NATIONAL TAXPAYERS UNION FOUNDATION

Issue Brief

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Antitrust "Precrime:" What Regulators Can't Know Will Hurt You

One of the troublesome aspects of antitrust enforcement is that the very nature of regulating competition forces regulators to become prognosticators -- enforcers of competitive precrime. It is with this responsibility in mind that the modern legal framework for antitrust, the consumer welfare standard, attempts to tie antitrust enforcement to somewhat objective, data-driven demonstrations of likely harm to consumers. The easiest way to define this is in terms of lasting higher prices, but deceptive practices and likely harms to innovation are also among possible considerations.

Nevertheless, even a data-driven approach to antitrust still "involves a bit of prophesying."[1] That is risky because, as the saying goes, "it's tough to make predictions, especially about the future." It's especially tough for regulators to make predictions, swayed as they are by political pressures and public sentiments that may be detached from economic reality.

The resurgence of interest in more aggressive antitrust enforcement has been spearheaded by progressives of the so-called "neo-Brandeisian" school. These antitrust maximalists desire to remove the focus on benefits and harms to consumers and return to one

Key Facts:

Progressives wish to revert to old antitrust presumptions that concentrated market power inherently leads to future societal harms.

The history of government antitrust intervention in technology markets suggests regulators are terrible at predicting future innovation and creative destruction.

Keeping the focus of antitrust on demonstrable economic harms is a better way to protect both consumers and innovation.

[1] Adam Thierer and Trace Mitchell, "The Crystal Ball of Antitrust Regulators is Cracked," *National Review Online*, July 21, 2020. https://bit.ly/3anmp5h.

on market "structure." For example, current Federal Trade Commission (FTC) nominee Lina Khan calls for the "rehabilitation" of trustbusting, including "a strong prophylactic orientation against the concentration of private economic power."[2] This focus on the *process* of competition rather than its real world *effects* leads neo-Brandeisians to demand crackdowns on the most successful companies in order to prevent the rise of "big anything," even in the absence of demonstrable harm to consumers.[3]

Similarly, any time a new company manages to establish a strong position in a given market, reactionaries (usually joined loudly by the competing companies the newcomer has displaced) cry "monopoly" and call for releasing the dogs of antitrust. These frequent, periodic panics always seem to presume that *this* new market leader is going to be unstoppable, its sheer size rendering its dominance absolute, a phenomenon the Cato Institute's Ryan Bourne calls "monopoly fatalism."[4]

A good example of this fatalism can be seen in the tone of reporting drawn from leaked FTC documents pertaining to their 2012 antitrust investigation of Google, which the FTC ultimately chose not to pursue. An example is in "How Washington Fumbled the Future" from Politico, which laments a missed opportunity to kneecap Google in part because of regulators' misguided assumptions about the future impacts of technologies such as targeted online advertising.[5]

Lawyers love few things more than lawsuits, and government lawyers love nothing more than suits against household name companies. While the FTC's economic analysts were more circumspect, it should come as no surprise that its lawyers were eager to take Google on, arguing that the company's partnerships to have its search engine installed as the default on most mobile devices "foreclosed competing search providers from a significant part of the smartphone market."[6]

However, the documents show that FTC's economic team took a more measured approach, noting that nothing in Google's agreements with the mobile manufacturers prevented consumers from accessing a bevy of competing search apps. They pointed out that "changing the default search option on mobile browsers involves a few taps,"[7] which called into question whether any genuine harm to consumers could be demonstrated in court.

At the heart of the analysis that informed the FTC's commissioners is a series of prognostications that proved incorrect. The lawyers misunderstood the development of targeted advertising technologies that comprise more than half of digital ad spending today. The economists underestimated the massive growth in search via mobile phone, the channel through some 62 percent of searches is conducted.

And they all failed to predict the competition which has characterized the advertising market as a whole since the investigation concluded in 2012. Facebook had its initial public offering just months earlier and has since grown eight-fold. Amazon has made significant inroads in attracting ad spending, given that ads for shopping search results are some of the most lucrative.

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[2] Lina M. Khan, "The Ideological Roots of America's Market Power Problem," *Yale Law Journal Forum*, June 4, 2018. Khan continues, "...one reason the present antitrust framework fails to adequately address market power is that the law pegs liability to welfare *effects* rather than to the competitive *process*."

