Putting the Genie Back in the Bottle – or Adapting to the New Reality?

Comments on the CMA's 'Online platforms and digital advertising' Market study interim report

Dr Oles Andriychuk | @oandriychuk1
Senior Lecturer in (Competition and Internet) Law,
Co-Director of the Centre for Internet Law and Policy[1]
University of Strathclyde, Glasgow UK oles.andriychuk@strath.ac.uk

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From digital naivety to digital pragmatism

Online platforms grow exponentially. Unexpectedly for most, they have reached the top of the world rankings of the companies with highest market capitalisation. Today they keep demonstrating an unprecedented dynamic of further expansion, increasing vertically and horizontally, entering new geographic and product markets,

[1] In accordance with the ASCOLA transparency rules, I confirm no conflict of interest. This paper represents my personal academic opinion and should not be attributed to the position of the Centre I co-direct.

synchronising, synergising and cross-fertilising their data, algorithms and user experiences. Like King Midas, everything they touch, they turn into gold, instantly creating added value for their customers and shareholders. The fuel that keeps the engine on, is big data: collecting –> categorising –> profiling –> synchronising –> predicting –> targeting –> recommending –> satisfying –> and thereby being able to collect more: this is how the perpetual business cycle of Bentham's digital panopticon and (again Bentham's) digital 'happiness machine' functions.

Being by its very nature rather sluggish and inert, the mainstream perception of online platforms was until recently deeply embedded in an outdated narrative of garage-entrepreneurship, egalitarianism, liberal-democratic altruistic evangelism, helping humankind to bid a final farewell to authoritarianism, obscurantism and propaganda by eliminating borders and multiplying possibilities for everyone. It is only the recent turbulence caused by fake news and the post-truth society, epitomised in the CambridgeAnalytica scandal, that has triggered a reconsideration within mainstream societal opinion as to the multifaceted role of online platforms. UK/EU law and policy try to take a lead in these processes of reconceptualisation. They aim inter alia to regulate the uncontrolled growth of online platforms in order (i) to protect competition and consumers, but also implicitly (ii) to mitigate the ever-expanding gap between the UK/EU on one hand and the US and China on the other, catching up the time and momentum that was lost in the decade of digital naivety.

As the Interim report explains, both online search- and online display advertising markets are highly oligopolised with Google for the former and Facebook & Google for the latter not only holding significant shares of the markets (referred to in the Interim Report as ‘platforms with ‘Strategic Market Status’ (SMS)) but also demonstrating a continuous, incontestable dynamic of further increase. Such well-known and widely discussed principles of the business of digital advertising as (i) network effects, (ii) the power of big data, (iii) the winner-takes-most and (iv) competition *for* the market convincingly show that the trend is stable, and the current incumbents will continue strengthening their dominance.

The inevitability of such universally observed systemic features of the digital economy as network effects and winner-takes-most also raise a more fundamental question: is it even possible to expect any meaningful and stable form of effective competition from the markets that demonstrate these characteristics as inherent, or would it not perhaps be a more realistic option to design the regulatory framework in a way that would internalise it from ‘bug to feature’, treating platforms with SMS as natural monopolies / de facto standard setters / public utilities / undertakings providing services of general economic interest or as common carriers? Putting it less controversially: would it not make more sense to perceive both approaches as non-conflicting and mutually supportive? Measures taken to protect the competitive process and consumer interests also help to set expectations for higher accountability from platforms with SMS. And

vice versa, imposing stricter regulatory requirements on the platforms with SMS would also provide their competitors (and consumers) with a better chance of competing (and consuming) from a specific platform on the merits.

The scope of the market study, and the overall legitimacy mandate of the CMA, requires it to focus on the issues related to the interests of consumers and competition. However, this does not mean that the broader spectrum of remedies, related to shaping the regulatory landscape in ways which would create room for newcomers by making the incumbents more fiscally accountable, should be beyond consideration. Both approaches constitute the subject matter of competition policy sensu lato, particularly given that the most plausible outcome of the market study will take the form of a recommendation to the government.

After all, competition is an inherently macroeconomic policy. Its reliance on microeconomic metrics does not exhaust its broader public mandate, especially if the discussion takes place at the level of ex ante recommendations rather than the level of ex post law enforcement. The Interim report defines such policy recommendations as structural '[i]nterventions to address specific sources of market power and to promote competition'. One of these policy recommendations is proposed below. Its aim is to mitigate the current paradoxical disproportion in the digital advertising markets. The proposal is based on treating each instance of viewers'

interactions with an ad as a separate transaction. The elaboration of this conception requires a reflection on the following components: (i) a zero-price market; (ii) UK/EU markets as net-consumers of online advertising; and (iii) the idea of digital taxation.

