INTELLECTUAL PROPERTY AND INFORMATION WEALTH
Issues and Practices in the Digital Age
Four Volumes

EDITED BY PETER K. YU

In today’s knowledge-based economy, intellectual property protection has taken on fundamentally new proportions, with profound implications for business, law, policy, and culture. Featuring insights from leading scholars and practitioners, Intellectual Property and Information Wealth brings new clarity to the issues, providing rigorous analysis, historical context, and emerging practical applications from the public, private, and non-profit sectors.

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Intellectual Property and Information Wealth

Issues and Practices in the Digital Age

VOLUME 4

International Intellectual Property Law and Policy

EDITED BY

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About the Editor and Contributors

Index
Doing Deals with Al Capone: Paying Protection Money for Intellectual Property in the Global Knowledge Economy

Peter Drahos

This chapter makes the assumption that there can be too much intellectual property. In other words, if states continue to increase and increase standards of intellectual property protection, at some point they will produce suboptimal outcomes for themselves. This assumption would have universal support among economists. It is explained schematically below.

The next section explains how the United States is globalizing and at the same time increasing standards of intellectual property protection. One clear effect of this is that the United States is gaining the possibility of increased economic rents from its intellectual property assets. However, setting higher standards of intellectual property is one thing and getting developing countries to comply with these standards is another. Section three then explains how the dispute resolution chapters of free trade agreements (FTAs) fit in with U.S. enforcement strategy on intellectual property.

The final section assumes, for the purposes of argument, that standards of intellectual property may be approaching suboptimal levels for the United States. This raises two important questions. Can we expect the United States to change its strategy on intellectual property? Can we expect that developing countries will stop signing FTAs with the United States that contain intellectual property chapters? The chapter offers reasons for why the answer to both these questions is likely to be no.

Too Much Intellectual Property?

Economic theory suggests that a society that had no intellectual property protection at all would almost certainly not be allocating resources to invention and creation at an optimal level. But equally, a society that went to extremes of protection would almost certainly incur costs that exceeded the benefits. Intellectual
property rights permit owners to exclude people from the use of socially valuable information. At some point, maintaining this power of intellectual property owners becomes too costly in terms of social welfare. The rules of arithmetic, for instance, can be used and reused endlessly. The costs of excluding people from the use of these rules would be very high in economic terms and in terms of basic human freedoms. Figure 5.1 captures the idea that one can have too much intellectual property protection.

The claim that there is a level of intellectual property protection that produces an optimal outcome in terms of social welfare raises an important issue in the context of development. Are there different optimal points for countries at different stages of development? It is clear that imitative production and learning are important to developing countries. Multinationals operating in developing countries typically do so with higher levels of knowledge assets than domestic firms. There is scope for domestic firms to benefit from this positive externality. Whether domestic firms make productivity gains is profoundly affected by the property rules that govern imitative production. Imitative production and learning requires an appropriately designed set of intellectual property rights (e.g., rules that permit some degree of reverse engineering).

Imitative production typically requires less capital, a factor that is important in developing countries. If, following Coase, we think of property rights as a factor of production, it follows that those property rights should be designed in ways that match the comparative advantage that a country has in other factors of production. This suggests that there will be real long-run costs for developing countries if they continue to participate in a global regime of intellectual property rights that continues to ratchet up standards of protection. Much the same conclusion follows from the theory of comparative capitalism. This theory suggests that countries must choose their system for regulating intellectual property with an eye to how it will fit other crucial legal and industry policy institutions (e.g., competition policy to labor market policy. Property and these other institutions form an organic whole. Whether or not particular property rights contribute to the well-being of the whole is a matter of careful diagnosis. Crucially, just like a physician, countries must have the freedom to design the right treatment once the diagnosis has revealed the source of the problem. As Jeffrey Sachs says, development economics must strive to be more like clinical medicine in its approach to problems. The idea that there are different optimal points of intellectual property protection for different countries is captured in Figure 5.2. Even if there are benefits for New Guinea in having a patent system (and this is an open question), an optimally designed patent system for New Guinea is likely to be very different than that for the United States. In Figure 5.2 Country b's optimal point of intellectual property protection is well and truly passed by the standards of protection desired in order for Country a's optimal point to be reached.