[3] This structuralist approach to competition assumes that market power is too dangerous to be countenanced even if not being leveraged actively. See Lina Khan, "Amazon's Antitrust Paradox," *Yale Law Journal Forum*, Vol. 123, No. 6, Jan 2017. Regarding the consumer welfare approach to antitrust, Khan writes "this approach equates harm entirely with whether a firm *chooses* to exercise its market power through price-based levers, while disregarding whether a firm has *developed* this power ... But allowing firms to amass market power makes it more difficult to meaningfully check that power when it is eventually exercised."

[4] Ryan Bourne, "Is This Time DIfferent? Schumpeter, the Tech Giants, and Monopoly Fatalism," Cato Institute Policy Analysis, No. 872, June 17, 2019. https://bit.ly/3dsrR8Y.

[5] Leah Nylen, "How Washington Fumbled the Future," *Politico*. Mar. 16, 2021. https://politi.co/3v0TRGS.

[6] Internal FTC memos leaked to Politico, pg. 10, "FTC lawyers' memo to commissioners," accessed Mar. 17, 2021. https://bit.ly/3alTKxr.

[7] Internal FTC memos leader to Politico, pg. 6, "FTC economics memo to commissioners," accessed Mar. 17, 2021. https://bit.ly/3alTKxr.

From a consumer welfare perspective, the FTC economists' reluctance to impose punishments based on its (wrong) guesses about the future represents a welcome level of humility on the part of a federal agency. As the Mercatus Center's Adam Thierer and Trace Mitchell have noted, this willingness to concede the limits of their predictive capability has been entirely too rare in the history of antitrust regulators.[8]

As Bourne observes, channeling the economist Joseph Schumpeter, not only is it "almost impossible to predict market evolutions or technological transformations," but basing competition policy on the conceit that we can predict these things can itself hamper disruptive innovation. "Extrapolation of the future based on the present," Bourne concludes, "could lead to wasteful lawsuits absorbing resources that could otherwise fund innovative products or product features."[9]

The rise of the digital economy, in particular, is littered with bold predictions about lasting monopolies that have aged poorly, thanks in no small part due to its relatively low barriers to entry. It's worth examining a couple of these in more detail to see what they reveal about the assumptions held by supporters of expanding antitrust.

Blockbuster

The video rental chain Blockbuster's annihilation is often invoked as the archetypal story of creative destruction via technology,[10] punctuated most recently by the production of a documentary about its demise by its innovative executioner, Netflix. No doubt, executives at the pioneering rental-by-mail turned digital streaming service found some brutal irony in the fact that they attempted to sell Netflix to Blockbuster for a mere $50 million in 2000.[11] At its height in the early 2000's, Blockbuster was valued at $5 billion. Netflix's market valuation as of March 2021 is over $224 billion.[12]

While it's amusing to think about the gravity of such a miss in retrospect, the FTC didn't see Netflix coming either. In 2005, Blockbuster attempted to negotiate a merger with its brick-and-mortar video rental rival, Hollywood Video. The proposed deal, valued at $1 billion, immediately caught the eye of the FTC, which demanded Blockbuster provide proof that the merger wouldn't violate antitrust laws.[13] Once subject to the FTC's raised eyebrow of disapproval, Blockbuster dropped their proposal.[14] Only five years later, Blockbuster was filing for bankruptcy.

The FTC was able to dissuade Blockbuster's acquisition of Hollywood Video largely on the assumption that their combined total retail market share (over 50 percent) would be insurmountable.[15] Even if a merged Blockbuster-Hollywood Video used its large market share in movie rentals to gouge consumers, as its detractors and competitors alleged it would, it could only exercise this supposed monopoly power within the realm of physical retail stores that rented out physical copies of movies.

Yet even in 2005, Blockbuster was already competing not only with other physical retail chains, but also Netflix's online rent-by-mail model, nascent online video streaming services, cable pay-per-view services, and Redbox's automated video rental kiosks.[16] It wasn't a particularly fiscally healthy company either, having failed to generate net profits since 1996. In fact, 2005 proved to be a tipping point year for

