

A reply to Kimberlee Weatherall's article 'Locked In: Australia Gets a Bad Intellectual Property Deal', in *Policy Summer* 2004-05

Global IP Markets Require Global Consistency

Rationalising international property rights across borders will promote creativity and prosperity worldwide, argues **Tony Healy**

Intellectual property rights (IPR) are a magnificent device. The income they generate pays for the work of research scientists creating new medicines, software engineers designing better ways for communicating and film makers creating the next *Master and Commander* or *Shrek*. They pay for the newspapers we read every day, even if online.

IPR created the search engine Google, which has transformed the lives of information workers and created 2,300 rewarding jobs for researchers and a US\$50 billion economic powerhouse. They created the easy-to-use Microsoft desktop software that more than 90% of people use at work and at home.

In America, core copyright industries generated \$626.6 billion in 2002—6% of US gross domestic product—and employed 5.48 million people. Total copyright industries generated \$1.25 trillion in revenue and employed 11.47 million workers.¹

For Australia, copyright industries contributed \$19.2 billion in industry gross product in 1999-2000, representing 3.3% of Australia's gross

domestic product. They employed 345,000 people, comprising 3.8% of Australia's workforce, as at June 2000.²

Consistency, not harmonisation, is key

By any measure, intellectual property rights are important. They are also global. That creates several vulnerabilities, especially since file sharing networks make theft so easy. For example, music sales underwent a dramatic decline starting in 2000, the year that file sharing with Napster became possible, according to a careful analysis by Stan Liebowitz of the University of Texas. Sales volumes fell to the levels of 17 years ago.³

That's why trade negotiators seek to bolster intellectual property rights in agreements such as the Australia-US Free Trade Agreement (FTA). They seek consistency, so that investment in one

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nation is not undermined by lax IP protections in another. In this sense, IPR are trade-enabling and competition-enhancing.

Many critics of the Free Trade Agreement interpret these changes as harming Australia because we're a net importer of IP. This criticism was present in Kimberlee Weatherall's article in the Summer 2004-05 *Policy*, for example. It's an unnecessarily fearful interpretation.

Stronger laws governing IP recognise the increasing role of intangibles, R&D and intellectual property in the world economy. As such, it benefits innovative and creative Australians and keeps our economy internationally competitive. It also preserves Australians' access to new medicines and movies.

It's also worth noting that, although Australia is a net importer of copyright material, our exports are growing faster than our imports. Over the period 1995-96 to 1999-2000, export revenue from the core copyright sector increased by 44%, while import revenue increased by around 29%.⁴

Copyright term extensions are fine

One feature of the FTA's IP provisions that attracted particular opprobrium is the extension of copyright term to life plus 70 years. Critics have had enormous fun with this, generally invoking Professor Lawrence Lessig's claims that the sole reason is to preserve copyright in Mickey Mouse for Disney.

In fact, there are some good reasons for extending copyright terms. William Landes and Richard Posner have pointed out that term extension compensates for the greater ease of copying, which otherwise undermines the value of copyright holdings.⁵ This is particularly appropriate now that CD and DVD burners are becoming widespread. Liebowitz points out that about 75% of American file-sharers had CD burners in 2004.⁶ Figures from 2002 showed file-sharers were more than twice as likely to have CD burners as members of the general population.

Second, Liebowitz and Stephen Margolis contend that, although the present value of future term extensions might be small, it might also represent a cross-over point for writers and other creators on marginal incomes, thus encouraging the creation of more works.⁷

Third, they point out that publishing, movie-making and computer games are businesses that depend on occasional hits. High revenue streams from occasional hits subsidise a large range of additional titles. For example, the 124 best selling books in 1987 generated US\$1 billion of total US\$1.7 billion sales for that year, according to research by Liebowitz. In this context, the additional revenue from term extensions might be an essential part of the publishing process, rather than the superfluous profits that extension critics claim.⁸

There's an analog to this in patents too. Only about one in five pharmaceutical research projects results in a commercially successful product.

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Fourth, Liebowitz and Margolis also identify a problem in the claim of free culturists that greater distribution causes no harm to the creator.⁹ There are certain works where it does. People value uniqueness and variety, which is why expensive cars preserve their premium prices even though there are cheaper alternatives, and why art works are sometimes given unique serial numbers. Further, some derivative works can damage the original. Therefore, they conclude, IP plays an important role of stewardship.

As to claims that term extension would impose harmful costs on Australia, analysis by the Copyright Agency Limited suggests the actual effect would be tiny. At universities, for example, only 4.5 pages in every 10,000 copied would be newly captured by term extensions. The additional cost per student is less than one cent per year.¹⁰

There's also a curious inconsistency in critics' arguments. They tend to argue, as Kim Weatherall does, that stronger IP harms those who derive new works from old. This is the famous rip, mix, burn imperative of Lawrence Lessig's free culture

movement. However copyright does not preclude any genuine new creative works. It protects only the implementation, not the idea.

Unwarranted attacks on important IP mechanisms

The most controversial feature of the American IP system, and thus of the new IP provisions in the FTA, is the Digital Millennium Copyright

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Act (DMCA), which received a blast in Kim Weatherall's article. The DMCA prohibits the use of technical measures to defeat copyright protections on movies, songs and software. If we believe copyright is important, then the DMCA is a legitimate response to modern environments.

