

## **GOVERNMENT POLICY FOR FOSTERING INNOVATION**

### **Remarks before the China Council for the Promotion of International Trade and U.S. Chamber of Commerce**

**Global Forum on Intellectual Property Rights Protection and Innovation  
Beijing  
March 28, 2007**

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I am honored to be here this morning to speak before this Global Forum. Let me express my appreciation to the China Council for the Promotion of International Trade and the U.S. Chamber of Commerce for asking me to participate. My colleagues at the Federal Trade Commission and I have had numerous opportunities over the past several years to travel to China for various seminars and meetings, most of which have focused on consumer protection matters or on the draft Anti-Monopoly Law. We are grateful for the opportunity again to express our views.

The topic of this plenary session – “The Appropriate Role for Government in Fostering Innovation” – is broad and has the potential to touch upon a wide array of policies. As the agenda for this program makes clear, policies relating to tax, investment, venture capital, education, and research and development funding all play important roles in fostering innovation. My focus this morning will be more limited, though, because I speak from the perspective of an enforcement official in an agency with responsibility for competition and consumer protection. Rather than attempting to address government’s role comprehensively, I will be addressing four policy issues that relate to my agency’s experience with conditions that foster innovation and development: (1) the protection of economic stability through the assurance of rule of law, (2) the protection of intellectual property rights with the objective of encouraging competition and innovation, (3) the potential injury to economic development from government inhibitions on competition, and (4) the counterproductive effects of misspecified rules that have at times been adopted by competition authorities themselves.

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<sup>\*</sup> The views expressed in this presentation are those of the author and do not necessarily represent the views of the Federal Trade Commission or of any individual Commissioner.

## THE ASSURANCE OF RULE OF LAW

In identifying the roles of government in creating an environment conducive to innovation and development, I begin with one that is both basic and essential: the protection of economic stability through the assurance of rule of law. This is so obvious that we typically skip over it, and I do not propose to dwell on it this morning. I mention it in the context of a Global Forum, though, because it relates directly to my agency's expertise in technical assistance.

In recent years the Federal Trade Commission has worked with developing economies and emerging competition and consumer protection regimes throughout the world. Our experience is consistent with the observations of other commentators who have addressed the conditions necessary for growth and prosperity.<sup>1</sup> If a nation's economy is to succeed, government must begin with certain mechanisms and protections that are largely taken for granted in developed economies throughout the globe. There must be basic property rights, with systems for registering property, conveying property, and protecting investment in property. There must be basic contract rights, with systems that enable parties to order their affairs and to enter into mutual commitments on which they can rely. A recent World Bank study warrants close reading for its identification and measurement of obstacles to critical business activities that are needed for development. The list of activities includes those I have mentioned here – registering property, protecting investors, and enforcing contracts – as well as others such as starting a business, employing workers, and receiving credit.<sup>2</sup>

One of my predecessors and current colleagues at the Federal Trade Commission, William Kovacic, in 2001 published a law review article surveying the literature and drawing conclusions about the importance of law reform for successful economic development. He wrote:

advocates of economic law reform rank specific measures by their importance and choose assistance strategies that focus chiefly on the greatest needs. Modern commentary on economic reform has tended to emphasize five law reform prerequisites for economic development:

1. Creating and defining private property rights and creating systems for recording and transferring such rights.
2. Establishing contract principles and enforcement mechanisms to facilitate exchange.

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<sup>1</sup> See, e.g., WORLD BANK, *DOING BUSINESS IN 2005: REMOVING OBSTACLES TO GROWTH* (2005); WILLIAM W. LEWIS, *THE POWER OF PRODUCTIVITY* (2004); HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL* (2000); HERNANDO DE SOTO, *THE OTHER PATH* (1990).

<sup>2</sup> WORLD BANK, *supra* note 1. A press release describing the study is available at <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20250634~menuPK:34463~pagePK:64003015~piPK:64003012~theSitePK:4607,00.html>.

