

Pro-Innovation Competition Policy: Microsoft and Beyond

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How Should Competition Policy Transform Itself?
Designing the New Competition Policy
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Principles of Sound Competition Policy

- Competitive market mechanism
 - Not regulatory
- Support the market
 - Not replace it

Persistent Errors

- “the free market” defined as no government action
- Pro-competition policy and pro-innovation policy are opposites

Tasks of Competition Policy

(we will examine in Innovation Context)

- Horizontal Agreements
- Anti-Monopolization
- Damage Control (anticompetitive regulation)

Tasks of Competition Policy

Innovation Context

- Horizontal Agreements
 - Mergers or contracts between incumbents, innovative entrants
- Anti-Monopolization
 - Incumbent monopolist raises entry barriers
 - Group of Oligopolists raises entry barriers
- Damage Control (anticompetitive regulation)
 - Regulation biased against innovative entrants
 - From overseas (marketing, business model innovation)
 - With new technology (technical innovation)

Hypothetical Monopolization (consensus)

An incumbent monopolist.

New entrepreneurial technology => threat or new competition.

Monopolist imitates. Free market prefers entrepreneurial technology.

Wave of new entrepreneurs.

Incumbent monopolist offers to pay the first entrepreneur not to compete. “No.”

Monopolist: distribution channels must not distribute entrepreneur's technology.

Without widespread distribution, the first entrepreneur fails.

Wave of entrepreneurship stops.

The threat of competition passes, leaving the monopolist in place.

Very Rare? Impossible?

An incumbent monopolist. Microsoft

New entrepreneurial technology => threat or new competition. Browser

Monopolist imitates. Free market prefers entr Browser War on Merits.

Wave of new entrepreneurs. Internet

Meetings

Incumbent monopolist offers to pay the first entrepreneur not to compete. "No."

Monopolist: distribution channels must not distribute entrepreneur's technology.

Without widespread distribution, the first entrepreneur fails. ISP, OEM

Wave of entrepreneurship stops.

distribution

The threat of competition passes, leaving the monopolist in place.

Only Microsoft Software in key PC
& Internet connection technologies

Server side is more competitive, but
PC and access to server are bottleneck

Microsoft

- Discard myths
- Lessons for competition policy from Microsoft's success at monopolization
- Lessons for competition & innovation policy from Microsoft's failure at competition on the merits

Microsoft Myths to Discard

- “accused of competing too hard”
 - “Competing too hard” is not illegal and Microsoft did not do it.
- “accused of innovating too fast”
 - “innovating too fast” is not illegal and they didn’t do it
- “Government was picking winners”
 - Lower entry barriers would have let the market decide on the winner

Competition Policy Lessons

- Monopolization is Real
- “Vertical” Monopolization Cases Exist
 - Browser was complement to Windows monopoly
 - Successful Browser would lower entry barriers
- Monopolists Can Hold Entry Barriers High
 - Failure of Browser (caused by distribution restriction)
 - Market forces would have lowered entry barriers

Competition & Innovation Policy

- Fact 1: Microsoft did not invent or commercialize the browser
- Fact 2: Browser imitator Microsoft could not catch up to browser innovator Netscape without blocking Netscape's distribution
-Microsoft failed at competing on the merits

Competition & Innovation Policy Lessons

- No opposition between Innovation and Competition in Schumpeterian Industries
 - Innovation is a form of competition
 - Entry barriers are block to innovation competition
- Government Policy to prevent high entry barriers was both pro-competition and pro-innovation

Competition & Innovation Policy Lessons

- Outsider's Incentives for Innovation
 - Entry Barriers
 - Expropriation of returns by Incumbent Monopolists
 - (motivation for open source movement)
- Network effects and innovation incentives
 - Innovation in Applications Software raises returns to Windows
 - Monopolist can expropriate more of returns to applications innovation

Innovation from entrepreneurs more broadly

- Economic Value from graduates of great universities
- ... and from entrepreneurs
 - Larry Ellison (Oracle), Mark Andreessen (Netscape)
 - (college dropout) Bill Gates (Microsoft 1975)
- Economic Value from the great established companies
 - IBM (1975); Microsoft (1995)
- ... and from entrants / outsiders
 - Microsoft (1975); Netscape (1995)
 - Many others

Using those Lessons for the Three Tasks of Competition Policy

- Horizontal Agreements
- Anti-Monopolization
- Damage Control (anticompetitive regulation)

Anti-Monopolization

- Lessons of *Microsoft* are obvious.
 - Policy should oppose entry-barrier raising monopolization.
 - Practical caution: US won the *Microsoft* case, but the “remedy” does very little. Against a very successful monopolist, have (1) a very strong case and (2) luck.

Horizontal

- Agreements Among Competitors
- Role of Entry.
- Easy entry => don't worry.
- Entrants as part of the agreement among competitors => potential worry.

Three Contexts and a Proposal

- Mergers to settle patent lawsuits
 - Mergers with innovative entrants
 - Patent lawsuit settlements in which the *injuring* party is paid.
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- Conceptually, competition from entrants is competition
 - Practically, it is sometimes more difficult to assess future competition from entrants

Damage Control

When Governments Limit Competition

- Import Competition and Legal Barriers
- Regulatory Capture
Sophisticated Import Barriers (non Tariff)
- Lobbying Government for Protection from Competition

“Intellectual Property Rights”

- Patents, Copyrights, etc.
- Latest Example of Seeking Protection from Competition
- At their worst when preventing both long run and short run competition

Famous False “Results”

- Stronger “IPR” => more long run innovation
 - False in general: Many policy boundaries for strengthening “IPR” give inventor right to block other inventions
 - “IPR” may raise entry barriers even in the long run
 - Right of early inventor to control later inventions
 - Right to control interfaces with complements

Example: Extend Hollywood's Rights under Copyright?

- Suppose Teenagers are copying music illegally
 - (a bad thing)
- “Intellectual Property” Policy Might
 - Require PCs, Consumer Electronics, to be copy-proof
 - Ban discussion of copying technologies (a critical method for improving electronic devices)
 - Make manufacturers of PCs, Consumer Electronics, etc., liable for copyright infringement
 - Etc.
- Britney Spears has the legal right to control PC and consumer electronics innovation (a worse thing)

“IPR” Extended to Block Innovation by Others

- May increase Entry Barriers
- If linked to existing market power
- e.g. Proprietary interface standard in network industry

Pro-Innovation Competition Policy

- Choose cases using competition policy principle of supporting competition
 - Rigorous care not to pick winners or regulate
- Choose cases where long run competition will be supported
 - Entry Barriers
- Worry a great deal about anticompetitive, protectionist, “Intellectual Property” rights.