

Intellectual property rights, foreign trade and investment

Preliminary

Should less-developed countries respect and protect the Intellectual Property Rights (IPR) of foreign countries and multinationals? They are often tempted *not* to do so by the prospect of enjoying the benefits of foreign technology, inventions and creativity, without paying for it. Consequently, there is a perennial tension between innovative multinationals and third world governments.

Whether third world governments *should* enforce foreigners' IPR raises two main questions:

1. Is Intellectual Property (IP) a legitimate form of property, or is it an anti-market monopoly created by governments in collaboration with vested interests? If so, should third world governments enforce IPR for moral reasons, on principle, as with other rights, especially other property rights?
2. If third world governments do not regard Intellectual Property as a legitimate form of property, or if they decide to sacrifice principles or morality in favour of crude expediency, is it in their pragmatic interests to enforce IPR?

The *intended* benefits of not recognising or enforcing IPR include:

- Cheaper and more plentiful products.
- Foreign exchange savings – in that the flow of royalties would be almost exclusively out of such countries.

Needless to say, tensions emerge between multinationals and governments that are disrespectful of IPR.

IPR is not a single conception. Governments tend to differentiate. They might respect copyright on books, but not software; they might respect patent rights on machinery, but not on pharmaceuticals.

One of the more intense debates concerns the policy of the South African government which allows generic substitutes for pharmaceuticals before their patent rights have expired.

Before addressing these questions, this paper considers some of the more fundamental questions, such as the status of other (non-IP) property rights, and the determinants of prosperity.

Why property rights?

There are profound and mundane reasons why property rights ought to be upheld by all governments. Ultimately our most fundamental rights – the right to life, freedom of association, bodily integrity *et al*, are property rights in ourselves. The rights to personal belongings – toiletries, clothes and so on – are property rights. In an important sense, all rights are property rights.

In view of research over recent years, there is no longer room for informed debate about the determinants of prosperity – why some countries are rich and others are poor. One of the crucial policy ingredients of the world's successful economies is a legal order that respects and enforces property rights, including IPR.

There are a number of reasons why property rights are important. The importance of incentives is now widely recognised. In particular, material incentives are important motivators for most people, from labourer to business leader, and from house wife to politician. Only if people and companies can enjoy the fruits (property) of their endeavours are they likely to be highly productive. Property rights are presupposed by the concept of the profit motive. It is the right to acquire, use, encumber,

consume and dispose of property that is an essential ingredient in any policy package if there is to be prosperity. Markets without property rights are distorted and inefficient.

If it is true that property rights other than IPR are efficient, it follows that IPR is also likely to be efficient. This is obviously not the place for a discourse on precisely why property rights “work”.

The evidence (below) shows that countries with market economies tend to prosper and also tend to respect IP. The case for the protection of IP presupposes that there is a case for the law to recognise and protect property *per se*. There is clear correlation between countries that respect basic property rights and prosperity.

The evolution of intellectual property rights

It is ironic that in modern times the principal criticism of IPR, and the main reason for wanting to curtail IPR in under-developed countries, is the concern that IPR has the effect of denying the public the benefits of inventions, creativity, discoveries and innovations. The irony is that the word “patent” is derived from the Latin *patens* meaning “open”. To patent something, *patentere*, meant to lay it open, to expose it.

In other words, patent laws were seen as a means of making innovations open and available. Prior to patent laws, innovation and creativity was clouded in great secrecy. The way for people to benefit from their creative endeavour was to keep the fruits of their endeavour away from the public, for fear that others would “steal” it. Music lovers are familiar with stories about how composers would hand out their scores at rehearsals and performances, and collect them back afterwards, because if anyone had a copy they could freely reproduce it, and the composer would not be able to benefit. This meant that it would be in their self-interest to do something else – not what they were best at and what society most wanted them to do – and/or to emigrate, to the benefit of the country that protected their rights, at the expense of the one they left.

