Property, Intellectual Property, and Free Riding

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Intellectual property law is in need of reform. Many of the problems stem from the association that lawyers and judges often make between *intellectual* property and *real* property. In fact, there are very few similarities between the two fields of law.

Intellectual property protection in the United States has always been about generating incentives to create. Thomas Jefferson was of the view that "inventions . . . cannot, in nature, be a subject of property;" for him, the question was whether the benefit of encouraging innovation was "worth to the public the embarrassment of an exclusive patent." In this long-standing view, free competition is the norm. Intellectual property rights are an exception to that norm, and they are granted only when—and only to the extent that—they are necessary to encourage invention. The result has been intellectual property rights that are limited in time and scope, and granted only to authors and inventors who meet certain minimum requirements. In this view, the proper goal of intellectual property law is to give as little protection as possible consistent with encouraging innovation.

This fundamental principle is under sustained attack. Congress, the courts, and commentators increasingly treat intellectual property not as a limited exception to the principle of market competition, but as a good in and of itself. If some intellectual property is desirable because it encourages innovation, they reason, more is better. The thinking is that creators will not have sufficient incentive to invent unless they are legally entitled to capture the full social value of their inventions. In this view, absolute protection may not be achievable, but it is the goal.

The absolute protection or full-value view draws significant intellectual support from the idea that intellectual property is simply a species of real property rather than a unique form of legal protection designed to deal with public goods problems. Protectionists rely on the *economic theory* of real property, with its focus on the creation of strong rights in order to prevent congestion and overuse and to internalize externalities; the *law* of real property, with its strong right of exclusion; and the *rhetoric* of real property, with its condemnation of "free riding" by those who imitate or compete with intellectual property owners. The result is a legal regime for intellectual property that increasingly looks like an idealized construct of the law of real property, one in which courts seek out and punish virtually any use of an intellectual property right by another.

The effort to permit inventors to capture the full social value of their invention—and the rhetoric of free riding in intellectual property more generally—are fundamentally misguided. In no other area of the economy do we permit the full internalization of social benefits. Competitive markets work not because producers capture the full social value of their output—they don't—but because they permit producers to make enough money to cover their costs, including a reasonable return on fixed-cost investment. Even real property doesn't give property owners the right to control social value. Various uses of property create uncompensated positive externalities, and we don't see that as a problem or a reason people won't efficiently invest in their property.

The goal of eliminating free riding is ill-suited to the unique characteristics of intellectual property. Treating intellectual property as "just like" real property is a mistake. We are better off with the traditional utilitarian explanation for intellectual property, because it at least attempts to strike a balance between control by inventors and creators and the baseline norm of competition.

The Free Riding Model of Intellectual Property

The idea of propertization begins with a fundamental shift in the terminology of intellectual property law. Indeed, the term intellectual

property may be a driver in this shift. Patent and copyright law have been around in the United States since its origin, but only recently has the term intellectual property come into vogue. A quick, unscientific search for the term "intellectual property" in federal court opinions shows an almost exponential growth in the use of the term over the last six decades.

As the term intellectual property settles over the traditional legal disciplines of patents, copyrights, and trademarks, and encroaches as well into such neighboring bodies of law as trade secrets, the right of publicity, misappropriation, unfair competition, and idea submissions, courts and scholars increasingly turn to the legal and economic literature of tangible property law to justify or modify the rules of intellectual property.

This change may inherently affect the way in which people think about intellectual property rights. Ask a layperson, or even many lawyers or judges, what it means that something is my property, and the general answer is along the lines of "you own it, so you and only you can use it."

The rise of property rhetoric in intellectual property cases is closely identified not with common law property rules in general, but with a particular view of property rights as the right to capture or internalize the full social value of property. In his classic work on the economics of property rights ("Toward a Theory of Property Rights" *57 Am. Econ. Rev. Papers & Proc.* 347,348. 1967), Harold Demsetz argued that property rights are valuable in a society because they limit the creation of uncompensated externalities. In a world without transaction costs, Demsetz argued, the creation of a clear property right will internalize the costs and benefits of an activity in the owner and permit the sale of that right to others who may value it more.

