



ECONOMIC ANALYSIS OF DIGITAL MARKETS ACT

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Lead Author: Robert Chovanculiak, PhD.
Institute of Economic and Social Studies (INESS), Slovakia

In partnership with:

Lithuanian Free Market Institute (LFMI), Lithuania
Centre for Economic and Market Analyses (CETA), Czech Republic
Institute for Market Economics (IME), Bulgaria

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Executive summary

The European Commission has presented a proposal for the Digital Markets Act (DMA). It aims to create fair and competitive digital markets in the EU and proposes to achieve this by introducing new *ex ante* regulations that will automatically apply to so-called “gatekeepers”. This group of gatekeepers will encompass a number of large internet platforms that meet selected size criteria.

This proposal has several shortcomings which may have a number of unintended consequences, harming both end and business users and slowing down the development and innovation of digital services in the CEE region.

The first shortcoming is the definition of “gatekeepers”. The suggested gatekeepers do not really have a dominant position within the economy as a whole. Within digital services, there is an intense competition between platforms against each other, while at the same time their position in the market is constantly being challenged by new innovators. In this regard, the European Commission’s proposals offer a static view of the market and competition. Public policy aimed at improving the EU’s innovation potential should look at more broadly defined and dynamic markets, taking into account the growth of new players.

The only area where the gatekeepers have the ability to influence the rules of the game is on their own platform. However, even though they have full control over setting the terms and conditions for users, they have no incentive to set them unfavourably as the interests of the platform are aligned with the interests of individual users. This is best seen when it comes to various practices that the DMA proposal restricts or outright prohibits.

In the study, we show that these business practices are time-tested and are legitimately used by many companies in the offline world. Moreover, there are a number of economic explanations in the literature as to why these business practices are not a manifestation of anti-competitive behaviour, but instead provide increased welfare for both the end and business users of the platform.

For these reasons, it is important for the CEE region to base public policy on a dynamic understanding of competition. Local digital markets are rapidly evolving and a number of fast-growing companies are emerging. Due to the potential leapfrogging costs of regulation, these companies may stall their growth, delay their entry into other EU markets or abandon the idea of joining with other growing companies to compete with more established platforms.

There are several examples of fast-growing digital companies from the CEE region, for example: internet security company ESET and mobile gaming company Pixel Federation in Slovakia; search engine Seznam and delivery service Rohlík in the Czech Republic; artificial intelligence company UiPath and other companies in the robotics sector in Romania; and IT company TenderHut in Poland.

We recommend a reconsideration of the centralisation and automated mechanisms of the ‘gatekeeper’ identification process and individual prohibited commercial practices within the DMA. From the perspective of the CEE region, it is important to maintain the dynamic element of competition. This can be achieved by replacing the static and *ex ante* approach in the DMA by a polycentric approach where capacities from member states are involved in decision making while maintaining an open regulatory dialogue in which internet companies themselves have the opportunity to participate.

At the end of 2020, the European Commission (EC) published [the Digital Markets Act \(DMA\)](#)¹ proposal as part of its European digital strategy. The DMA covers selected digital services, which are referred to as “Core Platforms Services”. Specifically, these are: online intermediation services (market places, app stores and social networks), (ii) online search engines, (iii) operating systems and (iv) cloud services.

For these types of services, the EC subsequently defined three criteria on the basis of which the EC will select specific companies and their platforms, which will fall under the label of “gatekeeper” and will be subject to the DMA. These three criteria are:

- Size and impact (annual revenues more than €6.5 billion, capitalization more than €65 billion)
- The control of an important gateway for business users towards final consumers (more than 45 million monthly active end users established or located in the EU and more than 10,000 yearly active business users established in the EU in the last financial year)
- Durability (maintains its size for at least three years)

Based on these criteria, only selected large foreign companies, also referred to as GAFAM (Google, Amazon, Facebook, Apple and Microsoft), will be subject to the DMA regulations. The DMA explicitly prohibits or instructs these “gatekeepers” to conduct certain business practices on their platforms. There are eighteen of these bans and orders in the DMA, and they are based on past or ongoing investigations and allegations related to [large technology companies](#)².

