

Patent Bargains in NICs: The Case of Brazil

Ladies and Gentlement:

In development economics, there is increasing consensus that strict patent laws enhance foreign direct investment (FDI) and research and development (R&D) into developing nations. The protection for intellectual property and patents in particular, are commonly presented as a central pillar of modern economic policy and "a catalyst for development."

More broadly, Cooter & Schaefer have argued that strict patent laws are a chief avenue through which rich and poor countries have a common interest in improving law-in-practice in the latter. The argument then goes to suggest that, by and large, precise rules which allow for simple or even mechanical decisions have a higher capacity to reduce costs in low-income countries than vague norms (or standards).

This proposition is in fact promoted by a number of developed countries, particularly the United States. It is also reflected in the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement, particularly in its articles 31(b) and 8, which discourage compulsory licensing of medicines. A compulsory license authorizes a third party to make, use, or sell a patented invention without the patent owner's consent. The World Trade Organization's (WTO) Declarations on the TRIPS Agreement and on Public Health adopted at Doha in 2001 go in the same direction, in that neither Doha declaration, nor TRIPS, provide a clear exception on public health grounds for the issuance of compulsory licenses.

U.S. advocates of TRIPS argue inter alia that all countries should welcome strengthened patent laws because they would encourage domestic innovation which among other things flourished in the early history of the United States. Advocates of this argument often refer to a classic econometric study by Edwin Mansfield suggesting that, in the United States between 1981 and 1983, 65% of pharmaceutical inventions would not have been introduced, and 60% would not have been developed, had patent protection not been obtainable. A second reason was that it would induce more inward technology transfer through foreign direct investment by multinational enterprises. As a third reason, the belief that stronger patent laws would presumably enhance foreign trade as the exporting countries would be less concerned about piracy in the importing countries.

In the backdrop of this strict regulatory regime flatly adopted by the WTO for all nations, certain countries do occasionally threaten to issue compulsory licenses which may sway overseas companies into selling drugs with large discounts or granting voluntary licenses domestically. In my paper, I focus on the specific dynamics and the implications of negotiations involving big pharma and Newly Industrialized Countries (NICs).

More specifically, I focus for now in one NIC, namely Brazil, and the Brazilian pharmaceutical industry is a case in point. Brazil illustrates well a bargaining theory of international negotiations over pharmaceuticals because it has routinely resorted to a negotiation strategy for price reductions premised on the credible threat of issuing compulsory licenses. Over the past decade, in numerous occasions, such as when negotiating price reductions for drugs such as Nelfinavir and Efavirenz or Gleevic, Brazil used aggressive tactics with big pharma that were made possible largely because of the country's credible threat of issuing compulsory licenses for local manufacture of generic medicines.

So here is my main claim: I argue that for NICS the notion that the lack of a strict patent regime particularly curtails FDI in R&D is potentially a false, or at least largely a vague, proposition. As so, discretionary usage of compulsory licensing within TRIPS' public health exception in pharmaceutical patents may, in fact, uphold a social bargaining surplus for NICs like Brazil.

This means that in times of public health crises within its TRIPS' rather moderate interpretation, not only be morally but also economically appealing.

Brazil's experience illustrates why, unlike in the case of developing countries, NICs may potentially benefit from such bargains without significantly curtailing FDI and enhanced R&D. That is, in the backdrop of an altogether weaker patent enforcement regime.

The existence of academic excellence in niche areas such as photonics, materials science, biotechnology and tropical agriculture, together with a TRIPS-compliant IP legislation, point out to certain fields where Brazil could potentially develop competitive advantages in pharmaceuticals. The country also possesses a sizeable and growing consumers market, a fairly stable (although problematic) political system, and the largest biodiversity in the world. However, there is very little innovation (in fact, almost none) in pharma in Brazil.

It is common to find the suggestion that the absence of a strong patent regime curtails the development of a Brazilian innovative pharma industry. But claims of this kind must be approached with care. In fact, the low levels of technological innovation within Brazilian pharma replicate the low levels of technological innovation that can be found in the whole Brazilian economy, and over time such levels of technological innovation have given limited responses to changes in the strictness of the country's IP legislation in pharmaceuticals.

What has been repeatedly overlooked is that IP law – like every other body of law – does not work in a vacuum; it is the broader institutional framework that counts.

The instability in the institutional framework applying to the pharmaceuticals industry dramatically affects its competitiveness and the propensity of these firms to innovate. The interaction of the Brazilian state in the pharmaceuticals sector takes place within a relatively fickle institutional framework, and accordingly the governmental policies in that sector have been marked by inconsistencies over time. In the end, the introduction of IP protection within

pharmaceuticals in the mid-1990s proves that IP laws will not produce the desired outcomes unless they are embedded in an adequate institutional environment.

In Brazil, the possibility of compulsorily licensing drug patents without breaching WTO rules combined with the possibility of manufacturing or importing generics has significantly enhanced Brazil's bargaining power for negotiating voluntary licenses and price reductions with big pharma. As described in our paper, in the period of 2000-2004, the price of the three most important ARVs present in the drugs cocktail offered by the Brazilian government at no cost to local patients were severely reduced.