The externality-reducing theory of property has led courts and scholars to be preoccupied with the problem of "free riding." If the goal of creating property rights is to equate private and social costs and benefits by having the property owner internalize the social costs and benefits, those who "free ride"—obtain a benefit from someone else's investment—are undermining the goals of the property system. The fear is that property owners won't invest sufficient resources in their property if others can free ride on that investment. To be efficient, logic would seem to suggest, we must eliminate free riding.

If one concludes that this logic applies to intellectual property as well, the implications are obvious. The way to get private parties to invest efficiently in innovation is not only to give them exclusive ownership rights in what they produce, but to define those rights in such a way that they permit the intellectual property owner to capture the full social benefit of the invention. If the social value of innovation exceeds the private value, as apparently it does, that simply means we don't have strong enough property rights, and too many people are free riding on the investments of innovators. Further, if one postulates that transactions involving intellectual property are costless, society as a whole should benefit, since the owners of intellectual property rights will license those rights to others whenever it is economically efficient to do so.

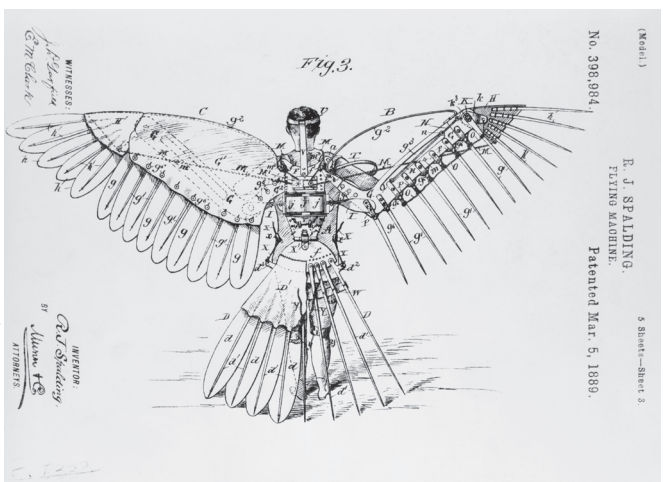
Intellectual property law has traditionally been chock full of opportunities to free ride—rights didn't protect certain works at all, were of limited duration, had numerous exceptions for permissible uses, and didn't cover various types of conduct. But if the economic goal of intellectual property is to eliminate free riding, these limits are loopholes to be excised from the law whenever possible. And so it has gone. By virtually any measure, intellectual property rights have expanded dramatically in the last three decades. Terms of protection are longer, the number of things that are copyrightable has increased, it is easier to qualify for copyright protection, copyright owners have broader rights to control uses of their works, and penalties are harsher. Trademark law has increasingly taken on the character of a property right, with the result that trademark "owners" now have the power to prevent various kinds of uses of their marks, regardless of whether consumers will be confused or search costs increased.

Courts applying the property theory of intellectual property are seeking out and eliminating uses of a right they perceive to be free riding. Some treat copying as free riding. They justify property-like protection for trademarks on the basis that it will prevent free riding. They debate the proper role of patent law's doctrine of equivalents in terms of whether it permits free riding.

The focus on free riding also leads to an assumption on the part of courts that all enrichment derived from use of an intellectual prop-

erty right is necessarily unjust. Some courts see any use of a trademark by a competitor or third party as problematic, not because it deprives the trademark owner of sales, confuses consumers, or increases search costs, but because it reflects "trading on the goodwill" of the trademark owner and therefore appropriates value that properly belongs to the trademark owner. Others create new intellectual property rights (or quasi-intellectual property rights) to permit their "owners" to capture new uses of their public data online, their Web servers, and even their golf handicap system.

The rationale isn't generally that the intellectual property owner has been harmed, but that the defendant has benefited, and that benefit involves taking something that doesn't belong to the defendant. Anyone who benefits from the use of the intellectual property right must forfeit the benefit to the intellectual property owner.



