Politics and Business in Social Media

Regulatory Responses to the Cambridge Analytica Revelations

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Chairman Grassley, Ranking Member Feinstein, and members of the committee, thank you for the opportunity to appear before you at today's hearing on Cambridge Analytica and the Future of Data Privacy.

I have had the opportunity to study communications, media, and internet policy issues over the course of many years and in several capacities, including in my current positions as the director and Gunter Professor of the Public Utility Research Center at the University of Florida and as a visiting scholar at the American Enterprise Institute. While I am proud to be affiliated with these organizations, I am appearing today solely on my own behalf, and the views and opinions I express should not be attributed to any of the organizations with which I am or have been affiliated.

I can summarize my testimony in three sentences. First, the activity that led to this hearing and current controversy—using Facebook and other social media data in ways that are not transparent to users—is not unusual in modern political activity. Second, Facebook's problems appear to result from a rapidly changing company allowing its business model to drift from forming communities to serving advertisers and developers, not from a lack of regulation. Third, new regulations aimed at Facebook's errors are more likely to protect the business from competition than benefit consumers.

Let me address each in turn.

Political Campaigns and Facebook

The Cambridge Analytica revelations triggered alarm as if using Facebook data was something new in presidential campaigns. It is not. That is not to say that it was appropriate for Cambridge Analytica to use data that it apparently was not

supposed to have. Rather it is important to put the data use in context.

The masters at integrating politics and social media were President Barak Obama's national campaigns, but they were not the first to do so. George W. Bush's presidential campaigns are noted for outclassing opposing campaigns in terms of microtargeting voters and using statistical modeling,[1] but the Democrats caught up by 2006, and President Obama's 2008 campaign was unprecedented in the sophistication in using social media and data analytics.[2] His 2012 reelection campaign was at an even higher level. For this reason, and because more has been written about President Obama's campaigns than on others, I will focus on his campaigns.

From the start, President Obama's campaigns for national office were uniquely capable at obtaining and leveraging Facebook data and tools. Facebook cofounder Chris Hughes helped put together the new media strategy for Obama's US Senate and then 2008 presidential campaigns.[3] But as Tim Murphy of *Mother Jones* wrote, there was a problem: "Facebook's terms of use limited the extent to which outside groups can mine the site. But the Obama campaign has found ways around those barriers too (sic)."[4] More specifically, supporters were encouraged to log into My.BarackObama.com—a website where supporters could join local groups, create events, get updates, and engage in fundraising[5]—using their Facebook accounts. This gave the campaign access to their Facebook data, which the campaign then used for microtargeting.[6]

The 2012 campaign's use of social media and other data eclipsed by a wide margin all other political campaigns before 2012. Its strategic approach was based in part on advice from Eric Schmidt, then chairman of Google, and executives from Apple, Facebook, Zynga, Microsoft, DreamWorks, and Salesforce. The campaign hired experts in the use of big data for retail, social media, and data mining, who combined the 2008 data and data-gathering approach with data from numerous other sources, including information on people's media viewing habits, use of frequent-buyer cards from supermarkets and pharmacies, hunting and fishing licenses, magazine subscriptions, interests expressed on other social media sites, and membership rolls from labor unions, professional associations, and web browsing histories. All this was used for fundraising, developing volunteer networks, and messaging.

Facebook's rapid growth led to it becoming a major source of information and an important communication channel for the Obama campaigns. Using the 2012 campaign's 25 million Facebook likes, the campaign matched Facebook profiles

with other data to develop granular voter profiles.[7] The campaign's tech team was reputed to be able to exploit Facebook capabilities before even Facebook knew they existed. The team customized a Facebook app so that "if an Obama supporter had, say, one thousand Facebook friends, the campaign could determine that nine hundred of them were already for Obama, focus on one hundred who were persuadable, and ideally zero in on six or so who lived in battleground states and were in regular enough contact to be considered real friends, not just Facebook friends."[8] An opt-in Facebook outreach program sent supporters messages regarding, for example, whether their friends had voted and then encouraged the supporters to contact those friends who had not voted.[9] This required intimate knowledge of Obama supporters' Facebook friends and the nature of their relationships.