The DMA proposal includes measures restricting business practices such as bundling different services, e.g. by pre-installing applications and favouring own services on the platform, or direct competition between the platform (using its collected data) and its business users. The DMA is also pushing for opening up e.g. operating systems for alternative app stores. In addition, the DMA is proposing more “innovative” regulations such as requiring the platforms to allow business users access to their infrastructure and to their resources and data. In short, these eighteen prohibitions and orders can be summarized as an effort to forcefully open platforms to the outside world and remove or weaken the ability of the platform to actively manage the operating terms and conditions for all actors within its ecosystem.

In cases where a company, previously defined as a “gatekeeper”, is in violation of any of the rules as outlined in the DMA, they will face fines. The DMA proposes fines of up to 10% of total worldwide annual turnover. In addition, companies may be divided, forced to sell their assets or be deprived of their intellectual property.

The aim of the DMA is to ensure that the markets in the EU where “gatekeepers” are present are fair and competitive, as envisaged by the European Commission. It is hoped that the DMA will foster innovation, encourage high quality digital products and services, ensure fair and competitive prices and secure free choice for users in the digital sector.

What is the problem with the DMA?

There are a number of problems associated with this regulation. First of all, it is an *ex ante* regulation. This is a significant difference from standard antitrust policy, which generally proceeds *ex post* - the antitrust conduct must be retrospectively proven in court. In respect of the DMA, certain business practices are identified *ex ante* as automatically monopolistic, and subsequently prohibited or regulated. The platforms themselves have to declare to the European Commission that they meet the criteria to become “gatekeepers” and are subject to all regulations.

In this analysis, we will focus on two fundamental problems with the DMA.

The first problem is the meaningfulness of the very identification of some companies as “gatekeepers”. An important issue, which is largely unaddressed by the European Commission, is that of what exactly are the selected companies supposed to be gatekeeping. In other words, what is their real impact in the economy, on the internet or on their own platform.

The second problem is the assessment of the specific prohibited and mandatory practices that the European Commission requires of “gatekeepers” in the DMA. These practices are often those which have been used by traditional bricks-and-mortar offline businesses, practices that have robust explanations in economic theory pointing to potential social benefits. We will take a specific look at three case studies of which incorporate these particular business practices.

Gatekeepers of what?

According to the European Commission, „gatekeepers” are simply internet companies that achieve a certain level of revenue and have a large customer base. The very setting of the criteria gives the impression of „reverse engineering”. That is to say, the individual criteria have been set up so that only selected large companies based outside the EU fall within them. From this point of view, it is a trade war and the DMA thus brings together all the negatives that are associated with this type of public policy.

For this reason, it is desirable to take a closer look at the meaningfulness of the very concept of „gatekeepers”, and to answer a question that the DMA does not sufficiently answer: what are these companies the “gatekeepers” of? There are basically three possibilities: of all economic activity, of the activity on the internet, or of the activity on their own platforms.

Gatekeepers of economic activity?

There can be no doubt that internet companies compete with traditional, bricks-and-mortar service providers. However, this competition is very far from labelling large internet companies as the “gatekeepers” of all economic activity. Let’s look at two major sectors that have been significantly affected by the internet: retail and advertising.

In 2019, online sales accounted for an average of **7% of total retail sales in the EU**³. In the pandemic year of 2020, we can expect this share to increase, but it will still remain relatively low in the EU compared, for example, to the UK or the US. Of this, sales via the so-called online marketplaces (i.e. potential gatekeepers) accounted for only 1% of total retail sales.

The same is true for two countries with relatively well-developed internet commerce. In Germany and France, e-commerce accounts for approximately 14% and 10% of retail sales respectively and, of this share, sales through Amazon account for 27% and 17.5% respectively. Thus, Amazon’s share of retail sales is only 3.7% in Germany and 1.7% in France. This highlights that there are no internet “gatekeepers” in retail in the EU.

Few economic activities in the offline world have been so profoundly affected by the advent of the internet as the advertising business. At the turn of the millennium, internet advertising revenues were virtually non-existent and two decades later they are reaching €65 billion in the EU. However, internet advertising still only accounts for approximately **half of total advertising revenue**⁴.

We can describe the specific distribution of advertising revenues using Germany as an example.

Advertising revenues in Germany [%]	
Radio	4
Outdoor	6.5
Print	29
Television	23
Digital	37.5

Source: ANA, eMarketer⁵

In this breakdown, it is necessary to emphasize that revenues from digital (internet) advertising often include traditional media such as newspapers. Of the total share of 37.5%, large internet companies such as Google or Facebook receive 27%. So, even though these companies have the vast majority of their advertising revenue, they cannot be considered “gatekeepers of the advertising business” by far.

