Us justice department's case against microsoft

Explain how economic theories and evidence can help in understanding the US Justice Department’s recent case against Microsoft, and in Microsoft’s defense against the accusations.

The continuing legal case against Microsoft began initially in September 1996 when the Department of Justice claimed that Microsoft forced computer makers to take Internet Explorer. By January 1997, Microsoft controlled 85% of the operating systems market. By August 1997 Microsoft and Apple Computers had agreed to a $250 million collaboration over various products and programs including most definitively making Internet Explorer bundled with Apple computers as its default browser. Within the next two months the Department of Justice created a suit claiming that Microsoft violated its 1995 consent decree, disallowing Windows operating system to be tied to any other products. Thus beginning a four year roller coaster of trial and appeals leading to presumed wins and losses for both sides, concluding with a November 1, 2002 settlement, finally approved on June 30, 2004 in a U. S. appeals court, citing it is in the public’s interests.

Throughout this case in many courtrooms and in front of numerous trial lawyers and judges a number of economic theories have been introduced and cited in the rulings for and against Microsoft. Beginning in December 1997 when Department of Justice Thomas Penfield Jackson, whom later was targeted as bias against Microsoft, stopped Microsoft from requiring the distribution of Internet Explorer with Windows 95 claiming theories of market “ lock-in”, a spoke in the wheel of “ path dependence”. Judge Jackson disputed that Microsoft Windows operating system owes the bulk of its market success to the high number of applications written for it. Also claiming “ lock-in” theory in that Microsoft was barring applicants to enter the market despite the fact that consumer and product tests and reviews showed Windows continuously beating out IBM’s OS 2, which ironically was compatible with Windows and yes came with a browser and had numerous applications written for it. Jackson pushed to label Microsoft as going against the Sherman anti-trust laws by reducing Netscape’s market share to create a monopoly over the operating system markets claiming a viable case of “ path dependence.” Path dependency is an argument that presumes that technology markets involve a danger of being “ locked-in” to an inferior technology when subject to changes in the network as the better product is not always the winner and in fact winning and losing is highly based on sheer luck and past historical events. Once “ locked-in” there is little opportunity to switch to the superior of the products as the costs of changing are made very high to protect the monopolistic company.

There are many opponents to the theory of “ path dependence” created by Brian W. Arthur. The major point of discrepancy is that Windows dominance throughout the operating system market was created by its economic efficiency and its position can be quickly eliminated with the introduction of system of better quality. Claims also include the caution that if “ lock-in” theories are generally accepted the number of suits filed will increase drastically as many markets are subject to market effects and high seller concentration. This ultimately can be detrimental to the entire marketplace, damaging industry growth creating unsure investors with the inability to seek refuge within productivity effects on a scale base.

According to the U. S. courts, Microsoft was establishing “ barriers to entry” and therefore in need of priority anti-trust intervention. The fear being that regardless if a new entry to the market had a superior product to the Microsoft operating system, Microsoft would still ultimately dominate the marketplace as the costs to switch would be tremendous, lying entirely in the hands of the consumer, as all of Windows and each of its compatible applications would be rendered useless, thus creating a “ lock-in” for Microsoft despite its inefficient capabilities. The example disputed throughout numerous debates was that of Macintosh would have been the better solution, however Linux despite being superior would be unable to overcome its “ lock-in” position. The concluding solution: Judge Jackson rules on June 7, 2000, ordering Microsoft to break up and form two separate companies, one producing Windows operating system and the other to handle software applications, including a barring from uniting for up to ten years.

Again opponents to the “ path dependence” claim that Microsoft’s dominance was in fact due to its superior products and a break up of the company would create a detrimental effect to welfare of technology, hampering innovation for years ahead. Bill Gates stated the break up would set Microsoft back some ten years. Also that the anti-trust laws cannot hold the same conditioning they did one hundred years ago over markets such as soy bean production as today’s high-tech markets are subject to rapid innovation and change that promotes aggressive behavior within the industry to stay ahead. This was the basis for the June 14, 2000 appeal by Microsoft over the District Court’s judgment. The appeals court ruled in favor of resisting Microsoft’s need to split into two companies but sided with the District Court in that Microsoft continually abused its monopoly standing within the software business. The major point in fact is that both courts presumably agreed that Microsoft’s success was largely attributed to luck and the “ lock-in” effect coupled with switching costs stifling consumers, rather than pointing to its efficiency contributing to its success. The contradiction that was introduced by the appeals courts against the “ lock-in” theory is that under the “ lock-in” theory only a monopolistic break up could disrupt the network effect cycle and restore the deteriorated competition as cited by the district court. But if this “ lock-in” theory were to hold strong then the appeals court decision to not separate Microsoft would ultimately contribute to its dominance. According to the Justice Department’s economic experts, the break up of Microsoft would create higher prices to accommodate both of the companies that would be trying to maximize profits by creating products that are complementary instead of the current production of a single product.