However copyright critics demonise the DMCA with oft-repeated tales of a Russian programmer being jailed when he visited America. The reality of that case is that the programmer had written a program that let others steal online books, was marketing it for payment, and had ignored requests from Adobe to discuss the issue. That is why he was arrested.¹¹

Another popular attack is made on printer maker Lexmark's use of the DMCA to thwart third party manufacturers of cheaper printer cartridges. Lexmark printers were designed to work only with Lexmark cartridges, but third party cartridge makers had circumvented those design restrictions so that their own cheaper cartridges could be used. Lexmark tried to bring actions against those cartridge makers under the DMCA, but failed.

On the surface, Lexmark's actions seemed to be simple price gouging but, in fact, the company relied on high cartridge prices to subsidise its printers and thus offer them at lower prices. This would have benefited customers who don't do a lot of printing. In this case, Lexmark's loss means that printer prices will be higher.

Patents need work

Patents provide the important second leg of intellectual property rights, and are especially important for pharmaceuticals. There is rightly concern about patents being granted too readily in software and business processes, but Australia will not resolve this problem by remaining aloof from the world. The patent system has been through similar controversies in the past. For example, there was debate when chemical compounds were first patented.¹²

Efforts simply to crack down on software patents could have unexpected effects in other industries, since 90% of software patents are held by firms in industries outside software, according to the OECD.¹³ Ronald Mann of the University of Texas also points out that it can be difficult even to categorise software patents, since they don't actually fall under a defined category.¹⁴

America's universally envied software and high-technology industry owes a lot to strong patenting, and this is a lesson that can benefit other nations including Australia.

America actively strengthened its patent system between 1980 and 1984 as a response to concerns about declining US competitiveness compared with Europe and Japan. It provided more staff and computer systems to the patent office, granted patent rights to universities and small businesses for government funded inventions, and compensated pharmaceutical companies for lengthy delays in testing drugs in the field. Equipped with new patents and other IP protections, entrepreneurs and researchers attracted venture funding and formed new start-ups. An area in San Francisco where several located themselves soon became famous as Silicon Valley.

Several studies report that patents have significant benefits for small firms and new entrants, directly contradicting the claims of patent opponents. This has particular relevance for Australia.

For example, Mann explicitly describes the alleged patent thicket as a myth. He writes:

This part explores several benefits, including the classic benefit of excluding competitors. In this industry at least, that benefit accrues primarily to small firms, protecting them from the competitive depredations of incumbents. Incumbents, by contrast, rarely

use patents to exclude smaller firms from the industry. The part also discusses a series of less conventional benefits small firms gain from software patents: as barter in cross-licensing arrangements, in signaling their technical competence to third parties, in converting tacit knowledge into a verifiable and transferable form, and in making the firm attractive to potential acquirers.¹⁵

Hall and Ziedonis make the same point:

... stronger patent rights may have facilitated entry by specialized firms and contributed to vertical disintegration in this industry.¹⁶

In general, patents are important for small companies to attract finance and prove their expertise. Lerner¹⁷ points out that, in bio-technology and semi-conductors, the firms with more and better patents have higher valuations both as privately held companies and when they IPO.

Conclusion

Movies, software, new technologies, medicines and news cost money. Intellectual property is a fair system that pays for those products and services, and it needs to adjust to new technological threats, including ensuring international consistency. The intellectual property provisions of the FTA help provide those adjustments and, in so doing, pave the way for innovative and creative Australians to prosper.

Endnotes

¹ S. Siwek, 'Copyright Industries in the U.S. Economy: The 2004 report', International Intellectual Property Alliance, 2004.

² Allen Consulting Group, *The Economic Contribution of Australia's Copyright Industries* (Sydney, 2001).

³ S. Liebowitz, *File-Sharing: Creative Destruction or Just Plain Destruction?* (University of Texas, 2004), 21.

⁴ Allen Consulting Group, *The Economic Contribution of Australia's Copyright Industries*, iii.

⁵ W.M. Landes and R.A. Posner, 'An Economic Analysis of Copyright Law', *Journal of Legal-Studies* (1989), 18.

⁶ Liebowitz, *File-Sharing*, 5.

⁷ S. Liebowitz and S. Margolis, *Seventeen Famous Economists Weigh in on Copyright: The Role of Theory, Empirics and Network Effects*, (AEI-Brookings Joint Centre for Regulatory Studies, 2004), <http://www.aei-brookings.org/publications/abstract.php?pid=421>.

⁸ As above, 13.

⁹ As above, 5.

¹⁰ Copyright Agency, Submission to Senate Select Committee on the FTA (2004).

¹¹ Adobe, Statement on the Sklyarov case (2004) <http://www.adobe.com/aboutadobe/pressroom/pressreleases/200108/elcomsoftqa.html>.

¹² J. Lerner, *The Economic Impact of Software Patents* (Brussels: Centre for the New Europe, March 2004).

¹³ OECD, *Report on Patents and Economic Performance* (Feb 2004), 6, <http://swpat.ffii.org/papers/oecd0401/oecd0401.en.html>.

¹⁴ R.J. Mann, *The Myth of the Software Patent Thicket: An empirical Investigation of the relationship between intellectual property and innovation in software firms*, (The University of Texas School of Law: 2004) <http://ssrn.com/abstract=510103>.

¹⁵ As above, iii.

¹⁶ B.H. Hall, and R.H. Ziedonis, 'The Patent Paradox Revisited: An empirical study of patenting in the U.S. semiconductor industry, 1979–1995', *RAND Journal of Economics*, Vol. 32, No. 1 (Spring 2001).

¹⁷ Lerner, *The Economic Impact of Software Patents*, 4.

'In sheer column inches, they eat their competitors.'

Diana Bagnall, The Bulletin on The Centre for Independent Studies.

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