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BRIEFING

*March 2008**

# Consumers Demand Action Against Abusive Monopolies

## Introduction

There is an ongoing debate in the competition community about the priority that should be given to curbing exclusionary practices by dominant firms. Some argue that dominance in the market is transitory in nature, encourages new entry and enhances consumer welfare by funding large scale innovation. Others argue that market power is rarely transitory and its abuse can retard the development of efficient and innovatory firms and undermine consumer welfare. This briefing lays out the consumer view and suggests future approaches for a more equitable market place.

## The Context

Consumers gain when they can choose between efficient producers that can enter and survive in markets based on merit. They lose when entry or survival is made difficult or impossible by the activity of incumbent monopolists. Monopoly power on its own need not harm consumer welfare. However, when it is used in an exclusionary manner it can harm short term consumer welfare, lowering choice and raising prices, and long-term consumer welfare through stifling innovation and hampering the efficient allocation of resources.

Exclusionary monopoly power can sometimes be bid away by other players in the market. However, this is not guaranteed and it often takes a good deal of time and regulatory intervention for this to occur. It is particularly unlikely that competition can eat away at monopoly power in markets where entry barriers are high, there is a legacy of government involvement or ownership, or where there are significant network effects. The experience of aviation, utility and telephony markets are a testament to this. Consumers are the losers when regulators mistakenly leave monopolists to abuse their power in the hope that eventually a competitor will cut them down to size.

Exclusionary behaviour can take a number of forms. Consumers cannot choose effectively and thus drive the competitive process when monopolists are allowed to operate exclusivity deals, rebates or loyalty payments that are targeted at excluding rivals from the market or blockading entry.

Such behaviours should be stopped through effective intervention by competition regulators.

## Recommendations

Consumer organisations thus:

1. Support the enforcement of provisions in competition laws that outlaw exclusionary behaviour by dominant or monopoly firms;
2. Call on close oversight of monopolist energy suppliers, such as has been seen in the EU;
3. Support regulators in Japan, South Korea and the EU to ensure that the important software and microchip markets are open to competition by backing their cases against Microsoft and Intel;
4. Call upon other jurisdictions to follow their lead in taking action in energy, software and microchip markets;
5. Recommend that exclusionary behaviour is judged against both short term (value for money and choice) and long term (efficiency and innovation) consumer welfare tests;
6. Recommend that public support for anti-monopoly intervention be developed through aggressive public education and outreach; and
7. Recommend that competition regulators engage in dialogue with consumers' organisations about the use and abuse of market power by dominant or monopoly firms.

* *This is a revised version of the same paper released in February, which is now withdrawn*

## Stopping monopoly abuse is at the core of competition law

Stopping powerful firms abusing their monopoly or dominant position is a centrepiece of any modern competition law. The abuse of power by monopoly or dominant firms causes significant welfare losses for consumers. There has been considerable debate around the world about whether controls on such abuses are tight enough or are fit for purpose in a modern competition law. Much of this debate is done in the name of consumer welfare. As consumers and consumer interest organisations we are uniquely placed to comment on this debate.

The origins of modern competition law lie in the control of the abuse of power by large industrial firms. The textbook examples of Standard Oil, through to AT&T, IBM and more recently Microsoft and Intel have been joined by more complex cases in the utility sector. What all cases share is that consumers see their welfare undermined by the behaviour of one very powerful firm.

The debate about whether competition agencies should look closely at monopoly power is focused primarily on two pieces of law – Section 2 in the Sherman Act of US and Article 82 of the Treaty in the European Union (EU).

Both pieces of legislation seek to limit the ability of those single firms with significant market power, or dominance, from abusing that power to the detriment of consumers through excluding rivals from effective access to the market. However, it is not just this area of law that is dependent on the way one views exclusionary behaviour. The view one takes will naturally have an effect on the way that mergers are reviewed; if one is more tolerant of exclusionary behaviour one is more likely to let mergers pass that create monopoly positions.

Some critics have argued that single firm dominance or monopoly power is either rare or incapable of being maintained in the face of more liberal markets.

They argue that if a firm has a monopoly position the excess profits that they earn will encourage others to enter the market and compete away this monopoly profit.

These critics further argue that punishing firms for gaining such market power, or monopoly positions, discourages innovation and investment; conversely gaining such power provides funds for innovation that otherwise would be competed away.

They argue that the intervention of regulators to scrutinise the behaviour of such firms makes them lose focus on their core business and on balance damages consumer welfare.

## Consumers need to balance short term and long term factors

For consumer organisations the key issue should always be about what is the impact on the consumer of the alleged exclusionary behaviour. However, we need to be careful that our view of consumer welfare allows us to balance both short-term (price, quality, choice) and long-term (efficiency and innovation) elements of consumer welfare. If we simply focus on short-term consumer welfare and demand ever lower prices and more choice we run a number of risks.

