

Veblen and Patents: An assessment of the strategy of multinational enterprises for protecting intellectual property rights

Ronaldo Fiani¹

Abstract

It is usually argued that without protection to intellectual property rights (especially patents) foreign direct investment by multinational enterprises would not take place, as it is a kind of investment essential to generate the new products which developing countries need to increase their welfare. According to this logic, the TRIPS agreement would protect intellectual property rights and promote development through technological advancement. However, there is significant evidence that TRIPS was the result of a select group of executives fostering their firms' monopoly rights. It is argued in this paper that Veblen's ideas can be a powerful tool to understand the strategies of multinational enterprises to assure monopoly rights.

Keywords: Thorstein Veblen, Intellectual Property Rights, Patents, Multinational Enterprise, Trade-Related Intellectual Property Rights Agreement (TRIPS)

JEL: B15, O34, P26, F13, F23, F53.

Introduction

The TRIPS Agreement has been presented as a necessity to promote innovative effort, which is essential to increase the welfare of developing countries through new products and cheaper production processes. According to this logic, the TRIPS agreement would protect intellectual property rights and promote development through technological advancement.

However, there is significant evidence that TRIPS was the result of a select group of executives fostering their firms' monopoly rights. It is argued in this paper that Veblen's ideas can be a powerful tool to understand the strategies of multinational enterprises to assure monopoly rights. In this sense, the first section discusses the TRIPS Agreement and its usual defense based on dynamic efficiency gains produced by patent rights that exceed static efficiency losses. The second section discusses Veblen's concept of strategic "sabotage", which has deep implications for Veblen's concept of efficiency. Then the issue of patents in Veblen is introduced in the third section through Veblen's analysis of intangible assets. The fourth section discusses Veblen's concept of efficiency as serviceability. The fifth section discusses some evidences of multinational strategies in TRIPS Agreement that corroborate Veblen's thesis. A brief conclusion ends the paper.

¹Economics Institute of Rio de Janeiro Federal University, Pasteur Avenue. 250/110 – Rio de Janeiro 22.290-240. Tel: +55-21-3873-5246. Fax: +55-21-2541-8148. Email: rfiani@gmail.com ; fiani@ie.ufrj.br

The TRIPS Agreement and the Argument of Patent Dynamic Efficiency

Usually the TRIPS Agreement is presented as the acknowledgement of the impersonal forces of internationalized markets. Given that the international mobility of capital was dramatically expanded by the so-called globalization movement since the end of the last century, it has become urgent to concede the demands of property rights protection in general – and specifically to the demands of intellectual property rights with particular emphasis on patents – unless one would want to renounce to share the technological advances diffused by multinational enterprises direct investment around the world.

This argument has some implicit questionable hypothesis: that multinational enterprises' investment results in technological diffusion appropriate to developing countries' technological catch-up needs; that multinational enterprises' investment is the only form of technological diffusion; that property rights (especially patents) are the most important determinant of foreign direct investment etc. All such hypothesis has been questioned in varying degrees in the economic literature on property rights (see Chang (2001) for a brief survey). However, less research has been done on the real motivations behind the permanent search for ever broader and more stringent protection of intellectual property rights in general and particularly of patents. Perhaps such lack of interest is explained by the fact that the usual argument that firms aim at patent protection – notwithstanding the monopoly positions such patent rights confer – to protect their innovations effort (which otherwise simply would not occur) is so deeply and broadly accepted that it has become common sense.

In fact, there is a common opinion among economists that granting a patent is a fair deal: one concedes a monopoly position – a patent – in exchange for more and more innovative efforts by the firms. In economists' jargon, one exchanges a *static inefficiency* (originated from the higher prices the monopoly resulting of patent rights awards) for a *dynamic efficiency* (more innovative activity stimulated by the monopoly positions granted by patent rights). Dynamic efficiency means more competition in the long run, which is valuable even at the cost of much less competition in the short run.

Stiglitz (2003: 4) gives a clear example of that kind of reasoning:

Markets by themselves thus will naturally lead to too little research, especially in certain areas, like basic science, where appropriating returns is particularly difficult. To improve matters—to increase resources devoted to research—two approaches have been taken. One tries to make the market for ideas more like the market for ordinary goods, by making it easier to exclude others from the benefits of one's research. By increasing the ability to appropriate returns, the extent of positive externalities is reduced. This entails creating intellectual property rights. But there is a huge cost associated with this strategy: while incentives to do research are increased, knowledge is not efficiently used, and market and monopoly power is conferred, thus reducing competition in markets. Balancing the two—the gains in dynamic efficiency with the losses in static efficiency—is not easy, and it is not clear that we have achieved the right balance. It should be clear, however, that those

who say the stronger the intellectual property rights the better are almost surely wrong, but such a position ignores the static efficiency costs.

Thus Stiglitz (2003) presents an instance of the typical defense of patents through dynamic efficiency hypothesis, notwithstanding the fact that he concedes in sequence (2003:4) that an increase in patent rights will not necessarily bring more dynamic effects beyond a certain point, for the use of previous ideas is usually the most important input to generate new ideas, and a stringent patent protection may impede or make the use of previous ideas more difficult.