This brief analysis of the economics of intellectual property in the context of economic development suggests that it would be prudent for states to retain design sovereignty over intellectual property rights. Moreover, given the differences in development among nations, one might expect to find a real diversity of standards of intellectual property protection. Yet, the one outstanding feature of intellectual property rights has been their relentless expansion in scope and length in the second half of the twentieth century. Old forms of protection as patent law and copyright have been expanded to accommodate new areas of subject matter, such as business methods in the case of the former and computer software in the case of the latter. New types of protection have come on the scene (e.g., protection for semiconductor chips, plant varieties, and databases). At the international level there has been a steady growth in the number of international treaties. In the nineteenth century, two important multilateral agreements on intellectual property were negotiated by some states: the Berne Convention for the Protection of Literary and Artistic Works (1886) and the Universal Convention for the Protection of Industrial Property (1883). Today, the World Intellectual Property Organization administers some twenty-three treaties.
on intellectual property. There are hundreds of agreements at the bilateral and regional levels that contain chapters on intellectual property. Most importantly, all the members of the World Trade Organization (WTO)—currently 149—have to comply with the standards of protection that are set down in the Agreement on the Trade-Related Aspects of Intellectual Property Rights (TRIPS). The role that the WTO and TRIPS play in the expansion of intellectual property rights is discussed in the next section.

THE GLOBAL INTELLECTUAL PROPERTY RATCHET

TRIPS was probably the most important agreement on intellectual property in the twentieth century, because it connected intellectual property standards to the tools of trade enforcement. It was the most important so far as pharmaceutical multinationals were concerned, because it meant that countries like India, which had major generic producers, had to grant patents on pharmaceutical compounds as a matter of domestic law. The elaborate ironwork of all patenting strategies for blockbuster drugs rests on key patents that protect the compound. Without such patents, generic companies may compete and the price of the compound inevitably declines.

During the 1980s, the United States had taken the led in TRIPS through a series of strategic bilateral negotiations on intellectual property with countries like South Korea and Brazil. An incentive that was held out to developing countries for the successful negotiation of TRIPS was that the United States would design from using its trade enforcement tools to obtain the standards that it wanted.

After TRIPS was concluded, the United States actually intensified the level of its bilateral activity. It used its trade enforcement tools under its Trade Act of 1974 to review the intellectual property standards of more and more countries, and it concluded many more bilateral agreements related to intellectual property than it had in the 1980s. In effect, it had created, without anyone really noticing, a global regulatory ratchet for intellectual property. The United States was the principal architect of this ratchet, with the European Union also making use of it to a lesser extent.

In short, this ratcheting process is dependent on

(a) process of forum shifting—a strategy in which the United States and the European Union shift the standard-setting agenda from fora where they are encountering difficulties to those fora where they are likely to succeed;
(b) coordinated bilateral and multilateral strategies for intellectual property, and
(c) the entrenchment in agreements on intellectual property of a principle of a minimum-but-not-maximum standard of protection.

Forum shifting in international regulation is made up of three basic strategies—moving an agenda from one organization to another, leaving an
The Importance of Bilateral Dispute Resolution fora in the Ratchet

One of the features of the FTAs that the United States has signed is that the dispute settlement chapters contain choice-of-forum provisions that give the complaining state the choice of forum in those cases where the state complained against a breach of the obligation. The capacity of a strong state to choose, as it were, the jurisdiction in a manner to its own advantage has important implications for weaker states, especially in those cases where the stronger state shifts the context of the multilateral dispute resolution mechanism of the WTO. One standard argument in favor of such fora, recently repeated in a report on the future of the WTO, is that no WTO process has a greater interest in the success of the WTO than the weak and the poor. If the United States and the European Union together create a bilateral framework of trade rules with enforcement mechanisms that both will have decided to use, the WTO will have created its own role as a forum for settling disputes.

