Locked In

Australia Gets a Bad Intellectual Property Deal

The intellectual property provisions of the US-Australia Free Trade Agreement are an unfortunate policy shift, argues **Kimberlee Weatherall**

A new chapter in Australian intellectual property (IP) policy

One of the more surreal moments in 2004 was seeing Prime Minister John Howard and Opposition Leader Mark Latham debate the finer points of patent law. IP became a hot political issue when the Australian government decided to allow significant chunks of Australian law to be re-written, or frozen, in return for a free trade deal with the United States. The debates about Chapter 17, the IP Chapter of the Australia-US Free Trade Agreement (AUSFTA), generated a lot of heat, and a lot of rhetoric. Parliamentary committees expressed concern; respected Australian economists condemned.

Kim Weatherall is a lecturer in the Faculty of Law, University of Melbourne and Associate Director (Law), Intellectual Property Research Institute of Australia.

It is time for a slightly calmer assessment. What does Chapter 17 really mean for innovation policy in Australia—and for Australian businesses, computer programmers, and consumers? I will argue that, far from being an uncontroversial affirmation of existing laws in Australia, it represents a decisive—and unfortunate—move in Australian IP policy. Australian policymakers are going to face significant challenges in implementing the treaty in ways that minimise burdens on the Australian economy.

Why is there so much IP in a trade deal?

At first glance, it might seem strange that there is a whole chapter about IP in what is supposed to be a free trade agreement. After all, when we think free trade agreements, we think about lowering tariffs, or eliminating trade-distorting subsidies.

Actually, the presence of IP here is not so surprising. IP has been in trade deals since at least the 19th century. And most famously, IP

was included in the suite of treaties setting up the World Trade Organization, through the Agreement on Trade-Related Aspects of Intellectual Property Rights, or TRIPS. Australia is party to many multilateral agreements on IP, and in general, they probably do more good than harm for Australia, because they offer a more certain, harmonised environment for Australian creators, and they help reduce the barriers that creators might otherwise face in trading overseas.

The devil is in the details

But there *is* something different and disturbing here. The first thing that strikes you when you look at Chapter 17 is its sheer complexity: at 29 closely typed pages, it is breathtakingly long, detailed, and opaque. There are provisions which seem entirely unrelated to any concerns that the US might have about the Australian IP system. In fact, the reason for much of the IP Chapter is not that Australia had a weak IP system. On the contrary, we have long had a very strong system of protection for IP owners. But the US wants to raise IP standards *worldwide*. Facing opposition in multilateral forums like the WTO, it has moved to impose its preferred standards through FTAs using a template approach—the IP Chapter in each FTA is negotiated according to a template set by the last, with the same provisions included in each, regardless of whether they address some 'problem' in the negotiating partner country.

It is important to realise just how unusual this is, and what it means for Australia. Treaty obligations are usually stated at a broad level, leaving plenty of 'wiggle room': space to craft implementing laws as they suit Australian interests. TRIPS has quite a lot of flexibility built in. Or take Article 11 of the World Intellectual Property Organization Copyright Treaty, which requires parties to provide 'adequate legal protection and effective legal remedies against the circumvention of effective technological measures that are used by authors'. The equivalent provision in AUSFTA goes on for two and a half single spaced, typed pages. It defines what technological measures are, what acts relating to them are proscribed, what exceptions may be provided, and even when and how new exceptions can be created, and what criteria we can apply in creating them.

Because Chapter 17 *is* so detailed, and covers the full gamut of all IP rights, it locks Australia in to one particular model of IP law. We have lost a lot of flexibility to choose and adjust our own IP policy. Take, for example, software patents. In Europe, software patents have proved highly contentious, with various attempts to draft new laws in this area stalled by policymaker concern and activism by important computer programmer interests. Currently, Australia grants patents for some software inventions, and has done since at least 1994, when the Federal Court upheld the patentability of a method for using an ordinary computer keyboard for producing Chinese character strokes in word processing programs. If we wanted to change our position here, we would find it a lot harder. We might find tariffs suddenly imposed on Australian lamb exports to the US.