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[8] Thierer and Mitchell, *ibid*.
[9] Bourne, *ibid*.
[10] Mike D. Sykes II, "Netflix is releasing a documentary about the last Blockbuster and everyone pointed out how mean that is," USA Today, "For the Win," Mar. 11, 2021. https://bit.ly/3uSSxWq.
[11] Marc Randolph, "He 'Was Struggling Not To Laugh': Inside Netflix's Crazy, Doomed Meeting With Blockbuster," *Vanity Fair*, Sept. 17. 2019. https://bit.ly/3uZIsHd.
[12] Netlfix Market Cap, 2006-2020, MacroTrends, accessed Mar. 20, 2021. https://bit.ly/3tBkhic.
[13] Federal Trade Commission, "Summons in a Civil Action," Federal Trade Commission v. Blockbuster, Inc., Mar. 4, 2005. https://bit.ly/3v4pBKW.
[14] Mike Musrgrove, "Blockbuster Withdraws Hollywood Merger Bid," *The Seattle Times*, Mar. 26, 2005. https://bit.ly/3mXO1Df.
[15] Tom Zeller, Jr., "Blockbuster Ends Bid for Rival," *The New York Times*, Mar. 26, 2005. https://nyti.ms/3txOKgW.
[16] Frank Olito, "The Rise and Fall of Blockbuster," *Business Insider*, Aug. 20, 2020. https://bit.ly/3xfbB3h.

the company; its growth plateaued, and then plummeted after the 2008 financial crisis.[17] In other words, anything can look like a monopoly if you narrow the market enough, especially when considered as a single snapshot in time.

Given the combination of internal troubles and its retail model being overshadowed by innovation, there is no way to know whether the FTC's involvement in killing the Blockbuster/Hollywood merger changed the ultimate fate of those companies or their industry as a whole. It does, however, highlight the difficulty of accurately projecting future threats to consumers based on a snapshot of today's market.

Microsoft Internet Explorer

This year marks the 20th year anniversary of the U.S. Department of Justice (DoJ) reaching its decision in its landmark antitrust case against Microsoft. Although Microsoft's competitive practices had been under federal scrutiny for many years, the actual charges the government pursued to completion hinged on its packaging the Internet Explorer web browser along with its dominant Windows operating system for free.

In some respects, the DoJ's arguments against Microsoft's use of Internet Explorer were similar to those contemplated by the FTC's lawyers against Google in 2012. The agency contended that Microsoft was using the overwhelming dominance of its Windows operating system and Microsoft Office suite to force computer manufacturers to pre-load Internet Explorer as part of the operating system at no additional charge.

While nothing prevented Windows users from downloading Netscape or any other competing web browser, Netscape's business model was subscriber-based and could not withstand sudden competition from a competent free alternative built into the operating system. Netscape had pioneered making web browsing accessible to average consumers and reached an incredible 90 percent share of that market by 1996. By 2000, Internet Explorer had a 95 percent market share instead.[18]

This remarkable transformation was in progress as the DoJ filed its antitrust suit in 1998. One of their core justifications was that "continued competition on the merits between Netscape's Navigator and Microsoft's Internet Explorer would have resulted in greater innovation and the development of better products at lower prices."[19]

The DoJ's conclusion was that ultimately "the purpose and effect of Microsoft's conduct with respect to Internet browsers have been and, if not restrained, will be:

1. to preclude competition on the merits between Microsoft's browser and other browsers;
2. to preclude potential competition with Microsoft's operating system from competing browsers and from other companies and software whose use is facilitated by these browsers;
3. to extend Microsoft's Windows operating system monopoly to the Internet browser market; and
4. to maintain Microsoft's Windows operating system monopoly."[20]

In retrospect, the harm to Microsoft's immediate competitor Netscape was obviously real, but the presumptions the regulators made about the resulting barriers to future competition proved to be way off

[17] Ben Unglesbee, "Who really killed Blockbuster?" RetailDive, Oct. 7, 2019. https://bit.ly/2RMqzgP.
[18] John Naughton, "Netscape: The Web Browser that Came Back to Haunt Microsoft," *The Guardian*, Mar. 22, 2015. https://bit.ly/3dtSN8t.
[19] U.S. Dept. of Justice, "Complaint: U.S. v. Microsoft Corp.," Filed May 18, 1998. https://bit.ly/3du5zUe.
[20] *ibid*.

the mark. Though Internet Explorer had developed into a product that was in many respects superior to Netscape Navigator, once Microsoft had captured the PC internet browser market, its innovation stagnated. This stagnation presented an opportunity that Microsoft's many rising competitors did not miss. For all of its supposedly impregnable monopoly power, Microsoft couldn't stop users from using Internet Explorer to find and install competing browsers, and consumers did, in droves.

