EXECUTIVE SUMMARY

The choice of an appropriate patent term can affect positively the economic well-being of Canadians by stimulating research and development (R&D), investment and jobs in high value-added industries. Recently there has been a growing international consensus, led by the United States and others, in support of a 20 year patent term. This is reflected in the 1990 MTN draft final document (the so-called Dunkel text) and NAFTA. The international standard has been set. Nonetheless, in light of escalating R&D costs, there are some suggestions that a longer patent term may be needed to amortize development costs over a longer period. How should policy makers in Canada address this issue if it is eventually raised? This Paper marshals a number of relevant considerations.

What is the optimal patent term? Do some industries require even a longer term than that now provided? The aim of this Paper is to: (a) summarize the conclusions of economic theory on the determination of the optimal patent term; (b) contrast these theoretical conclusions against the recent experience in the pharmaceutical industry; (c) discuss the trade policy implications of the patent term; and (d) address issues of patent policy, besides the patent term, that are likely to be important in Canada's trade with its partners.

The patent system is premised on the reasoning that private markets do not permit innovators to make sufficient profit to recoup their investment. The purpose of patent protection is: (a) to encourage investment in R&D; and (b) to spread the resulting new knowledge throughout the economy. In setting the patent term, authorities have to make a trade-off between: (a) the social cost, in the form of higher prices over the short to medium term, of conferring monopoly rights on the inventor for the duration of the patent life; and (b) the social benefits in the form of increased productivity created by a strong commitment to innovate by business, and of lower prices of new goods and processes after the patent has expired. The criteria for a patent term decision must reflect two features: (a) the lure of monopoly profit must stimulate socially optimal investment in R&D to the level where benefits exceed the costs; and (b) investors in the innovation business must be assured that competitive imitation will be held in check sufficiently long such that monopoly profits exceed R&D outlays.

The determination of optimal patent term involves weighing the benefits against the costs to the economy of extending or shortening the patent term. The longer the patent term, the higher are profits from innovations for potential investors in R&D, and the greater the level of on-going innovation, but the longer society has to wait for