In a surprise turn of events the ruling was turned in favor of Microsoft, claiming, as stated earlier, Jackson’s previous statements to journalists were sufficient evidence of his bias against Microsoft. The Supreme Court, on August 7, 2001, reversed the ruling that Microsoft was an illegal monopoly. On September 6, 2001 the Department of Justice states that it no longer seeks to pursue either the break up of Microsoft or the bundling issue at the center of the case. The next month followed with an approved settlement between the Department of Justice and Microsoft over anti-trust charges, however nine states still sought stricter infractions against Microsoft, seeking to have Internet Explorer placed within the public domain, along with other commitments including the ability of computer makers to remove some Windows features. Following lawsuits have followed, including suits by AOL Time Warner and Sun Microsystems, Inc., both settled through monetary resolve. Finally, on June 30, 2004, the U. S. appeals court approved Microsoft's settlement with the Justice Department, saying it is in the public's interest.

As the above stated is the path Microsoft has traveled to continue it process of continuing software market innovation, it is necessary to look at what allowed many companies and the justice system to confront and challenge Microsoft's work ethic and productivity. To speak from the side of Microsoft, Microsoft dominates in software markets where reviews and evaluations show they have the best products and do not in markets where other products are superior. Also, under monopolistic practices traditional views of economics suggest that prices are maximized to maximize profits, however within all the markets where Microsoft has a substantial holding prices have fallen dramatically. Also, the " lock-in" theory stresses that technology industries get stuck with low quality products, but history shows that in high-tech markets, superior products eliminate inferior ones, as was the case with the superior Excel over Lotus 1-2-3 and Microsoft Word over the inferior WordPerfect. Reviews are the main contributor to the success of these products. Reviews gave landslide wins to both Excel and Word, where Microsoft Money was the inferior product to Quicken it failed. According to the Justice system these products carried " path dependence" that " locked-in" the inferior products (from which of these products the statement is directed is unclear) and therefore “ locked-out” innovative newcomers. Examples of “ lock-in” are products that become highly publicly used such as the telephone or VCR become the norm and consumers will relinquish from trying others products that vary from the standard. The antagonist to this is that the high-tech market changes so rapidly that competitive advantages have a short lifespan. Also, that consumers are able to handle the concept that if everyone knew another product was better and more efficient would not someone find a way to cut the costs to switch to the superior product. Evidence clearly suggests that yes a single product leading to increasing returns for the company often dominates markets such as software markets, however its replacement often happens at a record speed when a product comes along that is clearly superior. Think of game play consoles; Nintendo GameCube was almost placed into extinction with the introduction of Playstation 2 and Microsoft Xbox, whose prominence will not be countered with the introduction of Xbox 360 and soon Playstation 3.

To counter the anti -trust issue against Microsoft, economists have argued that Microsoft has neither raised its prices nor restricted the output of its products, both traditional elements within a monopoly. Microsoft, on the other hand, offers good quality products at prices that are attractive to consumers and this has lead to Microsoft’s large market share. The problem that lingers is why has a company that has made good products at good prices been placed under such large scrutiny. Three ideals that have allowed firms to be exposed are arbitrary law, perfect competition, and economic versus political power.