While Apple had signed an agreement to carry Internet Explorer as their default browser on their Macintosh computers, they also developed their own Safari browser and released it in 2003 for both PC and Mac products. Mozilla Firefox, ironically developed from the remnants of Netscape's Navigator, launched in 2004 and captured 31% of the desktop browser market by 2010. Meanwhile, Google's Chrome launched in 2008, and by 2014 its 48% market share was more than Firefox and Internet Explorer combined.[21]

Meanwhile, by the end of 2020, both Internet Explorer and its successor app, Microsoft Edge, barely combine for fifteen percent of the desktop browser market share, in spite of still being installed as defaults on every Windows device.[22]

For this unfortunate lack of foresight, Microsoft was nearly broken up, only avoiding structural separation after years of strict oversight, countless millions in legal fees, and a settlement with the government. It is difficult to say in hindsight that any appreciable consumer benefit resulted from the whole proceeding.

Conclusions: Those who don't learn from the mistakes of the past would like to regulate our future.

The cases of Blockbuster and Internet Explorer are just a few of many examples of "expert" regulators completely misjudging how a company's market dominance would affect consumers in the future. Indeed, in a free market, the moment in time when public cries of "monopoly!" are loudest is in retrospect often when a company is at or past its peak.

These cases also show the power that the FTC and DoJ have to enforce against presumptions of future harm even under the existing consumer welfare framework. Contrary to complaints that antitrust is constrained to only focus on prices, the government won the Microsoft case that largely "hinged on an innovation theory of harm," in spite of providing a product to consumers for free.[23]

The FTC's win rate in merger challenges remains incredibly high when they can muster a solid argument that the transaction would result in economic harms. This already gives regulators a great deal of power to conduct what Adam Thierer calls "regulation-by-raised-eyebrow,"[24] blocking transactions like the Blockbuster/Hollywood merger without even going through a full review.

While a successful antitrust enforcement by government regulators is easily seen, the potential benefits that go unrealized when their judgment errs is harder to quantify. The present balance in antitrust law accounts for this by placing the burden of proof on the government to demonstrate probable harms to consumers. This grants companies a measure of innocence until proven guilty,[25] and provides a more stable, predictable regulatory environment that encourages capital investment and innovation.

Antitrust hawks like would-be FTC Commissioner Lina Khan propose to flip this balance entirely. Because they presume that companies above a given size or market share obtain a level of power that is inherently harmful to society, advocates of this school of antitrust see the potential error rate of an aggressive, pre-

[21] "Desktop Browser Market Share Worldwide," GlobalStats statcounter, accessed Mar. 27, 2021 https://bit.ly/2QgRSiT.
[22] Gregg Keizer, "Top web browsers 2020: Edge makes double digits," *Computer World*, Nov. 2, 2020. https://bit.ly/3sB7lri.
[23] Sam Bowman, "The Consumer Welfare Standard: Bringing Objectivity to Antitrust," *ICLE tl;dr*, Feb., 2021. https://bit.ly/3xgYKxs.
[24] Adam Thierer, "The End of Permissionless Innovation?" The Technology Liberation Front Blog, Jan. 10, 2021. https://bit.ly/3mX819b.
[25] Ben Sperry, "The Dangerous Implications of Changing Antitrust Presumptions," Truth on the Market, Oct. 27, 2020. https://bit.ly/3gyHQ7F.

crime approach to enforcement as acceptable collateral damage.[26] Alarmingly, both the House Antitrust Subcommittee's majority report[27] and Republican Rep. Ken Buck's "Third Way" report[28] embrace much of this approach, including setting presumptions against vertical mergers and acquisitions by the largest tech firms.

Especially in emerging technology, each antitrust punishment handed down in error represents the destruction of potential innovation. Sadly, history shows that regulators are all thumbs when trying to point the way to the future.

About the Author

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[26] See Khan, "The Ideological Roots of America's Market Power Problem." See also Bill Baer, Testimony to the House Committee on the Judiciary, Oct. 1, 2020. https://brook.gs/3dytJNH Baer urges the committee to affirm via legislation that "showing a risk of a reduction in competition is sufficient" to justify antitrust enforcement.
[27] U.S. House Committee on the Judiciary "Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations," 2020. https://bit.ly/32qN4tD.
[28] Rep. Ken Buck, "The Third Way," report to U.S. House Committee on the Judiciary, 2020. https://bit.ly/3eb0NdD.

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