Regulating Online Platforms:
Where, Not Whether, to Draw the Line
A Position Paper in Prepared in Advance of the
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Abstract

We all want to keep the internet as open, as flexible, as innovative, and as valuable as possible. We can all agree that some regulation is needed of online platforms and online businesses, but we probably cannot agree on precisely what forms of regulation are appropriate and what forms will be unduly restrictive. Economics forms the best discipline for assessing regulatory alternatives, and faculty in the area of information, economics, and the study of internet business models are best positioned to frame the discussion of the regulation of online platform.

1. Introduction

We all want to keep the internet as open, as flexible, as innovative, and as valuable as possible. And many of us assume that this means the net should be subject to no regulation at all. This argues for letting innovators, entrepreneurs, and investors try as many things as possible, as quickly as possible. It argues for letting markets sort things out. In its most orthodox form, this argues that any attempt to outthink and outsmart the markets is unnecessary. Worse, any attempt to outthink the markets will create significant delay in innovation, perhaps allowing the innovator’s advantage to shift to looser regulatory environments overseas, while adding no meaningful or necessary forms of protection for consumers.

And yet most of us can agree that some form of regulation of online platforms is appropriate. Imagine a hypothetical firm Hootel.com, a sort of X-rated version of a hotel and apartment search and rental platform. In Hootel.com you not only acquire a room in a foreign city for a couple of nights, but a sexual companion as well. It gives whole new meanings to the idea that you don’t just visit Paris, or New York, or any other cosmopolitan city, you actually live there. Most countries, most states and provinces, and most cities would agree that they have a legal and moral right to regulate such platforms in the interest of public safety, and to slow the spread of diseases such as HIV/AIDS.
2. OK, Some Regulation May Be Justified

OK. So most of us can now agree that there is a line that platforms should not cross. But where do we draw the line? Where do we set the boundary for what online platforms are and are not permitted to do? The fact that we can agree on one or two extreme examples where regulation is appropriate does not suggest that we can agree on much else in the regulation of platforms.

Should we permit Airbnb to flourish because it is economically efficient to allow the owners of properties to find their most economically valuable use? If it is more profitable for building owners to refuse to renew the leases for some apartment residents in San Francisco and to convert their properties into full-time Airbnb rentals, should we permit it without question? If the residents object to being evicted from their apartments rather than having their leases renewed, or their neighbors object to having strangers and transients in an apartment building so that their home feels like a hotel, should we protect residents instead of property owners? If hotel operators argue that owners who rent through Airbnb have an unfair advantage because they pay fewer taxes, have fewer regulations on safety, or can locate in residential neighborhoods where hotels cannot, should we impose greater restrictions on Airbnb to level the playing field?

Who would really benefit from these additional laws and regulations and how do you balance competing interests? How would you decide on the appropriate guidelines for regulators to follow?

If taxi and limo drivers object to Uber Black should we care? If Uber Black is more efficient than a limo company because of its technology, is that enough reason to endorse Uber? If Uber Black makes better use of its resources than taxi companies do because it is unregulated, is that enough reason to let it operate in competition with taxi companies? Is there any legitimate basis for an objection to Uber Black? What about the other forms of Uber, which compete more directly with taxis throughout the day? Should Uber Taxi be subject to all of the same regulations as traditional taxi drivers? Who would really benefit from these additional laws and regulations and how do you balance competing interests? How would you decide on the appropriate guidelines for regulators to follow?

Suppose that a platform gains an unfair competitive advantage over other online firms by integrating numerous services. First, what is an unfair advantage?

- Is it unfair for Google to promote its own products over those of competitors? If Google believes that its own offerings are superior, and if it provides them to consumers without charge, then who is being harmed?
- Was it unfair for Microsoft to bundle numerous services together into Windows, providing them without charge to consumers? Were consumers harmed or did consumers benefit? How would you know?
- Is it unfair for Google to do the same today and bundle so many services into its platform? Are consumers harmed by the number of free services Google offers, essentially destroying potential competitors? Or do consumers benefit from these services, which are mostly of very high quality, mostly well-integrated into Google’s portfolio of offerings, and almost always free?

