Intellectual Property and X-Inefficiency

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Intellectual property law creates exclusive rights in the hopes of promoting activities that benefit society. For example, patent law awards inventors exclusive rights to their discoveries in order to promote the progress of the “useful Arts.” Likewise, copyright law encourages authors and artists to invest time, money, and effort into creating new expressive works. Unfortunately, however, intellectual property can also harm society. Armed with exclusive rights, intellectual property owners can charge high prices for their discoveries and creations, and these high prices can harm consumers. Moreover, because inventors and authors often build on the works of their predecessors, strong intellectual property rights can slow technological and artistic progress.

In seeking to balance these considerations, legal scholars have turned to neoclassical economics, which is founded on the assumption that firms will relentlessly strive to maximize their own profits. Neoclassical economics predicts that the self-interested actions of firms will increase overall social welfare. This basic profit-maximization assumption, however, often does not hold true, and economists therefore have developed more complex economic models that recognize that firms often will not seek to maximize profits due to so-called “X-inefficiencies.” When firms suffer from X-inefficiencies, otherwise well-functioning markets may not maximize social welfare. Unfortunately, intellectual property scholars have failed to incorporate this more complex economic model into legal theory. This Work-In-Progress begins to remedy this omission.