of democracy (Mitchell/LaVecchia 2016).

The legal theorist K. Sabeel Rahman (2017) offers a theoretical framework to integrate antitrust and regulatory approaches in policy designed to curb excessive corporate power. His work draws not only on economics, but also on political science, sociology, and other disciplines – and shows what can be done when a more open and holistic approach to social science informs the academic analysis of corporate power. As Rahman relates, three broad categories of regulation can provide a "21st century framework for public utility regulation:"

- (1) [F]irewalling core necessities away from behaviors and practices that might contaminate the basic provision of these goods and services – including through structural limits on the corporate organization and form of firms that provide infrastructural goods;
- (2) [I]mposing public obligations on infrastructural firms, whether negative obligations to prevent discrimination or unfair disparities in prices, or positive obligations to proactively provide equal, affordable, and accessible services to under-served constituencies; and
- (3) [C]reating public options, state-chartered, cheaper, basic versions of these services that would offer an alternative to exploitative private control in markets otherwise immune to competitive pressures.

These three approaches have all helped increase the accountability of private power in the past. Cable firms cannot charge a customer a higher rate because they dislike her politics. Nor can they squeeze businesses that they want to purchase, charging higher and higher rates to an acquisition target until it relents. Nor should regulators look kindly on holding companies that would more ruthlessly financialize essential services.

The firewall strategy provides a useful approach to future merger reviews in the tech sector. A firm like Facebook may tout efficiencies from acquiring Instagram, WhatsApp, and any new social networking app on the horizon. With 360-degree surveillance of customers, ad-targeting will be better than ever. Yet the simple story of customers served

by optimal marketing has been dismantled by Ariel Ezrachi, Maurice Stucke, and many other scholars (Patterson 2017; Ezrachi/Stucke 2016a).² It is well past time for those writing about search engines to explore how to detect and deter abuses more rapidly, via utility regulation, rather than waiting for the years that the admittedly meritorious European Commission antitrust case against Google took to resolve (Pasquale 2017).

The European Commission has documented Google's abuse of its dominant position in shopping services. Subsequent remedial actions should provide many opportunities for the imposition of public obligations (such as commitments to display at least some non-Google-owned properties prominently in contested search engine results pages) and firewalling (which might involve stricter merger review when a megafirm makes yet another acquisition³). Similar action should be considered with respect to Amazon, or any platform, once it obtains a commanding position in a sphere of commerce intermediation.

REASSERTING THE POWER OF GOVERNMENT

Large internet platforms are now leveraging data advantage into profits, and profits into further domination of advertising markets. The dynamic is self-reinforcing: more data means providing better, more targeted services, which in turn attracts a larger customer base, which offers even more opportunities to collect data. Once a critical mass of users is locked in, the dominant platform can chisel away at both consumer and producer surplus. For example, under pressure from investors to decrease its operating losses, Uber has increased its cut from drivers' earnings and has price discriminated against certain riders based on algorithmic assessments of their ability and willingness to pay. The same model is now undermining Google's utility (as ads crowd out other information), and Facebook's privacy policies (which get more egregiously one-sided the more the social network's domination expands).

Beset by a rapidly consolidating economy and growing caseload, both competition authorities and judges face a confusing landscape of commentary on the power of massive digital firms. Some economists and business theorists see platform capitalists as powerful boons to consumers, forcing digital price wars among journalists, authors, livery drivers, hotels – and eventually, all laborers except those working at the key platforms. Others warn that, whatever short term gains these firms offer, their long-term effects are baleful (Pasquale 2016). Platform regulation calls for a cross-sector and interdisciplinary approach. An approach more open to the insights of social science generally – and not simply economics – can restore the purpose and power of government regulation of commerce in an era of digital capitalism.

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Notes on this publication

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Notes

- 1 – This has been mooted by the United States Federal Trade Commission's "Economic Liberty Task Force." The idea is critiqued in Vaheesan/Pasquale (2018).
- 2 – Patterson (2017) discusses issues of "unilateral control over information by individual firms" and how this may lead to manipulation of data by these firms; Ezrachi/Stucke (2016a) examine the effects of mass data collection and use of algorithms on antitrust law.
- 3 – See, e.g., List of Mergers and Acquisitions by Facebook, WIKIPEDIA, https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Facebook.

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