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TECHNOLOGY

The Amazon Monopoly Problem: Prime Time For Antitrust Action Vs. Internet Giants?

JED GRAHAM | 9/18/2017

A**mazon.com** (**AMZN**) kicked off its Whole Foods takeover on Aug. 28 by slashing the prices of avocados, kale and other items at the "Whole Paycheck" grocery chain by as much as 43%. Who could argue with that?

(Dennis Nishi)

Consumer welfare has been the foremost concern of U.S. antitrust law since the 1980s, with price hikes seen as the surest sign of monopoly power. Yet a growing chorus of critics complain that Amazon and fellow internet giants **Facebook** (**FB**) and Google-parent **Alphabet** (**GOOGL**) are becoming too dominant, snuffing out competition, innovation and even freedom of expression.

Wall Street is starting to ponder a trillion-dollar question: Could the Whole Foods buyout mark a turning point that leads to serious U.S. antitrust scrutiny for Amazon, Facebook and Google?

"In the face of bona fide threats of regulatory and political opposition to Amazon, we against all odds finally may be facing 'Peak Amazon,' " hedge fund manager Doug Kass wrote on July 11.

His warning was premature. The Federal Trade Commission cleared the Whole Foods deal in barely two months.

When it comes to total sales, **Wal-Mart**'s (**WMT**) $486 billion towers over Amazon's $136 billion in 2016, and its nearly 4,700 U.S. stores dwarf Whole Foods' 460. However, Amazon did grab 43% of U.S. online sales in 2016, as well as 53% of the growth in the fast-moving sector, according to **Slice Intelligence**.

Network Effects

Rather than unfair competition, Amazon, Facebook and Alphabet's Google are the beneficiaries of the internet's winner-take-all dynamics, says Joachim Fels, managing director at Pimco. These superstars "benefit from network effects that are especially strong in social media and software platforms, where the value of the services increases with the number of users," Fels wrote. "Size begets size, which in turn begets size."

If someone wants to connect with friends or customers via social media, Facebook is the obvious choice: 85% of Americans who are online are members. Not even Google could compete with that. And if you want to shop, where else to start but Amazon.com, which lists hundreds of millions of items?

But natural or not, their advantages unnerve observers from the far left to the White House and even at the pro-market University of Chicago, which spawned the big-isn't-necessarily-bad legal shift under President Reagan.

Bipartisan Backlash

Before Steve Bannon was pushed out of the White House as President Trump's senior advisor and returned to the populist, right-wing news site Breitbart, he reportedly made the case that Facebook and Google's dominance made them "essential elements of 21st-century life (that) should be regulated as utilities." Could that be sour grapes? A majority of Americans now say they get their news from social media sites led by Facebook and from Google's search.