3. Recognizing the formation of business enterprises in the form of partnerships, corporations, and sole proprietorships and specifying the means for governing such bodies.
4. Promoting capital formation through the sale of securities, issuance of debt, and pledging of assets.
5. Facilitating the exit of assets and their redeployment through bankruptcy procedures.

Pursuit of these aims would not come at the exclusion of other measures, such as adopting laws to control pollution, prohibiting restrictive business practices, and addressing other market failures.<sup>3</sup>

As to all of these activities and others, government has the central role of assuring that society is governed by “rule of law.” Legal scholars and philosophers see law as achieving order by providing the guidance of general rules by which people can orient their behavior. They have articulated eight principles that a system of rules must satisfy if it is to fulfill that objective:<sup>4</sup>

- *Basis for Decision.* The rules must be expressed in general terms that allow for consistent adjudication.
- *Public.* The rules must be publicly promulgated.
- *Prospective.* The rules must give advance notice of what is expected.
- *Clear.* The rules must be expressed in terms that are understandable.
- *Consistent.* The rules must be consistent with one another.
- *Capable of Being Followed.* The rules must not impose demands that are beyond the power of the subjects.
- *Stable.* The rules must not be changed so frequently as to prevent reliance.
- *Enforced as Written.* The rules must be administered in a manner consistent with their wording.

Echoes of these principles can be found in numerous policy statements that have been developed by multilateral governmental organizations. In its *Guiding Principles for Regulatory Quality and Performance*, for example, the OECD calls for members to “[e]nsure that regulations, regulatory institutions charged with implementation, and regulatory processes are transparent and non-discriminatory,” and it urges that

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<sup>3</sup> William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI.-KENT L. REV. 265, 269-70 (2001) (footnote omitted) (collecting authority).

<sup>4</sup> See LON L. FULLER, *THE MORALITY OF LAW* (1964). Legal philosophers have debated whether Fuller’s principles should be characterized as “morality,” but there seems to be general agreement that the principles represent “good legal craftsmanship” that are important for efficacy and efficiency. See, e.g., H.L.A. Hart, *Book Review of “The Morality of Law,”* 78 HARV. L. REV. 1281, 1285-86 (1965).

“programmes . . . establish clear objectives and frameworks.”<sup>5</sup> Similarly, the basic principles of the World Trade Organization include non-discrimination, equal treatment, predictability, and transparency.<sup>6</sup> In the competition field in which my agency works, an informal venue known as the International Competition Network, which currently numbers 100 competition agencies from 88 jurisdictions, has advocated principles of transparency, non-discrimination, and procedural fairness.<sup>7</sup>

## THE ROLE OF INTELLECTUAL PROPERTY RIGHTS

With this background, I turn to the role of government in fashioning legal rules that relate to one particularly important form of property, namely intellectual property. Because my time is limited this morning, I would like to direct your attention to a thoughtful speech that my colleague Alden Abbott delivered in Xiamen in September 2005 for a more complete statement of my agency’s views.<sup>8</sup> The full text is available on the FTC’s Web site, and I will simply highlight a few of his most general observations here.

As Mr. Abbott observes, intellectual property has a critical role in furthering economic progress and public welfare. This is because intellectual property both contributes to innovation and emerges from innovation, and innovation is essential for fostering a dynamic, growing economy. Innovation –

drives down costs through the development of more efficient production and distribution techniques. It stimulates economic growth by bringing to market new products desired by consumers and the business community. And it can limit the creation and exercise of market power by fostering the development of new technologies that permit new entrants to leapfrog the advantages and entry barriers enjoyed by entrenched dominant firms. Intellectual property, therefore, is a highly valued asset, and it has been granted substantial legal protection by the nations of the world. It is important that we preserve those protections.<sup>9</sup>

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<sup>5</sup> Organisation for Economic Co-Operation and Development, *Guiding Principles for Regulatory Quality and Performance* (2005), available at <http://www.oecd.org/dataoecd/19/51/37318586.pdf>. See also *APEC-OECD Integrated Checklist on Regulatory Reform* (2005), available at <http://www.oecd.org/dataoecd/41/9/34989455.pdf>.