PATENT DRAWING, INVENTION BY R.J. SPALDING - "FLYING MACHINE." MARCH 5, 1889. IMAGE: © BETTMANN/CORBIS

In Defense of Free Riding

The assumption that intellectual property owners should be entitled to capture the full social surplus of their invention runs counter to our economic intuitions in every other segment of the economy. In a market economy, we care only that producers make enough return to cover their costs, including a reasonable profit. The fact that consumers value the good for more than the price, or that others also benefit from the goods produced, is not considered a problem. Indeed, it is an endemic part of the market economy. I may be willing to pay $100 for a copy of *Hamlet*, but I don't have to—producers will compete to sell it to me for far less. If we were concerned with fully internalizing positive externalities in the marketplace, the ideal world would favor monopoly pricing and cartels over competitive markets, because monopoly increases the returns to producers, bringing them closer to capturing the full social value of their goods, reducing the free riding in which all consumers engage every day.

Tangible property law also implicitly rejects the idea that owners are entitled to capture all positive externalities. If I plant beautiful flowers in my front lawn, I don't capture the full benefit of those flowers—passersby can enjoy them, too. But property law doesn't give me a right to track them down and charge them for the privilege—though owners of property once tried unsuccessfully to obtain such a right. Nor do I have the right to collect from my neighbors the value they get if I replace an unattractive shade of paint with a nicer one, or a right to collect from society at large the environmental benefits I confer by planting trees. The same is true in commercial settings. The fact that my popular store is located next to your obscure one may drive traffic to your store, but I have no right to capture that value.

The very idea that the law should find a way to internalize these positive externalities seems faintly preposterous. Positive externalities are everywhere. We couldn't internalize them all even if we wanted to. And as noted above, there is no reason we should particularly want to do so. If free riding means merely obtaining a benefit from another's investment, the law does not, cannot, and should not prohibit it. If the marginal social cost of benefiting from a use is zero, prohibiting that use imposes unnecessary social costs.

We do sometimes try to internalize negative externalities in the real property context in order to avoid the tragedy of the commons. The central idea behind the tragedy of the commons is that joint or public ownership of a piece of property is inefficient, because nonowners who use the property have no incentive to take care of it and will therefore overuse it. Thus, common land shared by cattle owners is overgrazed, because in the private calculus of each cattle owner, their benefit from grazing (which inures entirely to them) exceeds their benefit from holding off (which is spread among all the users of the common). The property rights argument is that dividing the common into private property solves this problem by making each property owner liable for the consequences of her own actions.

Only where there is a tragedy of the commons do we insist on complete or relatively complete internalization of externalities. There is no tragedy of the commons in intellectual property. A tragedy of the commons occurs when a finite natural resource is depleted by overuse. Information cannot be depleted, however. Indeed, copying information actually multiplies the available resources, not only by making a new physical copy but also by spreading the idea and therefore permitting others to use and enjoy it. Rather than a tragedy, an information commons is a comedy in which everyone benefits.

This doesn't mean that intellectual property law is a bad idea. Rather, the basic economic justification for intellectual property law comes from what was only an occasional problem with tangible property—the risk that creators will not make enough money in a market economy to cover their costs. Information is different from ordinary goods because the marginal cost of reproducing it is so low. In a private market economy, individuals will not generally invest in invention or creation unless the expected return from doing so exceeds the cost of doing so—that is, unless they can reasonably expect to make a profit. To profit from a new idea or a work of authorship, the creator must be able either to sell it to others for a price or to put it to some use that provides her with a comparative advantage in a market.

Selling information requires disclosing it to others. Once the information has been disclosed outside a small group, however, it is extremely difficult to control. If we assume that it is nearly costless to distribute information to others, it will prove virtually impossible to charge enough for information to recoup any but the most modest fixed-cost investments. If the author of a book charges more than the cost of distribution, hoping to recover some of her expenditures in writing the work, competitors will quickly jump in to offer the book at a lower price. Competition will drive the price of the book toward its marginal cost—in this case the cost of producing and distributing one additional copy. In this competitive market, the author will be unable to recoup the fixed cost of writing the book. If this holds generally true, authors may leave the profession in droves, since they cannot make any money at it. The result, according to economic theory, is an underproduction of books and other works of invention and creation with similar public goods characteristics.