Even authors who acknowledge that patents may be an important instrument for income transfer from developing countries to developed ones (and even from some developed countries to other developed ones) resort to the dynamic efficiency hypothesis to defend the TRIPS agreement:

What emerges from this analysis is a picture of patent protection as an important method for appropriating the rents of an invention. Although it is not the primary method of rent appropriation, patent harmonization has the capacity to generate large transfers of income between countries, with the US being the major beneficiary. The developing countries are not alone in financing transfers, with Canada, the UK, and Japan also making sizable contributions. These transfers significantly alter the perceived distribution of benefits from the Uruguay Round, with the US benefits substantially enhanced, while those of developing countries and Canada considerably diminished. However, dynamic efficiency gains from increased innovation may go some way to offsetting the negative impact of these transfers, which is an issue for future research (MCCALMAN, 2001:182).

So, there seems to be room for a more careful investigation and perhaps a revision of the role of economic notion of dynamic efficiency. In effect, it will be argued in this paper that there is plenty of room for reviewing not only dynamic but also static efficiency, which should be replaced by another concept of efficiency, especially when discussing patent rights. But first it is important to consider what Thorstein Veblen – whose ideas are essential to this paper – thought about the problem of efficiency.

Instead of Productive Efficiency, Strategic “Sabotage”

In the beginning of *The Engineers and the Price System* (VEBLEN, 1944), Veblen makes a compelling effort to give the word *sabotage* a broader sense than simply an unsubordinated workers’ concealed act aiming at disturbing the normal production process and punishing inflexible bosses. For Veblen, sabotage means a kind of *business strategy* which may be applied by either workers or capitalists to advance their interests. Specifically for capitalists, sabotage may be used against competitors to secure an advantageous position. In Veblen’s words:

But all this strategy of delay, restriction, hindrance, and defeat is manifestly of the same character, and should conveniently be called by the same name, whether it is carried on by business men or by workmen; so that it is no longer unusual now to find workmen speaking of “capitalistic sabotage” as freely as the employers and the newspapers speak of syndicalist sabotage. As the word is now used, and as it is properly used, it describes a certain system of industrial strategy or management, whether it is employed by one or another. What it

describes is a resort to peaceable, or surreptitious restriction, delay, withdrawn, or obstruction.(VEBLEN, 1944: 4)

According to that conception of sabotage as a kind of industrial strategy one should not devise a sabotage act as a violent act, but on the contrary, “Sabotage commonly works within the law, although it may often be within the letter rather than the spirit of the law” (VEBLEN, 1944: 4). Sabotage does not mean to make insurgent violent acts: one should not imagine shops and factories’ buildings burning, machines torn down etc. On the contrary, sabotage is interruption, delay and restriction perfectly suited to the rules of the game – especially through a formalistic interpretation of the rules of the game.

So defined, what is the aim of one who employs the strategy of sabotage? Veblen’s analysis is worth quoting:

It [*sabotage*] is used to secure some special advantage or preference, usually of a businesslike sort. It commonly has to do with something in the nature of a vested right, which one or another of the parties in the case aims to secure or defend, or to defeat or diminish; *some preferential right or special advantage in respect on income or privilege*, something in the way of a vested interest. (VEBLEN, 1944: 4-5, our emphasis)

So, sabotage is the usual strategy to employ when one believes that one right or somehow vested interest is being threatened. So did workers to protect their special interests, as strikes may be correctly conceived as “a typical species of sabotage”, exactly as lockout by employers (VEBLEN, 1944: 5).

At this point, it is important to emphasize that Veblen does not attach any moral judgment to strikes, lockouts or any other kind of sabotage. He is very clear at this point: “All this does not imply that there is anything discreditable or immoral about this habitual use of strikes and lockouts. They are part of the ordinary conduct of industry under the existing system, and necessarily so” (VEBLEN, 1944: 5). And it can be no different, for according to Veblen sabotage appears in many forms in business life and not only as strikes and lockouts.

In a more general sense, sabotage is not to be morally condemned, according to Veblen (1944: 6-7)²:

Sabotage, accordingly, is not to be condemned out of hand, simply as such. There are many measures of policy and management both in private business and in public administration which are unmistakably of the nature of sabotage and which are not only considered to be excusable, but are deliberately sanctioned by statute and common law and by the public conscience”.

But what are these “measures of policy and management both in private business and in public administration” which are of the nature of sabotage according to Veblen? Veblen is

²See also Knoedler (1997) on the same point.

somewhat generic in describing those actions which, however being perfectly admissible in accordance with the law and social values, have the same nature of sabotage. As we read in Veblen (1944: 8):

A businesslike control of the rate and volume of output is indispensable for keeping up a profitable market, and a profitable market is the first and unremitting condition of prosperity in any community whose industry is owned and managed by business men. And the ways and means of this necessary control of the output of industry are always and necessarily something in the nature of sabotage – something in the way of retardation, restriction, withdrawal, unemployment of plan and workmen – whereby production is kept short of productive capacity.

This rather important passage deserves careful attention, for we can devise some important ideas quite different from what one can usually find in mainstream books (and handbooks). First, it is fairly clear that one can count among those practices which have the nature of sabotage all strategies businessmen devise to keep or sustain the profitability of their concern by *denying production in some degree in order to reinforce their advantages*. Therefore, the kind of economic environment which Veblen discusses is not the usual competitive world where producers are so small in number and importance that they cannot do differently from producing the maximum output they can, leaving for the market the task of setting the price and then their profitability. It is a world where producers have the freedom to and surely do set their production levels in order to reinforce their competitive position assuring bigger profits.

Second, such a strategy is typical of “any community whose industry is owned and managed by business men”. It amounts to say that the kind of situation which Veblen has just described is not an anomalous one. If sabotage is the rule of *any* community in which industrial production is private then some degree of denial of production is the rule and not the exception, so that “sabotage” has to be considered as a routine strategy to be employed by enterprises. It seems then that, consistent with Veblen, the case of production at full capacity – contrary to what mainstream economics usually supposes – is the real anomaly.

