

# Decoupling Intellectual Property's Incentive and Allocation Functions

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Daniel J. Hemel & Lisa Larrimore Ouellette, *Innovation Policy Pluralism*, 128 **Yale L. J.** \_\_ (forthcoming 2018), available at [SSRN](#).

It's rare for two [JOTWELL](#) editors to choose the same article to review. When that happens, it's surely a sign of an "instant classic." So even if you've read [Kevin Collins's laudatory jot](#) of [Daniel J. Hemel](#) and [Lisa Larrimore Ouellette's](#) superb piece a few months ago, you should read this one, too. And, if you didn't read that review, you should definitely read this one.

If double coverage weren't enough, three years ago, [my jot](#) reviewed Hemel and Ouellette's brilliant article, [Beyond the Patents-Prizes Debate](#). Besides explaining the importance of considering the full panoply of tools to incentivize innovation—such as patents, prizes, grants, and tax credits—Hemel and Ouellette showed that these tools could be decoupled and refashioned to create effectively new, mutant-like rights with potentially superior effects than in their "pure" form.

In this follow-up article, Hemel and Ouellette insightfully discern the broad theoretical ramifications of their previous IP reconstructions. Because Kevin Collins's jot lucidly summarizes the expanse of the article's exposition, I focus on the article's most salient insight—namely, that IP's "incentive" function is separable from its "allocation" function. Specifically, the "incentive" function refers to the market-based financial reward provided to innovators for producing an innovation (and here I elide the distinction between R & D-based "inventions" and commercialized "innovations"). The "allocation" function concerns the payment of a proprietary price by consumers (and intermediaries) to access innovations covered by IP rights.

Traditionally, IP scholars have recognized these two functions, but have assumed that they are essentially coupled. Indeed, the oft-stated benefit of IP rights over prizes and grants is that IP offers market-based rewards generated (if the rights are useful) by supracompetitive payments from the market to the innovator. Yet, as Hemel and Ouellette show, IP's incentive and allocation functions are wholly separable.

Critically, Hemel and Ouellette rightly contend that many criticisms (and proposed reforms) of the IP system often concern either the incentive or allocation function, but not both. For instance, consider the criticism that intellectual property rights punish the less well-off by allowing for supracompetitive pricing, pricing out consumers who otherwise would have bought the protected goods in a competitive market. This is a criticism of IP's allocation function, but not its incentive function.

For instance, once an innovator acquires a patent from the Patent Office, the government could acquire the patent (via mandate) at fair market value and then make the invention available to commercializers for free. To the extent that the fair market value roughly represents the profits or licensing fees the innovator would have earned by retaining the patent, the reward would be essentially the same as in a market system. Yet, the allocation of the product for free to intermediaries and end-consumers substantially differs from IP's traditional market-based, allocation system. Namely, in place of market users paying supernormal prices for the patented product, the government would collect the funds for

payment to the innovator by other means, such as general taxation.

Because taxation may offer efficiency and distributive benefits relative to a patent system, such an approach may be preferable to traditional allocation schemes. Although my own view is that governments cannot easily determine fair market value—and, indeed, there is a rich literature on the pros and cons of “patents buyouts” of this sort—Hemel and Ouellette are the first to recognize the core theoretical and policy implications of this sort of “pluralistic” “mixing” and “matching” of innovation incentives.

Hemel and Ouellette’s framework allows IP scholars to better theorize the function and role of IP, and to identify reasons why different combinations of IP and non-IP mechanisms may be optimal in specific circumstances. For example, market-based allocation mechanisms may be preferable when the value of the innovation is difficult to ascertain *ex ante*. Yet, because inventors are not usually the best commercializers of their inventions, it may sometimes be more sensible to provide the inventor a fixed payout from a patent auction—in turn offering a limited-term “commercialization” patent to the winning bidder simply to commercialize and sell the invention, which may reduce overall deadweight losses (see my piece, [Commercializing Patents](#) for a similar proposal, yet not as well-theorized as the proposals in Hemel and Ouellette’s article).

The meshing of IP and non-IP tools, which the authors term innovation policy “pluralism” (and Collins aptly terms “hybridism”), is not merely a theoretical refinement designed for forward-looking policymaking; it also provides a more nuanced account of today’s innovation landscape. In addition to the [Bayh-Dole Act](#), prizes, grants, and patent auctions, the theory helps one to understand such diverse areas as the [Hatch-Waxman Act](#), price caps on patented products, research tax credits, standards essential patents, compulsory licensing for digital audio streaming, and academic publishing. Given its broad theoretical and practical import, and immediate recognition among the community of IP scholars, this not-even-yet-published article will surely be a canonical work for many years to come.

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