IP law is the child of technology and a law that seeks to tackle the future, not the past. The technologies of creation and distribution are constantly changing—we need only look around at the way that peer-to-peer applications have changed the way people use and consume music. What was impossible a couple of years ago is old hat today. IP law needs to be flexible, to accommodate new technologies, and it needs to be reviewed frequently to make sure it is achieving its basic goals. This will be infinitely harder to do in light of 29 pages of prescriptive terms.

The technologies of creation and distribution are constantly changing—we need only look around at the way that peer-to-peer applications have changed the way people use and consume music.

The other inevitable result of AUSFTA is that Australian copyright law in particular has become even more complex than it already was. Just a couple of years ago, the Australian government commissioned the Copyright Law Review Committee to find ways to *simplify* Australian copyright law. That will be impossible now. We have already had some 80 pages or so of new copyright legislation, and there is more to

come. Copyright law has always been a 'tax on readers'; now, it is the Income Tax Assessment Act of Australia's creative industries.

Is adopting US law a good policy choice?

AUSFTA does not just lock in current law. It actually requires significant *changes,* particularly to copyright, to make our law more like the law of the US (notably, the US did not undertake to make any changes to *their* IP law). Is US law a good model for Australia?

Adopting US standards here means adopting a part of US economic policy. It is important to realise that even though the US creative and innovative industries may be world leaders, that does not mean US copyright law—the law that seeks to provide incentives for such creation—is the optimal policy for Australia.

Australia is a relatively poor international performer in global innovation. We employ fewer innovators and particularly scientists than other OECD countries, we do not invest in R&D, especially in the private sector, and our universities are not well-resourced.

International competitiveness, especially for advanced economies, depends increasingly on innovation: the creation and commercialisation of knowledge. The role of policymakers is to foster an environment—including appropriate levels of IP protection—in which innovation can flourish. Australia's aim should be to determine an optimal level of IP protection for Australian conditions, and to implement it so far as possible within constraints imposed by international treaties and conditions.

Determining optimal IP settings is difficult, because it requires us to reach a balance between competing interests. On the one hand, IP law must provide sufficient incentives for economically efficient investment in innovation and creativity. This is achieved by giving creators and innovators IP rights like copyright and patents—exclusive rights in their creations and innovations, for a limited time. This ensures that creators can appropriate at least some of the value they create.

On the other side of the balance, we need to ensure an appropriate level of diffusion and use of the products of creativity and innovation, and room for cumulative innovations. This means we do *not* want to create rights that are too strong. Economists have long recognised that IP protection can be excessive. If IP law gives too much control, it may impose significant burdens on society: by raising prices for consumers and users of IP, and unduly restricting diffusion of knowledge. It may enable IP owners to act anti-competitively, and claim super-normal profits. What is 'too much' or 'too little' depends on a country's circumstances.

The US is a net exporter of technology. US income from technology, according to OECD figures, is more than double what it pays to other countries. These conditions make strong IP law a rational policy choice. When the US strengthens IP law, and hence increases the rewards reaped by its creators in the US market, it is likely that a significant proportion of the profits will go to American creators.

On the other hand, Australia has a large trade deficit in the area of intellectual products. In 2002-03 Australia paid royalties and licence fees of $1.82 billion to the rest of the world, and in return, received royalties and license fees of some $618 million. Nor does it seem this will change in the immediate future. Professors Joshua Gans and Scott Stern have shown that Australia is currently a relatively poor international performer in global innovation, in terms of ideas generated, as well as the growth rate of ideas production.[1] We employ fewer innovators and particularly scientists than other OECD countries, we do not invest in R&D, especially in the private sector, and our universities are not well-resourced. We have no comparative advantage in this area.

When Australia strengthens IP law, Australian consumers and users bear all the additional costs. But a very large proportion of the direct benefit flows to overseas creators. As the Productivity Commission has previously concluded, this means that the optimal level of IP for Australia is not likely to be as high as the optimal level for the US. In other words: what's good for them is *not* necessarily good for us.

Of course, it *is* good for the US. From a US perspective, raising the level of IP protection in

Australia to the same level represents an unalloyed benefit to US interests. American consumers and users bear none of the increased costs, but American innovators selling their products here reap the reward. No wonder the US has made higher IP standards a key objective in bilateral trade negotiations.

A spur to further Australian creativity?