Third, there is no use in applying to this world the concept of efficiency usually conceived by economic orthodoxy as professed by mainstream economics. There is simply no efficient output to be considered in economic calculations, for such efficiency would undermine the profitability of industry which is the reason of private enterprise. It is a world where there is no expectation of getting closer to the ideal of mainstream economics efficiency and efficient allocation of factors of production (one should not forget his remark on the “unemployment of plan and workmen”), for it would be irrational for a businessman to act this way – because it would undermine the competitive position and the profitability of his own business.

This kind of approach has left some interpreters to perceive in Veblen's discussion of sabotage the same contradiction between workmanship and predatory instincts present in other aspects of Veblen's work as, for example, Layton (1962: 65): "Viewing the contemporary scene, Veblen saw an irrepressible conflict between business and industry. Business represented the predatory instinct; the businessman profited by interrupting or hindering production, that is by "sabotage." Industry represented the creative instinct".

But why producing at full capacity would be an irrational decision? That is perhaps one of the most interesting and simultaneously important sources of divergence between Veblen and the economic orthodoxy, as for Veblen there is always the threat of what he calls between inverted commas "overproduction". The industrial system is permanently growing ahead of demand for it releases extraordinary productive forces, and so there should be paid careful attention as excessive supply is always risking spoiling the market. Again in Veblen's words(1944: 8):

The mechanical industry of the new order is inordinately productive. So the rate and volume of output have to be regulated with a view to what the traffic will bear – that is to say, what will yield the largest net return in terms of price to the business men who manage the country's industrial system. Otherwise there will be "overproduction", business depression, and consequent hard times all around³.

The conclusion Veblen offers us could not be more alien to the orthodox approach to the problem of economic efficiency (1944: 8-9):

Overproduction means production in excess of what the market will carry off at a sufficiently profitable price. So it appears that the continued prosperity of the country from day to day hangs on a "conscientious withdrawal of efficiency" by the business men who control the country's industrial output. They control it all for their own use, of course, and their own use means always a profitable price.

Summarizing, the general idea is that the increasing productivity of modern industry results in a structural and so permanent threat of overproduction, a threat businessmen try to avoid by refusing to produce at full capacity – an inefficient solution to mainstream economics – in order to protect their profits. But the fact is that in the modern industrial world there is no room for the concept of efficiency as described by the Paretian condition when one considers Veblen's view. Thus there are reasons grounded in Veblen's ideas to leave behind mainstream economics

³ Veblen seemed to identify two possible causes of overproduction, speculation and the development of productivity:

The immediate economic fact for which "overproduction" stands is, therefore, a divergence between the nominal, accepted valuation and the actual present value of property engaged in production, in consequence of which the nominal earnings of capital (and in some cases the real earnings as measured in means of livelihood) are diminished.[...]

This divergence may be due to several different causes, but usually and mainly to two general ones,- a speculative movement, and an increased efficiency of industry. The action of the former of these needs no discussion here. A speculative movement may have pushed prices up unwarrantably. A fall of general prices, due to improved processes of production, may have depressed the actual present money value of property engaged in production below its nominal value. (VEBLEN, 1892: 490)

efficiency concept and that is a preliminary step which is fundamental to understand Veblen's discussion of patents.

That discussion is indeed very brief and it is developed in the context of intangible assets. In spite of its brevity, Veblen's discussion of patents – and of intangible assets in general – is very illuminating and deserves much more attention than that it usually gets. The next section will consider Veblen's concepts of intangible assets and patents. In the sequence, it will be argued that Veblen's discussion of efficiency may provide the foundations for a new concept of efficiency which would not be based on resource allocation but on Veblen's concept of serviceability.

Patents as Intangible Assets for Veblen

To properly understand Veblen's analysis of the economic role of patents, one should consider first his distinction between physical items of productive capacity and the same items as "assets". Then, that distinction has evolved a step further, into a distinction between tangible and intangible assets. Such distinctions are presented in Veblen's paper "On the Nature of Capital: Investment, Intangible Assets, and the Pecuniary Magnate" (VEBLEN, 1908) and because they are directly related to the issue of patents, they will be considered hereinafter.

The first distinction is between physical items of productive capacity and the same items as "assets". Such distinction in Veblen's analysis results from the separation of two economic roles. The first role of tools, raw material and equipment is that of "productive goods", meaning "the industrial, or technological, efficiency and subservience of the material means of production." The second economic role – for the same goods – derives from "the pecuniary use and effect of invested wealth" (VEBLEN, 1908: 104). That distinction should be done, according to Veblen, notwithstanding the fact that they could be two different roles of the same goods. In other words, the fact that one piece of productive capacity is applied to satisfy a human necessity (very broadly devised) should not conceal the fact that the same piece is supposed to contribute positively to the wealth of its owner helping to generate a positive pecuniary flow of revenue. Veblen is quite clear on this point:

Investment is a pecuniary transaction, and its aim is pecuniary gain, - gain in terms of value and ownership. Invested wealth is capital, a pecuniary magnitude, measured in terms of value and determined in respect of its magnitude by a valuation which proceeds on an appraisal of the gain expected from the ownership of this invested wealth. (VEBLEN, 1908: 104-5)

Then Veblen continues underscoring the fact that there is no strict and unidirectional relation between the "material serviceability of the capital goods" (its usefulness to the community) and the "pecuniary serviceability" of the same capital goods to its owner. In fact, the material serviceability of capital stock may be deranged exactly by the needs of pecuniary serviceability:

The ownership of the material equipment gives the owner not only the right of use over the community's immaterial equipment, but also the right of abuse and of neglect or inhibition. This power of inhibition may be made to afford an income, as well as the power to serve; and whatever will yield an income may be capitalized and become an item of wealth to its possessor. (VEBLEN, 1908: 106)

More paradoxical than that (for those who believe that profits come basically from the utility capital items have to society), Veblen makes clear that in modern industry it is rather common that pecuniary services are in opposition to material services:

Under modern conditions of investment it happens not infrequently that it becomes pecuniarily expedient for the owner of the material equipment to curtail or retard the processes of industry, "restraint of trade". The motive in all such cases of retardation is the pecuniary expediency of the measure for the owner (controller) of capital, - expediency in terms of income from investment, not expediency in terms of serviceability to the community at large or to any fraction of the community except the owner (manager). Except for the exigencies of investment, *i.e.*, exigencies of pecuniary gain to the investor, phenomena of this character would have no place in the industrial system. They invariably come of the endeavors of businessmen to secure a pecuniary gain or to avoid a pecuniary loss. (VEBLEN, 1908: 106)

The last passage has strong connections with Veblen's concept of "sabotage", as already seen. It must be remarked that the point to be underscored here is not only that for Veblen the conditions of profitability of capital – what defines capital items as *assets* – usually do not contribute to the maximum welfare of the community made possible by the productive base, but also – and perhaps more importantly to the discussion which is the central theme of this paper – that strategies to restrain the economic activity are part of the *current* arsenal of business strategies. Such strategies are not occasional or typical of extreme moments of business activity, but they are a permanent part of the businessmen strategic tools and they resort to them routinely.

The objective behind those strategies is always that of preserving competitive advantages to the owner of capital, and not to satisfy society's needs: it is production for profit, not production for the common good. Of course the idea that production is production for profit and not for the common good is not alien to mainstream economics. The difference here between Veblen and the mainstream economic theory is about the *coincidence* between production for profit and production for the common good. Mainstream economics affirms that there is a natural coincidence between the two, the searching for profits resulting necessarily in an increase in the aggregate welfare. For example, in the case of concern here, mainstream economics asserts that the incentive produced by the monopoly profits generated by patent protection guarantee that there will be an innovative effort which will in the long run increase community's well-being, as that effort will result in more efficient production of better goods.

However, for Veblen such coincidence between the look for profits and the common good is not natural, on the contrary, there is usually a contradiction between the two. The reason why that

contradiction comes into view is that for Veblen the pecuniary motives do not work in the mainstream economics ideal world of perfect competition, but in the real world competition where any expedient *provided by social institutions* to assure an advantage in competition will be taken.

That is an important point to be underlined here. The difference between Veblen and mainstream economics result from the fact that, while mainstream economics assumes the rules of competition to be the abstract and idealized *pureeconomic* rules of the perfect competition model, Veblen considers that not only economic rules but also social rules (laws and habits of thought) regulate competition, serving to pecuniary motives. So it comes as no surprise that the kind of behavior Veblen identifies in businessmen is rather different and far more complex than the behavior assumed by mainstream economics. The harmony assumed by mainstream economics between pecuniary and productive serviceability results from the highly idealized institutions which regulate competition in its abstract competitive model.

Once the difference between capital as composed of productive items and capital as a collection of assets is made clear with the associated conclusion that businessmen decisions are directed by assets profitability and so frequently presents some degree of divergence with what would be functional to the community, distinguishing between tangible and intangible assets, is the next step. First, Veblen makes clear that intangible assets are subject to the same requirement of providing yield to their owner as tangible ones: “Their intangibility is a matter of the immateriality of the items of wealth [...] of which they are made up, but their character and magnitude as assets is a matter of the gainfulness to their owner of the processes which their ownership enables him to engross” (VEBLEN, 1908: 111-2).

Then, one must not look for the difference between intangible assets and tangible ones in their requirement of net income generation. That requirement operates for any kind of asset irrespective of its materiality or immateriality, and surely the same requirement applies to patents, one kind of intangible asset. However, according to Veblen, there is an important difference between intangible and tangible assets: the first ones are *not* of a technological or industrial character and according to him “herein lies the substantial disparity between tangible and intangible assets” (VEBLEN, 1908: 112). But if intangible assets are not of technological or industrial character, what is their essential character in the modern economic system?

The first step to understand these assets properly, according to Veblen, is to recognize the usual fact that social rules also operate to provide advantages to social groups and individuals through *income distribution*:

The principles and practice of the distribution of wealth vary with the changes in technology and with the other cultural changes that are going forward; but it is probably safe to assume that the principles of apportionment, – that is to say, the consensus of habitual opinion as to what is right and good in the distribution of the product, – these principles and the

concomitant methods of carrying them out in practice have always been such as to give one person or group or class something of a settled preference above another. (VEBLEN, 1908: 112)

Those social rules have been a common fact in the human history according to Veblen (1908: 113), for “Principles (habits of thought) countenancing some form of class or personal preferences in the distribution of income are to be found incorporated in the moral code of all known civilizations and embodied in some form of institution”. The novelty about capitalism is that it transforms these advantages in income distribution produced by social rules in *assets to be valued* in proportion to the access they provide to a privileged position in income and wealth distribution: “When property rights fall into definite shape and the price system comes in, and more particularly when the practice of investment arises and business enterprise comes into vogue, such differential advantages take on something of the character of intangible assets” (VEBLEN, 1908: 113). If such privileges in income and wealth distribution can be transferred through selling and buying, then their character as capitalistic assets is fully achieved and realized through capitalization of the value of the advantage each privilege confers to its owner, by the same rule which applies to tangible assets.