In the United States, the traffic in the trade in intellectual property-based assets, that is driving the global regulatory ratchet for intellectual property protection. Other FTAs that do not have the United States as a party contain much more modest chapters on intellectual property. Because the parties are not intellectual property importers and have little to gain from raising the current international standards of protection, the FTA between Australia and Thailand, for example, contains only a few articles on intellectual property. It simply commits the two parties to TRIPS standards. Similarly, the Singapore Australia FTA intellectual property chapter contains a modest set of articles.

The focus on FTAs at this time can also be explained in terms of the effective resistance that the United States has been encountering at the TRIPS Council in the last several years. The TRIPS Council was the venue in which African states in June 2001 launched an initiative aimed at examining the role of intellectual property rights in access to medicines. The end of 2001 saw WTO members agree to the Declaration on the TRIPS Agreement and Public Health. The declaration that the U.S. pharmaceutical industry counted as a blow to its interests and that it did its best to downplay. Similarly, the review of Article 27(3)(b) of TRIPS that was started in 1999 has not run the way that the United States would have liked. In essence, the United States wants to bring TRIPS in line with what is its own domestic position: "virtually anything is patentable," and, instead, what happened during the course of the review was a very wide-ranging dialogue in the TRIPS Council that raised many issues about patents, including the need to better integrate the provisions of TRIPS with a regulatory approach toward biotechnology that states agreed to in the context of the Convention on Biological Diversity. Developing countries were able to resist U.S. proposals in the context of the TRIPS Council because outside of the Council they were being given assistance by civil society actors. These actors were able to provide technical expertise and, through global campaigning, prove to be effective at raising questions about the origins of TRIPS and its moral legitimacy.

The threat of both civil society and developing countries to the TRIPS Council was one highly visible forum in which they could communicate their resources. The response of the United States has been to focus on FTAs. The FTAs that the United States has signed indicate that it has sought and in many cases obtained standards that are relevant to the relevant state that bring states to the United States domestic position. These FTAs also increase the enforcement of the United States, something that is discussed in more detail in the next section.
where the relevant FTA sets a standard that is not to be found in TRIPS (such as an extension of the copyright term, or an obligation on a drug registration authority to check for the existence of patents in relation to a drug registration application by a generic company), and so dispute resolution under the FTA will be the only option. There will be other situations in which a state that is party to the TRIPS agreement and a FTA with the United States may breach an obligation that is common to both agreements. Which forum the United States decides to settle a dispute in will be affected by a variety of factors, but it is worth noting that U.S. FTAs on intellectual property contain more precisely articulated standards on some topics, whereas the TRIPS standard is somewhat vaguer and more open-ended. By way of example, Article 39(3) of TRIPS, which deals with the protection of data that are submitted by a pharmaceutical company to a drug registration authority for the purposes of obtaining marketing approval, does not specify a period of protection for those data. Subsequent U.S. FTAs have set a minimum standard of five years of protection.32 In any dispute over the period of data protection, it would work to the advantage of the United States to have a specific standard to point to in the relevant FTA, rather than attempt to redact into the TRIPS standard. Moreover, any dispute in TRIPS that related to public health and patents and that affected developing countries would be granted a large number of third-party rights. Certainly, developing countries such as Brazil and India would reserve third-party rights, and so probably would African countries that have become very active in the TRIPS Council on intellectual property rights and access to medicines issues.33 Such a trade dispute would rapidly escalate into a complex functional confrontation, a confrontation which would confront the energetic hands of civil society groups to assist developing countries. For such reasons, FTA dispute resolution processes may well prove to be a more suitable forum in the eyes of the United States for settling disputes over intellectual property.