Indeed one of the first and most conspicuous rewards for countries that start protecting IPR to this day is the emergence of a vibrant productive music industry that often becomes a significant foreign exchange earner.

Inventors would benefit from new technologies by keeping them a dark secret. When people could not sell or earn royalties from their inventions and discoveries, they (a) would not share them with others, especially not potential beneficiaries and competitors, and (b) they were disinclined to spend time or money innovatively, or on research and development (R&D).

Innovation was so clouded in secrecy that there were strange beliefs in the origins of new ideas and technologies. There were stories about mystical creatures that operated at night, and there were beliefs in sinister conspiracies at work.

Patent laws were created in order to encourage people to share their inventions with others for the benefit of all. The logic was obvious: if people could *own* the right to their creative endeavours they would be able to earn more by sharing them with others than by concealing them. Innovations would spread rapidly through and to the benefit of society. Entrepreneurs rather than inventors would do more with them, and they would be able to compete with each other. More and more people would be encouraged to invest in innovation.

Policy paradigms and IPR

The rest is history. Countries that followed this path – and that were at the time a lot less advanced than the countries now doubting the wisdom of IPR – became the world's first advanced countries. Obviously, this does not suggest that prosperity is mono-causally achieved. IPR alone is not enough. Nor is anything else. At least not on its own. As we shall see (below), in the real world, national prosperity is achieved when countries implement a policy paradigm, an important component of which is IPR.

Often governments delude themselves into thinking that they can select randomly from any policy philosophy or paradigm; that they can mix and match diverse policies; that they can have the proverbial best of all worlds. The problem is that policies from opposing paradigms are contradictory. Instead of getting the best of all worlds they end up with the worst. Instead of coherent policies they concoct what can best be described as “policy bastards”.

This is as true of the new South Africa as it was of the old. In the old SA, the policy mix was a bewildering and utterly incoherent array of contradictory policies. The most obvious manifestation was that people of colour were subjected to extreme *dirigisme*, whilst whites were relatively free. Apart from these contradictions, there were countless others, consistent with the thesis of this paper, that policies seldom exist in isolation. The philosophy that informed policy for whites was consistent with and included a high level of respect for IPR, and other rights in general. The protection of IPR, though not overtly racial, was, in practice, meaningless for blacks, because they were debarred from going into business – with trivial exceptions. They were, for all practical purposes, confined to being employees of whites.

Sadly, things have not changed adequately. Anti-black discrimination has been replaced by a much milder form of anti-white discrimination. More importantly, no coherent policy paradigm has been adopted. There is conterminous nationalisation and privatisation; intensive regulation and liberalisation; central planning and devolution; tax cuts and tax increases that off-set each other, achieving nothing other than confusion and economic distortion. It is not surprising that in such circumstances, the government is intensifying enforcement of some IPRs (software) whilst withdrawing protection for others (pharmaceuticals). The only coherent patterns are to be found within individual ministries. To the extent that there is a paradigm, it can be called the “messy path” or “muddling along” approach.

This malaise is characteristic of most African countries, and is, arguably, why the continent is in such a parlous state.

IPR and prosperity

As we have observed, there is no longer room for informed debate about the policy paradigm that promotes the prosperity of nations. The evidence suggests that there are no alternatives. There is one way, and only one way, to prosper. That is to implement “economic freedom”, including IPR. Countries closer to economic freedom (as defined in the studies cited below) prosper and those that do not languish. That is it. There is nowhere else to go. There does not appear to be an African approach, as Nyerere hoped – or a Japanese, Jewish, or Indian one – that works for some whilst alternative paradigms work for others. Whatever the merits of non-economic policy variables might be, if they are not contained within what has been defined as “economic freedom”, they will not deliver. It is really that simple. Governments have a simple choice: they choose poverty for their subjects, for whatever political or social reason, or they choose prosperity. No amount of obfuscation and beating around the bush can change that.

Various seminal studies that have been conducted in recent years have provided evidence that is as close to proof as one is likely to get in the social sciences. Seen collectively, what these studies show is that, no matter how it is defined, so long as it is a *bona fide* definition, “economic freedom” always and everywhere results in prosperity, whilst its absence always and everywhere results in stagnation or decline.