On the contrary, if we wanted to label them in some way, they instead be called “welcomers”, who have made advertising accessible and cheaper for many businesses and end-users. It has been estimated that due to better efficiency and more competition, advertising has become **90% cheaper with the advent of the internet**⁶. Similar conclusions hold true for transaction costs when small and medium-sized businesses are selling their products through internet companies such as Amazon. Therefore, large internet companies have increased the level of competition in the economy by helping many small and medium-sized businesses compete with large, established companies. Thanks to them, even a micro-business or a non-profit, for whom this was not possible before, can pay for targeted advertising with a budget of tens of euros. Internet advertising has taken over a portion of the advertising business, but at the same time it has made the whole sphere bigger.

Gatekeepers on the internet?

Logically, large internet companies have a more dominant position on the internet when compared with their position in the whole economy. However, when assessing this position, it is important to look not only at the static status, but also at how it has been achieved and how it has been dynamically evolving over time.

Essentially, a company can become successful **in two ways**⁷: When its customers have a choice and choose it or when they have no choice and have no other option but to choose it. A company that succeeds in the first instance is called an innovator. The one that succeeds in the second instance is a monopoly. At present, the world’s most successful companies succeeded in the first way. At first, each company had to convince customers that it had better services than their competition. Google better than Yahoo, Facebook better than MySpace, Amazon better than Ebay, Apple better than Nokia, etc. The „market dominance” of today’s tech firms can more aptly be described as “highest customer approval rate”.

Moreover, just because a company gets the “highest customer approval rate” in a particular segment (posting photos, videos, short videos, streaming, social media, search, interactive games, microblogging, etc.)

does not mean that it can abuse its position. Today, all the big internet companies are competing with each other for the most important commodity - attention of the end-users. This is where every company is in cross-competition with the others. At the same time, they are also competing for business users and advertisers.

In addition, there is constant and dynamic competition on the internet in the form of innovations and new approaches. For example, Amazon has a strong position in retail sales, but is being caught up by the Shopify commerce platform. The latter offers similar services to Amazon, but Shopify has identified a different approach. Instead of one big platform, it allows the emergence of a network of independent merchants. This new Shopify model grew faster than Amazon during the pandemic, reaching 40% of Amazon's GMV (Gross Merchandise Value - revenue processed by all stores built on the platform). It has already overtaken yet another e-commerce dinosaur, eBay, 3 years ago.

The situation is similar also when it comes to social networks. Among these social networks, Facebook is the one with the highest customer approval rate. However, TikTok has been nipping at its heels in recent years, reaching its first billion users **twice as fast as Facebook**⁹. In addition, in 2020, TikTok overtook Facebook in the US in the average number of hours a user **spends on a social network**⁹. TikTok is often referred to as a social network for the young, but the youngest actually spend most of their time on a new interactive game/social network called Roblox. In the US, children spend an average of 2.6 hours a day on Roblox, which is **twice as much as on TikTok or YouTube**¹⁰.

Even though a static view of market shares and overall size of different internet companies may give the impression of dominance, the reality is that within the digital market there is a constant flow of competing, innovating, shifting focus, restructuring business models, which ultimately leads to offering better services. Something that we expect from a competitive market and is absent in the case of monopolies.

Gatekeepers on their own platform?

Where the "gatekeepers" really have the position of a gatekeeper is on their own platform. However, this is not a bug, but a feature of the system that delivers significant potential benefits to all business and end users. The gatekeeper of a platform is its equity owner whose long-term interest is to maximize the value of its ecosystem and only the platform can do this by creating the conditions and rules that will **attract enough users to the platform**¹¹. We discuss the empirical relevance of this economic proposition below in three case studies.

In addition to competition between platforms, there is also an evolutionary development of the technology relevance. Thus, even if a platform maintains its market position in the long term, it can easily lose relevance. It will remain guarding the technology in which it provides the best service, but this evolutionary technological stage will become irrelevant in terms of impact and the attention of users, as well as government officials and politician, will shift elsewhere.

In the past, there have been many such shifts, for example, from hardware (IBM) to operating software (Microsoft) to web browsers (Chrome) to web services (Facebook, Amazon) to mobile phones (Apple) to mobile apps (TikTok). Today, a number of other evolutionary steps are already taking shape, from artificial intelligence, to augmented reality, to virtual reality, to various types of implants. This is the level of "meta-competition" to consider when evaluating the impact of "gatekeepers" on platforms.

