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I found it interesting listening to Kent Hughes and Alan Nymark discuss the modest amount of government funding for innovation. Mr. Nymark discussed budget cuts and Mr. Hughes discussed the pilot projects the U.S. government is promoting. They both rely increasingly on the private sector to push the envelope of innovation. The capital necessary to develop technology is simply not available from other means.

I kept listening for that golden nugget that tells us why and how innovation occurs. I have not found it yet. Maybe if I listen to more presentations this afternoon, I will figure it out. However, I am supposed to discuss something different: how trade policy is used as a tool, arguably to promote innovation.

Trade policy can be used to promote innovation in different ways. It can be utilized to encourage a friendlier investment environment, to better protect intellectual property rights, or to improve the exchange of scientists, technical personnel, and business people by removing visa and other restrictions. This list is not exhaustive.

The one aspect of trade policy that I know a little about is how intellectual property laws affect what we in the United States perceive to be our ability to produce technology and to enjoy the commercial benefits flowing from those technological innovations.

Trade and trade policy is about confrontation. It is not about cooperation. Trade negotiators basically engage in very confrontational, often highly charged discussions aimed at solving a problem that is perceived to be an impediment to commercial interests.

There are two sides to an intellectual property issue: how many patents does it take for a country to be a technological leader and how does the fact that you get lots of patents make you an innovator and a technological leader. It all depends on what patent strategy you follow. We, in the United States, look upon intellectual property, patent, and trademark laws as proprietary. "I invented it. I wrote it. It is mine."
Stay away.” In the United States, a person who comes up with a great invention can get a patent on both the developed invention and likely possibilities, although every aspect of the patent may not have been reduced to practice. Thus, a person who gets a broad patent will not share it. Consequently, in the United States, fewer patents are filed because one person can get a big and powerful patent.

In Japan, on the other hand, the practice is different. I recently spent four days in Japan at a conference on patentability of software, and we talked about patents and the impact that patenting has on software innovation. The people in large Japanese corporations who file patent applications basically work on a quota system. The more patents you file, the more you get paid, and the more you get promoted. The key criteria is not necessarily how good the patent or the technology is, but how many patents you file. More is better because the Japanese attitude toward what a patent does is different.

The Japanese believe that a patent is a trading chip. The more patents you have, the more leverage you have to negotiate with somebody else to cross-license their technology to you. I do not remember the exact terms between the heartland and the rimland, but the argument generally was that if you do lots of patenting on the rimland, you can get access to the heartland. However, the patents you may be getting on the rim may only be minor improvements from the basic technology which are very good trading chips but not truly innovative. Thus, there are different attitudes between the United States and Japan.

In terms of long-term innovation strategy, it is difficult to say whether the Japanese or the U.S. strategy is better. The mere fact that a country gets a lot of patents and copyrights is a very poor indicator in my mind of how far and how quickly that country is going to push innovation.

I have recently been working on a case that is a good reflection of Japanese strategy. An American biotech company came up with a new biotechnical product: a string of 500 and some odd amino acids. The company got a patent in the United States and in Japan. That Japanese patent described the product exactly as stated: a string of 500 and some odd amino acids. The first Japanese company copied the entire product with every string and element intact. The American company sued the Japanese company and won. It was a case of infringement, pure and simple. The second Japanese company invented a drug that copied the American product with one small exception: one of the 500 amino acids had been changed. The company applied to the Japanese patent office and got a patent. There was no therapeutic difference whatsoever. There was just one simple change. In fact, we later learned that the change had been made by mistake. When the matter was taken before the Japanese court, the court threw out the U.S. patent,
arguing that the patents were different. I am not sure this procedure pushes innovation very much.

However, the narrow scope of patent protection practiced by the Japanese permits people to invent around the basic invention and everybody gets a share of it. That may be a good way of developing your economy, but it does not strike me as the best way to push innovation.

Moving onto trade law, U.S. companies in the late 1970’s to mid-1980’s came to the realization that they were increasingly vulnerable to piracy of their movies, records, books, and pharmaceuticals. These companies realized that there is a global economy and information was being disseminated effortlessly with the increased use of machines, like VCRs and photocopiers. These companies determined that if only there were better copyright laws in places like China and Malaysia, they would have a tool to fight this piracy. As a result, various international fora were convened where intellectual property issues were discussed. The World Intellectual Property Organization (WIPO) was one such forum where companies attempted to negotiate improvements in patent and copyright systems around the world. However, nothing came of these fora because if you are the company importing this technology, you like the status quo. It is easy to take someone else’s technology. On the other hand, if you are a company exporting this technology, you have an interest in changing the system.

The American business community was slow to figure out what worked in this context. The community would ask a foreign government, like Brazil, to protect American and Canadian software in exchange for America and Canada protecting Brazilian software. The Brazilians would laugh. It was a great deal for them since they do not export any software to the United States and Canada. The Brazilians would respond, “By all means, we will take all your stuff.”

The American business community finally figured out that it had to expand the dynamics of the discussion by threatening to block coffee, sugar, and shoe imports by Brazilians if Brazil did not protect their software. So, the community marched up to Capitol Hill and convinced lawmakers to change the law. As a result of a successive round of changes starting in 1984 with the enactment of changes to Section 301, the United States adopted an unfair competition provision into its trade law. The law was subsequently changed again and again with intellectual property issues becoming more and more prominent. The law progressed to a point where the United States could aggressively pursue bilateral discussions with foreign countries to improve protection of patents and copyrights by threatening trade sanctions.

