Two-Part Pricing and the True Cost of Patents

Anup Malani & Jonathan Masur

Patents are commonly thought to offer a straightforward tradeoff between incentives for innovation and higher prices. If an innovative firm receives a patent, that firm can block competitors from producing the same product and charge consumers monopoly prices. Those higher prices give the firm a greater incentive to innovate in the first place – it stands to earn greater profits – but they also harm consumers who cannot afford the higher-priced good. But what if the conventional wisdom is wrong and this tradeoff is not inevitable? We argue that a variety of financial institutions, including health care and patent pools, mitigate or even eliminate the problem of monopoly prices. As a result, patents don't really offer a compromise between efficiency gains from innovation and efficiency losses from monopolies; they create a transfer of wealth from current consumers to future consumers. Since investor wealth translates into innovation that benefits future consumers (assuming finite patent terms), the tradeoff that should drive optimal patent policy is how much we value consumer welfare today versus consumer wealth in the future.