<sup>6</sup> See, e.g., World Trade Organization, *Understanding the WTO: Basics –Principles of the Trading System* (2007), available at [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

<sup>7</sup> The principles are included in a set of eight *Guiding Principles for Merger Notification and Review Procedures*, which are available on the Internet at <http://www.internationalcompetitionnetwork.org/media/archive0611/icnnpguidingprin.htm>.

<sup>8</sup> Remarks by Alden F. Abbott, Assoc. Dir. for Policy and Coordination, Bureau of Competition, Fed. Trade Comm’n, *The Harmonization of Intellectual Property Rights and Competition Policy: A Unified Approach to Economic Progress* (Sept. 8, 2005) (hereinafter *Harmonization*), available at <http://www.ftc.gov/bc/international/docs/abbottipchina.pdf>.

<sup>9</sup> *Id.* at 1.

A strong intellectual property regime is needed to provide an incentive to undertake costly and risky investment in innovative activities:

It can be very expensive to conduct the research and development that is necessary to come up with new products and technologies, and there can be many failures before a successful innovation is achieved. There would be little incentive for firms to make such a risky investment in research and development if others could freely copy or use a successful innovation and prevent the inventor from realizing well-earned rewards. Strong intellectual property rights are one of the most important means for providing those incentives. In the United States, IPR laws give the innovator the right to exclude others from using its invention for a specified period, and thus guarantee the innovator an opportunity to realize a return commensurate with the value of the invention and the risk that was undertaken. Protecting IPR is one of the major challenges – and obligations – of a global economy.<sup>10</sup>

If a government's intellectual property regime is to succeed in providing meaningful protection, it needs to have certain basic elements:

- The inventor must have a legal right to exclude others from using his invention.
- If the inventor chooses to commercialize his invention, he has to be free unilaterally to set the price at whatever level he chooses.
- If the inventor chooses to license his invention, he has to be free unilaterally to set the license fee at whatever level he chooses.
- There should not be a presumption that a patent or other intellectual property creates market power.<sup>11</sup>

Intellectual property rights are often implicated in standard-setting activities. As Mr. Abbott observes, “[s]tandard setting is increasingly important as a way of reducing transaction costs, and standards have a particularly important role in ensuring compatibility and interconnectivity of products and services.”<sup>12</sup> Because standard setting normally enhances economic efficiency, it generally does not raise significant concerns under competition law; we consider it procompetitive. Antitrust concerns have arisen on occasion, and Mr. Abbott addresses those in his Xiamen remarks, but those circumstances are limited. One of my colleagues from the U.S. Department of Justice Antitrust Division will have more to say about standard-setting in a speech tomorrow here in Beijing at the China Electronics Standardization Institute.<sup>13</sup>

One other aspect of an intellectual property regime warrants special mention. We view patent quality as very important – if you want strong IP rights, you need good IP.

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<sup>10</sup> *Id.* at 2.

<sup>11</sup> *See id.* at 3.

<sup>12</sup> *Id.* at 3-4.

<sup>13</sup> Remarks by Hill B. Wellford, Counsel to the Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, *Antitrust Issues in Standard Setting* (Mar. 29, 2007), available at <http://www.usdoj.gov/atr/public/speeches/222236.htm>.

