

## **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

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*



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





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.



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

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- Excessive skepticism towards horizontal

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

that compulsory access is found to be necessary as a remedy for violations of other, more general provisions of the law, that

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.