It is also worth noting that one option for a losing state under recent U.S. FTAs is the payment of a monetary assessment, a fine in other words. The possibility of obtaining a fine may have some influence on the preferences of U.S. intellectual property industries when it comes to choice of forum. Intellectual property lobby groups, such as the International Intellectual Property Alliance, have become adept at quantifying the size of their losses when it comes to matters of intellectual property infringement.34 One practical concern for the groups is that litigation in the WTO, even if successful, does not require the sanctioning government provide help to the complaining private actor. However, under the U.S.-Australia FTA, for example, there is nothing that would prevent the U.S. government, if it were successful in a dispute and Australia elected to pay a monetary assessment, from channeling some or all of this money back to the companies that claim to have been most damaged by the relevant measures. States may in certain cases prefer, for reasons of domestic politics, to buy their way out of their obligations, rather than change an infringing

Australia lost a trade case with the United States over its Pharmaceutical Benefits Scheme, for instance, it would be difficult for any Australian government to be seen to be introducing measures that went in the direction of increasing the price of medicines.35 At least in some cases, members of the U.S. intellectual property industry might take the pragmatic view that the possibility of obtaining a monetary assessment that went some way to matching their lost royalties or sales was sufficient inducement for them to support bringing an action under a FTA.

Summing up, we can see that in the case of intellectual property there are incentives for both the U.S. government and U.S. companies to use the dispute settlement chapters of FTAs, rather than the WTO's DSU. There are basic but important facts about obtaining higher standards from developing countries. If the United States does nothing to enforce these higher standards, then the potential economic rents that it has secured will be lost. As Michael Senger has noted, creating the legal obligation to pay the United States billions in intellectual property revenue is not the same as collecting.37 In much the same way that the United States has projected invisibility on the negotiation of these higher standards, it must also project the image of the relentless enforcer of these standards. At least in some cases, FTAs may be a better forum for the United States in which to settle a dispute over intellectual property rights.

CONCLUSIONS ABOUT THE FUTURE OF GLOBAL IP LAWMAKING

We saw from our discussion above that there are different optimal points for states when it comes to setting standards of intellectual property protection. This claim is true for developed countries as much as it is true for developing countries. Australia is the world's fifteenth largest economy, but its optimal mix of standards of intellectual property protection is lower than that of the United States. Prior to the FTA with the United States, it had been recognized for a long time in Australian policy circles that, from an economic point of view, Australia should only do what was minimally necessary when it came to complying with international standards of intellectual property protection.38 In fact, one interesting possibility is that the United States itself may have pushed its own domestic standards past the optimal point of protection. There is, for example, a recent debate in the United States about the operation of its patent system with no shortage of proposals for reform. A recent report of the National Research Council, for example, noted that it was unclear to what extent the drive toward stronger patent protection created benefits beyond the narrow sector of pharmaceuticals and chemicals.39

If within the United States, there are growing doubts about the wisdom of continuing to ratchet up domestic standards of intellectual property protection, one might be tempted to conclude that the United States internationally will become more subdued in its demands for stronger and stronger protection. This seems possible scenario.
There is, however, another possible scenario in which the United States continues to promote high standards internationally while reforming its own system domestically to achieve a more optimal mix of standards from the point of view of innovation. In other words, the United States will play by one set of rules domestically and another different set internationally.

There are two basic strategies that the United States could follow to achieve this objective and more or less remain within its international obligations. The first rests on the fact that the FTAs that the United States signs are based on the principle of a minimum-but-not-maximum standard of protection. Under a FTA a state can if it so chooses move to higher standards of protection than are required under the agreement, and moreover it can do so unilaterally. So, for example, a state could move to a thirty-year patent term while the United States retained a term of twenty years. Likewise, a state could remove or reduce its capacity to issue government use licenses for patents while the United States retained its own capacity to do so. The United States could in its trade negotiations with other states continue to pressure them to move toward higher standards while not moving in this direction itself. Why states might agree to move in this direction is something we consider at the end of this section.

