Charles D. Weller
1100 Republic Building
25 Prospect Avenue
Cleveland, Ohio 44115
(216) 736-7936
[redacted]

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Comments on New Economy,
Antitrust Modernization Commission,
Topic III, A.1:
Does antitrust doctrine focus on static analysis, and does this affect its application to dynamic industries?

THIS IS ONE OF THE QUESTIONS ON WHICH COMMISSION MEMBERS SHOULD FOCUS THEIR UNIQUE EXPERIENCE AND EXPERTISE TO LEAD A CHANGE IN ANTITRUST DOCTRINE FROM A STATIC ECONOMIC EFFICIENCY THEORY THAT TELLS AMERICAN WORKERS AND COMPANIES TO COMPETE IN WORLD MARKETS ON EFFICIENCY, TO A NEW ECONOMIC THEORY THAT ALIGNS WITH THE AMERICAN GENIUS FOR PRODUCTIVITY, INNOVATION AND UNIQUE VALUE

One hundred years ago this year, Einstein changed the course of science from one of the greatest scientific theories of all times, Newtonian physics, to a new theory, Quantum physics, because Newtonian physics simply did not work at the atomic level. A new theory was needed.

The same is true today for antitrust doctrine. As a policy and legal matter, static economic efficiency theory, like Newtonian physics 100 years ago, is elegant but inadequate for the dynamic global industries and markets of our times, especially for the United States. Fortunately, outside the specialized world of antitrust and economics departments, there is a new, highly developed economic theory in use world-wide, the Theory of Productivity, Innovation and Unique Value principally developed by Harvard's Michael Porter. I strongly urge the Commission to focus on this question and as a result recommend to Congress, the federal agencies, state attorneys general and governments, the courts and international governments and antitrust agencies that antitrust policy should evolve from static efficiency economic theory to the Theory of Productivity, Innovation and Unique Value as soon as possible, for the reasons summarized below and elaborated in the book Charles Weller, Ed., Michael Porter, Peter Staudhammer & Scott Stern, *Unique Value* (2004 & 2005). [1]

1. Static Economic Efficiency Theory Can Only Produce "Miniscule" Increases in the Standard of Living

Every day, headlines blare "Why Asia Will Eat Out Lunch," "Cutting Here But Hiring Over There," "China Economy Rising At Pace To Rival U.S.," "The Three Scariest Words in U.S. Industry: 'The China Price,'" "How Long Can Workers Tread Water," "As Rich-Poor Gap Widens in the U.S., Class Mobility Stalls."

[1] http://www.atlasbooks.com/marktplc/01314.htm Portions of this comment are also used in the author's Comments to the Commission on International and Merger Enforcement questions.

Yet antitrust doctrine in the U.S. today (and for the last 30 years) is based on static economic efficiency theory, an economic theory that, in effect, tells American workers, companies and communities:

> "Our antitrust and economic theory says you must compete with the Chinese and others in the new global economy on the basis of efficiency."

"[F]ormal economic theory of the market" emphasizes its "static-efficiency characteristics," a former Chairman of the President's Council of Economic Advisor (Charles Schultze) explains, but efficiency theory can only produce "miniscule" increases in the standard of living, in sharp contrast to the facts that show that "what is far more important" about a competitive market is its "capacity to stimulate and take advantage of advancing technology" -- to innovate:[2]

> Had the triumph of the market meant only a more efficient use of the technologies and resources then available, the gains in living standards would have been minuscule by comparison.

"Innovation" is "a distinguishing characteristic of the United States," and "Americans over two centuries used their freedom to provide comfort and security, and so came to advance the well-being of all mankind." Herold Evans, *They Made America* 10 (2004). Thus "[u]nderstanding just what innovation is and how it comes about is a vital subject for the 21st century, when intensifying competition from around the world requires Americans to innovate as briskly as did those first adventurers." *Id.*

Static economic efficiency theory does not do that. As Peter Drucker bluntly puts it: economic efficiency theory is a theory of "an economy that is briskly standing still," and innovation is "an event they cannot deal with, a sort of uncontrollable and unpredictable catastrophe, like earthquakes or pestilence." *Age of Discontinuity* 143, 148 (1968).

An economic theory that can only produce "miniscule" increases in the American standard of living and provides no real understanding of innovation or how it comes about -- static economic efficiency theory -- cannot be an acceptable antitrust policy, especially when there is an alternative (see part 3).

2. Legally Static Economic Efficiency Theory-Based Antitrust Will Increasingly Lose in Court

In addition, as the defense bar takes increasing advantage of a new combination of Supreme Court precedents, *California Dental* and *Oracle* will increasingly represents the government's future in court -- they will lose. The Supreme Court in a number of decisions, when used in the right combination factually and legally, has made antitrust policy based on efficiency economic theory effectively unenforceable. Some of the Court's key decisions are:[3]

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[2] C. Schultze, *The Public Use of Private Interest* 25 (1977). Congress has also specifically found that "technological innovation" is "critical" to the "ability of the United States to raise the living standards of Americans." The National Cooperative Research and Production Act of 1993 ("NCRPA"), 15 U.S.C. secs. 4301-05.

