



# CLOSING GAPS FOR PROMOTING INNOVATION

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*“Intellectual efforts create new technologies, products, and services, describe new ways of doing things, and expand the cultural richness of society. They result in intellectual assets, pieces of information that may have economic value if put into use in the marketplace. To the extent that their ownership is recognized, such assets are called intellectual property. The economic returns on them depend on the costs of their creation, their desirability to potential users, the structure of markets in which they are sold, and the legal rights that permit their owners to control their use.”*

- Institute for International Economics<sup>1</sup>

The U.S. patent system for intellectual property is the best in the world. But, unfortunately, it is not functioning at its full potential. The current negative publicity<sup>2</sup> and proposals<sup>3</sup> for improvement are overlooking the root cause of the problem, and bypassing problem definition.

The basic reasons for the deficiencies in the U.S. patent system are:

1. Overemphasis of patent as a legal instrument, and
2. Inadequacy of systems for its use as industrial property right.

Effective patent system is critical to modern economy. According to the Organization for Economic Cooperation and Development (OECD), “Among the few available indicators of technology output, patent-based indicators are probably the most frequently used. Most national S&T (science & technology) publications include a section on patents.”<sup>4</sup> An efficient patent system, with effective commercialization capabilities of innovation, is critical for the vitality of the economy.

Currently, the value of patents are almost always established through a litigation process — which is time consuming and expensive. Besides, the patent valuations are generally based on the negotiating strengths of the parties involved — capital and legal resources. Since patents do not have intrinsic value (value without expensive litigation), companies that have significant marketshare do not license patents until litigation starts. This delays the economic activities based on the commercialization of the inventions that could have otherwise started much earlier.

The legal theory inherent in the patent system is property rights. The Federal Trade Commission describes how the property rights are applicable for patents: “This (patent) property right can enable firms to increase their expected profits from investments in research and development, thus fostering innovation that would not occur but for the prospect of a patent. Because the patent system requires public disclosure, it can promote a dissemination of scientific and technical information that would not occur but for the prospect of a patent.”<sup>5</sup>

However, property rights by itself does not result in economic activity. In his comparative analysis of the developed and underdeveloped economies, Hernando De Soto describes how the property rights are transformed into capital — the force that raises the productivity of labor and creates the wealth of nations.



Mr. De Soto writes, “Every parcel of land, every building, every piece of equipment, or store of inventories is represented in a property document that is the visible sign of a vast hidden process that connects all these assets to the rest of the economy. Thanks to this representational process, assets can lead an invisible, parallel life alongside their material existence. They can be used as collateral for credit.”<sup>6</sup>

The methods and means for converting the property rights inherent in tangible goods and properties into capital are well developed in developed countries, but not in underdeveloped countries. However, such means and methods for converting patent rights — intangible property rights — into capital do not exist even in developed countries. Instead, the value of patents are, more often than not, established through the litigation process — or lie dormant without ever becoming commercially valuable. In an increasingly global information economy, it is critical to develop systems for maximum exploitation of intellectual properties.

One of the necessary steps needed is to directly link the property rights inherent in the patents to the already well developed financial systems. Commercial banks routinely accept real estate, buildings and other tangible property as collateral, but consider patents as intangible assets with zero value for financing purposes. For technology businesses, establishing an intrinsic value creation system for patents would be highly helpful — changing the current situation in which patents are worthless without significant capital and/or legal resources. Creating patent valuation expertise (similar to real estate appraisal) within the banking sector is one way to create intrinsic value for patents.

The U.S. Constitution authorizes Congress “to promote the Progress of Science and useful Arts, by securing for limited Times to . . . Inventors the exclusive Right to their respective . . . Discoveries.”<sup>7</sup> Therefore, Congress is within its rights to create legislation to close the gaps between the patent system and the financial system, which provides for the creation of the means and methods for the conversion of patent rights into credit and capital.

Closing the gaps between patent and capital will help promote the full potential of the strengths of American innovation and ingenuity, contribute to economic prosperity of the nation, and help maintain global technology leadership.

## Reference

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