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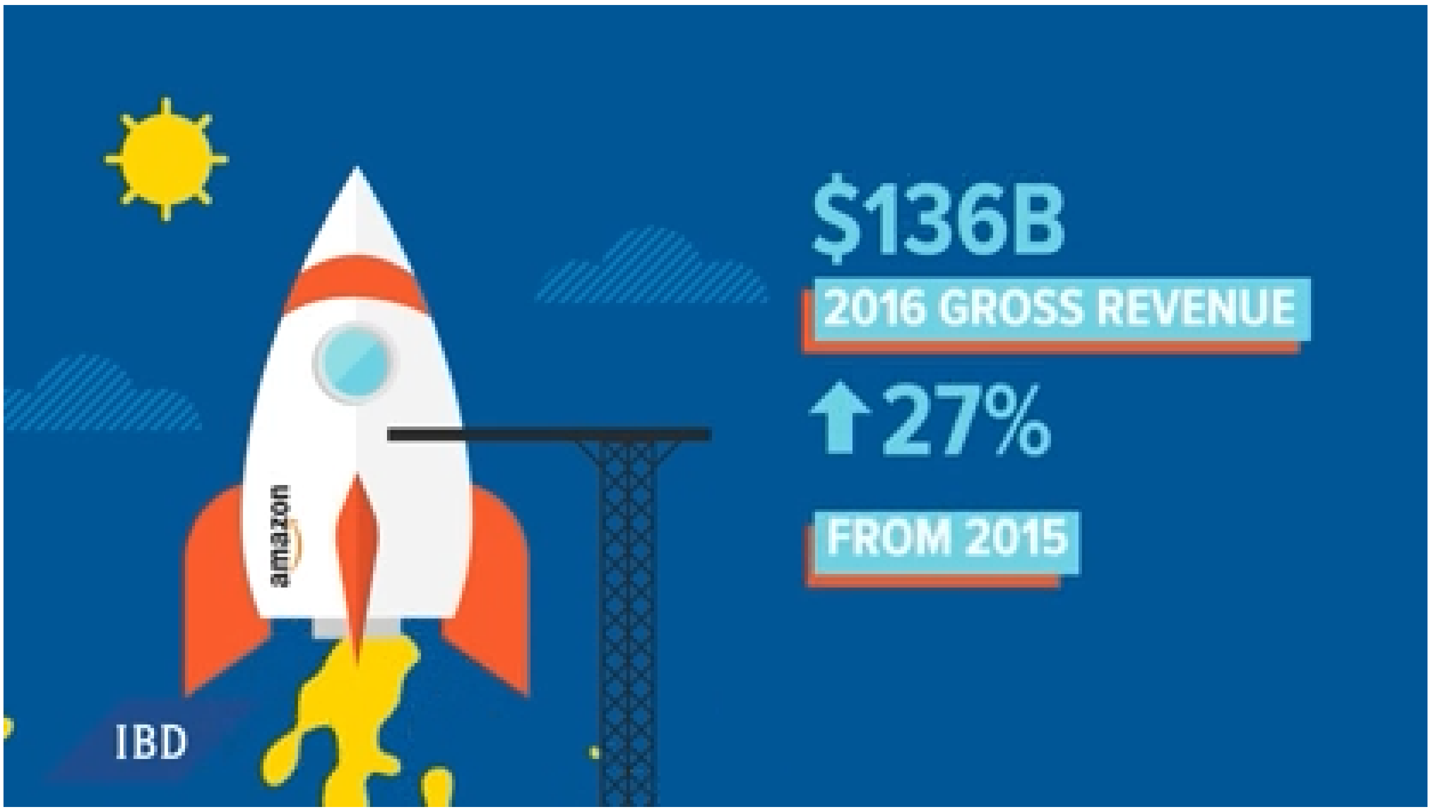

Yet many conservatives and even some libertarians with traditionally hands-off inclinations toward business are growing concerned over the internet giants' power. That's intensified after Google's recent firing of an engineer for politically incorrect views on women and the high-tech workforce, and moves by Facebook and others to combat "fake news" and ban offensive speech.

Trump raised the possibility of antitrust action against Amazon during the campaign. He still has CEO Jeff Bezos' empire in his sights, even if his real beef is with the Bezos-owned Washington Post. "Amazon is doing great damage to taxpaying retailers. Towns, cities and states throughout the U.S. are being hurt — many jobs being lost!" Trump tweeted recently.

Worries about Amazon's impact on retail jobs and wages also risk making it a prime target on the left. Democratic Party leaders called for an antitrust crackdown as part of their "Better Deal" economic platform in July. Although they singled out the cable industry, rather than the Silicon Valley and Seattle tech giants, that could change. Rep. Keith Ellison, who represents Minneapolis and serves as deputy chair of the Democratic National Committee, recently retweeted a Bloomberg opinion column titled "Should America's Tech Giants Be Broken Up?" with a one-word response: "YES!"

Innovation Stifled

Economists and technologists worry that these internet companies' dominance will snuff out innovation. Consider **Snap** (**SNAP**), which raised $3.4 billion in March in the biggest IPO in three years. Already hopes have faded that it might erode Facebook's position. Analysts say Facebook has simply copied Snapchat's popular features and left it in the dust. With Snap shares lagging below its IPO price, funding may be harder to come by for the next David to challenge a Goliath.

Luigi Zingales, finance professor at the University of Chicago Booth School of Business, is calling for a more-proactive antitrust approach that would have kept Facebook from buying up Instagram and WhatsApp. He says the antitrust action against **Microsoft** (**MSFT**) in the 1990s and early 2000s helped create a climate in which Facebook and Google could rise to the top. But he worries that the current crop of leaders are growing too powerful to cut into their advantage. "A system where this does not change is a system that is fossilized and hurts everyone," he said.

Current antitrust policy focuses on preventing companies from consolidating power to raise prices, harming consumers. But Lina Khan, until recently a fellow at the New America Foundation's Open Markets program, argues that a new approach is needed to address companies like Amazon that operate online platforms.

"The economics of platform markets create incentives for a company to pursue growth over profits, a strategy that investors have rewarded," Khan wrote in the Yale Law Review. "Under these conditions, predatory pricing becomes highly rational — even as existing doctrine treats it as irrational and therefore implausible."

