

WINNERS, LOSERS, AND MICROSOFT: COMPETITION AND ANTITRUST IN HIGH TECHNOLOGY. BY STAN J. LIEBOWITZ AND STEPHEN E. MARGOLIS. OAKLAND, CALIF.: THE INDEPENDENT INSTITUTE, 1999

Antitrust regulation has been in a steep intellectual decline since at least the mid-1970s. Much of that decline has been due to the fact that Austrian and Chicago critics have eviscerated the conventional theory and empirical “evidence” that was said to rationalize traditional antitrust enforcement. A dwindling number of antitrust scholars now believe that market concentration, barriers to entry, foreclosure, or predatory practices can secure “monopoly” and misallocate resources. Similarly on the empirical side, the evidence that free-market dominant firms restrain trade and raise prices has proven to be nonexistent. Revisionist case analysis has demonstrated that most antitrust defendants were expanding output, innovating rapidly, and lowering prices. Thus, with no theory and no evidence, one might think that the critics had won the war and that antitrust would be headed straight for policy oblivion.

Well not quite. The resourceful antitrust community has simply gone ahead and reinvented itself by developing several new theories and an entirely new approach to evidence. (Unfortunately, the new approach is that favorable evidence no longer matters.) All of this is important since the antitrust enthusiasts and regulators intend to apply their newer theories to the current high-tech industry cases, most importantly *U.S. v. Microsoft*, where their application threatens substantial economic havoc. It is in this context that *Winners, Losers, and Microsoft* by Stan Liebowitz and Stephen Margolis, appears at a most opportune moment, indeed. This carefully written and thoughtful book is devoted to a critical examination of these new theories and to a search for evidence, any evidence, that these new theories can support antitrust.

The core of the newer theories is the notion of “network effects.” Network effects arise whenever the value of a good to a consumer depends importantly on the number of other consumers that use the good, i.e., the more consumers that use computers with email or fax capabilities, the more valuable it becomes having a computer with such capabilities. These increasing returns (advantages) to consumers with compatible computers are clearly beneficial; but, say the critics, they tend to “lock in” some initial technological innovation as a kind of industry standard (and lock out would-be competitors) and create a fatal “path dependence” that ultimately can lead to (inefficient) monopoly for the first-mover firms.

The most notorious example of a path-dependent standards monopoly is the so-called QWERTY typewriter keyboard. Critics hold that the placement of the keys (first developed for manual typing to curtail jamming) was always less than optimal, yet the inefficient standard persisted right into the computer age because of network effects and path dependence. Similarly, consumers have allegedly been “trapped” in several other high-tech market failure situations that require, supposedly, remedial antitrust regulation.

The devastating criticism by Liebowitz and Margolis of the newer market-failure theories occupies the first half of their book. They admit that network effects can exist and can be important to consumers in some (though certainly not all) industries. They even admit that network effects may lead to high market share (they call it “monopoly”) in certain circumstances. But, breaking sharply with most theorists, they argue that the process of achieving the high market share outcome is both competitive and efficient and usually does not represent any market failure. Network effects provide efficient benefits to consumers and are not “externalities” that need any regulatory correcting. Moreover the competitive process (of attempting to monopolize) means that any monopoly is, ultimately, unstable and that newer, more efficient innovations will break through leading to some new monopoly. As they put it:

These monopolies . . . are efficient outcomes in network industries, where the network effect, or scale economy, is strong. It is not our argument that such monopolies would never arise, but rather that these monopolies would not be locked in. Such industries are serial monopolies; one monopoly after another. . . . The stakes are always high in such industries. The new entrant seeks not to coexist with the incumbent, but rather to replace it. These high stakes, and the rivalry that they create, is apparently sufficient discipline to hold monopoly prices in check and to keep the rate of innovation very rapid. (p.15)

The second half of the book (including chap. 2 from the first half) is a series of case studies that aim to demonstrate the correctness of their theoretical conclusions. Do network effects lead to monopoly, and does one monopoly tend to replace another? Are inefficient standards or technologies locked in and can they be unlocked by the free-market process? And most importantly for antitrust purposes, how have successful firms (like Microsoft) achieved their dominance with respect to certain products? And once firms achieve market dominance, what happens to price and innovation?

The case studies are fascinating. The QWERTY keyboard, supposedly a path-dependent mistake, is shown to be the result of an efficient market process; the superiority of the so-called Dvorak keyboard is exposed as a myth. VHS format videorecorders deserve their success; they became the industry standard when they offered a longer playing time than Beta. Command-line DOS was faster than Macintosh and had a cost advantage, while Microsoft platforms demonstrated a commitment to backward compatibility, Apple did not seek continuity in its operating systems—and lost its customers. The Lotus spreadsheet ultimately failed

because of strategic managerial errors and because “competing products (such as Excel) were judged to be superior in quality.” Indeed, the general argument and evidence with word processors, personal-finance software, desktop-publishing software, and browsers is that consumer perceived quality ultimately determines market share. Alternatively, when products perform poorly, as with Microsoft’s online service, Microsoft Network, even bundling them into the desktop cannot make them successful.