Figure 1 shows a World Bank study for the decade of the 1970s. The greater governments’ tax consumption was the lower was economic growth. High aggregate tax collections (transfers) are one way to measure the role of the state in the economy as opposed to that of the market. Countries where aggregate tax (i.e. the total tax receipts in a given economy as a percentage of GDP) – as opposed to nominal tax rates – was high, coincide substantially with countries that have low levels of IPR protection.

FIGURE 1: Government Share of GDP and Growth¹

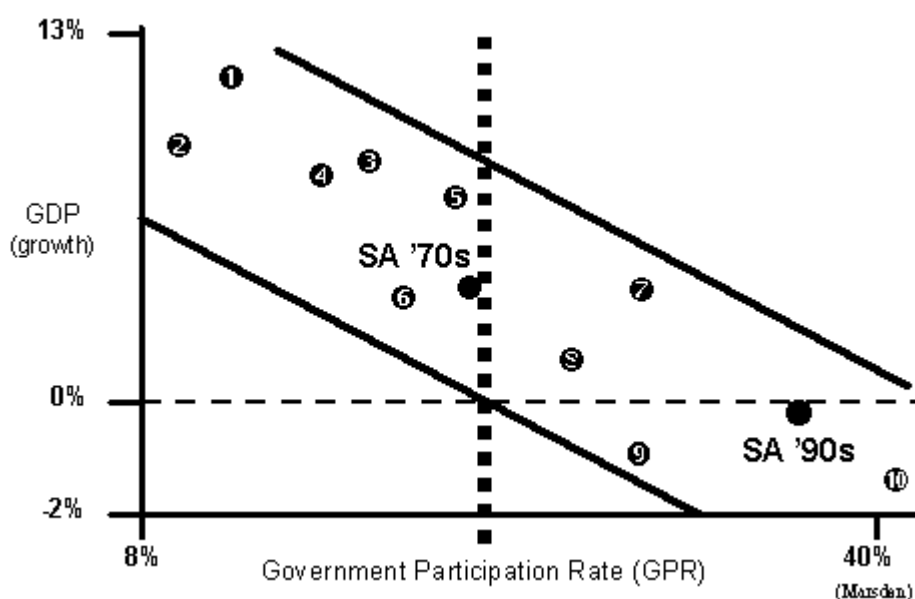
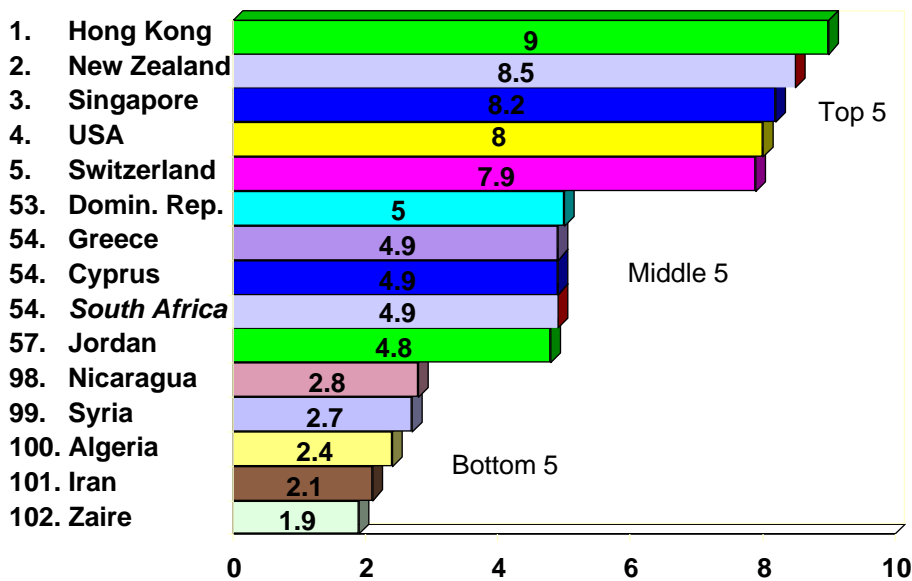


Figure 2 is from the Gwartney/Lawson *Economic Freedom* study. It shows how countries were ranked by the panel of 60 international economists who worked on the definition of economic freedom, with the top, middle and bottom five included here by way of illustration.