Another innovation was a program called Dreamcatcher, a tool that analyzed what people wrote on campaign websites to assess sentiments and shape wording for messages.[10] The campaign gathered people's writings by asking them to make notes or tell stories. For example, the Pennsylvania campaign website asked people to tell why they wanted to be involved in the campaign and what President Obama had done that benefited them. The campaign's tech teams then analyzed the text—looking for emotions expressed, sentiments, priorities, etc.—for purposes of targeted voter engagement and customized messages.[11]

President Obama's campaign also surpassed Mitt Romney's in terms of analyzing TV viewing habits in detail, enabling the Obama campaign to narrowly focus TV ads. According to articles in the *Atlantic* and ProPublica, the campaign matched lists of voters to the names and addresses of cable subscribers.[12] The campaign team built a tool called "the optimizer" that correlated set-top box data with the campaign's own data. This gave the campaign information on which households had, for example, watched the first presidential debate.[13]

Other campaigns have engaged in similar microtargeting and analytical efforts, including Mitt Romney's presidential campaign. But President Obama's campaigns were noteworthy for their unique access to Silicon Valley talent and their sophisticated use of Facebook and other social media information.

Facebook's Business Failings

I now turn my attention to the nature of Facebook's failings. The company's primary failure is not being clear and candid with its users. (I distinguish between Facebook's users, who are the subscribers, and the company's customers, who are

the entities that buy ads and other services because of the company's user base.) For markets to perform well, users should have complete and understandable information on the nature of the services they are using, even those that have a zero monetary price as in the case of Facebook. This isn't happening. The company has changed how it serves and uses its subscribers without ensuring that they fully understand Facebook's evolving roles in their lives.

Facebook's mission statement is: "Founded in 2004, Facebook's mission is to give people the power to build community and bring the world closer together. People use Facebook to stay connected with friends and family, to discover what's going on in the world, and to share and express what matters to them." This appears to have been true in 2004,[14] but things changed when growth and monetizing users became the company's primary metrics of success. In summary, Facebook morphed from a connector of communities to someone that investigates people's lives, filters their Facebook communications, and annexes nearby communities, such as Instagram and WhatsApp.

Facebook's rapid growth stalled in 2007, prompting the company to hire specialists whose primary purpose was to increase the number of regular users.[15] These experts, with backgrounds in internet marketing and building large customer bases, had direct access to Facebook CEO Mark Zuckerberg and provided a laser focus on growing the user base. The head of the first team, Chamath Palihapitiya, has expressed regret over what he appears to view as psychological manipulation that the company used to accelerate growth.[16] A former Facebook product manager has also lamented his role in "turning Facebook data into money, by any legal means."[17] These emphases led the company to begin developing ways for third parties to study users for retailing, scientific, and political purposes. It seems fair to describe the company's activity as gathering people into a context in which they reveal information about themselves so that others can use that information for marketing products and ideas. In a sense, Facebook's users are its product.

Facebook's shift in focus from creating community to growing numbers and serving marketers appears to be a case of a company allowing itself to drift: Each step over the years probably made sense by itself, but taken as a whole they constitute a change in who the company is. At one time Facebook was a place where friends could share with little thought about who might be watching. Reality changed long ago, but only now are some users catching on. They must feel like they have been in "The Truman Show"—a movie starring Jim Carrey in which the main character is living a seemingly ideal life in a friendly community until it is revealed that every aspect of his life has been captured by hidden cameras and

broadcast to strangers.

Many companies have gone down this road—taking their current customers for granted in some sense and focusing on monetizing them rather than respecting the relationships. For example, once it developed Windows, Microsoft knew it would be costly for people to switch to other PC-operating systems and applications because they would lose access to old files and struggle to share files with others. The company leveraged this for years by producing and charging customers for less than stellar versions of Windows. Customers felt compelled to "upgrade" because failure to do so could result in their being unable to share files with people who used the newer version. This gave Microsoft large profits for a while, but the profits became opportunities for Apple, Google, and others, who have given customers great alternatives to Windows. Windows' loss of prominence led Microsoft to recently announce that it will no longer have a Windows division.[18]

One of Facebook's methods for expanding its reach was developing News Feed, which sends content to users based on Facebook's algorithms. News Feed has been profitable for Facebook,[19] but it has changed the company's relationships with its users. Now Facebook effectively chooses what people see, and it favors particular types of content. A recent and perhaps most famous episode is the suppression of content from Diamond and Silk. It seems fair to say that Facebook has become a discussion monitor, determining who is allowed a voice and who hears what voices on the platform. This is different from being a builder of community where everyone is connected and free to express him or herself.

