Keynote speech

The challenges of big tech in finance

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The Challenges of Big Tech in Finance

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October 6, 2021
Bank for International Settlements
Outline

1. The Economics of Increased Concentration
2. Concerns about Digital Competition
3. Pro-Competition Digital Regulation
4. Handling Big Tech in Finance
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The market for beer

Anheuser-Busch
InBev

Heineken

Interpreting greater concentration

Increasing concentration could mean:

More competition

or

Less competition
Potential sources of increased concentration

Good/Natural Causes: *More competition*
- Superstar firms
- Globalization

Bad/Unnatural Causes: *Less competition*
- Reductions in merger and antitrust enforcement
- Increased regulatory barriers to entry

*Cuts both ways (natural cause but might have bad side effects):* Increasing returns to scale and network externalities
Some evidence for less antitrust enforcement in the United States

Number of Cases Filed by the Department of Justice Under Section 2 of the Sherman Act of 1890

Source: Grullon, Larkin, Michaely (2016).
Also, stronger intellectual property protections and potentially regulatory barriers
Retail concentration growth may reflect “good” causes while healthcare may reflect “bad” ones.

Change in Concentration, Markups, and Efficiency in the Retail and Healthcare Sectors, 1988–2015

Note: Concentration measured by Herfindahl-Hirschman Index (HHI); markups represent markup of price over cost; efficiency measured by output per hour. “Retail” is “consumer sector” in Crouzet and Eberly.
Source: Calculations based on Crouzet and Eberly (2018).
What about them? Good or bad sources of growth?

Source (images): Google (top left), Facebook (top right), Amazon (bottom).
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Features that make digital markets “winner take most”—through a process called **tipping**

- Network externalities
- Economies of scale/scope (near zero marginal cost)
- Data as a barrier to entry
- Capital and brands
- Behavioral features—consumers do not seem to switch

*These features are present in other markets as well, just not in nearly as strong a form individually and in combination.*
High or rising market shares

Chart 1.B: Combined indicative market shares of current leading two companies in selected UK digital markets

Sources: StatCounter\(^{21}\), Comscore\(^{22}\), eMarketer and company reports\(^{23}\)

Even with tipping, winners could be overthrown and replaced by another winner.

**Competition in the market**

Multiple competitors at a time

**Competition for the market**

One leader, can be replaced

Source (images): Fortune; NPR; Facebook;
Why is “free” costly?

- Zero is just another number—equilibrium price might be negative
- Pay more in cash due to advertising markups
- Pay in data, privacy
- Lost quality, variety
- Lost innovation
Not just organic growth, over 400 acquisitions (including aquihires) by major platforms as well

Google

Facebook

Source (images): Wikimedia.
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3. What Should Policy Do?

The UK Digital markets unit (as proposed)

The Code of Conduct is similar to existing antitrust rules

Principles for businesses with “strategic market status”:

- Access to designated platforms on a fair, consistent and transparent basis
- Prominence, rankings and reviews on designated platforms on a fair, consistent, and transparent basis
- Not unfairly restricted from, or penalized for, utilizing alternative platforms or routes to market
Digital markets unit

Develop with stakeholders

3 functions

Data mobility and open standards

Market A

Market B

3. What Should Policy Do?

Digital markets unit

Develop with stakeholders

3 functions

Data openness

Government has launched the Digital Markets Unit

Digital Markets Unit

A Digital Markets Unit (DMU) has been established within the CMA to begin work to operationalise the future pro-competition regime for digital markets.

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The internet was supposed to usher in a new era of competition

- Anyone can start a company in their dorm room.
- Low fixed costs, zero marginal costs.
- Can take advantage of the long tail.

But instead we’ve gotten more concentration.
Many also expected that the fintech space would create opportunities for new entrants.

- But we have also seen a large rise in big tech entering the financial space.
Is this good concentration or bad concentration?

- **The fine line**: leveraging market power in one sector to dominate another vs. providing benefits to consumers based on scale and scope.

- **Entering finance is different from selling books**: Amazon competes with small bookstores but big tech is competing with big finance, which often faces insufficient competition.

- **Concerns about regulatory arbitrage**: Tech is the ultimate unregulated sector, move fast and break things. To the degree it is arbitraging its (non-regulation) to succeed in a highly regulated sector.
Goals for public policy

• Keep as much good competition that benefits consumers as possible. If the digital giants are succeeding based on superior products and increasing competition in finance that is good.

• Pro-competition regulation from the digital side along with tougher merger enforcement to ensure a code of conduct, interoperability, and limit growth through merger.

• Maintain regulation from the finance side so big tech does not engage in regulatory arbitrage.

*It is hard to get this right—but even harder to clean up the errors later if policymakers get this wrong.*
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