For these reasons, it is important for the CEE region to base public policy on a dynamic understanding of competition. Local digital markets are rapidly evolving and a number of fast-growing companies are emerging. Due to the potential leapfrogging costs of regulation, these companies may stall their growth, delay their entry into other EU markets, or abandon the idea of joining with other growing companies to compete with more established platforms.

There are several examples of fast-growing digital companies from the CEE region, for example: internet security company ESET and mobile gaming company Pixel Federation in Slovakia; search engine Seznam and delivery service Rohlík in the Czech Republic; artificial intelligence company UiPath and other companies in the robotics sector in Romania; and IT company TenderHut in Poland.

Three case studies of internet companies' business practices

Google search pre-installed on mobile devices

There is currently an ongoing lawsuit in the US whereby [the Department of Justice is suing Google](#)¹² for alleged anti-competitive conduct. The subject of the lawsuit is that Google pays mobile phone manufacturers for pre-installing the Google's search engine into the devices. For example, Google pays Apple between USD 8 billion and USD 12 billion a year to have Google's search engine [pre-installed on their iPhones, iPods, etc](#)¹³.

There are a number of flaws in the efforts to restrict this business practice of the internet companies. The first is that this business practice is quite common in the offline business. Most often, a manufacturer (e.g. Coca Cola) pays a retailer (e.g. Tesco) to place his products in more exclusive areas of the store. This is a so-called "slotting contract" and the economic literature describes a number of reasons why it potentially [leads to higher welfare](#)¹⁴. Ultimately, this practice is nothing but a classic trade promotion and all the standard economic conclusions about the impact of competitive pressure on efficiency are valid here.

This practice, specifically in the case of Google, reduces the cost for consumers to search for the optimal app. At the same time, it leaves them free to choose other apps of their preference. In this way, some consumers benefit more by not having to decide and choose from a wide range of alternatives. Often these are indifferent consumers or consumers who prefer Google's services. A minority of consumers find this step slightly more costly as they have to install their preferred search application if their preferred app is not the one provided for by Google.

However, this is not the overall effect of this business practice on consumer welfare. The moment Google pays phone manufacturers to install its search engine, it is *de facto* subsidising the price of phones for end consumers. The price of phones is determined by supply and demand in the market, and Google's subsidy actually reduces the cost of producing a phone. Since phone manufacturing is a competitive market, manufacturers have to pass on some of this subsidy in reduced phone prices. This means that phone manufacturers (e.g. Apple) are indirectly [negotiating subsidies for their customers with Google](#)¹⁵. This seemingly suspicious business practice results in higher welfare for consumers.

Apple's closed operating system ecosystem

Apple has changed the way the phone looks - a touchscreen without buttons. Of similar importance, however, was how Apple changed the way the software works. In a world of relatively open operating systems like Windows, Apple came up with a radical change. Its iOS operating system was and is heavily closed, centralized and uses strict rules. This means that outside developers must abide by the rules of the iOS ecosystem, Apple has the right to review and potentially reject developer-designed apps and their installation by end customers is done exclusively through the App Store. Thanks to these innovations in ecosystem rules, Apple has been able to create a safe, secure, and convenient space for hundreds of millions of iPhone users. In doing so, it has also created sufficient demand for app developers' work.

Thus, Apple's closed operating system with one App Store is not necessarily the result of an abuse of dominance, but the result of an effort to maximize welfare for customers and developers. In a world of scarce resources and uncertainty, there is a real trade-off between security and open systems. Any pressure to open up the iOS to other alternative stores, or to weaken [Apple's position in application approval decisions](#)¹⁶, will inevitably lead to a decline in security for customers.

The question of iOS opening to alternative third-party stores is currently the point of a lawsuit between Apple and game studio Epic Games. The studio released an update to its Fortnite game for Apple devices in 2020, in which it allowed players to purchase in-game credits (called V-Bucks) outside of the official App Store payment system. By doing so, Epic Games broke the rules and therefore Apple pulled its game from the App Store. Epic Games points out that Apple has a monopoly within its iOS and does not allow third parties to open their own app stores on these devices. In turn, Epic Games says this leads to Apple being able to charge an unfair 30% fee for its services on the App Store.