However, in spite of the fact that tangible and intangible assets are subject to the same process of capitalization, Veblen does emphasize that *the source* of the potential revenue which will be capitalized in the asset value is different according to the *materiality* of the asset – i.e., if tangible or intangible. It happens so because “in the case of tangible assets there is a presumption that the objects of wealth involved have some (at least potential) serviceability at large”(VEBLEN, 1908: 115), which means that tangible assets are presumed to derive their revenue to be capitalized from the potential value of the flow of products they yield.

But the reality of the intangible goods is rather distinct, for “in the case of intangible assets there is no presumption that the objects of wealth involved have any serviceability at large, since they serve no material productive work, but only a differential advantage to the owner in the distribution of the industrial product” (VEBLEN, 1908: 113). In a footnote at the end of this statement, Veblen observes that the characterization of patent rights as an intangible asset of this sort has been criticized (VEBLEN, 1908: 115-6, n. 1). Against that criticism, Veblen first affirms there is no value judgment in classifying patents as intangible assets so defined. But his second remark is very important and of direct interest here:

The invention or innovation covered by the patent right is a contribution to the common stock of technological proficiency. It may be (immediately) serviceable to the community at large, or it may not; [...]But, whether the innovation is useful or not, the patent right, as an asset, has no (immediate) usefulness at large, since its essence is the restriction of the usufruct of the innovation to the patentee. Immediately and directly the patent right must be considered a detriment to the community at large, since its purport is to prevent the

community from making use of the patented innovation, whatever may be its ulterior beneficial effects or its ethical justification.(VEBLEN, 1908: 116, n. 1)

In the quotation above Veblen makes clear that independently from the nature of the innovation to which the patent right is attached, the patent right per se is detrimental for it prevents new knowledge to be used by the community, it means, the patent right limits severely the *serviceability* of the innovation by restraining its use. Here there is no resource to a “dynamic efficiency” to counteract a “static inefficiency”: it is at first and fundamentally recognized the negative effect of the patent on the productive capacity of the society and *only after that* any positive or ethical consideration is accounted for. The reason for such preeminence of the detrimental effects of patent rights come from Veblen’s concept of serviceability, which provide a rather different foundation for efficiency analysis than mainstream concept of efficiency (either static or dynamic), as will be discussed in the following.

Neither Static, Nor Dynamic Efficiency: Serviceability

For Veblen, efficiency means that there were no gluts or waste along the vertical industrial chain, in spite of the intense specialization promoted by the advanced division of labor of modern industry. In effect, efficiency – as Koedler (1997) has remarked – is an engineering concept, according to which efficient production means a steady and undisturbed flow of goods and services across the complementary branches of industry.

In Veblen’s own words:

[...] each industrial unit, represented by a given industrial “plant”, stands in close relations of interdependence with other industrial processes going forward elsewhere, near or far way, from which it receives supplies – materials, apparatus, and the like – and to which it turns over its output of products and waste, or on which it depends for auxiliary work, such as transportation. (VEBLEN, 1919: 15).

Once defined in such terms the characteristics of modern industrial productive system, Veblen clearly states what he understood as efficiency and efficient production:

By virtue of this concatenation of processes the modern industrial system at large bears the character of a comprehensive, balanced mechanical process. In order to an efficient working of this industrial process at large, the various constituent sub-processes must work in due coordination throughout the whole. (VEBLEN, 1919: 16).

Efficiency for Veblen is clearly defined as coordination of production activity across the branches of a modern economic system with intense division of labor, and not as production at full capacity without idle resources anywhere in the system. It is not surely the idealized world of Pareto’s efficiency; it is a world where goods and services flow without disturbance.

Veblen attached a great importance to that undisturbed flow of goods and services because any significant disturbance would not be confined to a localized small group of industries:

The disturbance is rarely confined to the single plant or the single line of production first affected, but spreads in some measure to the rest. A disturbance at any point brings more or less derangement to the industrial process at large. So that any maladjustment of the system involves a larger waste than simply the disabling of one or two members in the complex industrial structure. (VEBLEN, 1919: 17).

This concept of efficiency as well-coordinated economic flows across an industrial system with advanced division of labor is perfectly suited to the reality of a world where firms may deliberately operate in less than full capacity production in order to reinforce their competitive position increasing their profits.

But why should one assume that a well-coordinated flow across industry is the efficiency target to be achieved? The root of this concept of efficiency goes deeper in Veblen's ideas than only assuring the steady working of input-output chain across the industrial sector. One can identify this root in Veblen's concept of instinct of workmanship. In effect, according to Veblen (1898: 196), the basis of the search of efficiency – in the sense of a smooth working of the economic system without discontinuities – is to be found in the discomfort that the lack of effectiveness produces in one's own sense of worth:

Under the canon of conduct imposed by the instinct of workmanship, efficiency, serviceability, commends itself, and inefficiency or futility is odious. Man contemplates his own conduct and that of his neighbors, and passes a judgment of complacency or of dispraise. The degree of effectiveness with which he lives up to the accepted standard of efficiency in great measure determines his contentment with himself and his situation.