The antitrust laws rely heavily on arbitrary language that reflects the arbitrary rulings within perfect competition. Consider pricing, if one sets its prices above it competitors it can be seen as trying to monopolize, setting prices below can reflect unfair competition or restraining trade and if prices are similar to that of competitors the charge can be a scheme to fix prices. Therefore regardless of any price you set you are in violation of the anti-trust laws. Who is prosecuted is ultimately up to the prosecutors and whom they see as firms that hold large market share or whom is enjoying large profits. Also under the anti-trust laws, the " essential services" doctrine states that ' a product or service that becomes widely used and relied upon loses it private character and effectively becomes private property, to be shared with rivals and the government.' Presumably the Windows operating system became a red mark under this doctrine. The unfortunate factor is that firms are penalized for making great products that are successful. Also, consider the charge that Microsoft held a monopolizing market share. This definition is subjective to the prosecutor as well. Microsoft holds approximately 5% of the worldwide market share, but has 50% of the PC software market and 80% of the software for Intel based PCs. What is the determining factor to decide where a Monopoly is created? The result is that Microsoft has been forced to self-regulate to avoid constant prosecution, and this is the path to slower innovation.

Perfect competition is the ideal theory not on how competition actually works but instead on how it should work. Ideally every market should be saturated with a great number of firms and impending newcomers to the market, with each firm holding a small share of the market. Entrance into the market should be cost-free and no firm can change its pricing to change its market share and products should be indistinguishable. Under such profits are rendered non-existent as any profit would be considered an imperfect market and after covering costs the ideal situation is a firm showing a loss. This is in theory but in reality there is no industry that is like this as all of the entrants would decease due to a lack of the ability to survive. This ideal of perfect competition was one of the theories used to combat Microsoft.

The concept of economic power versus political power is the ideal that many suits brought up as antitrust suits are contrived as revengeful plot to gain back market share that has been taken from the initiating party. Instead of creating products that are more efficient and more able to compete. The difference between economic and political power is that economic power is the power to create and produce using intellectual capability to achieve no successes, trading voluntarily to the advantage of all parties. While political power is power used to force and punish, involving physical aggrandizement used to overpower other parties. Microsoft is a leading cooperative producer flaunting only economic power. The powers that restrain them are not consumers, for which profit from Microsoft creating economical and efficient products, but instead the rivals bring suit not in the interest of the overall market but only in fear of losing even more share of the market.

Traditional economic theory promotes that economic efficiency is derived from price and quality, which determine the outcome within the market. Though the court doesn’t mention the theory of path dependence explicitly, the evidence provided by the plaintiffs strictly resembles the elements enlisted under the Arthur theory. ‘ The argument is that a positive feedback loop due to static economies of scale and demand-side network effects led to the so-called intractable ‘ chicken-and-egg’ problem, which caused a ‘ Microsoft-winner-take-all’ and a ‘ Mac-OS/2-Linux-loser-gets-nothing’ solution. Microsoft is also blamed for being an inferior lock-in standard today due to positive feedback. There is no statement claiming that Microsoft gained its dominant market position simply by chance and was able to out do Apple in the battle for the predominance in the OS market in the mid 1980s. There’s also no explicit statement that

Microsoft would have been an inferior technology inspired by early luck in comparison with its early competitors in the mid 1980s. Concerning the early technology selection problem during the standard battle between Microsoft and Apple, there’s no link with ARTHUR’s theory within the court’s argumentation. As a result, Microsoft is not explicitly blamed for having been an inferior solution in the past. But Microsoft is implicitly blamed for being an inferior lock-in standard today who gained its dominant market position in the past by positive feedback and whose predominance is protected by the applications barrier to entry. The court claims that Apple Macintosh, OS/2 and Linux haven’t been able to overcome the applications barrier to entry which implies that these alternative OSs are thought to be at least of the same or even of better quality than Windows because no competitor with worse quality could compete effectively with the incumbent. In this respect, the court argues completely according to ARTHUR’s theory that there’s almost no possibility to ‘ unlock’ the Microsoft monopoly. The judge doesn’t mention explicitly the term ‘ inferior lock-in monopoly’ but also demonstrates that Microsoft isn’t believed to survive due to superior product quality but simply by anti-competitive means, which protect and enhance the applications barrier to entry.’ (1a.)

Fortunately, for the future innovations within the software market and the constant advance, Microsoft is free to create new efficient products at reasonable products for the future to come. That arbitrary economic theory almost crushed this opportunity and stalemated the innovation process speaks volumes about the need to produce legislation that can be accurately held accountable to guide all firms. Whether there need be strict rules to account for different markets and product types to discern between never changing marketplaces to industries that turnover a week at a time is left unclear. Regardless, Microsoft is not evil for creating a profit on an increasing returns agenda, that is what is available in markets that hold market share and volume advantages.

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