On the possibility of introducing a ‘pay-per-display’ tax

It goes without saying that the idea of a zero-price market does not imply that the products/services are actually provided for free. Online consumers pay with their data and their attention. Consumers of online advertising in addition pay by eventually buying advertised products and services. If some sort of ‘payment’ is being made and some added value is being created, why then is some sort of ‘tax’ not introduced?

Essentially, a typical consumer in Glasgow who sees a targeted ad about a new Netflix show on an NYT webpage pays to (1) NYT with her attention, (2) Google advertising service with her data and (3) Netflix by buying access/subscribing (or learning more about the show). Also, (4) Netflix pays Google for targeting the ad, and (5) Google pays NYT for displaying it. Out of these 5 transactions none is taxed in the UK/EU. An added value is created five times, but as long as physical goods do not pass physical borders (or at least as

long as the intermediary does not declare its profit in the UK/EU), the domestic fiscal authorities are not engaged. Not only is the situation illogical, it is also unfair with regard to other consumers as well as with regard to other producers.

The modelled scenario is quite typical as the UK/EU are net-buyers in the global digital market value chain: we consume online more than we produce. Essentially, all adtech infrastructure being non-UK/EU- based, pays their taxes (or rather arranges tax break deals) elsewhere. Every hour, minute and second domestic consumers make foreign algorithms stronger by fuelling them with personal data, which enables better profiling and better targeted advertising, which in turn increases UK/EU consumers satisfaction, and their loyalty to the foreign online platforms.

The most paradoxical part of this stylised model is that not only is the gap in these winner-takes-most markets constantly increasing due to the very design of the model, in many instances the UK/EU authorities do not receive even a (symbolic) share of the revenues extracted by foreign online platforms from UK/EU consumers at least five times per transaction. And if steps 4 and 5 in our example are unproblematic (foreign advertiser pays foreign intermediary and then foreign intermediary pays foreign publisher), not having a share in revenues generated by foreign (well, ‘any’) online platforms in the first three steps is either counterintuitive or myopic.

A possible way of remedying this discrepancy is to mimic the 'taxation' of the value chain performed by online platforms themselves. The most common, generic, starting point is in using the pay-per-display/click formula, which is fundamentally different to the model applied to non-zero-price markets. In the case of the latter we tax facts; in the case of the former we tax assumptions about the facts, which should happen in the future. And if there is no guarantee that each particular view of an ad by a UK consumer would lead to the purchase, there is a guarantee though that each million views by UK consumers will lead to "X" amount of purchases and "Y" amount of non-taxed revenue. So, both types of markets generate comparable outcomes in pecuniary terms, but the latter is taxed, while the former is not.[2] Firms sense this and prefer to use data-currency rather than money-currency, converting the former to the latter only when absolutely necessary.

The situation becomes even more obvious when we look not at the untaxed "Y" amount of guaranteed revenues generated by each million views of an ad, but at the cascade of profits, improvements and further synergies extracted permanently out of big (personal) data collected from the viewers for whom the ad was displayed. The fact that the price is zero does not mean that the profits generated by processing the data is zero. It is conceptually questionable why the profit is taxed only at the time when (and at the jurisdiction where)

[2] Or taxed marginally – following various optimisations, inter-jurisdictional transactions, and only a tiny fraction of revenues: declared profits.

big data are converted into money. The ‘data qua new-oil’ truism works well for illustrative purposes here if we extrapolate mutatis mutandis this model to the situation of real oil and imagine a scenario in which the jurisdiction at which the oil is extracted does not receive any share of the revenues out of it. In the case of digital advertising, the situation is further exacerbated by the fact that not only do UK/EU consumers provide their data for free, they also become dependent on the ever more effective advertiser, as their choices become navigated, channelled and curated in the future.

Another important specificity of the zero-price market, which justifies the reason for fiscal revision, is that the costs of taxation cannot be passed on to consumers: if advertisers began displaying more ads per screen, this would upset the equilibrium between the advertisers’ ability to display and the consumers’ willingness to watch ads per screen. Also, it would be economically counterintuitive to assume that the online platforms have not reached the imaginative maximum level of ads per screen already. Adding more ads would unbalance the established optimum, driving the consumers away (or in a world with no alternative, raising dissatisfaction with the status quo, decreasing thereby the barriers to entry for newcomers or increasing the momentum for incumbents’ competitors).