There are several problems with this claim. First of all, Apple doesn't have a monopoly on distributing games to people. Epic Games studio can and does use a number of other platforms and stores. Their games are played through various consoles, Android phones, or PCs. They can sell their V-Bucks on all of these platforms. They even sell them outside of the online environment via physical vouchers in retail stores.

Second, Apple's 30% fee is not the exception but the rule. Other mobile stores like Google Play, Amazon Appstore, Samsung Galaxy Store and Microsoft Store charge the same. And the same amount is charged by online console game stores like Xbox, PlayStation, Nintendo and Steam. There are even higher fees on other well-known platforms like Twitch (25 - 50%), YouTube (45%), Amazon Video (50%), or readers like Kindle (30-65%) and Kobo (30-68%). A study by Analysis Group compared Apple's fees with those of bricks-and-mortar stores and concludes that **the latter take a higher share of sales**¹⁷.

In addition, Apple charges half the fee from those developers who have had subscribers for more than one year or who have sales of up to 1 million USD. It's also important to point out that Apple provides all of its iOS services even for apps that are free - which means that they don't have to pay Apple any percentage of their revenue. According to a study by the Progressive Policy Institute - if we take the total value added by apps in the App Store (both free and paid) and compare it to the total fees collected by Apple, we get an **overall fee rate of 4-7%**¹⁸. This overall rate better reflects the relative level of fees than the marginal rate of 30% for a small fraction of developers. Looking only at the 30% fee is like looking only at the price of the most expensive business class flight tickets and ignoring the economy class prices.

Own services as a tool for competition and self-promotion by Amazon

At the end of 2020, the EC issued a report on the conclusion of its preliminary investigation into Amazon's practices, stating that Amazon breaches the antitrust laws. EC claims that Amazon does so by abusing its dominant position, using third-party information from the platform in the subsequent sale of own-brand goods and takes the advantage of unfair competition against other sellers on its platform¹⁹.

There are plenty of examples of Amazon's business practices being used in the offline world, just like in the case of the previous examples. Bricks-and-mortar retailers have been using it for at least a century. For example, the well-known department store Sears Roebuck was sending out trade catalogues in the US, using it as a tool to get the data based on which it was producing its own products. As early as 1927 it was selling a broad portfolio of products **under its own brand**²⁰.

Today, this business practice is widespread and for many retail chains, the sales of own-brand products account for as much as 20-46% of their total sales. For Amazon, this share is **only 1-2% of sales**²¹, therefore, Amazon is not the one to start this business practice and is not the leader in it either.

The same applies when using public and non-public data to decide which goods to include in the own-brand assortment. The original retail chains used the aforementioned catalogues and customer order data. Today, the retailers have data from their own retail chain, e-stores or various loyalty programmes and they work with external companies (such as Microsoft) to evaluate this data.

On the one hand, it is clear that Amazon, which provides its own products, competes with other sellers who use the platform. However, it is a misunderstanding of the role of competition and the market when the European Commission assesses business practices as anti-competitive simply because they are unfavourable for some competitors. From this perspective, any innovation that lowers prices would be bad. In the market economy, the main criterion for the legitimacy of commercial practices is **consumer welfare**²². And in the case of Amazon-branded goods and services, it is clear that they bring consumers **lower prices and more stable quality**²³.

Moreover, issuing one's own brand and favouring it may even be beneficial to Amazon's sellers and competitors who sell on the platform. For example, the cheap and high-quality products available on the platform attract new customers and thus **increase the overall demand on the platform**²⁴. The data on the growing third-party sales share of total platform sales suggests that this is a real effect. In 2014, this share was around 50% and **today it has reached 60%**²⁵.

The same principles and conclusion apply in another lawsuit in which the European Commission is bringing similar charges against Google, which favours its own services and products through its search engine.

Conclusion

One cannot disagree with the objectives of the DMA “to promote innovation, high quality of digital products and services, fair and competitive prices, and free choice for users in the digital sector”. The problem is that the means chosen in the DMA to achieve them will not necessarily lead to their fulfilment. They may even have the complete opposite effect.

