



# **The Hidden Costs of Free Goods: Antitrust Implications**

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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**

**Totally  
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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)

Google

skype™

## 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.

The Google logo, consisting of the word "Google" in its characteristic multi-colored font (blue, red, yellow, blue, green, red).

# 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





## 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!