Is it even necessary or appropriate to try to protect consumers from harm they might potentially suffer online? Clearly, we protect kids from smoking and drinking, partly to protect them from harm they cannot yet fully evaluate for themselves, and partly to protect ourselves from the
externalities that intoxicated teenage drivers impose upon their friends and other drivers. We agree that teenagers can’t always judge the long-term impacts of smoking or of other potentially harmful activities, and we feel that society has the right to protect them. But is it really possible that some consumers cannot judge the impacts of their online activities? Isn’t this the age of the internet, of online access to everything, and of perfectly informed consumers? Is it possible that some consumers don’t know how Google and Facebook use their information, or how big data integrators merge their transaction histories from all of their online activities? Is it possible that some consumers don’t know how this information can lead to their paying higher prices, or even being denied employment or being denied access to some services?  

3. So Where Should Regulators Draw the Line?  

OK, so how should regulators choose where to draw the line when regulating online platforms? Honestly, we don’t yet know. But I believe that responsibility for providing guidance and guidelines falls upon the academic community that studies online platforms, if only by default. The community of internet innovators and entrepreneurs want no regulation at all, and it is hard to blame them. It is not clear what should be regulated or how it should be regulated, and until we know more, the foremost regulatory guideline should be “Do no harm!” It is clear that inappropriate regulation and overly restrictive regulation will reduce consumers’ choices and their access to new products. And it is also clear that regulation of any kind will cost innovators and entrepreneurs significant amounts of money by reducing investment opportunities. Innovators and entrepreneurs are going to be too generous in what they permit, and too reluctant to impose restrictions of any kind.

The legal and regulatory community is trying to use the same frameworks that have been used to regulate interstate and international commerce for decades, with only mixed results. It’s clear that the amount of information available for targeted advertising today is not just greater than before, but qualitatively different from anything we’ve seen in the past. Privacy regulation based on primary identifiers is not adequate in an era of big data, when we can identify almost anyone uniquely from his or her transaction history without relying on name, tax id, or street address. Online anonymity is a myth. The implications of online privacy violations are also different from the implications in more traditional businesses, since targeted marketing online does not just mean sending unsolicited ads, but also means price discrimination. A well-informed seller can charge higher prices to travelers based on their need to travel, and can charge higher prices to anyone, in any market, in ways that we have never debated as a free society.

And academics are beginning to study the legal, economic, strategic, and social welfare implications of platforms. Four faculty members, Marshall Van Alstyne, Kevin Boudreau, Andrei Hagiu, and Geoffrey Parker, have organized The Platform Strategy Research Symposium, a conference at Boston University that addresses the most current research topics

3 http://questromworld.bu.edu/platformstrategy/.
in platform strategy and economics. They have included a discussion session on platform regulation in the meeting agenda⁴.

4. Candidate Topics for Discussion of Platform Regulation

I am going to propose the following topics for discussion at the Platform Summit, as candidate areas where it may be necessary to clarify the policies for regulating platforms. I do not mean to suggest that any or all of the areas require tighter restrictions, but I do want to suggest that all of them require clarification.

- **Is the platform already illegal because it supports activities that are illegal?** This is probably the easiest area to discuss. Platforms designed for the easy exchange of narcotics or fully automatic assault rifles, or platforms designed for the sale of counterfeit goods, or platforms designed to support illegal activities like the distribution of pornography, can probably be regulated without much controversy. There will certainly be discussions about victimless crimes⁵, but these are the same discussions that societies have used to regulate these activities before the advent of the internet, and these discussions probably do not require the specialist skills of internet economists.