Intellectual property, then, is not a response to allocative distortions resulting from scarcity, as real property law is. Rather, it is a conscious decision to create scarcity in a type of good in which it is ordinarily absent in order to artificially boost the economic returns to innovation. But solving the "problem" of intellectual property does not require complete internalization of externalities.

How do the implications of my approach differ from the free riding argument? The critical difference is that intellectual property law is justified only in ensuring that creators are able to charge a sufficiently high price to ensure a profit sufficient to recoup their fixed and marginal expenses. Sufficient incentive, as Larry Lessig reminds us, is something less than perfect control. Economic theory offers no justification for awarding creators anything beyond what is necessary to recover their average total costs.

What's Wrong with Overcompensating Creators?

The argument so far shows that there is no economic justification for granting inventors and creators the right to control positive externalities flowing from their creations, except to the extent necessary to enable them to cover their average fixed costs. But, the reader might object, showing that there is no need to grant such control doesn't compel the conclusion that there is anything wrong with giving creators greater control over positive externalities. Wouldn't it be easier just to treat intellectual property rights as absolute?

There are a number of costs to granting overbroad intellectual property rights. These costs fall into five categories. First, intellectual property rights distort markets away from the competitive norm, and therefore create static inefficiencies in the form of deadweight losses. Second, intellectual property rights interfere with the ability of other creators to work, and therefore create dynamic inefficiencies. Third, the prospect of intellectual property rights encourages rent-seeking behavior that is socially wasteful. Fourth, enforcement of intellectual property rights imposes administrative costs. Finally, overinvestment in research and development is distortionary.

None of this is intended to suggest that intellectual property is a bad idea. Far from it. Rather, the point is that we cannot and should not seek

to internalize all positive externalities and prevent free riding on intellectual property. Granting intellectual property rights imposes a complex set of economic costs, and it can be justified only to the extent those rights are necessary to provide incentives to create. The economics of intellectual property simply do not justify the elimination of free riding.

How Can We Strike the Right Balance?

In the search for the proper economic balance, the rhetoric of free riding seems unlikely to offer any substantial aid and quite likely to lead us astray. The concept of free riding focuses on the economic effects on the alleged free rider—whether the accused infringer obtained a benefit from the use of the invention, and if so whether it paid for that benefit. The proper focus is on the intellectual property owner, not the accused infringer. The question is whether an extension of intellectual property rights is necessary to permit intellectual property owners to cover their average fixed costs. If so, it is probably a good idea. If not, it is not necessary, and the likelihood that it will impose costs on competition or future innovation should incline us to oppose it. Whether an accused infringer obtained a benefit without paying for it bears only indirectly on that question. Free riding encompasses both conduct that simply captures consumer surplus or other uncompensated positive externalities and conduct that reduces the return to the intellectual property owner to such an extent that it cannot cover its costs. Only the latter is of concern, and free riding as a concept will not help us to distinguish the two.

If we are wrong to think of intellectual property rights in terms of free riding, how then are we to think of them? Several possibilities come to mind. First, it might be possible to rehabilitate the property analogy by disconnecting the concept of property from the arguments against externalities and free riding. It is possible to talk of intellectual property as a species of property more generally without applying the inapt economic lessons from different types of property with different characteristics. The key is to think of property so broadly that different legal regimes can fit under the tent. As Benjamin Kaplan put it, "To say that copyright is 'property' . . . would not be baldly misdescriptive if one were prepared to acknowledge that there is property and property, with few if any legal consequences extending uniformly to all species and that in practice the lively questions are likely to be whether certain consequences ought to attach to a given piece of so-called property in given circumstances."

But these nuanced analyses of the variety of possible property rules are the exception, not the rule, in the wave of property-based IP theory and court decisions. Far more common is an assumption that intellectual property is just like real property. My worry is that the rhetoric of property has a clear meaning in the minds of courts, lawyers, and commentators as "things that are owned by persons" and that fixed meaning will make it too tempting to fall into the trap of treating intellectual property as an absolute right to exclude.

