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Digitalization and market concentration

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The trend towards global oligopolies challenges regulators

Artificial intelligence (AI), this topic is just on everyone's lips. AI raises complex questions: What will jobs look like in the future? Which professions will still exist at all? What can we believe in the future when fake news or generated audio and video clips flood social media? How can our democracies address such challenges?

The EU as pioneer of AI regulation

The very fear of an Orwellian future of systematic misinformation and threats to personal freedoms and privacy has prompted the European Union to take action. This month, Brussels adopted the world's first legal framework on AI. It will gradually come into force from next year. Some applications will simply be banned altogether (such as Chinese-style social scoring). Other applications will be restricted to a greater or lesser extent, depending on the risk. Deep fakes (Chancellor Olaf Scholz warmly congratulating Vladimir Putin on his election victory in a video message) will have to be marked as such.

The EU launches an AI framework

It came as it always does: some private sector representatives criticize the EU’s effort, claiming that the regulation is going too far and predicting that Europe will once again be left behind in technological progress. Meanwhile, consumer advocates argue that the regulation doesn’t go far enough. If you get equal criticism from both sides, you are usually approximately right. To me it seems that Brussels found a quite reasonable balance.

The winner takes it all!

But that does not mean that the challenges for the regulatory authorities are over. The competition enforcers are confronted

with a new reality. AI, like other digital markets, is almost limitlessly scalable beyond borders. This lays the groundwork for increasing global economic concentration. And it also entails the risk of abuse of excessive market power by a few companies.

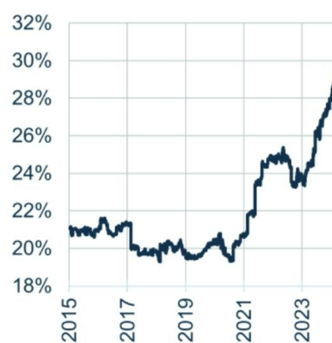
Global scalability leads to risk of market concentration

In recent months, LBBW Research has repeatedly pointed out the significance of a few tech stocks for the development of the stock market. Without the six top stocks, which now account for almost a third of the total capitalization of the S&P500, the US stock market would not only not have risen since the beginning of 2023, but would have actually fallen! Some are already warning of an AI-bubble comparable to the Dotcom episode.

AI euphoria is not comparable to the Dotcom bubble

In my opinion, the greater risk lies in the possibility that the valuations of the tech giants are actually justified. In the Dotcom bubble, many hyped companies lacked a sustainable business model (who actually remembers Pets.com?). The chart shows that the profit margins of today's Big 6 are indeed high and still rising rapidly. This suggests we are not looking at speculative exaggeration but rather at genuine market power.

Profit Margins of the 6 Tech Giants



Source: LBBW Research. (Margins of Alphabet, Amazon, Apple, Meta, Microsoft und Nvidia weighted by market capitalization. Last update: 12.03.2024)

Developments like these cannot leave the competition authorities indifferent. And indeed, they do not: earlier this month the EU commission fined Apple 1.8 billion euros for anti-competitive behavior in its App Store. The case brought about by Spotify, itself a dominant streaming behemoth. A considerable amount of money, you'd think. But it's peanuts for Apple. 1.8 billion euros is equivalent to the profit Apple earns in less than four days!

If the competition watchdogs fail to curb the pricing power of big tech companies like Amazon, Microsoft, Nvidia, Meta or Alphabet we as users all lose out. It remains to be seen, however, how national competition authorities can control global oligopolies.

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