How “Intellectual Property” Impedes Competition

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Any consideration of "intellectual property rights" must start from the understanding that such "rights" undermine genuine property rights and hence are illegitimate in terms of libertarian principle. Real, tangible property rights result from natural scarcity and follow as a matter of course from the attempt to maintain occupancy of physical property that cannot be possessed by more than one person at a time.

"Intellectual property," on the other hand, creates artificial scarcity where it does not naturally exist and can only be enforced by invading real, tangible property and preventing the owner from using it in ways that violate the supposed intellectual property rights of others. As Stephan Kinsella points out, had a particularly gifted Cro-Magnon man been able to patent the building of log cabins, his heirs today would be entitled to prevent us from building cabins on our own land, with our own logs, until we paid whatever tribute they demanded.

The business model required by proprietary digital information is even more invasive of genuine property rights than traditional copyright law. The digital copyright regime in force under the terms of the Digital Millennium Copyright Act (DMCA), the WIPO Copyright Treaty, and the TRIPS provisions of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), focuses entirely on preventing one from using his own hard drive and other property as he sees fit. It is actually illegal, thanks to such legislation, to sell hardware capable of circumventing DRM (digital rights management) or to publicize the codes enabling someone to circumvent it. As Cory Doctorow points out, "It's funny that in the name of protecting 'intellectual property,' big media companies are willing to do such violence to the idea of real property–arguing that since everything we own, from our t-shirts to our cars to our e-books, embody someone's copyright, patent and trademark, that we're basically just tenant farmers, living on the land of our gracious masters who've seen fit to give us a lease on our homes."

All-pervasive DRM prevents the easy transfer of content between platforms, even when a CD or DVD buyer simply wants to play the content somewhere more convenient. And the DMCA legally prohibits circumventing such DRM, even when–again–the purchaser simply wants to facilitate his own use on a wider and more convenient variety of platforms.

The levels of invasiveness required by "intellectual property" in the digital age cannot be exaggerated. The intrusive and inconvenient DRM embedded in proprietary media, and the draconian legislation criminalizing technical means of circumvention, should make that clear. The logical tendency of the digital copyright regime was portrayed quite convincingly by Richard Stallman in a dystopian short story, "The Right to Read" (just Google it–it's well worth your time).

Corporations rely on increasingly authoritarian legislation to capture value from proprietary information. Johann Soderberg compares the way photocopiers were monitored in the old USSR, to protect the power of elites in that country, to the way the means of digital reproduction are monitored in this country to protect corporate power. Privileged state-connected economic interests are becoming increasingly dependent on such controls. Unfortunately for them, such controls are becoming increasingly unenforceable thanks to BitTorrent, strong encryption, and proxy servers. Case in point: the "DeCSS uprising," in which court injunctions against a code to hack DVD encryption met with the defiant publicizing of the code on blogs, mirror sites, and even T-shirts. The unenforceability of intellectual property rights undermines the business model prevalent among a major share of privileged state-connected firms.

Obsolete Business Model

In the old days, the immense value of physical assets was the primary structural support for corporate boundaries and in particular for the control of corporate hierarchies over human capital and other intangible assets. This has changed as physical assets have become less important than human capital. As human capital becomes the primary source of corporate equity, the old rationale for corporate institutional control is evaporating.

In the information and entertainment industries, before the digital and Internet revolutions, the initial outlay for entering the market was in the hundreds of thousands of dollars or more. The old electronic mass media, as Yochai Benkler put it, were "typified by high-cost hubs and cheap, ubiquitous, reception-only systems at the end. This led to a limited range of organizational models for production: those that could collect sufficient funds to set up a hub." The same was true of print periodicals: Between 1835 and 1850, the typical startup cost of a newspaper increased from $500 to $100,000–or from roughly $10,000 to $2.38 million in 2005 dollars.

The networked economy, in contrast, is distinguished by "network architecture and the [low] cost of becoming a speaker." The central change that makes this possible is that "the basic physical capital necessary to express and communicate human meaning is the connected personal computer." The desktop revolution and the Internet mean that the minimum capital outlay for entering most of the entertainment and information industry has fallen to a few thousand dollars at most, and the marginal cost of reproduction is zero. The networked environment, combined with endless varieties of cheap software for creating and editing content, makes it possible for the amateur to produce output of a quality once associated with giant publishing houses and recording companies. That is true of the software industry, the music industry (thanks to cheap equipment and software for high-quality recording and sound editing),desktop publishing, and to a certain extent even film (as witnessed by affordable editing technology and the success of Sky Captain). Podcasting technology makes it possible to distribute "radio" and "television" programming, at virtually no cost, to anyone with a broadband connection. A network of amateur contributors have peer-produced an encyclopedia, Wikipedia, which Britannica sees as a rival. As Tom Coates put it, "[T]he gap between what can be accomplished at home and what can be accomplished in a work environment has narrowed dramatically over the last ten to fifteen years."

