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Is there a need for platform neutrality regulation in the EU?☆

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ABSTRACT

Motivated by the policy discussion in the EU whether to impose non-discrimination obligations for dominant online platforms, we analyse whether such regulation is warranted from an economic point of view. Our contribution is threefold. First, across several platform contexts, we identify (i) (paid) prominence of some third parties over others and (ii) the favouring of a platform's integrated services over independent entities as common discriminatory conducts of online platforms. Second, within this scope, we review the economic literature and find that discrimination in the form of paid prominence may often be in the interest of consumers. However, smaller or low-quality content providers are likely to be worse off, which gives rise to concerns regarding dynamic efficiency and long-term variety in those markets. Additional problems may arise if platform operators are vertically integrated with content providers. Third, based on these theoretical insights, we recommend that EU policy makers should not adopt a neutrality regulation for platforms prematurely. Instead, we recommend to impose new proportionate transparency rules for dominant platforms in order to facilitate the identification of actual misconduct and legal enforcement.

1. Introduction

The rapid growth and the economic success of platform business models shape how today internet users can access digital services and content. On the one hand, online platforms now represent main gateways for businesses, services and content providers, as well as advertisers to gain access and exposure to consumers. For example, the European Commission recognizes the central role of online platforms as “key gatekeepers of the internet, intermediating access to information, content and online trading” (European Commission, 2017a, p. 7).

On the other hand, there have been concerns about the market position and the economic power that some online platforms have gained in the internet ecosystem. For example, after an investigation of platforms’ business models and trading practices, the European Commission has announced that particular scrutiny will be given to platform-to-business trading practices and the concern that some platforms may engage in discriminatory behaviour. In particular, an intermediary may engage in discriminatory behaviour by favouring its own products or services or by discriminating between different third-party suppliers and sellers. Whereas such practices can also be found in traditional media markets, e.g., with respect to advertisements for affiliated content and services, the Commission worries that such discriminatory practices could possibly be harmful to downstream competition if exercised by a

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platform in a gatekeeper position. Thereby, the European Commission emphasized the significance of platforms for small and medium enterprises (SMEs): 82% of SME respondents in a survey conducted by the European Commission rely on search engines to promote products and/or services online, while 42% use online marketplaces to sell their products and services (European Commission, 2017a).

In this context, the European Parliament has recently stressed "the need for net neutrality and fair and non-discriminatory access to online platforms as a prerequisite for innovation and a truly competitive market" in its report on platforms and the digital single market (European Parliament, 2017, Nr.45). Inspired by these developments, we investigate in this article whether a "neutrality regulation" for dominant internet platforms in the EU is indeed likely to spur static and dynamic welfare.

At first, it should be highlighted that a general platform neutrality principle, which would demand online platforms to present all of their content in a non-discriminatory way, is neither possible nor useful (see also Renda, 2015). Instead, it is often the inherent purpose of platforms to organize and present the available content or content providers (i.e., one market side) in an *objectively* justifiable manner (i.e., on objective content characteristics such as quality) such that they are most useful to consumers (i.e., the other market side). If the platform has personalized data about its users, this can also result in a personalized presentation of content for each individual user. There is no per se policy concern associated with this practice (Renda, 2015). However, this makes it generally very difficult to assess whether a platform engages in non-objectively justifiable discrimination (biased intermediation), which could be a policy concern.

To this end, in Section 2, we discuss and present (possible) non-objective discriminatory practices of platforms in several different contexts, such as operating systems (OSs) and devices, e-commerce and search engines. We demonstrate that "sponsored prominence" is a particular discriminatory conduct that occurs often and across different platforms. Sponsored prominence means that platforms may choose to grant selected content a more prominent presentation on their platform and that this selection is to some degree *independent of the objective characteristics* of the content. In other words, some content may be featured more than other content, just because it paid the platform for this prominence, or because it is the platform's own content. Such discrimination of content is then not necessarily in the best interest of the platform's users and can have significant ramifications for the economic success of the content providers, also because it may interfere with a content provider's "organic prominence" that is based on objective criteria.

In Section 3, we survey the extant economic literature on possible welfare consequences of sponsored prominence in comparison to a "neutral" platform regime, in which only organic prominence is allowed. Based on these insights, our goal is to offer a theoretically founded assessment of such policy interventions on the involved stakeholders and overall welfare. On the one hand, this includes the impact on prices and quality, which ultimately determine consumer surplus. On the other hand, this involves an analysis of producer surplus, i.e., firms' profits, and in this case also the distribution of surplus between the platform and the various third-party firms that operate on the platform. Moreover, we will discuss economic efficiency from a static and a dynamic viewpoint. Whereas the former is concerned with maximizing consumer or total surplus at a given point in time, the latter considers long-term market dynamics and thus the impact on investments and the variety of offerings available. It is widely recognized that innovation and technological progress have been the main drivers of the internet's success and therefore dynamic effects should play an important role in any assessment of potential policy interventions (see, e.g., Bhargava, Evans, & Mani, 2016).

By considering both efficiency goals, in Section 4, we wish to shed light on the trade-offs that may stem from a platform neutrality regulation. Moreover, this allows us to assess and discuss the different concerns that have been raised with respect to discriminatory practices. The ultimate goal of this article is to provide a recommendation on whether non-discrimination rules for internet platforms do have virtue and what consequences to expect from their application. Finally, Section 5 concludes and discusses avenues for future work based on the limitations of this study as well as the identified research gaps.

2. Common discriminatory practices of online platforms

2.1. Definition of online platforms

We focus on platforms that constitute a *two-sided or multi-sided market*. The multi-sided business model is typical for many of the intermediaries in the internet that now represent important access points between consumers and third-party sellers, services and content providers.[1] According to Hagiu and Wright (2015), a multi-sided platform enables two or more sides to *directly interact*, meaning that those sides "retain control over the key terms of the interaction" (p. 163). Moreover, each side must be *affiliated* with the platform in the sense that they undertake platform-specific investments necessary to participate in transactions with other sides.[2] In turn, this regularly gives rise to *cross-side* or *indirect network effects*: the value of the platform to one side grows as the number of affiliates on the other side increases (Armstrong, 2006; Rochet & Tirole, 2006). As highlighted by Hagiu and Wright (2015, p.164), this definition allows to distinguish platforms from resellers and fully vertically integrated firms, which have sometimes also been classified as platforms (see Gawer & Cusumano, 2008). Moreover, we do not necessarily require cross-side network effects to be reciprocal. For instance, in the case of advertising users may not care about the number of advertisers on the other side, although

[1] In the following, we will use the term *content providers*, when we refer to the firms on the side of the platform opposite to users, irrespective of their special occupation. As highlighted in the case studies, those firms may be sellers, app developers, website administrators, service providers or content providers depending on the specific platform considered.

[2] According to Hagiu and Wright (2015, p.163) such platform-specific investments could be "a fixed access fee (e.g., buying a videogame console), expenditure of resources (e.g., spending time and money on learning how to develop applications using the iPhone's APIs), or an opportunity cost (e.g., driving to a shopping mall, joining a loyalty program)."