Khan may have a point: While shares of Amazon are off their recent all-time highs, they are still up 33% so far this year, even as earnings are expected to sink more than 20% in 2017.

Amazon Prime may have started as a loss leader to gain customer loyalty, but Amazon has made the service so broad and attractive — offering free shipping, Amazon Prime Video, various special offers and now discounts at Whole Foods — that it is creating a world in which people make purchases only via the internet giant.

Already about half of U.S. households are Amazon Prime members. And 55% of all online shopping searches started on Amazon last year vs. 30% in 2012. In recent months, **Nike** (**NKE**) and **Sears** (**SHLD**) threw in the towel and agreed to begin selling their athletic shoes and Kenmore appliances on Amazon.

As for Google and Facebook, proving a price monopoly is a nonstarter since their services are free to consumers.

Confused Antitrust Goals

But if not by pricing control, how should a monopoly be defined?

Under the Democrats' "Better Deal" outline, regulators would use criteria to judge whether a merger would "reduce wages, cut jobs, lower product quality, limit access to services, stifle innovation, or hinder the ability of small businesses and entrepreneurs to compete."

Those guidelines hearken back to "the bad old days of antitrust, when it was used to protect inefficient small businesses and to pursue confused social goals," wrote Elizabeth Popp Berman, associate professor of sociology at the University at Albany in New York. "While no one thinks that low prices for consumers are the only thing worth pursuing in life, they are the appropriate goal for antitrust because they make it coherent and administrable."

That consensus is entrenched in the antitrust enforcement agencies, codified into law through court decisions and resistant to change.

Platform Rules

Still, the EU's fine of Google for abusing its dominant position in internet search could hint at future U.S. policy.

In prioritizing its own comparison-shopping site in search results, the European Commission said Google "denied other companies the chance to compete on the merits and to innovate."

Online platforms, Khan noted, "control the essential infrastructure on which their rivals depend."

In a reflection of the increasingly fragile embrace of Democrats and Big Tech, the Google-funded, left-of-center New America think tank last month cut loose the Open Markets group after it praised the European Union's fine vs. Google.

While Google disputes the EU's charge, noting Amazon's lead position in shopping searches, it agreed to make changes by Sept. 28. The EU also is scrutinizing Google's bundling of its Google Play app store with its free Android app.

Luther Lowe, vice president of policy at **Yelp** (**YELP**), a crowdsourced review site, called the Google fine "the most significant enforcement event in consumer tech antitrust in nearly 20 years," alluding to the Microsoft case.

Yet the Microsoft antitrust fight was expensive and dragged on for years, underscoring the limitations of traditional antitrust actions in a complex and fast-moving industry.

Tech journalist Walt Mossberg and economist Hal Singer have promoted addressing monopolistic and discriminatory competitive practices through a "special, permanent, nonpartisan, independent commission — or even a special, narrowly focused court — to adjudicate disputes about internet issues." The issues could run from network neutrality violations to heavy-handed behavior by Google or Amazon.

Singer notes that such a tribunal already exists to handle complaints that cable companies are giving preference to their own programming.

Common Carrier?

While Google is in the EU's line of fire now, Amazon is starting to come under the microscope.

Stacy Mitchell, co-director of the Institute for Local Self-Reliance and co-author of the report, "Amazon's Stranglehold," argued at a recent Forbes forum that Amazon's anticompetitive effect stems from its inherent conflict as both a direct seller and the operator of a platform that it invites other sellers to use.

Khan cites Amazon's big discounts from **Federal Express** (**FDX**) and **UPS** (**UPS**) as a high-volume customer. Amazon passes along those discounts to independent companies that use its fulfillment services.

Extending its empire to 460 Whole Foods stores substantially increases Amazon's logistics footprint, facilitating in-store pickup by customers and lowering the cost of last-mile delivery. Amazon already has been taking steps to increase its own delivery capability, in part with its Uber-like delivery force of flextime workers paid $19 to $24 per hour.

While customers cheer the convenience and low cost, critics argue that companies may have no choice but to use Amazon's fulfillment services if they want to get competitive shipping rates and favorable listings.

"What Amazon has done is turn an open market into a privately controlled arena where it sets the terms by which other players may buy and sell," Mitchell said at a Forbes forum. "That's why its platform has to be broken off from its direct retail and made to comply with common carrier rules."

Yet the idea comes across as so radical, showing how poorly antitrust law is suited to dealing with today's tech titans.

"You want Amazon to look like the local power company?" countered Geoffrey Manne, executive director of the International Center for Law and Economics. "Are you familiar with the amount of innovation in public utilities?"

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