

Business Standard

Managing competition in a digital world

The internet governance model offers an alternative model to address the challenges posed by a network economy

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Addressing competition in the digital domain presents a formidable challenge for governments and regulators. Unlike the physical realm, where network effects are limited, digital products and services often exhibit robust network effects. Put simply, network effects occur when every new user enhances the value of the offering for all others. The telephone is a classical example. Networks defy the traditional economics of competition and efficiency. Instead, they can lead to winner-takes-all scenarios, creating monopolies or oligopolies. Recognising this characteristic of the network industry, AT&T, a hundred years back, described telephony as a natural monopoly. Google Search, Microsoft Office, Android OS, Google and Apple play stores, WhatsApp, and Facebook are examples of a multitude of network-economy products that have become near monopolies.

Conventional economic theories propound that competition drives down prices and improves quality and efficiency, and is therefore best for consumer welfare. In a network economy as networks amass vast user-bases, they enhance the value provided to each user and collectively increase society welfare. However, the concentration of power in a few profit-maximising entities poses risks, including the potential to destabilise

the political and social structures.

Historically, network effects were recognised in technologies like telephony, telegraph, railways and postal services but they comprised a small portion of the economy. Digitisation has increased the network economy's share in gross domestic product to substantial levels. Moreover, this trend is only going to grow. As networks expand and acquire large user-bases, their offers resemble public goods, though privately controlled, leading to significant policy implications. Consequently, addressing the economic reality of network effects has become imperative.

Both the Parliamentary Standing Committee on Finance and the Committee on Digital Competition Law set up by the Ministry of Corporate Affairs have recommended a law with ex ante control to deal with the emerging challenge of anti-competitive practices among major digital enterprises like bundling or tying products to existing networks, self-preferencing, preventing third-party products, monopolistic use of data, deep e-commerce discount, exclusive tieups, search and ranking preferences, restricting third-party apps, and anti-competitive advertising policies. They rightly pointed out that such practices reinforce the dominance of leading players, risking irreversible polarisation in favour of the incumbent. Given the fast-paced nature of the digital domain, they felt the ex post approach was inadequate and recommended an ex ante approach especially for those enterprises that had "a significant presence and as such, the ability to influence the Indian digital market".

A draft Bill has been put out for comment. The Bill has some similarities with the European Union's (EU's) Digital Markets Act, 2022. The EU had designated major online platforms as gatekeepers and proposed regulations to prevent practices like self-preferencing, leveraging market power in adjacent markets, hindering third-party access, and ensuring platform interoperability. The proposal for ex ante regulation sparks concerns that the regulatory environment may resemble the restrictive licence raj and inspector raj, potentially limiting the freedom that has characterised this sector thus far.

In the early 20th century, governments recognised the network effects in the telephone industry and took the lead in regulating the sector to prevent private monopolies and have multiple players. Measures included licensing, sub-dividing territories, and price regulation. The International Telecommunication Union, the regulatory framework at global level, was also government-led. While some measures like interoperability and common standards were beneficial, others failed to prevent the emergence of monopolies/oligopolies in the sector. India's experience serves as an illustration. India initially had a public-sector monopoly in telephony. It opened up the sector in 1994 but despite ex ante regulation, a two-player oligopoly has emerged. Similar monopolies/oligopolies exist in countries like the United States, the United Kingdom, France, the United Arab Emirates, and Singapore. Regulation slowed down innovation in the sector and

even after 100 years of existence, telephone calls were exorbitantly high and accessibility relatively low. Regulated prices provided assured and growing returns for incumbents, who, instead of prioritising innovation, prioritised turf protection and erecting entry barriers, masking these actions as regulatory compliances.

A stark contrast to telephone networks is the case of the internet, which is humanity's largest network with strong network effects. Developed as a non-profit private enterprise, it prioritised open networks with minimal government interference. Embracing open standards like TCP/IP, it established a multi-stakeholder governance framework involving industry, academia, government and civil society. There is no hierarchy among stakeholders and all, including governments, participate on an equal footing. Over its 30-year history, the internet has spurred transformative innovations, driving the digital economy's growth unlike anything before. Despite being a monopoly, the internet has propelled global economic and social progress. When some stakeholders tend to dominate decision-making, the same is tempered due to a multi-stakeholder approach.

The preceding case studies offer valuable insights. First, network effects are inherent and integral to a network economy and rules of classical economics will fail in these contexts. Secondly, public-sector monopolies, particularly in liberal democracies, are not a solution because they lag in innovation and efficient resource utilisation, thereby reducing consumer welfare. Thirdly, government-led regulation fails to prevent the formation of monopolies/oligopolies because incumbents start wielding considerable influence over policies. Fourthly, when governments are in the driver's seat, decision-making tends to be sub-optimal in terms of innovation because they may lack the understanding of unseen opportunities. Fifthly, while regulation is essential to curb the emergence of monopolies, it must ensure both consumer welfare and innovation.

In some ways, the internet is the reason for the explosive growth of the network economy. It is said every problem also contains seeds of its own solution. The internet governance model offers an alternative model to address the challenges posed by a network economy.

Accordingly, governments could consider creating statutory mechanisms for governing network-economy products, in which all stakeholders are on an equal footing. For example, there could be a multi-stakeholder group for app stores, which would include academia, startups and industry, government and civil society, ensuring fair representation and creating checks and balances which would prevent any one entity or group hijacking the governance. While maintaining oversight, governments may refrain from directly prescribing solutions, however retaining overriding powers whenever national security, sovereignty, or substantial public interest is involved. Such an approach would also be consistent with the government's "minimum

government maximum governance” thinking, offering a new paradigm for effective governance of the digital network economy.

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First Published: Apr 15 2024 | 10:28 PM IST

Page URL :https://www.business-standard.com/opinion/columns/managing-competition-in-a-digital-world-124041501127_1.html