5 reasons for introducing the ‘pay-per-display’ tax

There are at least five concurrent reasons for introducing the ‘pay-per-display’ tax in the context of online platforms and digital advertising. The first two are implicit and strategic. They go beyond the scope of the market study and beyond the argument of this submission. Those are: (1) generating an important and stable source of income for the public budget and (2) remedying the disparity of the situation where companies extract significant revenues from the UK/EU consumers but pay taxes (or rather receive tax breaks) elsewhere, having a positive spillover effect on foreign economies and a negative spillover effect on UK/EU economies.

The other three reasons are explicit and structural. They are directly relevant to the market study. Introducing the ‘pay-per-display’ tax would (3) square the equilibrium between ‘pushed’ and ‘pulled’ advertising, as the rivalrous (zero-sum) choices of the consumers are steered by targeted advertising, and producers pay premium for such navigation. Targeted advertising thus can be seen as a form of suggested, or ‘pushed ad’. The reason for taxing pushed ads is not conceptually different than the reason for taxing pulled ads (e.g. TV advertising). The absence of ‘pay-per-display’ taxation of pulled advertising is explained by practical reasons as tax is imposed on the publishers (and intermediaries) at the moment they receive the payment from the advertisers. The cross-border nature of the business model of digital advertising by online platforms does not envisage such an option as the payments are often done outside the tax jurisdiction of the UK/EU. Introducing a ‘pay-per-display’ tax would

allow a more accurate calculation. This reason is legitimate even if it concerns marginal, incremental adjustments.

In addition to the above, (4) introducing a 'pay-per-display' tax would remedy the existing disparity with untaxed added value generated out of processing big data. While the main addressee for reason 3 is the publisher and the situation with the pushed advertising model is not conceptually different to the situation with the pulled advertising model, the main addressees of reason 4 are the range of intermediaries matching advertisers, publishers and consumers (i.e. online platforms). Even if most of the added value they produce is generated from algorithms, skill and luck, at least some is generated from big (personal) data, which consumers 'pay' to them by receiving in return free content, curation and other personalised services. These zero-price payments are currently not taxed, which is a lacuna. Last but not least (5) 'pay-per-display' taxation would have a positive impact on the competitive dynamics of the market by making online platforms with SMS more accountable, enabling thereby existing and potential competitors more room for action.

The prima facie categorical allure of this proposal could be easily scaled by opting for a low/symbolic taxation rate. Its potential discouraging implications for small and medium-sized companies, competitors and newcomers could be easily avoided by selecting a minimum annual turnover threshold, which companies have to pass to qualify for the 'pay-per-display' tax – or it could be applied

progressively: the higher the turnover, the higher the rate. Even if not applied at this stage, it is important to articulate the conceptual inevitability and practical availability of this instrument as an effective remedy in the toolbox of the UK/EU regulatory authorities.

Digital Services Tax as an alternative

Revenues earned by online platforms from 1 April 2020 will be subject to new 2% Digital Services Tax (search engines, social media platforms and online marketplaces). Only companies with global annual turnover of £500 million (5% of which is generated in the UK) will be liable to the tax. According to the HM Revenue & Customs Policy Paper 'Introduction of the new Digital Services Tax', 'advertising revenues are derived from UK users when the advertisement is intended to be viewed by a UK user'.[3]

In their consultation on introducing the Digital Services Tax HM Treasury and HM Revenues & Customs were considering the option discussed in this paper,[4] but have decided to take an alternative approach, applying taxation in a less differentiated manner. Compared to the existing situation when taxes are imposed on profits rather than revenues, the Digital Services Tax is an important step, which will mitigate the existing disproportions. However, it is likely

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[3] HM Revenue & Customs Policy Paper 'Introduction of the new Digital Services Tax', 11 July 2019, available at https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax

[4] HM Treasury and HM Revenues & Customs, 'Digital Services Tax: Consultation', November 2018, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf

that most of tax optimisation techniques used now, could mutatis mutandis be used with regard to the Digital Services Tax.

The selected approach implies taxation of revenues rather than transactions. Monitoring and calculating revenues generated from UK users requires an access to information about transactions between advertisers and intermediaries, which often take place outside the UK jurisdiction, so the picture is likely to be fragmented and incomplete.

There is a direct correlation and causation between the amount of times, which a targeted advertisement is displayed for the selected viewers and the revenue generated from these interactions. The proposed pay-per-display approach would also allow a more accurate calculation of views actually generated in the UK.