A lot has been written about Veblen's concept of instinct as a human inclination of behavior, but it is not necessary to get deep into this point in order to understand that another conception of efficiency more centered in the serviceability of the economic system – it means, its capacity to satisfy human needs – is clearly possible from Veblen's analysis. Such a concept of efficiency is quite distinct from orthodox economics on two important accounts: (a) it is a practical concept, in the sense that it does not presupposes a highly abstract picture of the economic system, as the one which is typical of the perfectly competitive markets hypothesis indispensable to orthodox efficiency concept; (b) it is a concept that evaluates the working economic system in function of the society's needs which are not simply assumed as the aggregation of individuals' needs, as Klein and Miller (1996) have already remarked.

That second account is important in a particular sense that deserves to be fully considered. If one consider that the societies' needs to be satisfied are basically individuals' needs, it is hard to escape either from the orthodox difficulties related to aggregation of preferences, or from the individualistic solution of the market. However, if one considers efficiency to be the satisfaction of

societal needs it becomes less difficult to acknowledge that some of these needs are collective in nature and as so they may deserve solutions that transcend the market or an individualistic approach.

This last point is really important when one must evaluate a far-reaching agreement with economic and social broad implications for several countries around the world, as is the case with the TRIPS agreement. To evaluate a set of rules – like the TRIPS agreement – according to its effects on individuals is not the same as evaluating the same set of rules according to its effects on collective groups, because groups of people may have some characteristics that are specific to the group and cannot be properly understood when one considers the individuals.

This is fairly possible, for example, when one considers pharmaceutical drugs. For example, consider drugs used in tuberculosis treatment. Suppose that the price of these drugs simply make the medicine unaffordable to a whole group of individuals who by its own social condition cannot afford the drugs. Let's suppose that there is an initiative from the government to buy those drugs and to send them to the poor people that need them, but patents again make those drugs so expensive that it puts the government's budget to buy medicine to poor people at risk. That's the kind of situation that one cannot be assessed with orthodox tools like the Pareto-efficiency test.

It is surely hard to assess our example of a budget to buy medicine to poor people according to Pareto-efficiency criteria, as any change in the budget for drugs for poor people will necessarily improve someone's condition (either the people who pay taxes to help the government to buy drugs or the people who receive the drugs purchased by the government) and make others worse. It is not even assumed that the hypothetical high prices of those medicine caused by patents are subject to social welfare judgment according to Pareto-efficiency test, for the test usually takes for granted the institutional settings in the welfare analysis.

But it is also very hard to assess our hypothetical budget problem with the Kaldor-Hicks criterion. The Kaldor-Hicks criterion states that even if there is a new arrangement which puts one person in a worse situation and other person in a better one (what should in principle invalidate any Paretian welfare analysis which supposes that one can only take as an improvement a new situation where someone gets better while nobody gets worse), one can still evaluate the efficiency of the new arrangement simply supposing that the person that gets better may – hypothetically – compensate the person who gets worse. So, if the size of the improvement of the person who gets better is larger than the size of the loss of the person who gets worse, the person who gets better would – again hypothetically – compensate the person who has got worse off and still so make a net gain. In this case, as the compensation is done and there is still a net gain, one could say that the new arrangement would be efficient. If, on the contrary, the size of the improvement of the person who gets better is smaller than the size of the loss of the person who gets worse, the person who

gets better would not (always hypothetically) compensate the person who has got worse off (for there would be no way of still realizing a net gain) and the new arrangement would not be efficient.

There are important problems with the Kaldor-Hicks criterion (see Coleman (1980, 2003)), and so it is hard to understand what the Kaldor-Hicks compensation principle means by “efficiency”. First of all, there is no doubt about judging a situation as a Paretian improvement or not, but one cannot expect the same precision in Kaldor-Hicks criterion. This can be clarified by showing that there is no correspondence between Pareto-efficiency and Kaldor-Hicks test. As Coleman (1980: 513-4) has put before, a distribution that is Kaldor-Hicks efficient does not need to be Pareto superior. The fact that no compensation is effectively paid results in that some individuals get better and other get worse, and so there are no grounds to affirm that a new situation that is an improvement according to Hicks-Kaldor is also Pareto-superior. But a configuration that is Hicks-Kaldor efficient need not be a Pareto-optimum either, for there is nothing that prevents individuals in the new Kaldor-Hicks efficient configuration to further improve their gains through trade. Of course the reverse is not true: a Pareto-superior situation may be Kaldor-Hicks efficient simply because there is no way a winner may compensate a loser; and a Pareto-optimum may be also a Kaldor-Hicks efficient situation for there is no way a winner may compensate a loser and there are no further gains of trade to be made in the efficient configuration.

However, there is another problem with Kaldor-Hicks that is a more important reason for concern in relation to the kind of discussion is being developed here, a problem already pointed by Coleman (2003: 107): “The fact is that unlike the Pareto criteria, Kaldor-Hicks allows for both winners and losers. If the worries about interpersonal comparability are legitimate, Kaldor-Hicks reintroduces them; it does not solve them”. Coleman’s remark is crucial here: it would indeed be a great problem in the hypothetical example presented above to decide what to do with the government budget to buy medicine to poor people on issues of who can compensate who: the poor who need the medicine or the taxpayers that want to keep their money. Substituting capacity to pay compensation for utility does not seem to be any solution to that difficult choice, especially when there are huge differences in relative wealth among groups of people, as it is typical of developing countries.