In our analysis, we have shown that although the EC has strictly defined the boundaries beyond which an internet company is a gatekeeper, it is difficult to prove that it is a gatekeeper that has a dominant position within the economy as a whole. Likewise, it is difficult to prove that it is a gatekeeper who does not have to face competitive pressure and new innovators on the internet. The only space where gatekeepers have the ability to influence the rules of the game is on their own platform. Although they have full control over setting the terms and conditions and can make them unfavourable for users, they lack the motivation to do so. As equity owners of the platform, their interests are aligned with the interests of all participants in their ecosystem. It is in their self-interest to set the terms and conditions for platform participants in such a way as to maximize the long-term value of the platform. If they do not do this, the relevance of their platform will decline and it will be crowded out by its competitors. In the online world, this is usually a very fast process.

This conclusion is confirmed also by the three case studies. These show how business practices used by gatekeepers, which would be restricted or prohibited by the DMA, have in fact been practiced in the past by traditional companies in the offline world. These business practices have the potential to increase platform efficiency and welfare of both merchants and consumers.

We therefore recommend to reassess the strict definition of the criteria that automatically classify an internet company as a gatekeeper subject to *ex ante* regulation. Such an automated and *ex ante* regulation cannot take into account the complexity and diversity of individual internet companies, their services, the different situations and conditions in each sector and, above all, the dynamic development of all these parameters over time.

We recommend replacing these proposed procedures with a much more individualised approach, whereby each company and its business practices are treated individually. This would allow them to engage in a dialogue and to present evidence and arguments regarding their classification as gatekeepers and also on the individual business practices they use, which are suspicious from the EC’s point of view.

We also recommend to reassess the centralisation of the whole process of identifying gatekeepers and individual business practices. Internet companies provide different services in different EU countries, have different market positions (see for example Alza vs Amazon in the Czech Republic and Slovakia) and are perceived differently by both end and business users. These conditions are best known to national antitrust institutions and should therefore have an important say in identifying gatekeepers and assessing their business practices. Such a polycentric approach to creating conditions for internet companies has several advantages over a **purely centralised approach**²⁶.

First of all, there exists a possibility for different authorities to specialise in different cases and to make use of existing know-how and human capital at the level of individual member states. The very process of “competition” in the evaluation of different internet companies is very important too, since it helps to discover the right regulatory framework for the internet ecosystem. This avoids the real risk of inappropriate EU-wide regulation being adopted at the centre, with the consequent costs hitting all countries. By contrast, in a polycentric model, there is much more room for experimentation and, if mistakes are made, they only have local effects. In this way we increase the likelihood that individual EU countries will identify the right regulatory processes and these can then be spread across the EU.

If the DMA is enacted as proposed, its operation may create a number of unintended consequences that will harm consumers, smaller businesses and significantly slow down the development of the digital economy in the EU. These unintended consequences may include:

- Invoking retaliatory measures at international level
- Reducing the accessibility of certain services to EU consumers (already demonstrated in practice following the introduction of the GDPR)
- Rules will favour platforms that European jurisdictions cannot reach (e.g. Chinese, Russian...)
- Reducing the security of services (or reducing the availability of the services as a consequence of reducing the ability to guarantee security)
- Distorting competition - the rules will create a cost „step“ that will be difficult/impossible to overcome for a growing service when reaching a certain threshold size
- Disrupting the flow of investment - the incentive for small growing companies to merge with larger ones will be reduced (after merging, they would become subject to the gatekeeper rules)
- Making things more difficult for small vendors/developers/.... The rules may cause platforms to look for other legal means to control entry to the platforms (e.g. technology, logistics and similar requirements)
- Mandatory opening of gates to all sellers/developers/... may lead to adverse selection. Large platforms may see more entry of lower-quality partners and exit of higher-quality ones (better matching the nature of the local ecosystem). This will not only lead to a decline of the platform, but also to the reduction in the quality of services.
- Legally restricting the creation of binding conditions on the platform will harm not only the platform, but also all the partners who have adapted to the rules (many because the structure of the rules suits them) and will have to face competitors who can legally circumvent the rules.

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About author



Robert Chovanculiak, PhD. is an analyst at INESS (Institute of Economic and Social Studies), Bratislava, Slovakia, and research fellow at the CEVRO Institute University in Prague, Czech Republic. Robert's fields of expertise are internet technologies, sharing economy, crowdfunding, economic policy and regulations. He authored numerous policy papers and reform proposals in these fields. His research papers have also been published in academic journals, e.g. paper on the Private provision of public goods via crowdfunding were published in Cambridge University Journal of Institutional Economics. He is also the author of an economic bestseller "Progress without Permission" which was also translated into Czech language.

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