



Contents lists available at ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

Intellectual property, pharmaceutical MNEs and the developing world

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ARTICLE INFO

Keywords:

Innovation
Intellectual property
Pharmaceuticals
The developing world

ABSTRACT

The paper examines the structure of pharmaceutical R&D funding, spillovers and public-private-academic research linkages in the developing countries. The paper also examines several policy options aimed at mitigating the trade off between the twin and often conflicting objectives of preserving incentives for the multinational enterprise (MNE) innovation and making patented drugs accessible to the poor countries at affordable prices. The paper argues for a vastly expanded size and scope of public-academic-nonprofit funding of R&D, whose results could become a global public good. Finally, the paper suggests that the international business scholars further explore the implications of the strong private-public-academic linkages found in the pharmaceutical research combined with the trends towards open innovation and economic development.

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1. Introduction

In poor and rich countries alike, perhaps nowhere is the tension between markets and public policy greater than in the global pharmaceutical industry comprising of traditional pharmaceutical firms as well as biotechnology firms specializing in pharmaceuticals. At the center of this tension is the need to preserve incentives for innovation by granting patents, while at the same time keeping the price of prescription drugs affordable.

Several international business (IB) scholars have revisited this classic conflict between markets and public policy and brought it to the forefront of academic discourse and raised questions about the role of multinational enterprises (MNEs) in the development of emerging economies (Ghauri & Buckley, 2006). Buckley and Casson (2003) note that academic research in IB is increasingly divorced from the political, social, and economic issues involved in globalization. These issues go to the heart of the MNE's strategy, structure and performance as well as its legitimacy and sustainability in its current form (Ghauri

& Cao, 2006). As Rugman and D'Cruz (2000) note, in the flagship model of the MNE, which dominates many industrial networks, particularly in pharmaceutical industry, non-business players such as the public sector, nonprofits and universities have no influence over strategy. Lodge and Wilson (2006) maintain that the traditional ideas from which corporations have derived their legitimacy – property rights, efficiency of the market, and technological progress, for example – are not sustainable as sources of legitimacy. The basic problem, as Dunning and Narula (2004) suggest, is the fundamental difference in the objectives of MNEs and the democratic national governments. The objective of the MNE is to maximize its shareholder welfare, while the objective of the national government is to maximize the welfare of its citizens (Ghauri & Buckley, 2006).

Few issues in recent years have generated and continue to generate more North–South economic debate and controversy than the 1994 Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). TRIPs are now a key part of the trading system under the World Trade Organization (WTO) framework. For the purpose of this paper, the term “intellectual property” (IP) refers to all technology-based intangible assets of a firm: an idea or a design for a new product or a process, a new molecular

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entity, a computer software package, and the like (Rao & Klein, 1994).

The TRIPs agreement involves more than the narrow issue of trade flows between nations. Indeed, the term “trade related” is something of a misnomer in the sense that the agreement requires sweeping changes in the IPR regimes of many developing countries with important implications for *economic development*. The agreement has implications for the benefits of MNE innovation, funding and location of R&D, MNE linkages with the public sector, academic institutions and foundations, technology transfer and spillovers. In the context of pharmaceutical MNEs, the implications of the TRIPs agreement go to the heart of the *health of nations* via its potential impact on innovation and the price of patented drugs. Broadly, it is the impact of TRIPs on developing countries and development, rather than trade, on which this paper is focused.

It is the negative impact of extending strong IPRs to the developing country firms which causes continuing opposition to TRIPs. On the other hand, the first world's multinational enterprises argue that extending strong IPRs to the developing countries would bring them greater inflow of FDI in production and transfer of technology, all of which help raise the living standards in these countries (Mansfield, 1994). The debate between North and South concerning the application of TRIPs to the developing world's pharmaceutical industry, which survives and even thrives on rapid and low-cost imitations, is particularly acrimonious. The larger issue for the developing world is the potential negative impact of TRIPs on drug prices and the health and welfare of its population.

The main purpose of this paper and its contribution is to address, conceptually and empirically, the North–South debate over the TRIPs within the larger context of improving the health and living standards of the developing nations and the MNEs' critical role in it. Health is central to *economic development* as it is to economic welfare in poor and rich nations alike. According to the United Nations's millennium goals that it aimed to achieve by 2015, four out of the eight goals are related to health issues which include reduction in the spread of HIV and AIDS and malaria (The Economist, 2007).

Surprisingly, IB scholars, despite their unique interdisciplinary orientation and the obvious importance of the topic to the IB discipline, appear to have given scant attention to the issue. While much of the previous literature on this subject (Kremer, 2002; Lanjouw, 1997, 2005; Vachani & Smith, 2004; for example) has focused on the effect of TRIPs on the price of prescription drugs in the poor countries, this paper examines the structure of pharmaceutical R&D funding, spillovers and policy options that could mitigate the difficult tradeoffs between incentives for innovation and affordable drug prices. In examining these issues the paper benefited much from the works of Lanjouw (2003, 2005), Kremer (2002), Ghauri and Buckley (2006), and Kremer and Glennerster (2004).

2. Health and economic development

It has been well established that rising incomes, starting at very low levels, would result in improvements

in health simply because of greater availability of food, improved sanitation and the like. There is a growing and strong body of literature on health and development that treats health as a determinant of economic growth and welfare in a number of rather obvious but important ways (Bloom, Canning, & Jamison, 2004). Workers who are healthy are more productive than workers who are not; poor health reduces GDP per capita by reducing both labor productivity and the relative size of the labor force; rising longevity leads to planning for retirement and incentive for the current generation to save; healthier children have higher rates of school attendance; and longer life span makes investment in education more attractive. Cutler, Deaton and Lleras-Muney (2006: 115) in a study of the determinants of mortality within countries corroborated these findings. The authors conclude that “...much of the link between income and health is a result of the latter causing the former, rather than the reverse” (italics added). The authors also found that much of the correlation between income and health is explained by lower earnings of people who are sick rather than a causal relationship from high income to better health. Empirical estimates of the contribution of better health to economic growth are indeed large. In a paper Nordhaus (2003: 35) estimates that the U.S. economic growth adjusted for longevity increase was twice as large as unadjusted economic growth.

Health can also be viewed as a critical component of a country's infrastructure as well as an important environmental factor that could facilitate or discourage foreign direct investment and trade (Ghauri & Buckley, 2006). While there is vast amount of IB literature that focuses on the importance of FDI and trade to economic development, very little of it is devoted to examining the role of basic health – like basic education and other infrastructure – in facilitating FDI and trade. This is despite the devastating economic impact of such diseases as AIDS and malaria in the developing world. One needs only to consider the enormous negative impact of AIDS epidemic between 1985 and 2000 on the annual rate of growth of *economic welfare* (shown in Table 1) – i.e. GDP per capita adjusted for decline in mortality – in five East African countries.

3. Conceptual context

3.1. Market failure

It has long been established in the economics and business literature that the market for intellectual property suffers from certain unique problems that are

Table 1
The effects of mortality change on the annual rate of growth of economic welfare, five East African countries, 1960–1985 and 1985–2000

Country	1960–1985	1985–2000
Botswana	+2.7	–8.5
Kenya	+2.5	–5.3
Malawi	+1.7	–5.3
Zambia	+1.7	–7.9
Zimbabwe	+2.0	–7.5

Source: Adapted from Jamison, Sachs, and Wang (2001: 5).

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