¹ The numbers are examples of actual but here unidentified countries. The examples represent different per capita income categories.

FIGURE 2: Economic Freedom Ranking



Next we have a series of self-explanatory graphs from the same study showing that less-free countries are poorer, and that they have lower, if any, growth.

FIGURE 3: Economic Freedom and Wealth

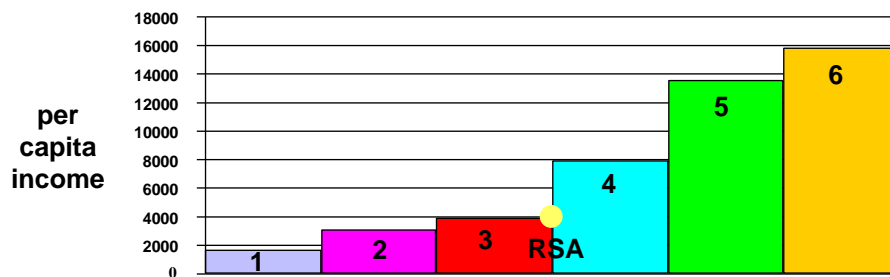


FIGURE 4: Economic Freedom and Growth

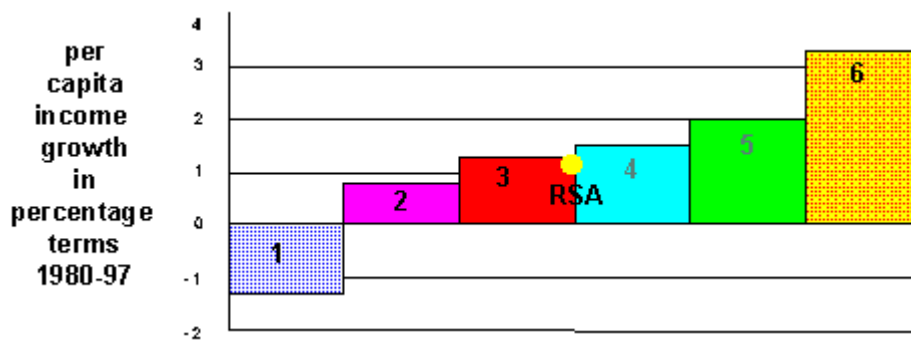


FIGURE 5: Persistently Free / Unfree Economies²

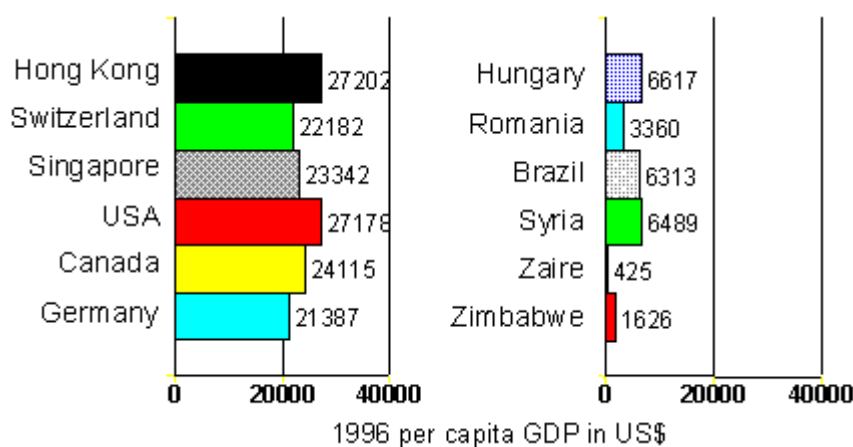


FIGURE 6: Persistently Free / Unfree Economies²
Per Capita GDP Growth Rates (in Percentage Terms) for 1990-96