About the same time, the United States was pursuing this bilateral strategy. The business community came to the conclusion that while picking up one country at a time was admirable, it would be more efficient to establish a new international norm. As this strategy was being
launched, the United States - alone in its view at the time - insisted on including a series of new issues on the agenda that would promote innovation, like better investment tools and better rules on intellectual property. The United States pursued this GATT negotiation starting in the fall of 1986 while simultaneously pursuing bilateral negotiations. Some worked better than others. Negotiations went pretty well with Korea and not quite so well with Argentina. Success varied from country to country.

What is clear is that aggressive unilateralism was an indispensable and necessary element of success in the multilateral negotiations. Without the aggressive unilateral move of the United States, the majority of countries would have simply stonewalled intellectual property issues at the GATT discussions. In fact, it was the distaste and discomfort of the U.S. unilateralism which propelled these countries to negotiate at the GATT, where they could unite together against the United States, rather than taking on the United States one on one.

We have done pretty well in the GATT and in NAFTA. Additionally, the United States has negotiated probably in excess of fifty bilateral agreements to this point. However, as I see it, these negotiations get you only so far. There are basically four big threats I perceive to the innovator who has invented a good technology and wants to take advantage of it in the marketplace. Those four things are: greed, lust, paranoia, and ignorance.

Greed is just about greed. Pirates only pirate successful products and not an unsuccessful product because there is no market for an unsuccessful product by definition. It is only the commercially successful product that is pirated and piracy perpetuates itself. The more money you make as a pirate, the more you try to influence local politicians to prevent them from either enforcing these laws that protect inventors or from ever enacting them in the first place.

Lust. Governments engage in industrial policy. Governments may call it different things, but they all engage in policies when they want to promote certain industries. We do it in the United States. In the United States, information industries are considered important to the future of America and the United States is doing a number of things to promote the evolution of information industries. Every country has a list and every country’s list is basically about technology, products such as chips, software, and ceramics. Does any country have an industrial policy to create an embryonic shoe industry or an embryonic chair industry?

So where is the all innovation going on? It is going on in all the high-tech industries and every policy is to promote the high-tech industries. So what do you do? You do something like what the Japanese did. You take your patent law and adjust it to grant very narrow scopes of patents so that when somebody comes up with a great breakthrough
technology, he has this tiny little piece of protection for it. You can invent around that tiny patent as much as you want and not share. Now you can conduct your industrial policy.

This can be done in other areas too. It can be done in the software area by government promotion in specific areas, like decompilation and reverse engineering computer programs. Under the auspices of studying a particular product, a company can make a product exactly like the original product, but different enough so that it does not infringe. In actuality the program is just like the original one because it behaves and does the same things as the patented program. Yet, such imitation is now encouraged because the government wants to develop software. That is lust.

Paranoia. Some countries feel that they are not competitive in leading edge technology and that given the current lay of the world landscape, they will never become competitive in leading edge technologies. Europeans are a good example since they are very much afraid that they will never develop a software product of any consequence. In fact, if you look at the European landscape, there does not seem to be much potential in the area. There are some computer companies there, but most of them are losing money.

Clearly, in an information age, a critical component is going to be computer software. If none of it is made in Europe, the Europeans are not participating. They are just consumers. This is paranoia. The Europeans are thinking, “We are not good at this stuff. We will never get good at it. Let us just maintain the policies which block the foreign market from getting into our markets. Or better yet, let us let them in, but let us compel them to share with us their technology as a precondition for coming in here.”

As a result, a couple of years ago, the European Telecommunication Standards Institute decided it was going to set standards for telecommunication in Europe. As a precondition to participating in the standard setting, you had to agree, before you even got to the negotiating table, to cross license your patent or copyright to all other participants in the process. You also had to agree to charge them the best rate that you have charged anywhere around the world in exchange for the license being good, not just in Europe, but globally.

Thus, you could only get in if you agreed to be part of the standard setting process without the guarantee that your technology would be adopted. The price you paid was that you would have to cross license your technology, something that you may not have wanted to do. You had to share your patents to get into the market. Paranoia.

Ignorance. One of the problems with using trade policy to protect intellectual property to create a better investment environment is that none of us are terribly good at understanding or grasping when we are doing a good job and when we are doing a bad job. It is difficult to
distinguish early on when we are promoting and tilling the fertile soil for more innovation or when we are doing things that are harmful to it. Often you cannot tell until much later in time.

A great example of this is the Internet since it has inadvertently turned out terrifically well. The Internet was a crummy little project being run by the U.S. government in order to get military bases to communicate with each other a little better. It cost a couple of millions here and there, and now it is treated as the savior of the human race. So it is possible to have innovation promoting activity when you are subsidizing an inefficient domestic industry — when you are doing something under the guise of other things. It is a mix between paranoia and ignorance.

Have trade policies worked in promoting intellectual property rights and getting better protection of rights? Unequivocally absolutely yes. Today there are pretty good, if not great, international rules on patents, copyrights, trademarks, and all sorts of property rights. Can you enforce them in every country? Not yet, but we are getting better at that too.

Is the environment generally better than it was ten years ago? Absolutely. Was it right to use unilateral trade policies to accomplish these goals? This program has produced a product. There is a result. Circumstance is better today than it was. Do we make a lot of friends? No. Is the objective in all this to be loved? No. The objective is to produce results. That is why trade negotiators are confrontational.

Is it better to use an aggressive, unilateralist approach to promote intellectual property instead of using the multilateral approach? It is always best to play nice. It is always better to abide by international rules, but it does not always work, which is part of the bottom line in all this. I do not know what specific measures are going to promote innovation, but I do know things that are not going to do it. I will just give you one example. Probably the biggest threat to innovation right now that I perceive both domestically and internationally is standards. The standard-setting process is being manipulated by people who want to compete with successful players in the marketplace in ways to slow down the successful guy and let the guy who wants to compete catch up. In the end, the successful guy is robbed from returns on his innovation and some of the incentive for further innovation is being removed. Standardization is the next big issue in this context.