But is this analysis short-sighted? Supporters of Chapter 17 make two further arguments. First, they say that harmonisation will encourage investment by US industries who will have the security of laws that they are comfortable with, and will reduce the costs of transactions across borders. The problem with this argument is that harmonisation is a myth. Even after Chapter 17, there are many significant differences between Australian and US IP law. For example, in Australia, we protect collections of facts, like phone books, as copyright works, and authors are granted moral rights—rights to be attributed as the author, and to prevent their work being treated in a derogatory manner. Cross-border legal costs will continue unabated.

Supporters also say that the 'balance of trade' argument fails to take into account that strengthening IP law could help Australia improve its balance of trade in this area. Michael Fraser, the CEO of Copyright Agency Limited, an agency that collects copyright royalties, specifically made this point to the Senate Select Committee:

> I think the fact that we are a net importer of copyright should not dictate to us a short-term view … I believe that if the infrastructure is there in terms of strong copyright protection, we can trade those kinds of copyright based works and services into the region and become a net exporter.

This is an easy, attractive argument, but it assumes that if some copyright (or patent) protection is good, then more is better. Not so.

When we strengthen IP, we do increase incentives for creation, but we also increase the costs for creators. Why? Because IP is not just an output. For most creators, IP is also an input, and stronger IP increases the price of that input. Call it the 'Isaac Newton Principle': if we see further than those who went before, it is because we stand on the shoulders of giants. This means that strengthening IP rights disproportionately benefits *current* IP owners—those who have already created—at the expense of the next generation, who want to build on what went before. The first Mickey Mouse cartoon, *Steamboat Willie* was partly based on Buster Keaton's silent film classic, *Steamboat Bill*. As Stanford Professor Lawrence Lessig has noted, Disney 'ripped creativity from the culture around him, mixed that creativity with his own extraordinary talent, and then burned that mix into the soul of his culture'. If Disney had had to ask permission for the privilege, his ripping, mixing and burning would have been more expensive, and might not have happened.

Stronger IP does not just advantage existing creators. It also gives *disproportionate* benefit to those who are already in possession of a significant IP portfolio. Disney, with its massive inventory of creative works, or Microsoft, with its store of patents, both have much to build on, and much to trade in return for any permissions they may seek. A first time independent director wanting archive material may have to buy everything. I am not aware of any specific studies of the issue, but it seems likely that more 'portfolio-owning' IP owners are based overseas. If this is true, then once again, the costs of beefing up IP rights are likely to be borne disproportionately by Australian creators, while a greater part of the advantages will flow overseas.

The costs of beefing up intellectual property rights are likely to be borne disproportionately by Australian creators, while a greater part of the advantages will flow overseas.

If it could be shown that some specific industry was being hampered by deficient IP protection, and that the benefits of strengthening the law to this industry outweighed the costs to the Australian community, then there would certainly be a case for reform, and possibly, for strengthening IP law. But each such case needs to be evaluated and proved. Good policy change requires a rigorous cost-benefit analysis.

Unfortunately, the process associated with the FTA has been characterised by a lack of proper economic evaluation. Ongoing policy reviews of patent and copyright law were sidelined, and past recommendations of bodies like the Intellectual Property and Competition Review Committee were overruled. No reference was ever made to the Productivity Commission for independent analysis. The government-commissioned economic study of the AUSFTA by the Centre for International Economics did not attempt to factor in *any* costs of the IP Chapter. The Senate-commissioned analysis done by Productivity Commissioner and ANU academic Dr Philippa Dee actually found the IP chapter was likely to impose costs on Australia. Several specific changes we have taken on in AUSFTA—the changes to digital copyright law, and copyright term extension—have been considered, and *rejected,* by Australian policy reviews.

No incentive is created by retrospective extension of the copyright term. Dead men do not write poetry. It represents a pure windfall profit for existing copyright owners.

The 'balance' of US law

So adopting US IP law is not automatically a good thing. Even more to the point, in copyright law, where the most significant changes have been wrought, there is a strong argument that US law does not represent an optimal balance, *even for the US*. In recent years, copyright owners have been successful in lobbying for more and more protection: the extension of copyright term, draconian digital copyright laws, and increasing limits on technology have been the order of the day. The calls of many law professors in the States have been joined by more and more editorials in the *Washington Post,* the *New York Times*, and even *The Economist* calling for a halt in the growth of copyright.