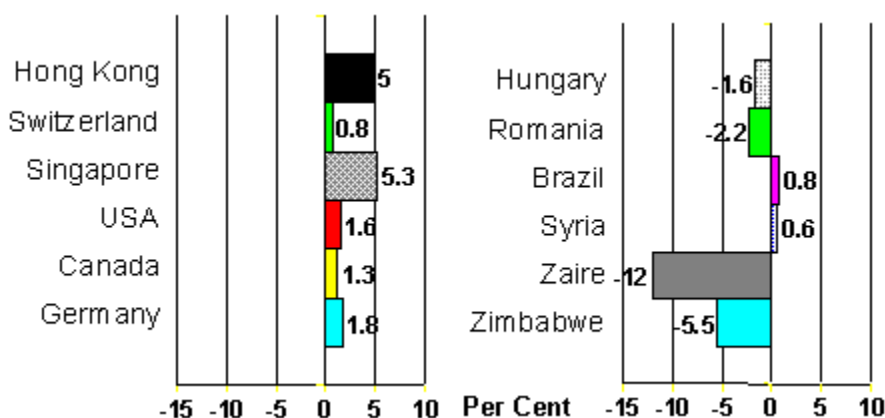


Figure 7 is from Gwartney and Lawson's Congressional evidence. Figure 8 shows that the average country is becoming more economically free, perhaps in response to the growing recognition that there is no realistic alternative for countries that want to prosper.

² These countries had the highest and lowest average freedom ratings for 1990-1996.

**FIGURE 7: Government Expenditure and Growth 1960-1996
for 23 OECD countries**

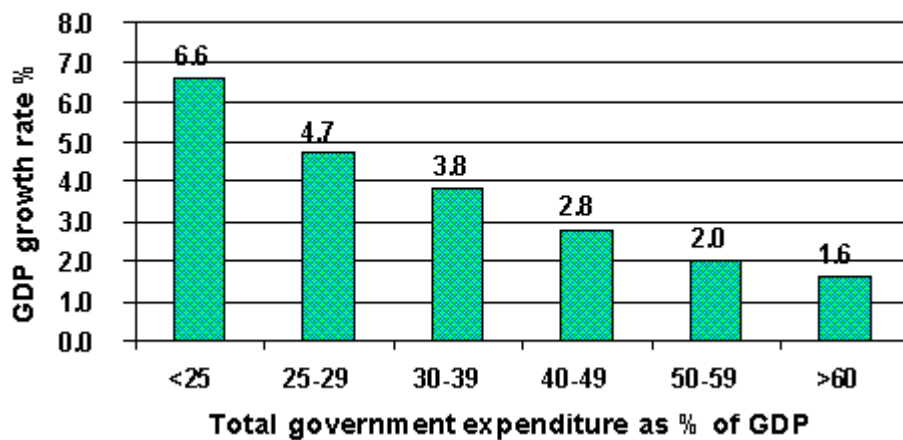
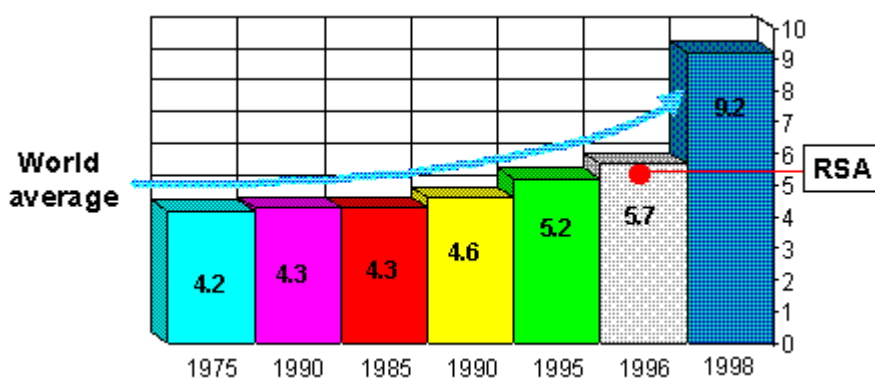