That was the focus of a detailed report that the FTC issued in 2003 after conducting extensive hearings on the alignment between competition policy and patent policy.<sup>14</sup> Among its many recommendations, the report advocates expanded funding for the U.S. Patent and Trademark Office, various other steps designed to minimize the issuance of questionable patents, and various steps designed to provide early and reliable notice of a patent's coverage in order to enhance business certainty. These recommendations were made with the objective of fine-tuning a mature, highly-developed system, and we believe they have now achieved wide consensus in the United States. The report has been cited favorably by the U.S. Supreme Court<sup>15</sup> and by the press.<sup>16</sup> It has been praised by my counterpart at the PTO,<sup>17</sup> and substantially similar recommendations have been issued by panel of our National Academy of Sciences.<sup>18</sup> We are aware that some readers outside the United States have misunderstood the message of the report, so perhaps we can come back to these issues in greater detail during the question-and-answer session that will follow this panel's prepared remarks.

Among the other important issues in the relationships among intellectual property rights, innovation, and competition are the assessment of IPR licensing and patent pools. I do not have adequate time to address these this morning, but they are among the topics discussed in Mr. Abbott's Xiamen speech,<sup>19</sup> so I hope you will make the effort to read it.

#### THE POTENTIAL INJURY FROM GOVERNMENT INHIBITIONS ON COMPETITION

Let me now turn to my third topic this morning, the potential injury to economic development from government inhibitions on competition. As a starting point on this topic, I would respectfully direct your attention to a speech that my agency's Chairman delivered last year in Beijing.<sup>20</sup> In that speech Chairman Majoras explained "why

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<sup>14</sup> FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (Oct. 2003), available at <http://www.ftc.gov/opa/2003/10/cpreport.htm>. The transcripts of the hearings underlying the Report and materials submitted by participants are available at <http://www.ftc.gov/opp/intellect/index.htm>.

<sup>15</sup> See *eBay Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837, 1842 (2006) (Kennedy, J., concurring).

<sup>16</sup> See *Patently Absurd*, WALL ST. J., Mar. 1, 2006, at A14.

<sup>17</sup> General Counsel James A. Toupin expressed substantial agreement with the recommendations during a panel on which he and I both appeared before the Federal Circuit Bar Association, Eighth Bench and Bar Conference (June 30, 2006). See also Brief for the United States as Amicus Curiae at 19, *KSR Int'l Co. v. Teleflex Inc.*, No. 04-1350 (U.S. May 25, 2006) (citing discussion of "comprehensive report" as to obviousness).

<sup>18</sup> NATIONAL ACADEMIES BOARD ON SCIENCE, TECHNOLOGY AND ECONOMIC POLICY, A PATENT SYSTEM FOR THE 21ST CENTURY (2004), available at <http://books.nap.edu/html/patentsystem/>.

<sup>19</sup> See *Harmonization*, *supra* note 8, at 9-11.

<sup>20</sup> Remarks by Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, *Promoting a Culture of Competition* (Apr. 10, 2006) (hereinafter *Culture of Competition*), available at <http://beijing.usembassy.gov/041006e.html>. Additional discussion of the topic may be found in a speech I

government inhibitions on competition are particularly troubling, why they are an attractive avenue for businesses who want protection from competition, and how we try to combat these restrictions through persuasion, when we cannot reach them through enforcement.”<sup>21</sup>

The speech focused mainly on what we call “competition advocacy” – our role in persuading other governmental agencies, which may not necessarily be subject to a competition mandate, to make decisions or take official actions that are consistent with the objectives of competition policy. In explaining this role, though, the speech makes a number of important observations that go beyond competition advocacy and are relevant to some of the broader questions on the role of government.

The first observation is that “[t]he idea of competition as a way to organize an economy often must struggle against other regulatory structures that are hostile to free markets.”<sup>22</sup> The Chairman’s speech recounts numerous examples of such hostility from past regulatory experience in the United States.<sup>23</sup> Examples are not limited to the United States, of course. It is now commonplace for competition authorities to express caution over the anticompetitive consequences that often flow from regulatory capture and rent-seeking.<sup>24</sup> Many jurisdictions have also adopted policies that limit governmental favoritism in the form of state aid. In the European Union the Treaty of Rome prohibits Member States from interfering with commerce among themselves.<sup>25</sup> In the United States the Commerce Clause<sup>26</sup> in our Constitution, now more than two hundred years old, has been interpreted as prohibiting state laws that mandate “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the

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delivered in Hangzhou last year. See William Blumenthal, Gen. Counsel, Fed. Trade Comm’n, *The Relationship between Competition Agencies and Other Units of Government* (May 19, 2006), available at <http://www.ftc.gov/speeches/blumenthal/20060519Mofcom-ADBFinal.pdf>.