[3] For an extensive roadmap for defense litigators, see Weller, "Winning Antitrust Litigation for Defendants and Advancing Antitrust Beyond Static Economic Theory Unconventionally," Chap. 7, *Unique Value*.

- the "Daubert 6," two decisions identifying a methodological flaw in efficiency economic theory -- "'in the real economic world rather than an economist's hypothetical model,' the latter's drastic simplifications generally must be abandoned," and the four unanimous Daubert"[4] decisions on when experts can, and cannot, be admitted at trial, make economic experts using efficiency theory vulnerable to exclusion from trial.
- California Dental[5] and the Court's 22-year string of precedents, sharply narrows when per se and other presumptions can be used.
- State Farm,[6] and Arthur Anderson and U.S. v. Booker this year, provide the precedent along with the above for fundamentally rewriting antitrust jury instructions for the first time since Socony-Vacuum.

Given the fundamental policy and legal problems of current antitrust doctrine based on the theory of static economic efficiency, what economic theory can and should replace it?

3. New Economic Theory for Antitrust Policy: The Theory of Productivity, Innovation and Unique Value

The Theory of Productivity, Innovation and Unique Value is a dynamic economic theory of wealth, prosperity, human dignity and long-term consumer welfare principally developed over the last quarter century by Michael Porter of Harvard Business School.

It is not the economics I was taught in college, it is not the economics taught in any economics department or law school antitrust course I'm aware of, nor is it in any antitrust text I'm aware of (which is basically why I published a book on it, *Unique Value,* with 5 chapters by Prof. Porter).

However, it is taught in business schools around the world, and it is used all over the world. To illustrate, in February the *N. Y. Times* reported that in China in June 2004 "an overflow crowd paid $1,000 a ticket" to hear Mr. Porter because of his "international reputation" for "works on competition between companies and across national borders." Barboza, "Seven Habits of Highly Effective Cadres," *N.Y. Times* B1 (Feb. 19, 2005). In the words of several prominent antitrust practitioners and scholars:

Terry Calvani, Former Commissioner, U.S. Federal Trade Commission, Member & Director of Cartel Division, The Competition Authority of Ireland; Lecturer on Law, Trinity College, Dublin:

> "[T]he work of Michael Porter" is an “antidote to the conventional welfare economics that has served as the foundation for modern competition policy for the last thirty years.”

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[4] Daubert v. Merrell Pharmaceutical, Inc., 509 U.S. 579 (1993); General Electric Co. v. Joiner, 522 U.S. 136 (1997); Kumho Tire Co. v. Carmichael, 143 L. Ed. 2d 238 (1999); Weisgram v. Marley Co., 145 L. Ed. 2d 958 (2000).

[5] Calif. Dental Assn v. FTC, 143 L. Ed 2d 935 (1999), remand, 224 F.3d 942 (9th Cir. 2000) (the Supreme Court held no “quick look” presumption could be used; on remand, the FTC lost their Rule of Reason theory; the FTC did not appeal).

[6] State Farm Mutual Automobile Ins. Co. v. Campbell, 123 S. Ct. 1513 (2003). See also BMW of North America v. Gore,517 U.S. 559 (1996).

Ky Ewing, Chair, American Bar Association Antitrust Section 2000-2001; former Deputy Assistant Attorney General, U.S. Department of Justice, Antitrust Division:

> "UNIQUE VALUE: COMPETITION BASED ON INNOVATION CREATING UNIQUE VALUE …is a book to be relished by thoughtful people who want to explore new dimensions of the competitive process, the very nature of which is changing as the 'knowledge economy' innovatively expands."

Thomas A. Piraino, Jr., Vice President, General Counsel and Secretary, Parker-Hannifin Corporation, Cleveland, Ohio

> "Michael Porter's economic analysis can revolutionize the way we think about markets and competition. Business executives, antitrust practitioners and anyone who cares about the economic organization of our society can gain valuable insights from Charles Weller's collection of some of Michael Porter's most original thinking. Mr. Weller's summaries and commentaries will be an invaluable aid to any interested reader."