FIGURE 8: Average Economic Freedom of the World



Costs and benefits

The most important insight of economics is, in my view, that, all benefits have costs. In a sense this observation is obvious. And yet, it is almost always ignored, even by professional economists. When governments want the benefits of non-recognition of IPR, they almost always ignore the fact that they and their subjects will have to endure the costs. Typically, the costs exceed the intended benefits, which, in turn exceed the realised benefits.

The second great insight of economics is that dynamic analysis is more important than static analysis. Likewise this is obvious, yet seldom remembered for the purposes of policy formulation.

The costs of low IPR recognition are, *dynamic* and there are *secondary* costs that occur over time, including the deleterious effects of low IPR recognition on foreign and domestic investment, biases against domestic R&D and innovation, economic distortion and misallocation of resources, lost domestic tax revenues from income and other standard taxes that would ordinarily flow from IPR revenues if enforced, and lost employment from IPR-related investment.

Arbitrary nature of IPR protection

One of the dilemmas in respect of the view that IPRs are a legitimate form of property, is the seemingly strange and arbitrary nature of the shelf-life of various forms of IPR. Protection in most

countries ranges from zero for ideas and applications of existing IPRs, through a few months for music – after which anyone else is free to perform a published pop song – to infinity for trade marks.

Patents enjoy twenty years of protection, whereas copyright on text as opposed to music, is protected for the life of the author plus fifty years.

In preparation for this paper I found no analysis regarding the anomaly that “property” which the law purports to be owned should lapse at all. A characteristic of other forms of property in all countries that respect property rights is that ownership is indefinite. Apart from death or estate duties, what people own is theirs for ever. What this limited recognition of *intellectual* property seems to tell us is that the basis for recognition of IPR is not necessarily the same as that for recognising other forms of property. IPR seems to have come into existence for purely pragmatic reasons and is protected only to the extent that governments can be persuaded that it is in their interests to do so.

Perhaps the next stage in the historical evolution of IPR ought to be the elevation of IPR to the full status of ordinary property.

Why African governments should respect and enforce IPR

The proverbial bottom line is that recognition of IPR is “the right thing to do”, morally and philosophically. But since ethical principles are not a basis for action by most third world governments, especially, as we have seen, in respect of IPR, they will be more inclined to do so if it is expedient.

The world’s experience makes it clear that pro-IPR policies should be implemented for purely pragmatic and selfish reasons – it is efficient to do so.

A research paper prepared by my assistant Greg High (available on request) shows that the newly industrialised countries (NICs) such as Hong Kong, Taiwan, Korea, Singapore and Mauritius – embarked upon their high growth phase by virtue of their paradigm shift towards economic freedom. In the early stages they, like the industrialised countries that preceded them, adopted IPR laws but did not enforce them consistently. The degree to which IPR was not enforced in such countries tends to be exaggerated by popular mythology, but, nonetheless, there was, and in some cases continues to be, a substantial underground market for pirated products. Soon such countries realise that they need to intensify IPR enforcement in order to gain respectability amongst foreign governments and investors, to stimulate domestic innovation, and to avoid retaliatory measures by aggrieved countries and companies.

International correlation between IPR and prosperity

There are various studies that show a high correlation between prosperity and IPR recognition. We have seen that economic freedom, of which IPR is regarded as a component, enjoys a near-universal correlation with prosperity. Whilst we have mentioned only the correlations with wealth and growth, there are equally high correlations with virtually all other indicators of “the good society”, such as life expectancy, infant mortality, literacy, housing, infrastructure, environmental health etc.