<sup>21</sup> *Culture of Competition*, *supra* note 20, at pt. I.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*, at pts. I-III (discussing price and capacity controls on the airline, rail, intercity busing, and trucking industries until they were successfully deregulated; shipment barriers in the wine industry; and limitations on truthful advertising claims). Examples discussed in other speeches can be found in medical services, legal services, funeral homes, real estate brokerage, and other industries with professional licensing. See Deborah Platt Majoras, Chairman, Fed. Trade Comm’n, *A Dose of Our Own Medicine: Applying a Cost/Benefit Analysis to the FTC’s Advocacy Program*, Address before Charles River Associates Program on Current Topics in Antitrust Economics and Competition Policy (Feb. 8, 2005), available at <http://www.ftc.gov/speeches/majoras/050208currebtopics.pdf>; Timothy J. Muris, Chairman, Fed. Trade Comm’n, *Creating a Culture of Competition: The Essential Role of Competition Advocacy*, Remarks before International Competition Network Panel on Competition Advocacy and Antitrust Authorities (Sept. 28, 2002), available at <http://www.ftc.gov/speeches/muris/020928naples.htm>.

<sup>24</sup> See, e.g., Dr. Ulf Böge, President, Bundeskartellamt, *State-Imposed Restrictions of Competition and Competition Advocacy*, Remarks before Opening Session of 2004 Seoul Competition Forum (Apr. 20, 2004).

<sup>25</sup> Article 86 of the Treaty limits the powers of the Member States to enact measures adversely affecting competition, and Article 87 authorizes the European Commission to challenge and order repayment of competition-distorting state aid.

<sup>26</sup> U.S. CONST. art. I, § 8, cl. 3.



latter.”<sup>27</sup> The Clause is widely recognized as having been essential to the commercial integration of the United States economy and to the successes that the integration yielded.<sup>28</sup>

A second observation from the Chairman’s speech relates to the reasons that governmental intervention can be so attractive to businesses seeking a haven from the rigors of competition:

Engaging in private anticompetitive conduct is risky for firms: predatory pricing requires the predator to lose profits in the short term; collusive behavior has the risk of cheating on the cartel; and there is the risk of detection and legal punishment. By contrast, persuading the government to adopt an anticompetitive restriction is much less risky: the costs of lobbying are low; the government enforces the restriction, which reduces the likelihood of cheating; and the ability of the competition agencies to intervene is limited.<sup>29</sup>

Government-imposed restraints on competition often prove to be especially effective and durable. In our experience, restraints authorized for government-controlled enterprises or imposed on the private sector pursuant to government regulation often have a greater adverse effect than anticompetitive conduct by private firms.

A third observation from Chairman Majoras’s speech is the identification of one reason that government can be persuaded to adopt restraints that injure competition and yield little public benefit:

the interests of the companies and the interests of the consumers are typically not well-balanced in this situation. The businesses who support these restrictions are usually well organized, have . . . access to lawmakers, and have strong incentives to get the restriction enacted because they will reap all of the supracompetitive returns. By contrast, consumers who would be harmed by the restriction are often unlikely to know about it, are poorly organized, and have limited incentives to stop the restriction because it may

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<sup>27</sup> *Oregon Waste Syst., Inc. v. Department of Env’tl. Quality of Ore.*, 511 U.S. 93, 99 (1994), *quoted in* *Granholm v. Heald*, 544 U.S. 460, 472 (2005).

