Facebook

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Economics 101: Lecture 1: In a free market, a willing buyer negotiates with a willing seller, and all being well they agree upon a mutually acceptable price. If not, they walk away.

In the current world, there are five behemoths that attract immense interest, namely, Amazon, Apple, eBay, Facebook, and Google. However, none of them behave precisely according to the dictates of the above. In the first place, only three of them essentially engage in the selling of products and services to end users. Furthermore, Amazon and eBay are marketplaces where other parties offer their products for sale, mostly at fixed prices, although eBay sellers may also provide a “best offer” facility and the possibility of auctions which closely approximate the workings of a free market. Apple simply offers its products at its chosen retail prices, often in its own shops, although there is a vibrant secondhand market for those customers willing to forgo, at least temporarily, being at the cutting edge of technology.

The really unusual cases are Facebook and Google. The great majority of all people who have an internet connection use these websites, yet they mostly appear to be oblivious to the nature of the activities in which they engage. Clearly, these people are not buyers because access to these services is provided for free. Furthermore, if, say, a photo is sent via Facebook, they are not sellers either because no charge is being levied upon the recipient.

But if Economics 101 teaches us anything, it is that if something is being transacted that has a value, and hence an associated cost, it must be paid for by someone if the provider is not to go bankrupt. But if the person sending a photo by Facebook, or conducting an internet search via Google, is not paying, then who is the customer?

The answer, as so often in the modern world, is advertisers. But if so, what exactly are they buying? The answer is data – data relating to those who use the service. Every time websites are accessed, cookies are planted, and data are stored, and as the data on an individual accumulate, it becomes possible for an algorithm to sum up that individual’s behavior and interests and to send that person a directed advertisement. And because so much is known about the individual, advertisements need only be sent to those whose prior behavior indicates a much improved likelihood of a response. That knowledge is worth money.

If asked, most young(ish) people will probably take the view that they have willingly signed away their privacy in return for free goods and services, although, in reality, almost none of them will have bothered to read the long list of terms and conditions that they have agreed. These effectively allow Facebook, for example, to use anything posted for whatever purpose it sees fit, even after you close your account – which is extremely hard to do in practice. But in the majority of

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cases, users are not explicitly asked if they wish to trade their data for these freebies, and they tend not to pay much attention to the fact that the intermediaries such as Facebook, lying between their online selves and advertisers, have become numbered among the most wealthy and powerful organizations in the world – Facebook, for example, banked nearly US$5 billion in profits during a single quarter of 2017.

A major problem arises, however, if the vast data banks, accumulated by the likes of Facebook, are used for purposes other than helping advertisers to target their customers. There are many less desirable end uses for personal data, which is why databases are constantly under attack by hackers who have, on a number of occasions, managed to steal the information from millions of accounts held by a variety of companies such as banks and utilities. But most of these thefts have acquired only a limited amount of personal data and have quickly been forgotten even by those directly affected. Facebook is an altogether different proposition because it collects not merely data on, say, your utility account but on events in your daily life that, in many cases, you do not wish to be passed on to third parties.

And Facebook operates on a far different scale. At the end of 2017, Facebook had over two billion monthly active users, so it is – and essentially always has been since its inception – understandably willing to turn a blind eye to what its data are used for, provided they raise some revenue. Hence, it was, perhaps, only a matter of time before one of those uses triggered a scandal that Facebook could not brush under the carpet. In the event, this proved to be its admission, under duress, that unspecified forces in Russia had used its database to interfere in the run-up to the US presidential election.

Given the extremely acrimonious debate that surrounded the legitimacy of Trump's election, it is hardly surprising that the circumstances under which the apparently legitimate use of Facebook data for academic research resulted in the illegitimate use of that data by a third party, Cambridge Analytica, have triggered a political scandal.

However, the first point to note is that the financial consequences of recent events are yet unclear. Not surprisingly, Facebook's share price plunged in the immediate aftermath of the Cambridge Analytica scandal, and US$50 billion was written off its market value in the course of a single day. But Facebook's founder, Mark Zuckerberg, has been careful to construct a share structure that enables him to control 60 per cent of the voting shares while owning only 13 per cent of the equity. Furthermore, investors have seen the share price soar to such an extent that they are almost all still comfortably in profit and hence have no incentive to push down that price in the medium term – bear in mind that Facebook even now trades at "only" 23 times its estimated earnings in 2018, comparable to, say, eBay and well below Twitter.

A second factor is that there will inevitably be a significant switch of users to other social media, although, as noted, a user's history may still appear on Facebook. Instagram is heavily favored partly because most users are ignorant of the fact that Facebook acquired Instagram for a "mere" US$1 billion in 2012 – it also owns WhatsApp. Equally, like all social media, Instagram is already being targeted by trolls, judgmental friends and, naturally, political disagreements, so the surge in its popularity may not last.

In any event, the elephant in the room is that we have yet to learn the extent to which the likes of Instagram have themselves been accessed without the (overt) permission of users. What is known, for example, is that 20 million users saw content on Instagram created by fake Russian accounts, but this may prove to be just the tip of the iceberg.

In principle, it is possible to force Facebook to mend its ways via the threat of regulatory intervention, although this will largely be a matter for the US authorities, as the European Commission has only limited powers to control internet activities based in the USA. What it can do is impose fines for data breaches and raise taxes on turnover in the European Union (EU), and it is noteworthy that the Commission will shortly be extending consumer protection regulations across the EU to encompass digital services such as Facebook that collect users' data instead of monetary payment. The sanctions of up to 4 per cent of the company turnover are fairly swingeing, but this remains subject to the need to avoid escalating the growing trade war between the USA and the EU given that it will be American companies that will be sanctioned.

So will social media, specifically Facebook, be able to consign the present scandal to the history books as has always happened in the past? It is unlikely that investors will bail out of Facebook – after all, where else can advertisers go to access a billion customers? And social media users are much more likely to switch from one Facebook subsidiary to another than to opt out entirely.

So yes, the current scandal means that increased regulation is inevitable, but will even the massive press coverage seriously impact the younger generation's addiction to the lure of free goods and services in return for access to their personal data? Unlikely.

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