The second strategy the United States might use to drive up standards internationally while playing by different domestic rules is based on its domestic institutional capacities to lower the costs of high standard intellectual property protection. Countries like the United States that have had long historical experience with intellectual property have allowed stronger standards of intellectual property to emerge while at the same time developing other regulatory means by which to regulate the potentially high costs of these stronger standards. The two obvious examples of this are licensing systems that do not require the permission of the patent owner such as nonvoluntary licenses of right, compulsory licenses, and government use licenses. The legal detail of these systems varies from country to country, but the crucial point for present purposes is that licensing systems can be devised to offset the cost problems that high standards of intellectual property create. 48 Another example of an institution that regulates the cost of intellectual property is competition law (antitrust) through doctrines such as the essential facilities doctrine, abuse of market power, or the control of mergers. 49 Competition law, as the example of Free Software Foundation demonstrates, can also be used to entrench an access regime to intellectual property, thereby limiting its costs.

Finally, the litigation market is itself a regulatory institution, and one that is especially important in the United States when it comes to regulating the costs of intellectual property.

The United States has the world's largest and richest market in high technologies. Companies wishing access to this market have every incentive to control strong intellectual property standards that bar or limit access. More importantly, many of these companies also have the means to contest intellectual property rights in the courts. It is plausible therefore to claim that over time the litigation
signaling to venture capital markets. But at the same time, high technology markets in innovation could not work without investment in public goods and without institutions that regulated the costs of those strong intellectual property standards.

Most developing countries do not have the institutional capacity to regulate the costs of strong intellectual property rights in the way that the United States is able to do so. Typically these countries lack experience in issuing compulsory licenses, do not have a tradition of competition law, lack strong litigation markets, and have low levels of local legal expertise in intellectual property. Indonesia, for example, has about forty patent attorneys, only ten of whom have a viable patent practice.13 This leads into the second issue that we raised at the beginning of the chapter. Can we expect developing countries to stop signing FTAs with the United States that impose on them obligations to enact in domestic law higher and higher intellectual property standards?

One obvious reply to this question is that developing countries will continue to sign such FTAs with the United States so long as they calculate that a FTA with the United States will confer an overall benefit on them. In other words, developing countries will be prepared to take losses on intellectual property in order to make gains in other areas such as agriculture. This raises a complex empirical issue, which is to the scope of this chapter to answer, as to whether in fact developing countries are actually making gains in FTAs. There is evidence to suggest that superior bargaining power is at work in shaping North-South FTAs in favor of the larger Northern country.14 Moreover, there is a more or less overwhelming argument that developing countries would do better to pursue agricultural liberalization in the WTO.15 FTAs are delivering little in terms of agricultural liberalization. It is not obvious that developing countries are making great negotiating gains in other sectors to justify the concessions they are making in intellectual property to the United States. Of course, it may be that developing countries are making these concessions in intellectual property on the assumption that their patchy domestic enforcement of intellectual property rights will reduce the economic losses of these concessions.

There may also be running in the background a non-economic calculation that helps to explain the actions of developing countries. In some realist approaches to international relations, the desire for security is thought to explain the motivation and conduct of states.16 In a world where there is one great power, smaller states might seek trade agreements with that power, calculating that the deepening of economic relations with that power will also help to improve security. On this line of argument, FTAs are part of a broader defensive strategy by smaller states. Smaller states know that the United States by virtue of its superior bargaining power will dictate tough terms, but motivated by concerns for security, they reason that it is better to have a bad deal with the United States than to have no deal at all. The bad deal becomes the price of a relationship that is important in the broader context of security interests. Robert Keohane’s insight of the “Al Capone alliance” may also be relevant here. In this type of alliance...
Three states, Australia, Singapore, and Chile, having signed FTAs with the world's last remaining superpower, appear to have become proxies of U.S. intellectual property standards in their trade negotiations with third parties. Their conversion may have everything to do with the Al Capone factor. It is better, for example, for Australia to be seen to be responsive to U.S. pressure to push for high intellectual property standards in their negotiations with third parties than to risk offending those U.S. officials who are urging Australia to do this pushing. If Australia tries and fails with Malaysia or China, then nothing is lost in terms of the relationship with the United States. In the unlikely event that Australia succeeds with China on intellectual property, Australia will have conferred a great benefit on the United States via the TRIPS MFN clause. Either way, once security enters the calculations of states, the option of pleasing power looks like the right one, just as it did for many businessmen in Chicago in the 1920s.

