

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE****Quality considerations in the zero-price economy – Note by Spain****28 November 2018**

This document reproduces a written contribution from Spain submitted for item 2 of the joint meeting between the Competition Committee and the Committee on Consumer Policy on 28 November 2018.

More documentation related to this discussion can be found at:

www.oecd.org/daf/competition/quality-considerations-in-the-zero-price-economy.htm

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1. The OECD has asked for contributions to the joint meeting of the Competition Committee and the Committee on Consumer Policy, scheduled for November 28, 2018. This contribution addresses the questions raised by the roundtable on “quality considerations in the zero price economy”, from a competition advocacy perspective¹.

1. Identifying dimensions of quality competition in zero price markets

2. In order to frame the debate, one initial point is that perhaps it is more accurate talking about non-positive pricing than talking about zero pricing. Sometimes, prices are even negative because products are not only free but also include additional services. Therefore, the distribution of prices is not bounded at zero. There is a continuous distribution of prices, which goes from (less frequent) negative values to (much more frequent) positive values. And this distribution of course includes zero pricing (Zero would be “just another number”²).

3. In situations of non-positive pricing, it is necessary to identify all other relevant product characteristics to infer the “actual price”, factoring in quality considerations. But this is not so different from other cases where price is positive. For instance, competition authorities do not focus only on prices (be it in a merger or in a conduct case). They also analyze quality (waiting times, duration of a trip, years of guarantee, different varieties...). If prices fall but quality goes down even more then there is an evidence of potential harm to consumers and total welfare.

4. Therefore, identifying quality is not such a different challenge in markets with positive and non-positive pricing. It is important in both contexts and it should not be necessarily more difficult where price is zero or below.

5. The tricky issue is not identifying quality in non-positive pricing contexts but identifying quality in digital markets. In digital markets many services are intangible, so quality is much more difficult to measure than when dealing with tangible goods (where one can look at years of guarantee, different varieties, power, energy efficiency...) or services (where one can look at waiting times, duration of a trip, frequency, energy consumption...).

6. Besides, in digital markets, scope economies and, especially, network externalities are much more frequent than in brick-and-mortar business, so services are

¹ Apart from “Identifying dimensions of quality competition in zero price markets” and “Challenges with competition analysis in the zero price economy”, the roundtable also aims at addressing “Demand-side concerns in the zero price economy”. This contribution focuses only on the first two topics.

² In the words of Evans (also quoted in the OECD Secretariat background note for this roundtable).

Evans, D. (2011), “The Antitrust Economics of Free”, John M. Olin Law & Economics Working Paper, University of Chicago, No. 555,

often tied and bundled. This makes quality very difficult to assess: are the bundled services independent or is one service part of the quality of the other?

7. Actually, the relevance of scope and network economies is an explanation for the incidence of non-positive pricing in digital markets. That is why both ideas (digital markets and non-positive pricing) are assimilated but then it is sometimes thought that identifying quality is daunting because of zero pricing when the challenge actually arises from the digitization of the economy.

8. Even if identifying quality in digital markets is complex (because of intangible services, tying and bundling...), there are still various valid options: personal data provided (a proxy of the privacy loss), time of attention, amount (e.g. number of banners or pop-ups) or time of advertising, the equivalent cost of premium services with higher quality (with stronger privacy or less ads), etc. The challenges of these options are assessed in the next subsection.

2. Challenges with competition analysis in the zero price economy

9. Zero pricing raises many challenges when practitioners have to apply conventional competition policy tools. Price has two advantages. On the one hand, it is the variable that better reflects competition dynamics in a market. On the other hand, it is a quantitative variable and hence tractable. Both features make prices an ideal variable to assess changes in consumer and total welfare when developing a theory of harm.

10. But, the fact that prices are zero does not make totally unfeasible the application of conventional competition policy tools. As was said before, identification of quality is not new to competition practitioners. And, despite the fact that in digital markets this is more challenging, some of the abovementioned proxies of quality (personal data, time of attention, density of advertising, cost of alternative premium services...) can be quantified, so changes in those variables can be assessed and comparisons between scenarios (actual and counterfactual) can be made. When these variables are rather qualitative (e.g. consumer inconvenience or privacy loss), they can be even transformed into quantitative or degree variables through various techniques (like consumer polls).

11. Sometimes the challenges for competition analysis in non-positive pricing markets are common also to positive pricing contexts. Needless to say, the most daunting challenge in a competition case is finding the counterfactual, in order to assess potential harm to consumer and overall welfare. This affects critical questions in competition like market definition or dominance.

12. For instance, one issue which is sparking lively debates is the level of user data needed to enjoy some services up to a point where it can be considered an exploitative abuse. Since the price of these services is zero or even negative, the exploitation of consumers would arise from the interpretation that the loss of privacy is equivalent to a deterioration of quality.

13. But proving an exploitative abuse is challenging anyway, even when it is done through (excessive) prices. First and foremost, proving dominance requires a robust market definition. Market definition is actually a specific challenge (on which we elaborate further below) in digital and zero pricing markets.

14. Besides proving dominance, showing the exploitative abuse can be tricky. And this challenge is common to positive and non-positive pricing. Regardless of the fact that

we are dealing with prices or with quality, a benchmark to compare with is needed in order to find the abuse: the extent to which the price is excessively high or the quality is excessively low. Using other countries as a benchmark might be unfeasible, since many companies in digital markets have privacy policies which do not vary across countries. And the comparison with other firms in different countries or in the same country but in different sectors may lack external validity.

15. Even in the case where a robust benchmark is found, the exploitative abuse must be proven by alleging that the difference (of prices or quality) between the actual level and the benchmark is excessive, which is finally a question of gradation and may involve some degree of judgement.

16. Another relevant task, if not the most, for competition policy practitioners is market definition. And in this case, as was said before, there are specific challenges of zero-pricing digital markets. Conventional tests for market definition rely on prices to assess demand substitutability, so an alternative tool is needed to assess demand substitutability depending on quality.

17. Leaving aside these specific issues of zero-pricing and quality, market definition is tricky because of the growing presence of platforms in digital markets. That is why it is so important to find the actual rationale for the zero pricing conduct.

18. More traditional explanations (building a consumer base or increasing the attractiveness of the firm) are not so relevant for market definition and the assessment of market power. In principle, these strategies are accessible to all firms without endogenous barriers, except for the fact that size normally can provide several advantages in this regard (given lower financial costs or agglomeration economies).

19. Other more modern and complex explanations for zero pricing, such as advertising or data accumulation, are of utmost importance because they are connected with the multi-sidedness of digital markets. In those cases, network economies (together with learning, scope and scale economies) can raise endogenous barriers to entry and growth in those markets, through chicken-and-egg and winner-takes-it-all dynamics. In other words, these strategies of zero pricing are not equally accessible to every competitor, so authorities must monitor them more closely.

20. At the same time, competition in digital markets can be a click/blink/swipe away, which is also relevant for market definition. Market power might be overstated if the definition is too narrow. Actual and potential competitors do not arise only from demand substitutability (firms or products which consumers consider substitutes) but from supply-side substitutability (firms which can rely on similar technologies to produce similar goods and services, even if they are not producing them).

21. To sum up, zero pricing in digital markets adds several challenges to competition policy. But these challenges normally imply the need to tweak, update and improve tools rather than revamping the conventional framework. So competition policy, with its current tools and flexibility, is equipped to deal with those challenges.