

Surplus extraction by network providers: Implications for net neutrality and Innovation

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This paper looks at surplus extraction by network providers who control the medium of information transfer between application developers and consumers, and addresses the following questions: is net neutrality beneficial to society? and does providing network providers flexibility in pricing stunt innovation in the long run? To answer the first question, it looks at a market consisting of a monopoly network provider and two application providers with non-substitutable products, using a simple single period model. It shows that net neutrality is necessary to ensure maximal benefit to the society. To answer the second question, the paper shows that a monopoly network provider, if allowed complete flexibility in pricing, does not necessarily stunt innovation. Looking at a market that consists of one network provider and one application provider, and using a simple multi-period model, it shows that given maximum flexibility the network provider not only encourages innovation when the potential benefits are sufficiently high but also maximizes surplus. This paper takes the view that the topic of net neutrality is not only controversial but also complicated, and suggests that policy makers use a balanced approach based on sound analysis.

*To read the Full paper, please contact Arun_Kumar@isb.edu