Firstly, a firm with enormous scale may be keeping prices at a low level to discourage entry. This can have the effect of putting off new entrants who may need to charge higher prices for innovatory products. We may also allow firms to lower their prices more slowly than they would in a competitive market by foreclosing entry or expansion through rebates and loyalty payments. We may thus think we have a competitive market when in fact we do not. In short simply focusing on short term consumer welfare issues may damage the long term viability of a market for consumers.

Conversely focusing too firmly on long term consumer welfare issues (efficiency and innovation) can cause a number of problems. Firstly, it can allow firms to carry out otherwise exclusionary behaviour if they can point to a pattern of innovation. It is always difficult to judge if the rate of innovation in an industry would have been higher with more competition. Secondly, it can allow otherwise anticompetitive behaviour or agreements that can make plausible claims to efficiency savings.

Consumer organisations must seek to balance out the short and long term impacts of alleged exclusionary behaviour. We must ensure that decisions made to the short term benefit of consumers do not harm the competitive landscape in the longer term. However, we must also ensure that the long-term health of the sector under review does not harm the short term interests of consumers in terms of lower prices or more choice.

If one looks at some of the recent cases in the field of exclusionary behaviour one can see where a consumer view of particular cases can, and should, lie. Two of the most high profile and controversial cases, in recent years have come in the high technology industries.

In part, the profile, and controversy, has arisen because both firms are major players in many aspects of business and home life. Secondly, the profile and controversy has arisen because of different approaches taken in the US and the EU (and elsewhere). The two firms to which we refer are Microsoft and Intel. In the case of the former we have seen one case completed and a number of others launched. In the case of the latter there is reportedly a European Commission (EC) Statement of Objections and action in South Korea, Japan and New York State.

Both cases provide clear examples of the different positions that can be taken on exclusionary behaviour and both give pointers as to how consumer welfare can be assessed and what view consumers organisations should take of such cases.

## The Microsoft case was all about balance

In the Microsoft case the most basic charge was that the company carried out a range of activities that made it difficult for rivals to enter the market for software products. Charges included the bundling of products with the ubiquitous Windows operating system, such as an internet browser and a media player, and the

withholding, or delaying of access to operating system code for rivals.

Microsoft responded to these charges by arguing that it had gained its monopoly position through providing products that consumers wanted and that adding increasing functionality to operating systems was in the consumer interest.

Consumers were happy to have a media player and an internet browser; and if they could get them for free from Microsoft. Even if it is bundled with the new operating system, the consumer welfare gain was clear.

Microsoft's argument was that it was simply adding new and free functionality to its existing and new products in response to consumer demand. The consumer got greater and greater functionality for no extra cost and choice was not hampered because rivals could easily convince people to switch at the click of a mouse.

#### The Intel case is much more straightforward

In the case of Intel the charges in Japan, South Korea, the EU and in New York State and private litigation in the US appear to be similar.

Intel is accused of stifling its rival AMD by offering inducements to computer manufacturers not to use AMD microchips in its products. It is also accused of threatening computer makers with the loss of bonus payments if they sold any, or a small number of, AMD powered machines.

Intel is also reported to have stymied AMD product launches through pressure on computer makers. Consumer organisations in Europe have also raised the issue of Intel exclusivity among some retailers (particularly MediaMarkt, Europe's largest electrical retailer). In early February, the EC conducted dawn raids in this matter.

Intel have defended their actions by pointing to the rate of innovation in the market for microchips, the general fall in prices of processors and the existing choice consumers have for machines powered by Intel or AMD chips. Their argument is that their behaviour is a robust form of competition and consumer welfare has been enhanced by driving down prices and ensuring innovation. The positions adopted by both companies in defence of their behaviour have been well received in some quarters.

#### Transatlantic differences exist

The sterling efforts of the US Federal Trade Commission in taking on major domestic exclusion cases has been unfortunately overshadowed by some shrill official US opposition to European action against Microsoft. In some US official circles at least it appears that exclusionary behaviour is viewed as relatively benign. The EU has grabbed the limelight by launching a number of high profile cases against Intel and triggered a second investigation of Microsoft in the internet browser market. It is also taking steps against a number of energy monopolies in Europe.

As we have noted before, for consumer organisations one of the key issues is the balance of short and long term consumer welfare – the need to ensure good value for money while ensuring that consumers can benefit from innovation and passed on efficiency gains in the future. One thus has to ask to what extent the investigations of Microsoft and Intel fit this model. Both companies point to their lower prices and enhanced performance over the decades and their centrality to the information technology revolution. Both point to new product lines and new functionality within their products. So how do we assess these claims?

#### How can consumers organisations judge exclusion cases?

One of the first things we can do is imagine a world without the behaviours alleged. We then need to balance the short term and long term alternative scenarios.