<sup>28</sup> *See, e.g., Granholm*, 544 U.S. at 472-73 (recalling objectives of Constitution’s Framers and reasons for prohibiting discrimination against out-of-state interests).

<sup>29</sup> *Culture of Competition*, *supra* note 20, at pt. I. *See also* Timothy J. Muris, Chairman, Fed. Trade Comm’n, *State Intervention/State Action – A U.S. Perspective*, Remarks before Fordham Annual Conference on International Antitrust Law & Policy, at 2 (Oct. 24, 2003), available at <http://www.ftc.gov/speeches/muris/fordham031024.pdf>. Muris writes:

public restraints are far more effective and efficient at restraining competition. Unlike private restraints, there is no need to maintain backroom secrecy or to incur the costs of conducting a covert cartel. Public restraints can be open and notorious. Public restraints are also a more efficient means of solving the entry problem. Rather than ceaselessly monitoring the marketplace for new rivals, a firm can simply rely on a public regime that, for example, provides for only a limited number of licenses. Perhaps the clearest advantage of public restraints is that they frequently include a built-in cartel enforcement mechanism. While cheating often besets private cartels, public cartels suffer from no such defect. Cheaters, once identified, can be sanctioned through government processes.



only cost any individual consumer a small amount of money, even though it costs consumers a large amount in the aggregate.<sup>30</sup>

This imbalance is addressed and modeled in an extensive economic literature that now traces back four decades.<sup>31</sup>

A fourth observation – and the last one I will provide this morning before turning to my final topic – is that tremendous damage to consumer interests has been done over the years in many jurisdictions, including my own, in the name of “consumer protection.”<sup>32</sup> Too often, well-meaning government officials seek to protect the public by imposing regulations that have the unintended effect of elevating cost, limiting entry, and depriving consumers of marketplace options. We recognize, of course, that markets sometimes suffer from imperfections and that consumers sometimes require protection through regulatory intervention. It is important, however, fully to analyze the competitive effects of the intervention; and it will be extremely rare that the appropriate form of protection will require suspension of competition as an organizing principle for the market.

#### THE COUNTERPRODUCTIVE EFFECTS OF MISSPECIFIED COMPETITION RULES<sup>33</sup>

If we are candid in developing a detailed list of governmental restraints that tend to suppress the competitive process, we need to recognize that the rules of competition enforcement authorities themselves have at times had a counterproductive effect. We in the United States have now had more than a century of experience with administering our antitrust laws, and our practices have varied widely over that period. In retrospect, it is now clear that many of our practices in the middle of the last century were ill-considered, at least to the extent that efficiency and consumer welfare are to be treated as touchstones of sound competition policy.

Without attempting to be comprehensive, one can identify numerous practices that may initially sound reasonable, but that on inspection tend to suppress competition or discourage investment or both:

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<sup>30</sup> *Culture of Competition*, *supra* note 20, at pt. I.

<sup>31</sup> See, e.g., MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965). For one of many useful discussions of the literature and theory, see W. KIP VISCUSI, JOSEPH E. HARRINGTON, JR. & JOHN M. VERNON, *ECONOMICS OF REGULATION AND ANTITRUST* 382 (4th ed. 2005).

<sup>32</sup> In the words of Chairman Majoras, “[s]ome producers cloak their requests for anticompetitive government action as consumer protection but, in reality, they are looking for a dispensation from market forces and a reduction in consumer choice.” *Culture of Competition*, *supra* note 20, at pt. I.

<sup>33</sup> The issues addressed in this section are treated in greater depth in William Blumenthal, Gen. Counsel, Fed. Trade Comm’n, *Reducing Governmental Impediments to Capital Mobility* (Aug. 17, 2005), available at <http://www.ftc.gov/speeches/blumenthal/050817asean.pdf>, from which this text is substantially derived.

