

Giving Monopoly a Cost by Tuure Parkkinen

MAKING THE INTELLECTUAL PROPERTY RIGHTS MARKET MORE EFFICIENT WITH A MARKET VALUE TAX ON PATENTS. INTERNALIZING POSITIVE EXTERNALITIES WHILE MINIMIZING NEGATIVE ONES.

The main pragmatic argument for patents is that new inventions – technologies and innovative applications thereof – can have significant *positive externalities* for others who can learn to utilize them as well, without them having to incur the development costs. As a result, without patents, the economic incentive to invent is not strong enough to make it profitable for individual people or companies to invest in research and development, even though the efforts might be net value producing for the whole economy.

Patents allow the inventor to capture a bigger share of the value that the invention produces, and this ensures that he gets duly compensated for his efforts. This creates incentive for researchers and developers to strive for new inventions.

Monopolies impose costs on others

However, patents – monopolies on technologies – can have significant *negative externalities* as well: they restrict others' freedom. Patents can be used to limit competition by preventing new inventions from entering the market and restricting technological progress by blocking further development of inventions and methods. Take for example the case of the oil industry buying up patents related to renewable energy technologies to control their commercialization and rollout, and thereby extend the life cycles of their oil-based technologies and maximize the value of their sunk investments in oil-related infrastructure and discovered reserves.

"Patent wars" can cause companies to pick their focus markets and business areas based on the level of IPR protection therein, rather than going after market gaps (Paik & Zhu 2013) – unfilled human needs – which causes inefficient resource allocation and reduces competition where IPR protection is

high. These patent wars involve significant costs, while it can be argued that they produce hardly any net real value for the whole economy. In 2011, Apple and Google spent more on patent lawsuits and patent purchases than on research and development of new products.

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Andrew Yglesias (2012) points out that intellectual property in general is more comparable to "land" than "capital" in classical economic models. They are monopolies by definition and non-fungible. Equal substitutes cannot be produced by human labor to compete with a patent, which does not qualify them as "capital" in the Georgist sense. (George 1879.)

And this is very relevant for a consequentialist approach to the questions of what kinds of intellectual property should be patentable and otherwise registrable – and, especially, what the costs of holding such intellectual property should be.

Market Value Taxation Could Improve Use-Efficiency

Many economists agree that land value taxation (LVT) would improve land (i.e. location) use efficiency. Similarly, taxing the holding of patents according to their market value seems like a very promising improvement for the intellectual property rights market.

Such a tax would not prevent the *developer* of the technology from receiving compensation for his efforts: He could price the patent according to the most productive use he sees available for it and a buyer who sees a better use would buy it off him and pay the higher taxes – just like in the case of land under land value taxation. Instead, the tax would make it much less unprofitable to *hold* patents for purely protectionist purposes. You would patent things only if you intended to use it productively or sell it for productive use right away. Patents would practically be on a constant auction to the most productive user!

Anyone who incurred bigger externality costs from another's patent than the patent holder could produce additional value with the help of that patent, would buy that patent off the owner. This would prevent extortion through such monopolies. Currently, "renewal fees" (EC 2012, p. 4) are the only cost to the holder for maintaining a patent and by no means reflect the negative externalities that the specific patent in question imposes on others by preventing productive use and development of the technology elsewhere.

The market value could be determined according to outstanding, binding purchase offers for the patent.

Taxation Is Justified in Many Ways

Does the government have a justification for taxing patents? It is hard to find anything with a more obvious right to charge for. Patents would not be possible without governmental agencies granting and enforcing patents by e.g. punishing for breaches. There are hardly any ways to implement intellectual property rights in anarcho-capitalism (see e.g. Kinsella 2008). There is no reason why the government couldn't take a large share of the profits made by holding patents – especially when such a tax would increase the efficiency of their use. A 10 per cent tax of market value would – like in the case of land – mean that the government takes roughly a half to two-thirds of the potential of the patent to generate additional profits.

Land and patents are similar in this sense:

- Both can be acquired and held for protectionist and hostile strategies that limit fair competition and others' possibilities.
- The risk of others doing so results in agents having to acquire and hold them for "defensive" purposes: preventing others from preventing them using the land or technology. (Kinsella 2008, p. 22)

- The revenue generation potential (and hence market value) of both depends heavily on the development of the whole economy.

The value of land in a city rises as its population grows – with both increased labor productivity (allowing people to afford higher rents) and increased scarcity of land – without any additional investments required from the landowner. (George 1879.)

Similarly, the value of a patent grows with the size of the market where the patent can be leveraged – without any additional marketing efforts from the patent holder. Compare developing, say, diabetes medication or touch screen technology for a market of 10,000 users or 1,000,000 with a similar distribution of purchasing power. Also the number of potential producers that could otherwise leverage the technology has an effect. A patent (a monopoly on technology) has no value, if there is no one else who would want to use the technology.

Because much of the value of both land and patents is generated by the whole society and increase simply with the size of the society, it is quite justifiable that part of the income they generate goes to the maintenance of such a society – and especially maintaining the structures that make such ownership possible in the first place: legislation and judicial systems that maintain and enforce patents. With constantly growing global markets due to growing populations and living standards, such a loss of margin would not significantly hamper the profitability of R&D activities.

The questions related to IPRs are not easy ones. This text provides no final answer, but aims to bring to the discussion the potential of market value taxation in improving the functioning of patent markets.

The author discusses issues regarding monopolies and other market imperfections further in his book "Fixing the Root Bug". This article is an adaptation of chapter 4.3.2 first published in the IPR Info. Read more and get the book at rootbug.org.

"In 2011, Apple and Google spent more on patent lawsuits and patent purchases than on research and development of new products."

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