The last chapter in the book, an appendix, is devoted to the current government antitrust case against Microsoft. Aside from network effects and lock-in theories already examined, Liebowitz and Margolis argue persuasively that the government’s case is intellectually wrongheaded with potentially disastrous economic consequences. They shred the government’s theories of monopoly leverage, tie-ins, predatory bundling, and underscore the fact that the government has no evidence whatsoever that Microsoft has restricted outputs or raised prices. (Economists for the government seem unaware and even uninterested in any empirical evidence.) Their greatest concern is that the government and many industry critics have proposed “freezing the operating system” and limiting any additional functionality as an antitrust remedy. Such innovational regulation would be a disaster.

This is an intelligent book that does much to demonstrate that the antitrust emperor wears few clothes. What the authors choose to say they say clearly and persuasively. Especially welcome is their central theoretical theme: that the market is a process that works efficiently for consumers and that the competitive market process looks like a series of “monopolizing acts.” Indeed, they speak harshly of “textbook models of competition” that take price and the nature of the product as “given.” And if efficient “serial monopoly” is the actual nature of competition in high-tech industries, then this condition must alter current notions of antitrust enforcement.

All true, but surely the bulk of this has been said many decades earlier by prominent Austrian theorists such as Mises, Hayek, Rothbard, Kirzner, and especially Schumpeter. One gets the impression (perhaps mistakenly) from their exposition that these ideas are recently discovered; certainly their intellectual origins are not detailed and none of the above theorists are even cited. (There is a strange passing reference [p. 244] to Hayek in a note [no index citation] but that is all.) Yet in a book where “history matters” in the success of quality products, one has a right to expect more history (and credit) for the Austrian theorists in their development of a correct theory of competition.

Also unclear is the status of competition theory generally and the proper application of antitrust, if any. Does their process theory of competition replace the orthodox model? And if not, why not? They tell us approvingly at one point that several economists have observed that the competitive model “is somewhat distant from perfect competition.” Somewhat distant??! And that their own theory of serial monopoly “alters the antitrust world somewhat.” Alters it somewhat??!

Why the caution here? The process theory of competition has nothing whatever in common with the orthodox approach: they are antithetical. The authors might reply that the process theory only applies if there are strong network effects, but this reviewer strongly disagrees. The process theory of competition applies to any open market and a review of previous antitrust cases would have demonstrated that truth beyond a doubt. Although Liebowitz and Margolis are skeptical of the application of antitrust to high-tech industries, they might have been skeptical about the entire antitrust world where "winners" have been routinely attacked for decades. Unfortunately, there is precious little antitrust history in this book; and it is difficult, therefore, for the lay reader to place the Microsoft disaster in any sort of context. It's clear that the authors mistrust conventional competition theory and antitrust policy but we are not quite sure how they would draw the theory and policy lines in different industries or with different issues at stake, e.g., price agreements and large mergers.

These are quibbles about things that the authors didn't choose to write about. What they did say is intelligent and important and deserves the widest possible understanding. The stakes are very high; regulatory control of product innovation in high tech industries would be disastrous. Professors who teach industrial organization, and all judges who decide antitrust cases, will profit immensely from reading this book.

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ANTITRUST: THE CASE FOR REPEAL. BY DOMINICK T. ARMENTANO. AUBURN, ALA.: MISES INSTITUTE, 1999

Most economists would, given the opportunity, offer some proposal to reform antitrust policy. Some would contend that this or that aspect of antitrust law should be eliminated or more weakly enforced. Only a brave few, however, deliver a deadly blow to the antitrust beast. In the revised second edition of his book *Antitrust: The Case for Repeal*, Dominick T. Armentano is not content to attack only one aspect of antitrust policy. Professor Armentano proceeds to demolish the very foundations of antitrust policy. No excuse for antitrust intervention remains standing—not predatory pricing, not tying agreements, not even price fixing. Lighter fare than his excellent book *Antitrust and Monopoly* (1990), Armentano’s *Case for Repeal* provides a coherent, accessible Austrian perspective on senseless and unjust antitrust law.