It's also true of news, with ever-expanding networks of amateurs in venues like Indymedia, alternative news operations like Robert Parry's and Greg Palast's, and Iraqis and American troops blogging news firsthand from Iraq, at the very same time that the traditional broadcasting networks are shutting down.

Agency Problems, Breakaway Firms

This has profoundly weakened corporate hierarchies in the information and entertainment industries, while creating enormous agency problems. As human capital eclipses physical capital as the main source of corporate equity, it becomes increasingly feasible for the human capital assets to vote with their feet. People can take their skills elsewhere, form "breakaway firms," and leave their former employers as hollowed-out shells owning little more than the company name. This has happened in a few high-profile cases, such as Maurice Saatchi's walkout from the Saatchi and Saatchi advertising agency, and Salomon Brothers' loss of a group of traders responsible for 87 percent of the bond-trading firm's profits. As organization theory writer Luigi Zingales put it, "[I]f we take the standpoint that the boundary of the firm is the point up to which top management has the ability to exercise power. . . , the group was not an integral part of Salomon. It merely rented space, Salomon's name, and capital, and turned over some share of its profits as rent."

Economist David Prychitko remarked on breakaway firms in the tech industry back in the 1990s when it was barely underway:

> Old firms act as embryos for new firms. If a worker or group of workers is not satisfied with the existing firm, each has a skill which he or she controls, and can leave the firm with those skills and establish a new one. In the information age it is becoming more evident that a boss cannot control the workers as one did in the days when the assembly line was dominant. People cannot be treated as workhorses any longer, for the value of the production process is becoming increasingly embodied in the intellectual skills of the worker. This poses a new threat to the traditional firm if it denies participatory organization.
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> The appearance of break-away computer firms leads one to question the extent to which our existing system of property rights in ideas and information actually protects bosses in other industries against the countervailing power of workers. Perhaps our current system of patents, copyrights, and other intellectual property rights not only impedes competition and fosters monopoly, as some Austrians argue. Intellectual property rights may also reduce the likelihood of break-away firms in general, and discourage the shift to more participatory, cooperative formats.

In this environment the only thing standing between the old information and media dinosaurs and their total collapse is their so-called intellectual property rights–at least to the extent they're still enforceable. Ownership of intellectual property becomes the new basis for the power of institutional hierarchies and the primary buttress for corporate boundaries.

The increasing prevalence and imploding cost of small-scale distributed production machinery, along with the rise of "crowdsourced," distributed means of aggregating capital from small donors, mean that physical production is governed by the same phenomenon to a considerable extent.

Without intellectual property, in any industry where the basic production equipment is widely affordable, and bottom-up networking renders management obsolete, it is likely that self-managed, cooperative production will replace the old managerial hierarchies. The network revolution, if its full potential is realized (as James Bennett put it in the appropriately titled article "The End of Capitalism and the Triumph of the Market Economy"), will lead to substantial redistribution of power and money from the twentieth-century industrial producers of information, culture, and communications–like Hollywood, the recording industry, and perhaps the broadcasters and some of the telecommunications giants–to a combination of widely diffuse populations around the globe and the market actors that will build the tools that make this population better able to produce its own information environment rather than buying it ready-made.

Paying for the Name

Another effect of the shift in importance from tangible to intangible assets is that a growing portion of product prices consists of embedded rents on intellectual property and other artificial property rights, rather than the material costs of production. Tom Peters, in The Tom Peters Seminar, was fond of gushing about the increasing portion of product "value" made up of "ephemera" and "intellect" (that is, the amount of final price consisting of tribute to the owners of intellectual property) rather than labor and material costs. To quote Michael Perelman, "[T]he so-called weightless economy has more to do with the legislated powers of intellectual property that the government granted to powerful corporations. For example, companies such as Nike, Microsoft, and Pfizer sell stuff that has high value relative to its weight only because their intellectual property rights insulate them from competition."

But intellectual property, as we have already seen, is becoming increasingly unenforceable. As a result, the ownership of proprietary content is becoming increasingly untenable as a basis for corporate institutional power. And we can expect the portion of commodity prices resulting from embedded rents on artificial property rights to implode.

