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Thomas Hazlett: Is Microsoft toast?

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The US government proved that Microsoft possessed, and illegally exploited, monopoly power in the "antitrust case of the century", the six-year action that ended in July 2004. The Final Judgment allowed Microsoft to remain whole, but imposed conditions that permit rival software makers to tuck their products into its Windows operating system. Anti-Microsoft groups were outraged; a spokesman for one said: "This decision represents the failure of antitrust laws in the high-tech industry… An unrestrained monopolist in the most vibrant sector of the economy cannot be good for America."

The critics were right: the Government's remedies have had little impact. Yet today customers are flocking to Microsoft's competitors. Hammered on multiple fronts by opportunistic rivals, the high-flying starship of the PC Age has stalled, and many wonder if it will now crash and burn.

Compare the fortunes of Apple and Microsoft. To most, Apple is yesterday's news, "That '70s Show." But the company, despite myriad marketing blunders, has survived, and today the Mac is back. Finally price competitive with PCs, and offering software used interchangeably with other programs, the company is staging a run. Apple's share of the US desk top computers market was up by half from 2003 to 2004.

That share is still low - just 3 per cent for desk tops, about twice that for notebooks - but a much bigger run may be in the offing. That is because of the plague that has hit the Windows world. Apple, with its tight, integrated interfaces cinching hardware to software has proven powerfully resistant to viruses and spyware, the poisonous infections of the internet. Meanwhile, Microsoft users scramble to update their software with the latest patches, frantically downloading anti-viral software, running and re-running spyware disinfectants. With the Mac offering equally proficient word processing, presentations, spread sheets, web browsing and e-mail, along with the standard multi-media applications, many are asking: Why bother?

Over the two year period commencing March 18, 2003, Microsoft shares rose 5.3 per cent; Apple's 373 per cent; and the Nasdaq Index, 43.4 per cent (bouncing back from historic lows). The upshot: while Microsoft's market cap has flat-lined at $260bn, Apple has jumped from $6bn to $35bn. Of course, the spectacularly popular iPod music box has generated much of the buzz - underscoring Apple's multi-pronged assault on the Microsoft Monopoly. Neither flank of the pincer movement was anticipated by regulators, or their remedies. Recall that the government's anti-monopoly solutions focused on gaining access for multi-media software, such as that provided by RealNetworks, to piggyback on the Windows network. Yet the creation of an entirely new web-based gizmo, tied online to Apple's iTunes, has proven the killer app. And despite the explosion in (legal) online music downloads, RealNetworks has seen its shares rise less than the Nasdaq over the past two years.

But the resurrection of Apple may only be a petty skirmish for Microsoft's field generals, as a new "browser war" has been launched. Mozilla, producing an "open source" web browser called Firefox, blasted onto the scene last year (with $25m in development funding from Microsoft rival Time Warner, owner of the presumably vanquished AOL-Netscape), and is now gaining traction. Microsoft's Internet Explorer dropped to below ninety percent market share for the first time in years this past February; Mozilla Firefox has 6 per cent. Customers are embracing Mozilla because it navigates the web faster than I.E., is free to download, and resistant to spyware.

Of course, Microsoft will do fine if its Windows customers use Firefox and like it; it will be easier to be a Microsoft customer if the malicious-ware of the internet is kept at bay. But the threat, just as with Netscape (and its embedded Java script) a decade ago, is that valuable functions will gradually shift away from Microsoft's domain - including, in the end, the operating system itself. This application creep happens so easily - take the Google gambit. A company provides a new and improved search engine, splices in a few well-targeted ads, and is now capitalized at $50bn. Microsoft, despite 'owning' the software on which the applications run, did not get here first. Ouch.

The range of product innovation chipping away at the large, increasingly vulnerable incumbent is impressive, and the diversity of organizational innovation more so. Apple is today on the upsurge because its personal computing systems have been vacuum-sealed, and because the company has - to the point of fetish - delighted in producing its own devices. While either was a distinct liability a decade ago, when Microsoft blew past by seizing the scale advantages of "open" operating system software, Apple's obsessions look smarter now. Yet, Mozilla opens its code to the world, generating robustness on pretty much the strategic polar extreme. Somehow, this seems to work in today's marketplace, as does the Google business model, which looks a lot like the standard pre-bubble dotcom. With the exception of the revenues (Google has some).

Its dominance challenged, Microsoft is naturally striking back - with a new, more bug-resistant Internet Explorer web browser, with vastly expanded email (Hotmail and MSN) offerings, and an array of intensive counter measures. While this looming competitive Armageddon may well rock Microsoft to its core, it most certainly will produce a new bundle of benefits for consumers - something the "antitrust case of the century" never did.

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James Boyle: State-scepticism

Tom Hazlett offers us a number of reasons to be sceptical of the value of the antitrust cases against Microsoft. His persuasive commentary has a lot in common with a more general scepticism of the need for antitrust enforcement in high tech markets.

The antitrust sceptics, as I will call them, believe that monopolies can actually encourage competitive ferment. Seeing that juicy hunk of monopoly rent, competitors will be frantic to capture it for themselves. Feeling the raptor-like competitors around it, the incumbent will have to lumber forward faster.

But what about "lock in" or "network effects"? Aren't there collective action problems in changing to a new operating system? Can't the maker of a dominant technology hold on to its customer base because of the enormous switching costs it can impose on its customers?

Hogwash, say the sceptics. First, consumers are not irrational - if costs get too high, they will switch. Second, monopolies like this may lead to even greater innovation. The competitors have to leap to an entirely new kind of technology, bypassing the monopolist altogether. (For a long time, it was assumed that Java was just such a threat to Microsoft's operating system.) Third, the sceptics think that the state lacks the foresight and surgical skills to trim the monopoly without distorting the market. Let the system work, and in the long run - in some kind of economic punctuated equilibrium - it will evolve beyond the problems.

These are powerful arguments and in some cases - the 1970's antitrust case against IBM, for example - I think they may even be right. But I think the sceptics ought to be wary before putting Microsoft in their pantheon of "unnecessary government interventions" into high tech markets.

Why wasn't Microsoft able to leverage its operating system monopoly into more general dominance; requiring Windows XP users to register for its Passport