In the aftermath of its negotiations with big pharma, Brazil became worldwide renowned for being the most successful 'developing country' that tackled AIDS. The World Bank predicted that by the year 2000, 1.2m Brazilians would carry HIV, the virus that causes it, but prevention schemes have held the number to roughly half of that, or 0.61% of the country's population.

Moreover, there are no obvious signs of reduced FDI in Brazil (Brazil's share of FDI in 2007 totaled US\$ 34.6 billion, almost twice as much as the previous year and one of the highest in the world amongst developing countries). In pharma, FDI in 2007 reached USD 164.4 million, which is consistent with the historic investment level observed in previous years.

There are three main reasons for why NICs (like Brazil) can benefit from bargaining around TRIPS. The first, derives from two sanction costs considerations: on one hand, NICs markets are too desirable to be sanctioned by industry; on the other hand, NICs the relative weight of sanctions in larger economies is lower, meaning that NICs can endure more sanctions even if imposed. The second is that compulsory licensing with respect to pharmaceutical products may not only be efficient but presumably is also politically appealing, as it includes the promise of lower prices to governments and consumers for pharmaceutical products. The third explanation for the efficacy of threatening to issue compulsory licensing by NICs derives from the existence of a local domestic generic industry that supports the process by reinforcing the credibility of the issuance of compulsory licenses.

All in all, it is unlikely that Brazil would be better off without issuing (or threatening to issue) compulsory licenses over ARVs, and this is particularly true once we take into account the potential devastating effects that an increase in the AIDS epidemic can cause. True, the amounts invested by big pharma in R&D in Brazil has been negligible, but it is a widely known fact that economies of scope largely favor conducting R&D activities in their home countries. All things considered, the assumption that stricter patent regimes preventing compulsory licensing would have a significant effect on the overall levels of R&D in Brazil is debatable at best.

The effect strong IPRs have on FDI is subject to two categories of balancing considerations. On the one hand, there is a trend toward harmonization of IPRs within TRIPS. Accordingly,

the attractiveness of countries that strengthen their IPRs marginally increases, whereas the relative attractiveness of those already affording strong IPRs marginally decreases.

On the other hand, there is a competing category of consideration, generally known as the localized ones. The prevailing assumption herein is that even with seemingly objective ownership advantages, MNEs must still decide on investment destinations. These decisions then depend on 'location advantages,' particular characteristics of target countries that make it profitable for the firm to produce abroad rather than at home.

A variety of such localized characteristics are well familiar within development economics writings. To begin with, a primary factor and the focal point of this study, is the political stability of the country.

We illustrate the problem of localized factors with a brief analysis of the Constitutional framework. Essentially, we suggest that it renders the Brazilian state weak on a fundamental level. By weak state one means a state that is captive to a wide array of distributional coalitions and thus is exposed to ravages of rent-seeking groups. In contrast, a strong state is able to develop a relative autonomy from such ravages.

There are two competing paradigms to explain failures of the liberalizing reforms to produce more innovation and trade performance in the Brazilian economy. The first is associated with a more orthodox, neoclassical political economy; the second, with a more heterodox view. Roughly speaking, the key distinction between the two is the role to be played by the government: while the former emphasizes the market as the engine of growth, the latter places the burden of fostering development on activist policies to be carried out by the state. IPRs laws play a very different role within each of such frameworks: while the former embraces IPRs protection with few reservations, the latter assigns a much more discrete, or even non-existent, role for IPRs protection.

In light of competing explanations, the question remains about the drawing of a conclusion about the comprehensive cause of the dearth of innovation in pharmaceuticals in Brazil. First of all, it is easy to see such orthodox neoclassic political economy and its heterodox views from the perspective of a market solution standing in opposition to a solution through the state. But in reality the frontier is much more blurry because of dynamic feedback mechanism between the two in that the market needs the state, as much as the state needs the market. In any case, it would be tempting to suggest that the issue should be resolved by making use of available evidence, but the problem is that the evidence available is equivocal, supporting elements of both paradigms.

Our explanation thus emphasizes the role of internal policy and political factors in Brazil, to suggest that the dearth of innovation in Brazil is ultimately related to its dysfunctional political system that imported into the democratic regime some of the worst features of the military regime which it succeeded.

We can now conclude. The case o Brazil illustrates three normative implications.

1. The first is that the importance of IP as a catalyst for development has been overstated. In NICs, deficient political institutions - not the lack of strict IPRs - is what essentially curtails FDI and R&D. This conclusion is at odds with the classic development economics paradigm adopted also by the WTO at large, according to which strict patent laws enhance FDI into poor nations.
2. The second is that the well-established proposition that precise rules are substitutes for lack of human capital in developing countries seems to have found an important limitation within IP law.
3. The third normative implication is that NICs, while being the primary target of TRIPS, are in reality the countries that benefit the most from bargaining around TRIPS through patent compulsory licensing or credible threats thereof.

Thank you very much.

Bruno Meyerhof Salama