- **Does the platform create value or merely exploit a regulatory loophole?** Uber Black provides a new service, a real-time market for cars and drivers during periods of peak demand when traditional taxi service is inadequate. Uber Taxi may simply be competing with traditional taxis, offering lower fares because they are subject to fewer regulations. If so, should Uber Taxi face stricter regulations, or should the regulations on taxis be relaxed? When is a platform creating value and when is it merely harvesting?

- **Does the platform create an environment in which market competition cannot effectively determine prices, requiring regulatory attention?** As we have discussed previously in this journal, there are categories of systems where the user does not pay for platform use. These are called third party payer systems⁶. The best known examples are of course Google, the old airline reservations systems Sabre and Apollo, and bank credit cards. Searchers do not pay to search; firms that need to be found pay to not be not found and competition between Google and Bing does not limit the price of keywords. Merchants need to accept credit cards, and competition among credit card issuers has raised the cost of their rewards programs, which are almost entirely borne by sellers; competition among credit card issuers does not limit the fees paid by merchants. Mandatory participation third party payer systems do not obey the same behavioral rules as traditional markets, and may require regulation to limit their power.

- **Does the platform create negative externalities that might disadvantage some consumers?** Negative externalities occur any time any of us engages in activities that harm others. Negative externalities have been discussed by economists since the beginning of economics as a discipline. Zoning laws suggest that I cannot operate a hog farm in my backyard or operate a large medical clinic in my home office. Does Airbnb

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harm anyone? It survived the referendum on Proposition F in San Francisco\(^7\), but an informed debate on the externalities of rental platforms is still necessary. The *dark side of the sharing economy*\(^8\) does indeed need to be understood, as well as the obvious benefits.

- **Does the platform create an environment in which platform envelopment provides the platform operator with unfair competitive advantage?** Again, I’m not sure what an unfair competitive advantage is. Is\(^9\) vertical integration by a search company an unfair form of platform envelopment\(^10\)? The Department of Justice clearly believed that bundling offerings together gave Microsoft an illegal competitive advantage, or more precisely, that it was able to leverage, protect, and extend its monopoly position in Windows to gain monopoly power in other areas of desktop PC software. The European Commission clearly believes that Google has similar forms of unfair advantage today that likewise enable it to leverage, protect, and extend its monopoly position in search to gain monopoly power in other areas of online services, from mobile phones to mapping, email, and others. And yet consumers clearly also receive benefits. How should platform envelopment be viewed and how should it be regulated?

- **Does the platform exploit an environment in which some parties can exploit differences in regulation across borders?** Google and Facebook earn their revenues in large measure through the value of the private information they are able to collect on their billions of users every day. These revenue sources are not available to European firms, which most adhere to stricter European privacy regulations. Google and Facebook can use these revenues to offer goods and services free, or at least at prices that home-grown European competitors cannot match. Should Google and Facebook be forced to follow the same privacy rules that European firms must follow, at least when Google and Facebook are operating in Europe? Is this simple self-protection, or an form of illegal non-tariffed-based protectionism\(^11\)?

- **Can consumers really judge the benefits and rewards, costs and risks, of using a platform?** Would warning on internet software sites be sufficient, the way warning labels are supposed to be sufficient in limiting tobacco smoking? Or are stronger restrictions required, at least for young internet users, the way society uses more than just warnings to limit teen drinking and smoking?

### 5. Who Should Decide?

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11. [http://www.huffingtonpost.de/eric-k-clemons/eu-datenschutz-rechtswidrige-unternehmenspraktiken_b_8490876.html](http://www.huffingtonpost.de/eric-k-clemons/eu-datenschutz-rechtswidrige-unternehmenspraktiken_b_8490876.html).
Of course, my academic colleagues should not have the last word. Indeed, ultimately, the entire internet ecosystem, of users, developers, and regulators will need to weigh in with their opinions and analyses.

I’m not certain that any of us have the right answers yet. But I am convinced that these are some of the questions that must be answered.