



The Hidden Costs of Free Goods: Antitrust Implications

Prof. Michal S. Gal

Prof. Daniel L. Rubinfeld

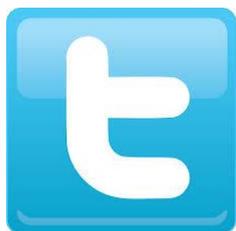
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Motivation

- Free – an important part of our ecosystem

- Why?

Google



Dropbox



WIKIPEDIA
The Free Encyclopedia



- Welfare effects?
 - Intuitive: give us more!
 - Second thought: tell us more!
- Implications for competition law

Motivations for Supply

Traditional motivations

- Economic
 - Direct cross-subsidies
 - Three-party two-sided markets
 - Freemium
 - Reputation and control
 - Exclusionary
- Cooperative creative activity: FOSS, Wikipedia
- Public recognition, influence, or political power
- Philanthropic – e.g., food and shelter



Motivations for Supply

New Learning – the “Free Effect”

- Zero as a focal point
- Behavioral economics shows that zero has a special value
 - Holds even when free is part of a costly bundle
 - Holds when goods are complements
- Free evokes a positive “affect”
- Free may have “nudge” qualities

Economic Effects?

- **Basic assumptions do not hold:**
 - Price does not cover the cost of production
 - Demand may not be correlated with quality
 - E.g., Network markets
 - Market players may not be profit-maximizers



Potential Positive Effects

- Saves costs (+free affect)
- Strengthening cross-network effects
- Competition over quality (+affect)
- Contribution to quality (FOSS)
- Increase demand: learning curve, reputation (Waze)



Starting point: free is socially beneficial



Potential Harmful Effects (1)

Benefits dwarfed by harm?

■ Bundling

- Exclusionary effect (+free affect)

■ Profit-making free-standing free goods

- Two-sided (Google) or two-staged (Waze)
- Unique nature: careful analysis
 - all affected markets should be analyzed
 - incentive to keep quality high
 - recoupment a preliminary indicator
 - exclusionary effects similar to bundling
 - maturity of the market is relevant

**Totally
FREE***

** not actually
free*



Potential Harmful Effects (2)

- **“Real” free goods**

- New goods
- May not allow as-efficient firms to compete (firms exit and re-entry costs are high)

Yet is welfare harmed?

- Production may be disrupted
- Product quality may be reduced

- **Can we rely on consumer choice?**

- Costs often indirect and not readily visible
- There are collective action and free riding problems

- **Fairness considerations**

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Implications for Competition Law (1)

- Difficult to account for non-economic concerns such as privacy
- Can an effects-based balancing analysis be workable?
- **Market definition**
 - Excellent example of need to modify
 - SSNIP test: 5-10% increase remains zero
 - *Kinderstart v. Google*: no relevant market
 - Search: The relevant market is on-line advertising
 - *Microsoft/Skype*: market in which all free goods.
 - SSNIQ? (Q=quality)

The Google logo, consisting of the word "Google" in its characteristic multi-colored font.The Skype logo, featuring the word "skype" in a blue, rounded font with a trademark symbol.

Implications (2)

- **Analysis of motivation**
- **Market Power**
 - Margins are not good indicators of market power
 - Must look at constraints in related markets
 - Expand analysis to cover quality, information costs and consumer choice
 - Innovation is likely to be an important issue
 - When all supply free goods (*Microsoft/Skype*)
 - Any attempt to raise price encourages switching
 - Real free goods?
 - Effects of changes in quality on market shares



Implications (3)



Welfare Analysis

- Focus on the interaction of the free good
 - False negative: focusing only on free goods
 - False positive: focusing on paid-good market
- Free does not imply a lack of welfare effects
 - Strongest case: bundling as a penetration strategy
 - Standalone free goods are unlikely to be a problem
- Is harm to one justified by benefit to another?
- Goal: consumer welfare, social welfare, or an effectively competitive process?

Predatory Pricing

- Dangers of an overly simplistic application
- **False positive**
 - Price below an appropriate measure of cost
 - EU law: presumption of illegality
 - French case: *Bottin Cartographes*
 - “Real” free goods might also be considered illegal
- **False negatives**
 - Recoupment in free goods market
 - Need to look at interrelated markets
 - *Wallace vs. IBM*: Easterbrook: When recoupment is improbable, there is no antitrust problem.

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Non-Monetary Effects

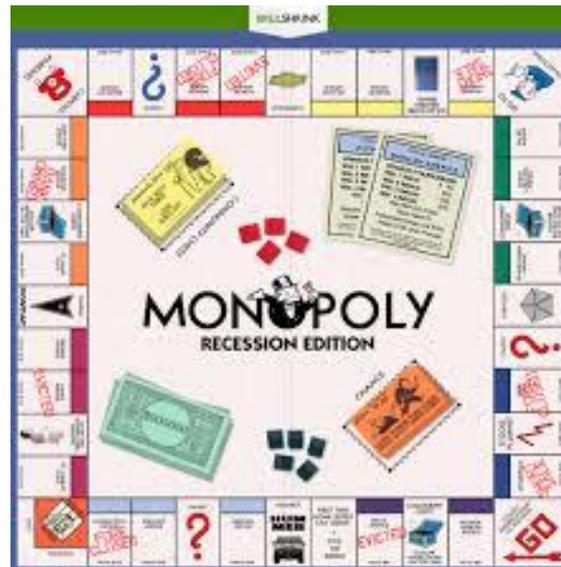
Should endeavor to identify and quantify?

- Decision-making is more complex, but nevertheless important
- Affect the efficient workings of the market
- Institutional difficulties
 - no expertise
 - economic models: no clear answer
- Administrative alternative, problem-solving
 - Effects on price and quality remain important
 - Regulatory options may be relevant



Attempted Monopolization

- Increased need to capture attempts to monopolize (+free affect)
- Regulates conduct ex ante, difficult to undo



Case Study: The Microsoft Browser

- IE “forever free” as a separate product
- IE bundled with the OS in Windows 98
- Is this predation in a separate browser market?
- Does this support a “maintenance of monopoly case?”
- The Court rulings
- Lessons

Case Study: The Google Investigation

- Dominant in search, smartphone OSs, and app stores for the Android OS
- Possible Article 102 violations (abuse of dominance)
 - Bias against display of rival shopping services?
 - Pre-installing Google Search and Chrome and setting Google search as the default
 - Offering financial incentives to exclusively install Google Search
 - OEMs cannot sell phones running on competing OSs that are Android based

Google Search - Issues

- How would these cases fare under U.S. law?
 - Exclusionary conduct?
 - Predation?
- How does one show bias?
- Lessons from prior Microsoft cases
- Applying Article 102

Conclusion

- Essential to recognize welfare issues
- Usually positive welfare effects
- Yet even “real” free goods might have price tag
- Require flexibility and awareness
- Antitrust not always the solution



Thank You!