With Chapter 17 modelled on US law, their problems are now, potentially, our problems too. There is not space here to consider all the changes wrought by the AUSFTA in detail. Instead, I will focus on two that make copyright here longer and broader.

Longer copyright

One change that has drawn particular attention—and opprobrium—is the extension of the copyright term. A few years ago, the EU harmonised to a copyright term of the life of the author plus 70 years. In 1998, the US followed. Now, Australia has got into the act. For some works, this means that copyright now lasts in excess of 100 years. The extension applies to both existing, *and* new works.

Seventeen leading economists, including five Nobel Prize winners, testified in the US Supreme Court that this is irrational policy. The retrospective application is particularly perverse. No incentive is created by retrospective extension of the copyright term. Dead men do not write poetry. It represents a pure windfall profit for existing copyright owners. As a policy, it is even more economically irrational for Australia, where much of the profits from term extension are likely to flow overseas.

Even for new works, the incentive is absolutely minimal: because any additional profits are reaped many years into the future, their present value is tiny. According to the same economists, a one per cent likelihood of earning $100 annually for 20 years, starting 75 years in the future, is worth less than seven cents today. Hardly the kind of incentive increase likely to convince anyone to do anything.

Those who support term extension argue that harmonisation in this area will reduce the cost of administering rights internationally. This argument is highly questionable, given that significant differences remain between the copyright terms applicable in Australia and overseas, particularly with respect to some employee-created works.

Supporters also argue that the costs of term extension are minimal, because few works are generating royalties so long after their creation. This misses the point, however: term extension means that even if a work is not generating royalties, those who want to use it in new creations—like our documentary film makers wanting to use archival footage—must ask permission. Try asking directors if the permissions process is costless, and you will get a sense of the hidden costs of term extension.

The anti-competitive effects of broader copyright

A second, key area of concern relates to the new laws Australia will acquire regarding digital rights management, or DRM. DRM refers to technologies used by copyright owners to control how consumers access and use copyright material in a digital environment. Examples include the encryption on DVDs or computer games, the password protection systems used on online databases, or the technological measures that make some music download files 'single play only'. Another example which will gain more prominence in the US from mid-2005 is the 'broadcast flag'—a piece of software code, embedded in digital television signals, which can be used to dictate what people can do with the signal—for example, by preventing home recording, or limiting home recording to a single copy. From July 2005, TVs, videotape recorders and DVD players sold in the US will have to recognise, and give effect to the broadcast flag.

The US has particularly draconian laws, known as the *Digital Millennium Copyright Act*, or DMCA, which make it illegal to circumvent DRM, and to distribute technology to circumvent DRM. The DMCA has been extremely controversial. In the last twelve months, there have been hearings in the US Congress specifically debating a bill—the *Digital Media Consumers' Rights Act*—to cut back on the protections given by the DMCA. Although the bill went nowhere in the end, the fact that it even got a hearing is symptomatic of real concerns even in the US.

While Australia already has anti-circumvention laws, in signing up to Chapter 17, we have agreed to move to something closer to the DMCA. We will have to strengthen our anti-circumvention laws in every way. These laws will now cover more technologies, ban more activities, and have fewer exceptions. It is worth noting that the recent review of our own digital copyright law found *no* case for strengthening our anti-circumvention laws.

Why is the DMCA so maligned? First, because DRM has a significant impact on the balance of rights between producers and consumers of copyright material. DRM can prevent *any* copying or access to works—even copying that would be excused under copyright law as a 'fair dealing'. Imagine, for example, a multimedia professional wants to use a small clip from a DVD to comment on the clip. Under Australian law, this would probably be a fair dealing, and not a copyright infringement. But if the DVD is copy protected, then this fair dealing may be impossible, and DMCA-style laws make it illegal to provide the technology for this copying.

DRM can also remove consumer freedoms we take for granted: making a back-up of our CDs, for example, or 'ripping' them to our MP3 player so we don't have to carry a CD collection around. Such copying is currently copyright infringement, although never pursued by copyright owners. With DRM, it could become impossible.

More importantly, DRM backed up by the DMCA can be used to restrict competition. One obvious example is that DRM can be used to segment markets geographically. Currently, commercial DVDs are region-coded: DVDs sold in the Australian region can only be played on players sold for the Australian region, and DVDs purchased in the US cannot be played on Australian machines.