The Theory of Productivity, Innovation and Unique Value (my name for it) is a new theory, and is as different from economic department economics as Quantum physics is from Newtonian physics, e.g.:

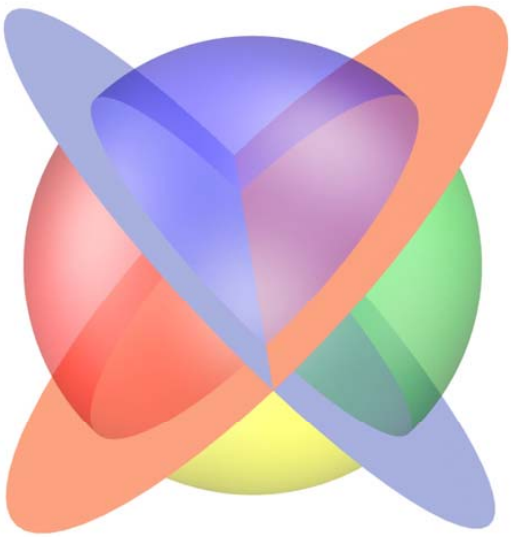
- Productivity, not Efficiency, is the central focus for raising the standard of living and for consumer welfare.
- "Positive Sum" Competition, competition that increases wealth through innovation creating unique value and raising productivity, is distinguished from "Zero Sum" Competition, a static theory that assumes scare resources, that wealth is fixed, and that the key competitive issues are allocative efficiency and wealth transfer.
- Long-Term Consumer Welfare, not just Short-Term Consumer Welfare, is the goal.
- High Wages and High Profits are celebrated as the result of "Positive Sum" Competition based on innovation creating unique value, greater productivity, and long-term consumer welfare.
- Unlimited Resources and Unlimited Wealth empirically replace the theoretical assumption of Scarce Resources because the historically unprecedented shift to an applied knowledge economy makes knowledge the largest driver of wealth -- and knowledge is an unlimited resource.
- The Theory Uses Three Key Variables -- (1) Five Forces, (2) the Type of Competition, and (3) the Business Environment "Diamond" (see Figs. 1 & 2).
- There are Two Key Types of Competition, not just one:

- “Type I Competition" over efficiency ("operational effectiveness")
- "Type II Competition" over innovation creating unique value to customers.

Competition based on innovation creating unique value means doing things differently from competitors. It involves choosing a unique position to deliver value to customers and tailoring business activities to that position. Creating unique value means companies and their employees must develop new products and new services, and new ways of conducting the activities of their business to set them apart from their competitors -- a form of competition in which the U.S. can excel, particularly in the rapidly growing new economy -- the knowledge economy.

Conclusion. The Commission, of course, is an advisory body and has no authority to act. Only Congress, the federal agencies, state attorneys general and governments, the courts and international governments and antitrust agencies, individually and collectively, have the authority to act. Yet rarely in antitrust is a group of such distinguished antitrust practitioners assembled. I urge them to seize this historic opportunity, focus on this and the two other questions I comment on, and lead a change in antitrust doctrine from static economic efficiency theory that tells American and other workers and companies to compete in world markets on efficiency, to a new economic theory that aligns with the American genius for productivity, innovation and unique value, and aligns with the economic and human interests of everyone everywhere -- the Theory of Productivity, Innovation and Unique Value. -- as soon as possible.

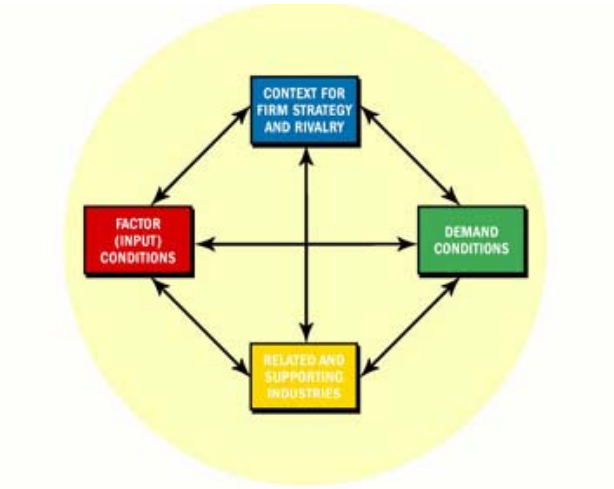
Figure 1:
Theory of Productivity, Innovation and Unique Value



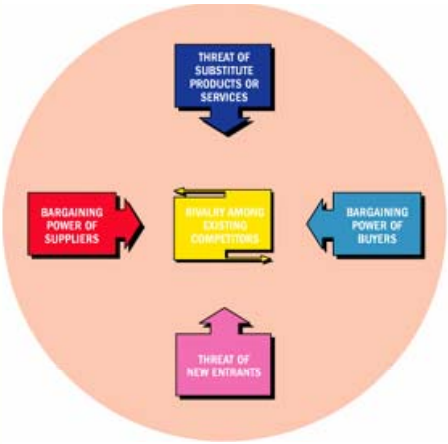
Five Forces	**(red "slice")**
Type (Sophistication) of Competition	**(blue "slice")**
Business Environment "Diamond"	**(4 color "globe")**

Figure 2:
Applying the Three Variables

Diamond



Five Forces



Type of Competition