

# PRICE THEORY AND INNOVATION THEORY: THE CHANGING BALANCE

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Role of competition policy in supporting  
innovation and economic growth

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PRICE

INNOVATION



ARROW

SCHUMPETER



# The Way it Was

- ▣ Up to about 1980, US antitrust was applied to preserve dynamic markets
- ▣ It was assumed that dynamism would come from upstarts
- ▣ Lower price and more innovation pointed in the same direction



# United Shoe Machinery, Wyzansky, 1954

- ▣ United Shoe Machinery imposed exclusionary ties, violated Section 2 of the Sherman Act
  - “[O]ne point is worth recalling. Compo’s inventors first found practical ways to introduce [a] process which United had considered and rejected.”
- ▣ “This experience illustrates the familiar truth that one of the dangers of extraordinary experience is that those who have it may fall into grooves created by their own expertness.”

# 1980 Forward


- ▣ AAG Baxter introduced price theory to antitrust
  - This was a way to minimize antitrust
- ▣ What about innovation?
  - This would take care of itself if firms are free
    - ▣ Schumpeter's gales of destruction
    - ▣ **Scalia in Trinko:**
- ▣ “[P]ossession of monopoly power is ... an important element of the free market system... **The opportunity to charge monopoly prices ... induces risk-taking that produces innovation ...**”

# THERE HAVE BEEN EXCEPTIONS

- ▣ ATT breakup in 1980s
- ▣ Clinton administration brought and won the Microsoft case
- ▣ While across the ocean
  - European Commission, Court:
    - ▣ Microsoft suppressed rivals' innovation incentives and the successful enforcement did not undermine Microsoft's



# BACKTO BUSH

- ▣ The teachings of Trinko resonated with the general philosophy of GWBush DOJ
- ▣ Price theory and innovation theory usually pointed in the same direction 
  - E.g., the merger of XM Satellite Radio and Sirius '08
    - “To the extent [of] concern that the combined firm might be able profitably to increase prices ..., efficiencies flowing from the transaction likely would undermine any such concern.”
    - “Any inference of a competitive concern was further limited by the fact that a number of technology platforms are under development that are likely to offer new or improved alternatives ...
  - The firms merged; prices rose 30% [consumer class action]



# A NEW ERA?

- ▣ Obama administration antitrust enforcers promise to turn the tide
- ▣ Innovation effects can cut for or against a merger or dominant firm strategy
  - Intel
  - Google ITA – flight search technology
  - The 2010 Horizontal Merger Guidelines
    - ▣ “A merger enhances market power if it is likely to encourage .. firms to raise price, reduce output, **diminish innovation**”
    - ▣ Agencies consider ability to conduct R&D more efficiently;
      - **“to appropriate the benefits of its innovation”**

# CONCLUSION