A major component of the business model that prevails under existing corporate capitalism is the offer of below-cost platforms coupled with the sale of patented or copyrighted spare parts, accessories, and so on at an enormous markup. So one buys a cell phone for little or nothing, with the contractual obligation to use only a specified service package for so many years; one buys a fairly cheap printer, which uses enormously expensive ink cartridges; one buys a cheap glucometer, with glucose testing strips that cost $100 a box. Hacking one's phone to use a different service plan, or manufacturing generic ink cartridges or glucose testing strips in competition with the proprietary version, is illegal. The same goes for manufacturing generic replacement parts for a car or appliance, in competition with the corporate dealership.

"Intellectual property" also serves as a bulwark to planned obsolescence and high-overhead production. As it is now, appliances are generally designed to thwart repair. When the repairman tells you it would cost more than it's worth to repair your washing machine, he's telling the truth. But he fails to add that this state of affairs reflects a deliberate design: The machine could have been designed on a modular basis, so that the defective part might have been cheaply and easily replaced. And if the manufacturer were subject to unfettered competition, the normal market incentive would be to do so.

Absent legal constraints, it would be profitable to offer competing generic replacements and accessories for other firms' platforms. And in the face of such competition, there would be strong pressure toward modular product designs that were amenable to repair and interoperable with the modular components and accessories of other companies' platforms. Absent the legal constraints of patents, an appliance designed to thwart ease of repair through incompatibility with other companies' platforms would suffer a competitive disadvantage.

At the global level, intellectual property plays the same protectionist role for transnational corporations that tariffs performed in the old national economies. It's hardly coincidental that the dominant industrial sectors in the global corporate economy–software, entertainment, biotech, pharmaceuticals, and electronics–all depend heavily on intellectual property. And the central focus of the neoliberal regime, which has been falsely identified with "free trade" and "free markets," is on strengthening the legal intellectual property regime as the primary source of profits.

On a global scale, patents lock transnational manufacturing corporations into a permanent monopoly on productive technology. The central motivation in the GATT intellectual property regime is to secure the transnational corporations' (TNCs) collective monopoly of advanced technology and prevent independent competition from ever arising in the Third World. It would, as the Third World Network's Martin Khor Kok Peng writes, "effectively prevent the diffusion of technology to the Third World, and would tremendously increase monopoly royalties of the TNCs whilst curbing the potential development of Third World technology."

Drawing to a Close

But to repeat, the good news is that, in both the domestic and global economies, this business model is doomed. The shift from physical to human capital as the primary source of productive capacity in so many industries, along with the imploding price and widespread dispersion of ownership of capital equipment, means that corporate employers are increasingly hollowed out and only maintain control over the physical production process through legal fictions. When so much of actual physical production is outsourced to the independent small shop (be it a Chinese sweatshop or a GM supplier) the corporation becomes a redundant "node" that can be bypassed. As blogger David Pollard described it, from the perspective of a future historian in 2015:

> The expensive outsourcers quickly found themselves unnecessary middlemen. . . . The large corporations, having shed everything they thought was 'non-core competency', learned to their chagrin that in the connected, information economy, the value of their core competency was much less than the inflated value of their stock, and they have lost much of their market share to new federations of small entrepreneurial businesses.

For all the harm it does, intellectual property is not really even necessary as an incentive for innovation. Industrial analyst F. M. Scherer argued in the 1990s, based on a survey of 91 companies, that some 86 percent of all process and product innovations would have been developed from "the necessity of remaining competitive, the desire for efficient production, and the desire to expand and diversify their sales."

And copyright is no more necessary for artistic creation than patents are necessary for invention. In the open-source world there are many businesses that manage to make money from auxiliary services even though their content itself is not proprietary. For example, Red Hat makes money off the open-source Linux operating system by customizing the software and offering specialized customer support. Phish has actively encouraged fans to share its music free of charge, while making money off of live performances and concessions. Radiohead offered a recent album for free download, collecting only voluntary contributions via what amounted to a glorified PayPal tip jar.

Since intellectual property is not necessary to encourage innovation, this means that its main practical effect is to cause economic inefficiency by levying a monopoly charge on the use of existing technology.

In any case, for those whose libertarianism follows from the principles of self-ownership and nonaggression, whether or not intellectual property is necessary to profit from certain forms of economic activity is beside the point. That's the same argument used by protectionists: Certain businesses would be unprofitable if they weren't protected by tariffs. But no one has a right to profit at someone else's expense, through the use of force. In particular, no one has the right to make a profit by using the State to prevent others from doing as they please with their own pens and paper, hard drives, or CDs. A business model that isn't profitable without government intervention should fail.

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