Summarizing, we can see that states are likely to continue to agree to the United States' terms when it comes to intellectual property rights in FTAs because they believe (1) they will make compensating gains in other parts of the agreement, (2) they can reduce the economic loss of these higher standards by adopting a go-slow approach on enforcement, or (3) that the mere fact of the agreement provides a relationship gain of some kind, especially in the context of security. The United States has every incentive to continue to pursue its agenda on intellectual property by means of FTAs. There is little prospect of it gaining higher standards in the WTO. The dispute resolution chapters of FTAs offer it a simpler environment, compared with the complex coalitional politics of WTO dispute resolution, in which to pursue enforcement of these standards. The United States can also control the potentially damaging effects of excessive intellectual property protection on its domestic economy by relying on other regulatory institutions such as litigation markets, contract law, and antitrust. By obtaining higher standards (and eventual compliance with those standards), the United States would be increasing the economic rent it obtains for its intellectual property assets from developing countries. Moreover, the United States would take the view that these higher economic rents are fair compensation for allowing developing countries greater access to its markets. No doubt this is a view of fairness that developing countries would contest.

The upshot of our analysis is that the United States will, for the foreseeable future, continue to lead the world into an era of higher and higher standards of intellectual property and that many states will on the basis of self-interest calculations follow it. As individuals in large developing countries grow wealthier, one would expect that there would be considerable interest in the purchase of U.S. companies rich in intellectual property assets. In globalized markets where companies can be bought and sold, a larger and larger percentage of the rent that flow from U.S. intellectual property assets will end up in foreign pockets. The fact that some individuals will massively benefit from monopoly privileges intangibles does not change the fact that eventually all countries will end up with their optimal point of protection. One suspects that many, if not most, already are.

NOTES
6. It was as Jerome Reichman observes "a revolution in international intellectual property law." See J.H. Reichman, The TRIPS Agreement Comes of Age: Conflict or Cooperation with the Developing Countries, 32 Case W. Res. J. Int'l L. 441, 442 (2000).
9. See, for example, the statement by a member of the office of the USTR Emory Rehn in Remarks of Mr. Emory Simon, 22 Vand. J. Transnat'l L. 367, 370 (1989).
12. For a detailed explanation of this strategy and some examples, see id. ch. 24.
13. Id. at 564-565.
15. Drahos with Braithwaite, supra note 6, at 134.
18. See Chapter 13 of the Thailand-Australia Free Trade Agreement.
19. See Chapter 13 of Singapore-Australia Free Trade Agreement.


26. Under the Bipartisan Trade Promotion Authority Act of 2002, the Congress has stated that one overall negotiating objective for the United States is to be in bilateral and multilateral agreements provisions that “reflect a standard of protection similar to that found in United States law.” 19 U.S.C. § 3002 (2004).


29. For an example of this, compare U.S.–Australia FTA, supra note 14, art. 12.3, with TRIPS, supra note 7, art. 27.1. Both deal with patentable subject matter.

30. See, e.g., U.S.–Australia FTA, supra note 14, art. 21.4; U.S.–Chile FTA, supra note 26, art. 23.

31. See chapter III, article 4(c) of the European Union–Chile FTA.


35. The methodology that the International Intellectual Property Alliance uses to estimate the size of trade losses due to piracy is described in http://www.iipa.com/docs/2006/0131methodology.pdf.


41. The interface between competition law and intellectual property is jurisprudently complex and really requires a tradition of competition law to develop in a country. See the collection of chapters in Section 2 of the role of competition law in *International Trade Goods and Transfer of Technology* (Keith E. Maskus & Jerome H. Reichman eds., 2004).

42. See Love, supra note 40 (citing P. M. Scherer).


About the Editor and the Contributors