

Let the Marketplace Judge Microsoft

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The government's antitrust suit against Microsoft Corp. raises important economic and public-policy issues about the dynamics of monopoly power in industries undergoing rapid technological change. Unfortunately, these issues have been obscured by the bashing of a company that is unpopular with both competitors and politicians.

Computer operating systems involve network externalities, whereby new users raise the benefits to others on the same system. Other networks, including telephone and stock exchanges, work in similar fashion. Members of the same system can communicate easily with each other, while members of different systems have greater trouble.

Competition among companies with different systems tends to eventually produce a single network standard that connects practically all users, the way Microsoft's Windows has managed to get about 90% of the market for operating systems. There is a growing call for government regulation of networks when inefficient systems become standard because aggressive companies gain an early adoption of their systems.

One frequently cited example of an alleged inefficient standard is the keyboard--the "qwerty" system named after its first six letters. However, economists Stan Leibowitz and Stephen E. Margolis have found no support for the claim that qwerty was inefficient when adopted. They also marshal persuasive evidence against allegations that the defunct Betamax videotape format was much better than the adopted VHS or that DOS and PCs prevailed over a superior Macintosh.

If highly inefficient systems did become standard, companies that had much superior products would use low prices and other attractions to take customers away from the less efficient systems. Government bureaucrats, lawyers, and judges cannot set better standards than the marketplace, especially in sectors with fast-changing technologies.

"CREATIVE DESTRUCTION." It's true that companies controlling efficient standards can have monopoly power, which can generate high prices for their products. However, in industries with very rapid technological change, such as the computer industry, monopoly positions tend to be temporary. The reason is that entrepreneurs find ways to develop better technologies so that they can leapfrog dominant producers. Rapid turnover of monopolies in dynamic industries such as computing suggests that antitrust policy should focus not on whether companies have large market shares but on how soon they are likely to be replaced by others with superior technologies.

This "creative destruction" by entrepreneurial activity is not merely theory. IBM monopolized mainframe computers in the early days of the industry. But the company missed the turn on PCs, and its market value declined enormously while it was surpassed by upstarts. Wireless phones, fiber-optic wires, and special services for business helped

MCI Communications, Ericsson, and others destroy the monopolies of government-regulated telephone companies such as AT&T.

PREDATORY PRICING? Companies that control operating systems are alleged to leverage their monopoly power in one market so as to gain dominant positions in related products. Microsoft's attempt to combine its own Internet browser with its Windows operating system is the immediate reason for the present Washington antitrust investigation of that company. However, leveraging monopoly power hardly describes what Microsoft is doing. A typical tie-in to extend economic power involves charging a monopoly price for the tied product, yet Microsoft gives the browser away.

Some politicians and competitors of Microsoft, such as Netscape and Sun Microsystems, respond that the company is engaged in so-called predatory pricing by giving its browser away. They argue that Microsoft will greatly raise prices in the future after its competitors are forced out. Companies that price aggressively have been accused of predatory pricing, but the legal suits over this issue have rarely concluded that the accused companies jacked up prices after competitors exited. Presumably, the reason is that other companies would enter and take business away if they tried to do that.

Several novel economic issues arise in industries with network economies. But we should resist proposals for greater government oversight of computing and other network industries with rapid progress. Competitors that develop superior technologies are far better protectors of consumers than government officials and bureaucrats who march to the beat of political popularity.