Effecting a Price Squeeze Through Bundled Pricing

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Abstract

We show that a monopolist over one product can successfully leverage that monopoly power into another market so as to exclude rivals from that market, by using bundled pricing. This strategy is part of an equilibrium in which the monopolist behaves rationally, both in the short run and the long run; that is, the exclusion does not require the monopolist to take short run losses in order to achieve long run gains. Rather, the exclusionary pricing is profitable in the short run, but would not be profitable in the absence of the competitor. We show that the bundled pricing unambiguously generates welfare losses, both in terms of social welfare and in terms of consumer surplus. Our model is applicable to a variety of industries, including pay television and computer software. The analysis is particularly relevant to the current debate over Microsoft’s bundling of its browser with its operating system. We examine the potential for requiring the sale of unbundled elements (without also precluding bundling) as an antitrust remedy, and find that such a requirement, coupled with an “adding up” rule, is an effective remedy in some cases. However, additional remedies are likely to be needed in the Microsoft case to address the special demand characteristics of new buyers of computers.

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