- Excessive skepticism towards horizontal restraints may discourage efficiency-enhancing joint ventures;
- Prohibition of licensing restrictions may impede the development and adoption of intellectual property;
- Prohibition of vertical marketing restraints may prevent the adoption of efficient distribution systems;
- Prohibition of exclusive contracts or long-term contracts may limit the ability of manufacturers to receive the assurance needed to finance new facilities;
- Prohibition of contractual provisions by which a manufacturer limits the prices at which its distributors are authorized to resell product may deprive end-use customers of valuable point-of-sale services or expose those customers to opportunistic pricing; and
- Imposition of uniform pricing requirements in the interest of fairness may reinforce pricing rigidities.

One could elaborate on each of these points in detail. With my limited time, however, let me focus your attention instead on three other areas of doctrine that continue in our judgment to be a source of excessive enforcement intervention in some jurisdictions.

#### A. Dominance and Monopolization

We are mindful that enforcement authorities are not fully aligned in their views towards the appropriate analysis of conduct by dominant firms. We in the United States believe that our view on the appropriate standard has proven itself in both the marketplace of ideas and the marketplace of real-world commerce.

Two key principles of United States law on monopolization should be highlighted as we think about the appropriate policies that might be adopted by government. The first and most important principle is that United States competition law does not condemn the mere possession of monopoly power, but punishes only misuse that results in a substantial injury to competition. In our view, punishment of a firm that obtains a dominant or monopoly position by reducing price or offering new or improved products or services is contrary to the goal of promoting competition. A free market system envisions that competitors will strive for a superior position through innovation, greater efficiency, or other legitimate competitive behavior. Innovation, economic growth, and vigorous competition would be stifled if the law were to punish successful market participants who achieve a dominant or monopoly position.

A second principle is that even firms with monopoly power are permitted to compete aggressively on the merits, even if a collateral effect is a bad outcome for their competitors. Competition is a rigorous process, and it will inevitably yield both winners and losers. If a firm is more efficient and can thereby reduce costs and expand sales at the expense of its less-efficient competitors, our competition laws are not infringed. There may be harm to competitors, but no harm to competition. Competitive conduct frequently looks like exclusionary conduct, because aggressive competition may harm less efficient firms. We do not protect less efficient businesses from legitimate, vigorous

competition, even where a firm holds a dominant or monopoly position. On the other hand, our competition laws prohibit a firm with monopoly power from engaging in conduct that has no legitimate business justification other than to control prices or exclude competition, because this type of conduct injures competition.

## B. Compulsory Access

As we survey jurisdictions around the globe, we have seen a recent and renewed interest in a particular form of intervention that is sometimes urged as a possible remedy for dominant firms – namely, compulsory access to their so-called “essential facilities.” We in the United States have developed substantial misgivings about intervention in this form, largely because of the adverse effects that I would like to describe here.

In the United States, our competition law generally does not restrict the right of a firm, including a monopolist, to exercise its independent discretion as to the parties with whom it will deal. Even firms with market power are permitted to refuse to deal with rivals. To require otherwise would subvert the firms’ incentives to innovate, invest, and compete.

Consider the analysis of a compulsory access requirement from the perspective of a potential investor. If the investor commits funds and the investment fails, it absorbs the entire loss; it does not receive any subsidy from its competitors. But if the investor commits funds and the investment succeeds, it must now share the benefits with its competitors. An asymmetrical system of this type discourages entrepreneurial risk-taking, encourages free-riding, and becomes what one of our commentators has called “an insurance policy for laggards.” To assure that investment and innovation are not discouraged, competitors must be confident in advance that they will not be required to share their successful assets with competitors. And to the extent that a legal system contemplates that mandatory sharing may be required in some instances, it will be important to minimize the disincentive for innovation and investment by providing sufficient detail to enable competitors to recognize in advance when the sharing obligations will be imposed.