The qualities of Facebook's advertising algorithms made the site popular with persons who want to communicate political messages. Indeed, Facebook encouraged this by allowing politicians to make profile pages before it allowed others. One of its first customers was Sen. Barack Obama (D-IL) in 2006.[20] But great targeting algorithms are valuable to good people and troublemakers alike, making Facebook a great place for Russians to disrupt political relationships in the US. The revelation that content on Facebook—some from fictitious persons—is not as trustworthy as people thought diminished the value of the network and created a political backlash. The company responded by engaging in further clampdowns, which only served to emphasize that the company is a filter rather than an open channel for communications.

Regulatory Response

I now turn my attention to my last point—namely that any new regulations

intended to address Facebook's challenges are likely to harm Facebook users. There are two reasons. One is that the problems are business problems that commonly occur. What makes this instance notable is that it has happened in a company that has about half the world's internet users as its base.[21] The second reason is that new regulations would likely serve to protect Facebook and other large internet companies from competition.

I have already described what I understand to be the nature of Facebook's problems. These show a company losing its focus and creating conflicting roles for itself with respect to its users. These problems are not unique to business: Government institutions, nonprofit organizations, universities, and religious institutions all commit similar errors.[22]

Losing focus should not be illegal. Such mistakes are natural results of innovation and change, and an opportunity for competitors, so restricting them would be futile and would damage a dynamic tech economy. It is beyond my expertise to say if the company behaved fraudulently or broke agreements with users—and I have no information that would lead me to believe that either has happened—but if it has done either, existing laws can address the situations.

Furthermore, any attempt to make such business mistakes illegal would likely make things worse since regulators would be making judgments on business models and strategy. Experience has shown that customers and businesses have better information on what customers value than do government regulators, making the free market the better disciplinarian than a less-informed regulator.

Another consequence of new regulations would be less competition for large tech companies, such as Facebook. The European Union's new regulations on data collecting, storage, and use, called the General Data Protection Regulation (GDPR), provide an excellent case in point. As my colleague at the American Enterprise Institute, Shane Tews, recently explained:

> [The GDPR requires] companies that collect or use personal data to ask for consent from their (European) users or customers. To comply with the GDPR, a company must protect information such as users' internet protocol (IP) addresses and cookie histories in addition to data such as names, addresses, government ID numbers, biometrics, race or ethnicity, sexual orientation, political opinions, and tagged photos. All organizations that collect personal information (including third-party vendors) are considered data controllers and are accountable for any data collected, processed, or

disseminated on an EU citizen. This includes companies that maintain databases containing personal data, even if they do not have a physical presence in the EU.

They also have to be prepared for requests from EU citizens, who can ask for their information to be corrected, updated, or deleted by the organization holding the data.

According to a recent PricewaterhouseCoopers survey, 77 percent of US companies expect to spend about $1 million or more to comply with the GDPR. Companies with the capability to separate and migrate data are moving quickly to transfer customers' data physically located in the EU onto servers in the US.[23]

These regulations put governments in a troubling role of setting boundaries on what people can know and how they can use what they know when the information is legitimately obtained. While narrowly targeted restrictions on data retention and use might make sense in the well-defined context of physician-patient relationships, for example, broad application impedes freedom, stifles innovation, and raises costs.

These effects on innovation and costs will lessen competition, resulting in harm to customers. Innovation is important to the competitive process. Economist Joseph Schumpeter called this creative destruction and explained that it is essential to well-functioning markets.

Numerous economic studies have demonstrated that regulations create costs that favor large incumbents. As economists James Bailey and Diana Thomas recently wrote:

> [Regulation] represents a significant barrier to entry for new firms that seek to enter a market. Knowing the ins and outs of a specific regulatory framework that governs a particular industry represents a fixed cost of doing business that can be difficult for new entrants to an industry to overcome. . . . [It also] leads existing firms to engage in less risky and innovative behavior. [And] regulatory compliance costs represent a differential burden for small versus large firms.[24]

Their study of the US economy found that increased regulation leads to fewer new businesses, less small business creation, and fewer large firms being replaced by

new competitors. Earlier studies also support these conclusions.[25]

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Chairman Grassley, Ranking Member Feinstein, and members of the committee, this completes my written testimony. I look forward to answering any questions you may have.

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[1] Microtargeting is identifying voter interests and propensities at a granular level so that a campaign can tailor messages, leverage relationships, and personalize interactions. Statistical modeling is applying advanced statistical methods to massive amounts of data to discover patterns in voter behavior that would be missed by more casual observations and conventional wisdom.

[2] Sasha Issenberg, "A Vast Left-Wing Competency: How Democrats Became the Party of Effective Campaigning—and Why the GOP Isn't Catching Up Anytime Soon," Slate, November 7, 2012.