A second alternative is to treat intellectual property as a tort. Unlike property systems, which focus on legally enforceable rights to exclude, tort systems are intended to compensate injured parties. A focus on harm to the intellectual property owner, rather than on the benefit conferred on the infringer, is consistent with optimal intellectual property policy. But the analogy to tort law is far from perfect. Tort law tends to focus on the defendant's conduct, assigning blame where the defendant could have acted differently, rather than focusing on the incentives given to plaintiffs. Furthermore, while basic tort principles design the law around compensating plaintiffs for injury, a significant branch of tort law is built around the concept of unjust enrichment—to recapture or at least to deny to the tortfeasor—positive externalities or spillovers. My fear is that drawing too close an analogy to the tort system will encourage the courts to focus attention on how the defendant was enriched, not on the need for compensating intellectual property owners.

Perhaps the closest legal analogy to intellectual property is a government-created subsidy. The point of intellectual property law is to depart from the norm of a competitive marketplace in order for the government to provide a benefit to a private party. The government is acting to benefit the public, supporting innovation that might otherwise never occur because the market would undervalue creativity. A similar argument can be made for welfare and other forms of government subsidy, such as education—that they are intervening to help particular people or activities in a way that the market would not in order to pro-

duce collateral social benefits.

Nonetheless, the analogy has problems. The fundamental differences between intellectual property rights and other forms of government subsidy have to do with how the recipients of that subsidy are selected and the size of the subsidy determined. While with most government subsidies the government makes both choices, in the case of intellectual property the government leaves those decisions to the very market it is attempting to influence. Because many criticisms of government subsidies focus on size and allocation, they may not apply to intellectual property.

A related formulation is intellectual property as government regulation. Intellectual property is obviously government regulation in the classic neutral sense of that term—government intervention in the free market to alter the outcome it would otherwise produce because of a perceived market failure. Further, copyright in particular (and, to a lesser extent, patent) have become increasingly regulatory in structure, with statutes setting out detailed rules, regulations, and prices for specific uses in specific industries. Nonetheless, there are some problems with the subsidy and regulation analogies. Drawing the analogy to welfare may have a problem similar to the problem with the property story: it brings with it too much baggage.

None of these analogies is even close to perfect. If there are sufficient dissimilarities between intellectual property and other areas of law, drawing analogies becomes problematic, not only because of the caveats that are required ("intellectual property is like any other tort, except in the following ways"), but because those caveats have a way of getting lost over time. This may be what has happened with efforts to talk about intellectual property as a form of property: over time, it is too easy to rely on the shorthand reference to property and to come to believe that intellectual property really is like other kinds of property.

In the final analysis, I don't know that we need an analogy at all. We have a well-developed body of intellectual property law, and a large and developing body of economic scholarship devoted specifically to intellectual property. The needs and characteristics of intellectual property are unique, and so are the laws that establish intellectual property rights. As the supreme court of Canada recognized 25 years ago, copyright law is neither tort law nor property law in classification, but is statutory law. It neither cuts across existing rights in property or conduct nor falls between rights and obligations heretofore existing in the common law. Copyright legislation simply creates rights and obligations upon the terms and in the circumstances set out in the statute.

UNITED STATES PATENT-OFFICE DEPARTMENT, WASHINGTON, D. C.—[PHOTOGRAPHED BY A. GARDNER, WASHINGTON, D. C.]

UNITED STATES PATENT OFFICE DEPARTMENT, WASHINGTON, D.C. IMAGE: © CORBIS

Intellectual property has come of age; it no longer needs to turn to some broader area of legal theory to seek legitimacy. The economics of intellectual property law should focus on the economic characteristics of intellectual property rights, not on inapposite economic analysis borrowed from the very different case of land.

If we don't need an analogy, maybe we need a new term. If people think of intellectual property as a form of property because of its name, then the name should probably go. But it has built up considerable inertia, and it does capture some of the similarities between the different fields it unites. Furthermore, none of the dozens of alternatives people have suggested seem likely to replace "intellectual property" in the public lexicon. So here's a modest suggestion: instead of intellectual property, let's start talking about "IP." Lots of people already use it as a shorthand anyway. And if we are so unhistorical that the use of the term "intellectual property" can make us forget the utilitarian roots of our protection for inventions and creations, perhaps over time we can forget the origins of the abbreviation, too. ■

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