Economic impact of patents essay examples

Business, Marketing

Patents are a way to grant monopoly to inventor in exchange for disclosure of inventors. Having publicly revealed an innovation, the producer gets the exclusive rights and hence more room for its successful monetization. The alternative for the inventor is to keep the invention as a secret, which is more attractive from the point of view of potential profits, but the inventor is exposed to the risks of information leaks.

Patents provide the incentive to innovate, with monopoly being the reward. Without patents, innovators would be challenged by the companies, which try to replicate the product not having spent on research and development. Monopolistic power allows the originator to keep prices high – empirical evidence suggests that prices for products drop by as much as 80% in the cases when the patents are upheld – with consumers suffering deadweight loss and originator enjoying excessive profits.

As the potential competitors – generic producers – are anxious to enter the market with replicated products to earn their share of market profits, there is an incentive for the originators to pay for prolongation of the patent or to secure against the litigation on upholding of the patent. The patents usually are treated in probabilistic way – at any moment there is a chance that the patent would be upheld, for that reason originator has the incentive to settle, which is called pay-for-delay. For instance, the originator producer may offer fraction of profits to generic competitor just to stay away from the market. This strategy may protect the monopolistic position as long as another competitor does not appear with the similar product, anxious to join the market.

The society, however, is worse off after pay-for-delay deals – the market remains uncompetitive and consumers pay higher prices. What could be the consumer surplus is simply being passed from one company to another – the only difference is that excessive profits are now being shared among more than one firm.

The best strategy for both sides depends on how strong the patent is, how profitable the market is, how difficult it is to replicate the product and a range of other variables.

References: Federal Trade Commission. Pay-For-Delay: How Drug Company Pay-Offs Cost Cost Consumer Billions. < http://www. ftc. gov/os/2010/01/100112payfordelayrpt. pdf> Retrieved on 10. 11. 2013

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