The problem with dynamic efficiency is not that patents do not provide incentives to technological innovation. The problem with dynamic efficiency is that it supposes patents a necessary condition to that incentive. It has already been extensively discussed in literature that: (1) patents are not in any occasion a necessary condition for innovations to be developed; and (2) there are many instances where patents have been used not to protect creative effort, but only to create barriers to entry – an instance of Veblen’s “sabotage”. In effect, the case for patents not being a necessary condition for innovative effort to occur has been presented from theoretical or empirical

points of view by Mansfield *et al.* (1981), Scherer (1984), Mansfield (1986), Levin *et al.* (1987), Scherer and Ross (1990), Ordover (1991), only to mention the basic references.

The use of patents as barriers to entry has a long history in economic literature as well as in American antitrust practice. In fact, it is a so long history that it is only possible here to indicate one of the several sources that summarize that history: Susan Sell (2003) shows that even in the United States until the mid-twentieth century all analysis stressed the monopoly aspect of patents and not its possible incentives to innovation. As Sell (2003: 66) explains, until the eighties “Patent rights were construed as monopolies, market power was presumed and these rights were subordinated to the dominant anti-trust policy”. From the end of the nineteenth century with the enactment of the Sherman Act until the end of the twentieth century, “This anti-patent environment, characterized by vigorous anti-trust enforcement and judicial attacks on the scope and validity of patents, led US businesses to question the economic value of patent protection” (Sell, 2003: 66). Given the particular emphasis on the antitrust use of patents, “More often than not, the courts presumed patents to be invalid, and patentees were criticized for setting monopoly prices for inventions that were already in public domain”. (Sell, 2003: 66). This picture of severe judgment of patents’ potential antitrust consequences only changed in the end of the last century, when it became evident to American policymakers that “[...] while US firms pioneered technologies such as the transistor, the video cassette recorder, and the integrated circuit, other countries, most notably Japan, successfully commercialized these US inventions” (Sell, 2003: 67). Then the emphasis changed accordingly from the monopoly threat to the innovative incentives resulting from patents.

However all those problems in judging static and dynamic efficiency – especially concerning patents –, one can perfectly judge all elements involved in a patent according to their serviceability to the society’s needs. One must simply ask about an enterprise behavior: is that behavior intended only to sustain an advantageous position through restraining economic activity – in Veblen’s view, is it a “sabotage” strategy – or does it really satisfy society’s needs by somehow meeting human necessities? But even so, one may still ask if firms effectively use the protection provided by patents’ monopoly rights to promote “sabotage” in Veblen’s sense and what is the relation of that “sabotage” to TRIPS Agreement. This will be the next topic.

Some Evidences on Multinational Strategies and the TRIPS Agreement

Susan Sell (2003) reports the mobilization of businessmen which originated the political pressure from developed countries’ governments, especially the United States and the governments of European Union and Japan that would eventually be consolidated in the TRIPS Agreement. In that effort to make the protection of intellectual property rights – and particularly patents – more rigorous and internationally uniform, a fundamental player was the Intellectual Property Committee

(IPC), created in 1986. As Susan Sell (2003) describes, the IPC was composed mainly of businessmen from software, entertainment and pharmaceutical industry⁴. Susan Sell explains succinctly what were IPC objectives and the success it achieved:

The IPC sought to develop international support for improving the international protection of intellectual property (patents, copyrights, trademarks, and trade secrets). The IPC, in conjunction with its counterparts in Europe and Japan, crafted a proposal based on existing industrialized country laws and presented its proposals to the GATT Secretariat. By 1994, the IPC had achieved its goal in the Trade Related Aspects of Intellectual Property (TRIPS) accord of the Uruguay trade round. (SELL, 2003: 96)

It is hard to find another case where several governments so completely acquiesced to the interest of private business⁵. The IPC succeeded not only in convincing the United States government to adopt its demands in the international negotiations of the Uruguay Round, but also succeeded in mobilizing its counterparts in the European Union and Japan to transform its demands in an international agenda. That mobilization was important, for “The transnational leadership of these US-based corporations was decisive in the achievement of the TRIPS accord” (SELL, 2003: 97). The result was that “These private sector actors succeeded in getting most of what they wanted from an IPC agreement, which now has the status of public international law”, and so “In effect, twelve corporations made public law for the world” (SELL, 2003: 96).

But what was the objective of those twelve corporations which “made public law for the world”? Christopher May (2000: 82, our emphasis) describes it very clearly:

Corporations who control major intellectual property resources undoubtedly like to retain their technological lead *vis-à-vis* their (potential) competitors. While needing to allow use and distribution on the basis of authorized license, as well as direct production or processing, unauthorized use of corporations’ intellectual property eats away at their market position, and may undermine it totally where market access is pre-dated by counterfeit availability. Thus, there was likely to be pressure on the US government to work towards an agreement to include TRIPS in the WTO’s treaties, and it was likely to come from the high technology, entertainment and luxury goods exporting sector of the US economy. In these sectors US corporations dominate the market based on their utilization of knowledge resources. *All sought to maintain their competitive advantage based on strengthening their control of the intellectual property elements of their activities internationally.*

While lengthy, the passage above is worth quoting in its integrity. There is here an obvious case of intangible assets (property rights – patents in particular) being used to restrain production, exactly the same way that Veblen had analyzed in his concept of industrial sabotage. The only and important difference – which Veblen could probably not anticipate at his time – was that such strategic restraint would extend *internationally* to several countries at the same time.

⁴In 1986, IPC was organized by executives from Bristol-Myers, CBS, Du Pont, General Electric, General Motors, Hewlett-Packard, IBM, Johnson & Johnson, Merck, Monsanto and Pfizer (SELL, 2003: 2).

⁵The IPC influence on American government went so far that IPC provided even legal support to the United States’ negotiation team (MAY, 2000: 82).

