

The Hidden Costs of Free Goods: Some 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
 - Three-party two-sided markets
 - Freemium
 - Reputation and control
 - Exclusionary
- Social interactions via cooperative creative activity
- Public recognition, influence, or political power
- Philanthropic



New Learning: Free Effect

- Much stronger lure than its actual value.

Economic Effects?

- **Basic assumptions do not hold:**
 - Price covers costs of production
 - Demand positively correlated to relative qualities
 - Market players 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 (Viber?)
 - incentive to keep quality high
 - recoupment preliminary indicator
 - exclusionary effects quite similar to bundling
 - level of maturity of the market

**Totally
FREE***

** not actually
free*



Potential Harmful Effects (2)

- **“Real” free goods**
 - New goods
 - Does not allow as-efficient firms to compete
- **Yet is welfare harmed?**
 - Continuous production?
 - Reduction in quality?
- **Can we rely on consumer choice?**
 - costs often indirect and elsewhere
 - collective action and free riding
- **Fairness considerations**

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Implications for Competition Law (1)

- “conundrums and confusion”
- Effects-based approach
- **Market definition**
 - SSNIP test: 5-10% increase remains zero
 - *Kinderstart v. Google*: no relevant market ?!
 - *Microsoft/Skype*: market in which all free goods.
 - SSNIQ?



Implications (2)

- **Analysis of motivation**
- **Market Power**
 - Generally: marginal cost-price indicate MP
 - Yet cost-price difference not useful
 - Difference in related market
 - Revenues from free good not useful (*Sun/Oracle*)
 - 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 no negative welfare effects
 - Strongest case: bundled
 - Weakest case: real free goods
- As-efficient competitor test not apply
- Is harm to one justified by benefit to another?
- Goal: welfare or competitive process?

Predatory Pricing

- Dangers of an overly simplistic application
- **False positive**
 - price below an appropriate measure of costs
 - EU law: presumption of illegality
 - French *Bottin Cartographes*
 - “Real” free goods might also be considered illegal
- **False negatives**
 - Recoupment in free goods market
 - Need: in interrelated markets
 - *Wallace vs. IBM*: When recoupment improbable no antitrust problem. **Indeed?**

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

Non-Monetary Costs

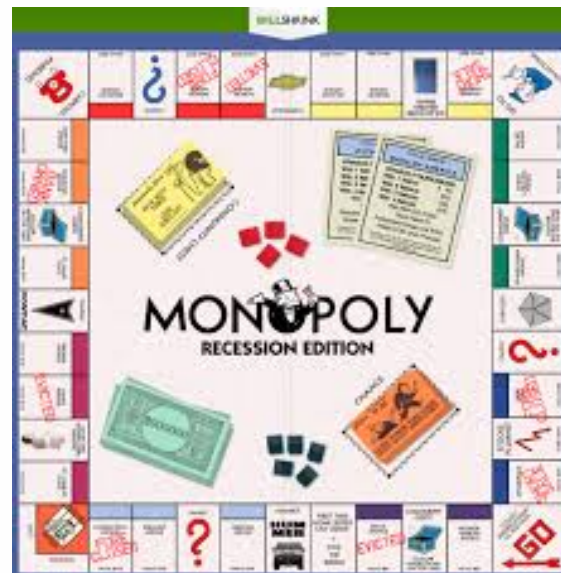
Should endeavor to identify and quantify?

- Unchecked, just because different form
- Affect the efficient workings of the market
- Institutional difficulties
 - no expertise
 - economic models: no clear answer
- Administrative alternative, problem-solving
 - beyond the mandate
- Yet effects on price and quality relevant



Attempted Monopolization

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



Conclusion

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



Thank You!

