Web giants shouldn't be regulated like utilities

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Should Google and Facebook be regulated like an energy company? Donald Trump's chief strategist, Steve Bannon, seems to think so. He purportedly sees public utilities as a regulatory model for the tech giants.

This seems odd, given how unpopular utility companies are on both sides of the pond. But armed with a caricatured view of what competition means, many politicians and commentators seem to believe these companies are monopolists running essential resource platforms unfairly.

Utilities regulation sets a precedent for dealing with these companies, whether through enforced data and information sharing, neutrality rules on searching functions, restrictions on content or even price controls.

Does this make any sense? Public utilities regulation is usually justified by the existence of a clear natural monopoly in an "essential" sector, characterized by high barriers to entry. In water or energy provision, for example, prohibitively large upfront capital investments in new pipes are required. This can make a single supplier efficient, in theory.

Regulation is then advocated to deter the monopolist from taking advantage of consumers. Facebook and Google undoubtedly have large market shares. Google has 88 percent of the market in universal search advertising and Facebook 77 percent of mobile social traffic.

The companies benefit from what are known as "network effects," meaning their products gain additional value as more people use them. This acts as an effective barrier to entry because it's difficult for newcomers to encourage a critical mass of users to switch platforms.

Yet, just because some utilities are natural monopolies does not mean firms enjoying monopoly-like market shares similar to public utilities. Google and Facebook are clearly not natural monopolies. There are Bing and Yahoo! directly competing with Google; Twitter and LinkedIn with Facebook.

On Jan. 31, 2009, Google's site suffered a major error that caused every listed search link to warn "this site may harm your computer". During that hour, visits to Yahoo! doubled compared to usual activity. Consumers clearly have options.

The overall “search” industry is much larger than the “universal search” industry too. People search for books or toys on Amazon, flights and hotels on Expedia or articles on Twitter, often wherever they are cheapest.

In fact, barriers to entry for search and social networks are actually low and the two markets are very contestable. While overturning Facebook and Google’s dominance would be tough for rivals, that is mainly because their network sizes add substantial value for consumers.

Both provide services that enrich our lives at little, or, in most cases, no direct cost to us, and can be used anywhere in the world. But they are not insurmountable. When other companies come up with better services, incumbents’ network effects can be overcome, or else MySpace, MSN Messenger and AOL would still be dominant and Yahoo! the largest search engine.

Nevertheless, some believe public utility-style regulation is needed because the companies’ vast power creates unfair competition on their platforms. The EU Commission personifies this mindset, recently fining Google 2.1 billion pounds for prioritizing its own services in search results, implying that Google should be totally neutral in search ordering as if it were a public network.

But unlike with real utilities such as energy, Google access is not completely essential to a firm’s existence or success, and Google itself is not a monopoly. Even to the extent its results are important to companies, Google still supplies free listings to rivals to its shopping business.

Complete search neutrality is an elusive concept anyway. Algorithms are developed that respond to feedback and user needs and preferences in an imperfect way. Their provision is itself part of the process of dynamic competition in the sector. If Google was perceived to be hiding better deals, other rivals would soon be eating their lunch at just one click away.

Sadly, critics of tech giants use bad logical reasoning, which says that because “competition is good” and competitors to Google and Facebook are competition, steps to assist those competitors must be good too.

Yet public utilities regulation forcing Google to share or make public its algorithms with competitors, users or public officials would reduce the firm’s expected profits, in turn reducing the incentive to invest and innovate. Ironically, the one sure-fire way to ensure the two companies become entrenched monopolies would be to regulate them as such.

Under regulation where algorithms were revealed, companies hoping to obtain good search results would seek to “play” the algorithms, making the search engines less useful to consumers, and in turn raising the cost of providing “good” search engines overcoming this manipulation.

Changes to algorithms would likely have to be approved by government officials too, slowing innovation and making it less customer-centric. We have seen this happen in actual regulated utilities, which often appear frozen in time. The overall result would be a less dynamic search engine and social media environment, where consumers may even have to be charged.

Then there are the non-economic implications. Granting government the whip hand would no doubt result in consequences such as policing content under the guise of eliminating “fake news” and forcing companies to share private data with government agencies.

Though they might think of it as “pro-competition,” allowing the sharing of data with competitors would also raise substantial privacy concerns and open up the whole process to capture by other companies.

Quite simply, there is no economic justification for regulating Google and Facebook as if they were public utilities. But there would be substantial harmful consequences.

Consider a thought experiment: would you rather Google operate more like your energy provider and Southern Railway, or your energy and rail providers more like Google and Facebook?

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