DMCA-style laws make it illegal to modify your player to play the DVDs you purchased in the US. Digital rights management raises barriers to international trade in legitimately produced goods. The result is higher costs for Australian consumers.

DMCA-style laws make it illegal to modify your player to play the DVDs you purchased in the US. In other words, DRM *raises* barriers to international trade in legitimately produced goods. The result, as the ACCC has pointed out, is higher costs for Australian consumers. This is perhaps one of the deepest ironies of the IP Chapter, coming, as it does, in a 'Free Trade' Agreement.

Region-coding may or may not last in the long term. But region-coding is not the only way that DRM-based control can be used to restrict competition. A further concern is that copyright owners will leverage the power arising from their control over movies and music, into markets for player devices. For example, currently the DRM used to protect DVDs—the Content Scrambling System or CSS—must be licensed by those who want to

make DVD players. According to open source advocates, open source producers in particular find it difficult, or impossible, to obtain the licenses. When government tries to 'pick technological winners', it is a recipe for innovation policy disaster.[2] Giving certain market players the power to pick winners is potentially even more dangerous. The stronger the DMCA-style laws we introduce in Australia, the more potential for such leveraging is created.

Finally, the DMCA has been abused in the US: to stifle cryptography research by threatening professors with lawsuits, and to control aftermarkets for products like printer ink cartridges, to prevent the development of interoperable software. US courts are currently grappling with these unintended uses of digital copyright law.

Australia may be able to avoid the worst of the problems that have beset the US as a result of the DMCA. We have the power to draft our own laws under the treaty.

I should note of course that Australia may be able to avoid the worst of the problems that have beset the US as a result of the DMCA. We have the power to draft our own laws under the treaty. Under AUSFTA, Australia actually has two years to draft our own Oz-DMCA. We can only hope that we do a better job of avoiding anti-competitive and abusive use of these laws.

Concerns for the future

But will we be *allowed* to do a better job? How much freedom will we have to avoid the imbalance that has arisen in US copyright law? Above and beyond the detailed, prescriptive provisions in AUSFTA; above and beyond the particular, costly copyright provisions we have been forced to accept, there is another, overriding concern: that all future Australian copyright policy will, from now on, be drafted with the US looking over Australia's shoulder. US lobby groups will no doubt oppose, directly and through the US Trade Representative, any implementations they consider less than optimal from *their* point of view.

In this regard, the US has 'form'. Representatives of the United States Trade Representative proudly point, in their appearances before Congress, to their high level of engagement with IP policy-making in other countries. Recently, Josette Shiner, Deputy US Trade Representative, touted the way that USTR and other agencies had pressed Singapore to publish draft legislation on the Internet, and how, less than a month later, 'US agencies and other interested parties—including pharmaceutical companies—are currently reviewing them'. She also specifically stated that she wanted Congress to quickly approve the AUSFTA, so that 'we may begin implementing agreed provisions *and working toward further reform*.' [3]

What to do?

What can we do about all this now? Unfortunately, the consultation process is over; we have committed to these detailed provisions, and we have already opened the door to influence. But there is also much we can do to mitigate any damage to Australian interests. Most importantly, we need to review and reconsider the legislation rammed through Parliament in August. We also need to re-think the way we 'do' IP policy in Australia, with more coordination between the multiple, competing government departments—the Department of Communications, Information Technology and the Arts, the Attorney-General's Department and the Department of Industry, Tourism and Resources, as well as the Department of Foreign Affairs and Trade—who all currently have a hand in IP reforms. Most importantly, we must adopt a transparent process for the further reform of Australian IP law post-AUSFTA, which must involve economic assessment of the costs and benefits.

In short, we need a better strategic vision of how Australia is going to manage copyright law, and indeed all IP law, in Australia's interests.

Endnotes

1. Joshua Gans and Scott Stern, *Assessing Australia's Innovative Capacity in the 21st Century*, (Melbourne: Intellectual Property Research Institute of Australia, 2003), p.3.
2. As above.
3. Testimony of Deputy US Trade Representative Josette Sheeran Shiner before the Committee on Finance, Subcommittees on Health Care and International Trade, US Senate, April 27 2004 (emphasis added).