If we telescope in on the IPR component of economic freedom we find that the correlation is nearly as strong, although there are rare and conspicuous exceptions. This is no surprise. We have argued that what matters is the policy mix or paradigm – the factors that characterise a country’s approach to economic policy. The overwhelming correlation that this produces will, predictably, weaken as one telescopes in on the individual components of the index.

By way of illustration of how strong the correlation is between IPR and prosperity, we refer to software piracy. The tables that follow show that countries with low levels of piracy are prosperous, whilst almost all countries with high piracy rates are relatively impoverished.

% Software piracy and per capita income

	%	US\$000
USA	27	27
UK	31	20
Japan	32	22
Denmark	32	22
Belgium	36	19
Finland	38	18
Canada	39	20
Sweden	43	20
France	48	19
Taiwan	63	17?
HK	67	21
Korea	67	19?
Nigeria	72	5
Romania	84	3
Russia	89	4
Indonesia	93	6?
Bulgaria	93	4
China	96	2?

Top and bottom 9 countries in terms of IPR enforcement

Top 9	US\$000	Bottom 9	US\$000
Australia	23	Columbia	5
Austria	19	Zimbabwe	2
Czech Rep	10	Dominican Republic	3
Denmark	22	Bulgaria	4
Finland	18	Guatemala	3
Germany	21	Honduras	2
Hungary	7	Ukraine	2
Iceland	19	Kenya	1
Ireland	18	Ecuador	4

Synopsis of conclusions and recommendations

- The status of IPR in different countries is both an integral part and reflection of the general philosophy or paradigm that informs the government concerned. In other words, such matters are seldom discrete issues: the declining respect for IPR in South Africa, for instance, is characteristic of the values and ideology that informs such policies as the nationalisation of foreign exchange earnings, and mineral and water rights; the increasing adoption of draconian anti-business laws that violate most principles of due process and the rule of law; and a growing disrespect for the constitution. Conversely, countries that respect IPR tend to do so as part of a positive economic policy environment characterised by due process; freedom of enterprise and contract; low taxes; demand-driven labour policies, and the like.

- Since virtually all countries purport explicitly and implicitly to regard intellectual property as property, the default assumption, for the purposes of this paper, is that it is. Accordingly, IPR violation in third world countries is regarded as the purposeful violation of property rights in general, which is likely to be indicative of generally hostile economic policy.
- The world's experience is that respect for IPR tends to coincide with prosperity, which, in turn, coincides with high rates of direct foreign investment and technology transfer; low inflation; low unemployment, and so on. IPR enforcement is higher in the world's most successful established and emerging economies.
- Superficially, it is inefficient for less-developed countries to be parasitic by not recognising the IPRs of others. In the real world, the benefits of such policies appear to be exceeded by unintended costs. Thus, even if governments disregard their moral obligations towards IPR holders, it is in their pragmatic interests to protect such rights. If they do not they incur the likelihood of reprisals by foreign countries and foreign governments. Additionally, they inhibit the likelihood of high rates of investment, technology transfer and growth. They also incur other costs, such as tax revenue losses.
- In summary, this paper has approached the IPR-Africa question on the assumption that governments in general, and African governments in particular, are unlikely to enforce IPR as a matter of principle. It argues that on purely expedient, selfish and pragmatic grounds it is in the self-interest of African governments, and the governments of other less developed countries, to adopt and implement pro-IPR policies and laws expeditiously. Ideally, they should do so as part of a comprehensive and coherent economic policy that coincides with the established definition of "economic freedom" as defined by its protagonists.

Further reading

Gwartney J & Lawson R (1999) *Economic Freedom of the World: 1998/1999 Interim Report - South African Edition*, Free Market Foundation (co-publisher), Johannesburg.

Gwartney J, Lawson R and Holcombe A (1998) Evidence to the US Joint Economic Committee, Washington DC.

Johnson BT, Holmes KR and Kirkpatrick M (1999) *1999 Index of Economic Freedom*, Heritage Foundation, Washington and *Wall Street Journal*, New York.

*This Briefing Paper was written by Leon Louw,
Executive Director of the Free Market Foundation*