At the same time it must be clear that, as Veblen wrote before, the issue at stake here with patent rights protection is much less of reaping the incentives it provides to innovative effort, and much more of assuring a dominant position through restraining potential competitors. It is so highly significant that according to the Pharmaceutical Research and Manufacturers of America (PhRMA), “the Indian patent system was the most direct motivation for US efforts in the Uruguay Round negotiations relating to patents” (SELL, 2003: 130).

Conclusion

The evidences on the strategic action took by multinational enterprises that resulted in the TRIPS agreement seem to corroborate Veblen’s concepts of strategic sabotage and patents as subject to the characteristics of intangible assets he once analyzed. Therefore, by taking intellectual property rights protection – particularly patent protection – to be an absolute value to be universally protected worldwide under severe uniform standards, the TRIPS Agreement denies important degrees of freedom to developing countries if they search to meet their populations’ demands. That absolute value conferred to patents and intellectual property results of a mainstream concept of (either static or dynamic) efficiency which must be reexamined.

Such reevaluation suggests Veblen’s concept of serviceability as a better standard of assessment of how to satisfy the needs of developing countries societies through patents and other forms of intellectual property rights protection. The so-called “harmonization” of protection of patents intended by TRIPS agreement has hindered developing countries from adopting measures against the use of patents to restrain economic activity and sustain advantageous positions, even at the cost of poor populations.

That concern is more important the more concentrated is the multinational industry from where the patents are being demanded, what strongly suggests that patents are being used in Veblen’s sabotage strategy to restrain international economic activity, global competition and so causing harm to developing countries’ people. This apprehension becomes especially relevant when one considers the TRIPS agreement effect of restraining domestic industry in developing countries, particularly pharmaceutical industry, weakening competition and therefore consolidating the advantage of developed countries pharmaceutical industry at the expense of the serviceability to the people of poor countries.

References

CHANG, Ha-Joon.(2001) “Technology Transfer, Intellectual Property Rights, and Industrial Development in Developing Countries: a Background Paper Prepared for World Industrial Development Report, 2001 of the UNIDO (second draft)”. Vienna: UNIDO.

COLEMAN, Jules L., The Grounds of Welfare. Yale Law School, Public Law Working Paper No. 43, 2003. Available at SSRN: <http://ssrn.com/abstract=388460> or doi:10.2139/ssrn.388460

COLEMAN, Jules L. Efficiency, Utility, and Wealth Maximization. *Hofstra Law Review*, 8, 1980, 509-551.

HICKS, J. R. The Foundations of Welfare Economics. *Economic Journal*, 49 (196), Dec. 1939, 696-712.

KALDOR, Nicholas. Welfare Propositions of Economics and Interpersonal Comparisons of Utility. *Economic Journal*, 49 (195), Sept. 1939, 549-52.

KLEIN, Philip A.; MILLER, Edythe. Concepts of Value, Efficiency, and Democracy in Institutional Economics. *Journal of Economic Issues*, 30(1), March 1996, 267-277.

KNOEDLER, Janet T. Veblen and Technical Efficiency. *Journal of Economic Issues*, 31(4), 1011-26 December 1997.

LAYTON, Edwin. Veblen and the Engineers. *American Quarterly*, 14(1) (Spring, 1962), 64-72

LEVIN, Richard C.; KLEVORIC, Alvin K.; NELSON, Richard R.; WINTER, Sidney G. (1987). "Appropriating the Returns Form Industrial Research and Development". *Brookings Papers on Economic Activity – Microeconomics*, 3: 783-818.

MANSFIELD, Edwin. (1986) "Patents and Innovation: An Empirical Study". *Management Science*, 32 (2): 173-81.

MANSFIELD, Edwin; SCHWARTZ, Mark; WAGNER, Samuel. (1981) "Imitation Costs and Patents: An Empirical Study". *The Economic Journal*, 91 (364): 907-918.

MAY, Christopher. (2000) *A Global Political Economy of Intellectual Property Rights: The new enclosures?* London: Routledge.

MCCALMAN, Phillip. (2001) "Reaping what you sow: an empirical analysis of international patent harmonization". *Journal of International Economics*, 55: 161–186

ORDOVER, Janusz A. (1991) "A patent system for both diffusion and exclusion". *Journal of Economic Perspectives*, 5 (1): 43-60.

SCHERER, Frederic M. (1984) *Innovation and Growth*. Cambridge, Mass.: The MIT Press.
 _____; ROSS, D. (1990). *Industrial Market Structure and Economic Performance*. Boston: Houghton Mifflin Co.

SELL, Susan K. (2003) *Private Power, Public Law: The Globalization of Intellectual Property Rights*. Cambridge: Cambridge University Press.

STIGLITZ, Joseph E. (2003) Globalization, technology, and Asian development. *Asian Development Review*, 20 (2): 1-18.

VEBLEN, Thorstein. *The Enginners and the Price System*. New York: The Viking Press, Inc., 1944.

_____. *The Theory of Business Enterprise*. New York: Charles Scribner's Sons, 1919.

_____. On the Nature of Capital: Investment, Intangible Assets, and the Pecuniary Magnate. *The Quarterly Journal of Economics*, 23(1), Nov. 1908, 104-136.

_____. The Instinct of Workmanship and the Irsomeness of Labor. *American Journal of Sociology*, 4(2), Sept. 1898, 187-201.

_____. The Overproduction Fallacy. *The Quarterly Journal of Economics*, 6(4), 1892, 484-492.