Compulsory access to a network or other infrastructure presents another problem – it chronically leads to disputes on the terms of access, especially price, and resolving those disputes often entails intervention by agencies or courts. In practice, compelling access to a network or other infrastructure requires the creation of mechanisms that will be needed to regulate the price and non-price terms of access and to monitor compliance. We have found that mechanisms of this type are generally beyond the capabilities of competition authorities. Most commentators agree that they are generally beyond the capabilities of the courts as well.

For these reasons, our view is that inclusion of compulsory access provisions in a competition law is neither advisable nor practical. As a general proposition, we do not require even dominant firms to share their physical facilities, to supply rivals or particular customers with goods or services, or to license their intellectual property. To the extent

that compulsory access is found to be necessary as a remedy for violations of other, more general provisions of the law, that remedy should be invoked only in the most exceptional circumstances.

### C. Mergers

The third area of government intervention warranting particular attention is merger control. From the perspective of efficient capital markets and from the perspective of the economic system as a whole, mergers encourage investment by providing entrepreneurs and investors with a means for recovering their funds and potentially earning a return. Enforcement authorities should take care not to interfere with this incentive unnecessarily. I would point to potential concerns with both merger process and substantive standards.

First, global merger process – we should start with some rough statistics. More than seventy jurisdictions around the globe now have some form of merger review. Most of the merger review regimes provide for extraterritorial application, and even mergers between two foreign companies are subject to local notification obligations if the parties satisfy the regime's nexus requirements. In total, the world's merger review regimes directly affect literally thousands of transactions every year. The vast majority of those transactions do not raise competitive concerns. For even the largest and most active jurisdictions, the number of transactions that require close examination each year can be measured in only the dozens. And for those transactions that do raise concern, only a handful will require detailed review or intervention by more than one or two jurisdictions. By contrast, of the thousands of transactions that are not problematic, many will be procompetitive and efficiency-enhancing.

As an increasing number of jurisdictions seeks to conduct merger review, the burden of cumulative merger filings has been growing. In response, the International Competition Network has developed Recommended Practices for Merger Notification Procedures.<sup>34</sup> Among the important recommendations are practices relating to Nexus to the Reviewing Jurisdiction, Notification Thresholds, Review Periods, and Requirements for Initial Notification. These recommendations are beginning to have a significant beneficial effect on global enforcement practices, and it is important for governments to bear them in mind as they develop their enforcement systems.

Let me turn from process to substance. If substantive merger standards are misspecified or misapplied, they can injure consumers and economic growth. As a practical matter, there is an emerging consensus among major jurisdictions on the analytical framework to guide merger analysis, with a focus on consumer welfare and a recognition of the benefits of efficiencies. When that framework is properly applied, different analysts should generally reach consistent results. Merger standards can be problematic, however, when they look beyond the competitive effects of the particular

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<sup>34</sup> Cf. *supra* note 7 (earlier reference to ICN). The Recommended Practices are available on the Internet at <http://www.internationalcompetitionnetwork.org/index.php/en/publication/294>.

transaction and give weight to non-competition considerations. That harms economic efficiency, and it distorts capital markets. It injures consumers. It suppresses growth.

#### CONCLUSION

Let me conclude by summarizing my main points about government policy for fostering innovation. Many areas of government policy development can have critical importance, but some of those are beyond my agency's enforcement mission, so I have limited myself this morning to topics with which the Federal Trade Commission has direct experience. Based on that experience, I would point to four roles that government might usefully serve to create an environment that fosters innovation and economic development. First, government needs to protect economic stability through the assurance of rule of law. Second, government should provide strong protection to intellectual property rights. Third, government needs to protect against the tendency to impose inhibitions on competition. Fourth, government should take care to adopt well-considered rules under its competition laws and should avoid excessive intervention by its enforcement agencies.

I again express my appreciation to the China Council for the Promotion of International Trade and the U.S. Chamber of Commerce for organizing this Global Forum. I look forward to your questions during the interactive discussion at the conclusion of this panel.