Monopoly Power? The Federal Trade Commission Wants to Break Up Facebook

Luca Formenti

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As of 2020, Facebook and its subsidiaries account for an estimated 70% share of the social media market, with roughly 5 billion active monthly users and almost one hundred billion U.S. dollars in ad revenues.1 While this undeniably powerful position has attracted criticism from politicians and economists for years, the United States' federal authorities did not directly react to it. This is about to change. On Wednesday, the Federal Trade Commission (FTC) announced a lawsuit against the conglomerate for breaking antitrust legislation. The main claim is that Facebook has been explicitly suppressing competition by buying up smaller companies to be able to collect monopoly rents. According to the attorneys filing the case, Facebook forces other companies into being acquired before they even have any possibility to threaten Facebook's market dominance by cutting off API access. Specifically, the FTC wants to unwind the acquisitions of WhatsApp and Instagram, i.e. require the sale of Facebook's two biggest subsidiaries. The first thing to be clarified is whether Facebook really does have monopoly power to a certain extent. The classical economic definition of a monopoly is a seller that is the only supplier of a particular good in combination with a lack of close substitutes. This unique position will enable the monopolist to charge a distinct monopoly price that lies well above marginal costs, which is contingent on the abovementioned substituteability of the good at hand, i.e. the degree of elasticity of the market demand, as well as the firm's marginal costs. The Lerner Index reveals this simple relationship beautifully:

$$p\left(\frac{1}{\eta_{\mathrm{p}}^{\mathrm{d}}}+1\right)=\frac{\partial C(Q)}{\partial Q}$$

The equation shows that as the price elasticity of market demand $\eta_{\mathrm{p}}^{\mathrm{d}}$ decreases, a firm with monopoly power will be able to increase its prices p even further. To which extent is this simplified model applicable to the case of Facebook? As we will see, not at all. First, as we can clearly infer from the Lerner Index, a monopoly is characterized by the control over effective industry supply, which provides for the power to adjust it contingently on the price elasticity of market demand. What actually distinguishes Facebook, however, is not the control over supply, but rather control over demand and its efforts to integrate it horizontally. In economic terms, such a firm is called a monopsonist. In contrast to a monopolist, a monopsonist buys goods as long as the marginal expenditure on a unit is smaller or equal than the marginal value of that good. A monopolist limits supply and drives market prices up, while a monopsonist regulates its purchases to push market prices down. Concretely, this means that Facebook has the ability to purchase goods for a lower price than in a competitive market, as it can exercise monopsony power over the sellers, which can be shown by the Buying Power Index (BPI):

$$BPI=\frac{\delta_{\mathrm{M}}}{\eta_{\mathrm{p}}^{\mathrm{S}}-\eta_{\mathrm{p}}^{\mathrm{D}}\left(1-\delta_{\mathrm{M}}\right)}$$

As we can see, the buying power of a monopsonist increases as the market share δ_{M} or the price elasticity of market demand $\eta_{\mathrm{p}}^{\mathrm{D}}$ increases, and decreases with an increasing price elasticity of total supply $\eta_{\mathrm{p}}^{\mathrm{S}}$. This relationship is quite intuitive: the more elastic the demand for a product, the higher the willingness of a firm to procure that product somewhere else, increasing its power to suppress bidding prices for single buyers. The more elastic the supply of a product, the higher the ability of suppliers to sell to other buyers, which decreases the buying power of a dominant purchaser by implication. This ability to purchase below the competitive market price creates, this time in analogy to monopoly power, a so-called deadweight loss, i.e. a loss in social welfare due to the inefficient allocation of resources. While mostly not critically scrutinized, after closer analysis, the monopsony power of Facebook turns out to be immense. In fact, all the suppliers – the users of Instagram, WhatsApp and Facebook – supply the "good" of personal data and human interaction with ads essentially for free. It would not be unreasonable to propose that the provision of data by individual consumers could indeed be monetized. This can be effectively prevented through the exercise of monopsony power; the elasticity of supply of social media use is very low, as almost nobody would be willing to switch from Instagram to other platforms that provide similar services. Similarly, the elasticity of demand is incredibly high – it would not bother Facebook a bit if one of the billions of sellers would quit using its services. Additionally, Facebook's market share is inordinate as well, as described at the beginning of this report. Taking all these factors into account in the equation above, it is very reasonable to conclude that Facebook's monopsony buying power is more than vast. Secondly, even if Facebook could be classified as one, a monopoly itself does not violate antitrust laws *per se*. The Sherman Anti-trust Act Section II Part II solely outlaws "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident", as established in the United States v. Microsoft Corp. case in 2001. Whether these criteria fit Facebook is certainly questionable, and actually proving that Facebook willfully maintains a monopoly position by suppressing competitors will be a tremendous challenge, especially since the main power of Facebook lies in the control of demand and not supply. Accordingly, one of the main remaining issues is that legal scholars fail to recognize that monopsony power is fundamentally different from monopoly power, and that one needs to tailor the respective legal measures to such a case. The attorneys' claims outlined in the beginning clearly demonstrate this fallacy. The first step would be to realize that there is economic value within the interactions of users and Facebook's several platforms, and that the harmful and anticompetitive behavior emerges through the capability of overseeing adherend effective demand. Often, the harmful effects of monopsony power are not conceived, as lower instead of higher prices are often associated with overall economic benefit for consumers. This erroneous perception of the relationship of a monopsonist and the sellers hinders a sensible antitrust analysis that reveals the fact that vast monopsony power does, in fact, create a substantial deadweight loss, and often leads courts not to consider monopsony cases with sufficient depth and rigor. Another problem that goes hand in hand with this lack of monopsony recognition is that even if Facebook's true form of market power would be recognized by the court, antitrust laws in monopsony cases require collusive behavior of several buyers. Nonabusive purchasing behavior conducted by single monopsonists, even if they are fully aware of their actions, do not violate antitrust laws. Therefore, it is questionable whether the current standing of antitrust legislation concerning monopsonies permit the prosecution of Facebook. However, bringing up a legal claim based on the potential monopsony power of Facebook is nonetheless more promising than relying on the monopoly assertion. The general goal outlined in antitrust legislation is, after all, consumer welfare. As long as there is proof of harm to end-user welfare, market power over input prices, and allocative efficiency, a case may be made with regard to antitrust violations through the exercise of a monopsony position.

To conclude, I personally believe that there is only a small chance that the FTC's lawsuit will be successful. Not only does Facebook have access to an Armada of top-notch lawyers, but the main issue is that the FTC fails to recognize that the true market power of Facebook does not primarily stem from the supply but from the demand side. Hence, while the FTC could potentially be successful to prosecute Facebook as a monopsonist, it won't be able to do so as long as it only evaluates the firm's breaches of certain sections of antitrust legislation, which are primarily designed to control monopolists. What adds more to the story is the fact that the FTC explicitly approved the acquisitions of WhatsApp and Instagram at the time. "Years after the FTC cleared our acquisitions, the government now wants a do-over with no regard for the impact that precedent would have on the broader business community or the people who choose our products every day," Facebook declared in a public statement on Twitter. Even if a legal claim could be established, there would be countless opportunities for Facebook to appeal the respective decisions, with high prospects of success. Consequently, I don't believe that we shall see a forced disinvestment of the conglomerate anytime soon.