In the short-term, in the Microsoft case, then one must ask what the market would be like if web-browsers and media players had not been bundled with the operating system and if software firms had had better access to the source code.

One then needs to take a quick cost benefit analysis for consumers – they would have lost through a lack of immediate and easy access to a browser and media player, but would have gained through more choice of programmes and service offers.

In the case of Intel the cost benefit analysis for short term welfare is simpler. One would have to ask what the market would have looked like if computer makers had been able to choose their microchips without fear of losing bonuses or being frozen out of product allocations. For the time when AMD had a technical advantage then the market would likely have seen significant market share shifts and greater choice for consumers. Computer makers would have been more able to negotiate discounts for computer chips from suppliers and would have launched computer lines on the basis of best performance rather than to maintain a relationship with a dominant monopolist supplier.

One must then look to the long term consumer benefit or loss from an alleged exclusionary behaviour. In both cases, the longer term welfare case is an assessment of the impact of the behaviour on innovation and efficiency. Proponents of the *laissez passer* view of exclusionary behaviour argue that firms need to make excess profits in order to encourage them to innovate. These excess profits then encourage entry that, over time, lowers those profits.

While the argument is plausible in the sense that we often find industries with high levels of innovation with large firms making large profits, a correlation of the two is not a causal relationship.

#### Consumers cannot wait for potential long run benefits

The argument importantly also assumes that market power is transitory in nature. The Keynesian aphorism that in the long run we are all dead operates quite well in this debate as the use and abuse of market power to block entry or exclude rivals can easily lead to the death of competitors long before the promised end-date of market power is forecast.

The ability of firms to maintain market power through exclusionary behaviour cannot be underestimated. There have been no new, fast growing, competitors to Microsoft in operating systems or Intel in microprocessors in the last few years. There has been no bidding away of supra-normal profits.

While faulty, under some circumstances, the efficiency defence standard is useful to apply here – if there are claimed efficiencies can we identify the mechanism by which those efficiencies will be passed on to consumers and passed on within a short time frame?

### Innovation benefit consumers in the short and long run

If innovation is to be stimulated by abusive market power then can we point to the mechanism that will ensure that innovation benefits consumers and can we show that.

The idea that innovation is fostered by allowing dominant firms to accrue market power and exclude rivals seems to run counter to everything we know about the operation of competitive market economies.

If monopoly drove innovation, as the apologists for exclusionary behaviour infer, we would never have seen the rise of low-cost airlines or the spread of telephony services. Both happened only because the dead hand of monopoly was broken.

The critics of action on abusive monopolies also seem to forget the often dynastic nature of dominance abuse. Microsoft was gifted its first steps on the road to monopoly by IBM, as was Intel. In the case of the latter there were attempts by the then monopolist to foster competition by forcing cross-licensing of intellectual property. Many other monopolies have come from government gift (airlines, local banks, utilities) or from gifted technical advantage (Microsoft, Intel).

### Can consumers trust all markets to auto-correct?

The idea of a 'pure' monopolist growing organically entirely under their own power has elements of myth. They are as much creatures of monopolist license or government largesse as they are market operators.

The debate about the efficacy of taking action against the abuse of monopoly power is essentially rooted in the assumptions that the protagonists take about the market economy. Those who oppose action against monopoly power do so on the basis of a double headed idea. On the one hand they have a belief that the market will correct abuses and on the other government will only create more problems through its action than it solves.

Proponents of action tend to view the market as less able to auto-adjust and view government or regulatory intervention as a necessary tool to correct problems that occur in the market. In essence the issue boils down to which one you view as the lesser of two evils – the self correcting market or the interventionist regulator.

### Is government action always necessary?

For consumer organisations the answer should be relatively simple. Consumer organisations were generally formed on the basis of campaigns around market failures or gaps in the market. One would thus not expect them to accept the view that markets self-correct. As demandeurs of government intervention one would expect consumer organisations to favour regulatory interventions over market self-correction.

However, there is also a healthy scepticism among consumer organisations about government intervention. Too many times they have seen governments mismanage public monopolies or offer consumers failed liberalisations where private monopoly simply replaced public monopoly.

Consumer organisations need to maintain their healthy scepticism of government and regulatory intervention allied to their recognition that markets do not always self-correct.

### Consumer gain from competition-driven innovation

In the case of monopoly power consumer organisations know that innovation springs from competing firms offering consumers choices between technologies or services.

They know, with bitter experience, that monopoly breeds firms that favour the quiet life over competition.

They know that new entrants can offer products, services and delivery mechanisms to consumers that have previously not even been contemplated by the incumbent monopolists.

Above all they know that consumer welfare is enhanced by efficient firms that deliver value for money, products and services in an innovative way.

They also know that this situation is best protected and driven by competition.

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