Armentano’s first chapter focuses on the Microsoft case. His cogent analysis of path dependence as an aspect of the Department of Justice’s attack is similar to, and draws from, earlier work by Liebowitz and Margolis (1990, 1995). Armentano’s concerns are much broader, however, and he uncovers the grievous errors in the government’s understanding of the competitive process they claim to be promoting. Microsoft’s decision to integrate its web browser into its Windows operating system was an effort to compete more effectively with its rival Netscape. If its innovation is judged by consumers to be superior, and is attained without legally restricting the entry of other firms, why should the Department of Justice balk at a resulting increase in market share? Antitrust intervention is an assault on efficiency and revealed consumer preferences.

In addition to the Microsoft case, Armentano considers several other key cases throughout the book: Standard Oil (decided 1911), Alcoa (1945), AT&T (1982), Staples–Office Depot (1997), and others. With each case Armentano refutes another argument for antitrust. In contrast to many neoclassical critiques of antitrust, the approach in *The Case for Repeal* is not empirical. Basing his views on sound economic theory, Armentano finds the weapons of logic quite sufficient to dismantle commonly accepted antitrust theory.

Rothbardian monopoly theory, summarized in an appendix to chapter three, is generally consistent with Armentano’s own approach. In Rothbard’s understanding of the market, information is never perfect, all sellers have some influence over price, and goods are never completely homogeneous (Rothbard 1993, pp. 560–660). Where information is imperfect, discovery matters. Antitrust authorities

might regard an increase in price (or a decrease in price) as monopolizing behavior, when in fact the change could be due to the discovery of new information about the market. Firms make mistakes, produce too much at times, and must reduce output and raise price. Because static equilibrium conditions can never exist in the disequilibrium of the actual market, and no demand curve is perfectly elastic, the conditions of perfect competition can never obtain. Comparing "competitive" and "monopoly" prices is therefore an exercise in futility—there are no independent criteria that would allow us to distinguish between the two.

Furthermore, in a world of subjective costs and benefits, antitrust authorities seeking to deter activities that reduce social welfare and social efficiency cannot have the information necessary to make good decisions. This last point is relevant when considering the "rule of reason" reforms that some have advocated for antitrust regulation. The "rule of reason" approach, which implies that the government ought to permit an activity when the social gains are expected to outweigh the social losses, fails for lack of sufficient information. Costs and benefits are not cardinally measurable, foreclosing any possibility of antitrust authorities summing up individual costs and benefits into useful aggregates. "Individual consumer and producer utility and surplus may exist, but these notions cannot be mathematically manipulated to allow any regulatory rule-of-reason judgments" (pp. 49, 50).

Looking at profits to determine if a monopoly exists and what its social costs might be is also problematic. Accounting profit is used to estimate economic profit, a theoretically illegitimate procedure. Even if this obstacle could somehow be overcome, the mere existence of monopoly profits does not justify government intervention. Government involvement in the marketplace is so widespread that the legal monopolies it forms "might well be inexorably intertwined in the actual business world: tariffs, quotas, licensing, and other legal restrictions always tend to generate economic rents in markets that are otherwise openly competitive" (p. 44).

Could we find in this a justification for keeping antitrust law on the books? Some have suggested that we turn antitrust law against the government by using it to break up government-enforced monopolies. Armentano maintains that this is ill-advised. As long as antitrust regulation exists, the danger remains that it will be turned against private business.

Armentano closes his book by contending that antitrust law violates basic principles of liberty. Even if it could be shown that efficiency dictates necessary legal constraints on market structure, antitrust law clearly interferes with essential rights to private property. Armentano writes:

The antitrust prohibition of price discrimination, merging, price fixing, and even free-market monopolization prevents freely contracting parties who hold legitimate rights to property from making, or refusing to make, certain contractual arrangements that they believe to be in their best interests. . . . [P]rivate and peaceful activities such as

price discrimination, merging, tying, and price fixing violate no property rights in the ordinary sense of the term; that is, they do not necessarily involve force, fraud, or misrepresentation. (pp. 99, 100)

It is entirely appropriate that low-cost sellers be rewarded with market share. Competition, in the sense that there are no legal barriers to entry, still exists even if an industry is highly concentrated. To interfere with the competitive process, to prosecute firms that undercut the prices of their rivals, "is blatantly protectionist of the existing market structure of suppliers" (p. 70). This, perhaps, is the real story of antitrust. Armentano shows quite effectively that no public interest rationale exists for antitrust regulation. Case after case reveals a common thread—outwitted, outperformed rivals seeking to use the brute force of government to put down their opposition. "Antitrust's dirty little secret," charges Professor Armentano, "is that the laws have been employed consistently to hamper successful business organizations and protect their less efficient rivals. One would be hard-pressed to discover a more immoral or irrational public policy toward business, or one more worthy of repeal" (p. 12).

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