[3] Tim Murphy, "Inside the Obama Campaign's Hard Drive," *Mother Jones*, September/October 2012.

[4] Murphy, "Inside the Obama Campaign's Hard Drive."

[5] Brian Stelter, "The Facebooker Who Friended Obama," *New York Times*, July 7, 2008.

[6] Henry Blodget, "How Facebook Co-Founder Chris Hughes Got Barack Obama Elected," Business Insider, June 2, 2009.

[7] Jonathan Alter, "Did Hipster Tech Really Save the Obama Campaign?," *Wired*, June 4, 2013.

[8] Alter, "Did Hipster Tech Really Save the Obama Campaign?"

[9] Alexis C. Madrigal, "When the Nerds Go Marching In: How a Dream Team of Engineers from Facebook, Twitter, and Google Built the Software That Drove Barack Obama's Reelection," *Atlantic*, November 16, 2012.

[10] Sean Gallagher, "Built to Win: Deep Inside Obama's Campaign Tech," Ars Technica, November 14, 2012.

[11] Sasha Issenberg, "Project Dreamcatcher: How Cutting-Edge Text Analytics Can Help the Obama Campaign Determine Voters' Hopes and Dreams," Slate, January 13, 2012.

[12] Madrigal, "When the Nerds Go Marching In"; and Lois Beckett, "A New Look at What the Obama Campaign Did with Its Much-Heralded Data Operation," ProPublica, November 29, 2012.

[13] Spencer Ackerman, "Wrath of the Math: Obama Wins Nerdiest Election Ever," *Wired*, November 6, 2012.

[14] Ben Mezrich, *The Accidental Billionaires: The Founding of Facebook, a Tale of Sex, Money, Genius and Betrayal* (New York: Doubleday, 2009).

[15] Mike Hoefflinger, *Becoming Facebook: The 10 Challenges That Defined the Company That's Disrupting the World* (New York: HarperCollins Publishing, 2017).

[16] James Vincent, "Former Facebook Exec Says Social Media Is Ripping Apart Society," Verge, December 11, 2017.

[17] Antonio Garcia-Martinez, "I'm an Ex-Facebook Exec: Don't Believe What They Tell You About Ads," *Guardian*, May 2, 2017.

[18] Tom Warren, "Microsoft Is Ready for a World Beyond Windows," Verge, March 30, 2018.

[19] Hoefflinger, *Becoming Facebook*.

[20] Blodget, "How Facebook Co-Founder Chris Hughes Got Barack Obama Elected."

[21] According to Statista, the number of internet users worldwide was 3.6 billion in 2017, while the number of monthly active Facebook users was 2.2 billion. See Statista, "Number of Internet Users Worldwide from 2005 to 2017 (in Millions)," accessed May 12, 2018, https://www.statista.com/statistics/273018/number-of-internet-users-worldwide/; and Statista, "Number of Monthly Active Facebook Users Worldwide as of 1st Quarter 2018 (in Millions)," accessed May 12, 2018, https://www.statista.com/statistics/264810/number-of-monthly-active-facebook-users-worldwide/. Internet World Stats estimates the number of internet users worldwide to be 4.2 billion. See Internet World Stats, "Usage and Population Statistics," accessed May 12, 2018, https://www.internetworldstats.com/stats.htm.

[22] Marketing experts Al Ries, Jack Trout, and Philip Kotler have documented numerous instances in business. See Al Ries, Jack Trout, and Philip Kotler, *Positioning: The Battle for Your Mind* (New York: McGraw-Hill Education, 2001).

[23] Shane Tews, "Privacy and Europe's Data Protection Law: Problems and Implications for the US," AEIdeas, May 8, 2018, http://www.aei.org/publication/privacy-and-europes-data-protection-law-problems-and-implications-for-the-us/?utm_source=newsletter&utm_medium=paramount&utm_campaign=cict.

[24] James Bailey and Diana Thomas, "Regulating Away Competition: The Effect of Regulation on Entrepreneurship and Employment," *Journal of Regulatory Economics* 52, no. 3 (December 2017): 237–54.

[25] See, for example, S. Djankov et al., "The Regulation of Entry," *Quarterly Journal of Economics* 117, no. 1 (2002): 1–37; L. Klapper, L. Laeven, and R. Raghuram, "Entry Regulation as a Barrier to Entrepreneurship," *Journal of Financial Economics* 82 (2006): 591–629; and K. Nystrom, "The Institutions of Economic Freedom and Entrepreneurship: Evidence from Panel Data," *Public Choice* 136, no. 3/4 (2008): 269–82.