

<b>Report No.</b>	HIAS-E-67
<b>Title</b>	Trade Liberalization, Absorptive Capacity and the Protection of Intellectual Property Rights
<b>Author(s)</b>	Arghya Ghosh <sup>(a)</sup> Jota Ishikawa <sup>(b)</sup>
<b>Affiliation</b>	<p>(a) School of Economics, University of New South Wales, Sydney 2052, Australia</p> <p>(b) Faculty of Economics, Hitotsubashi University, Kunitachi, Tokyo 186-8601, Japan</p>
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<b>Abstract</b>	<p>We examine how trade liberalization affects South's incentive to protect intellectual property rights (IPR) in a North-South duopoly model where a low-cost North firm competes with a high-cost South firm in the South market. The North firm serves the South market through either exports or foreign direct investment (FDI). The extent of effective cost difference between North and South depends on South's imitation, which in turn depends on South's IPR protection and absorptive capacity and North firm's location choice, all of which are endogenously determined in our model. For a given level of IPR protection, South's absorptive capacity under exports may be greater than under FDI. Even though innovation is exogenous to the model (and hence unaffected by South's IPR policy), strengthening IPR protection in South can improve its welfare. The relationship between trade costs and the degree of IPR protection that maximizes South welfare is non-monotone. In particular, South has an incentive to protect IPR only when trade costs are moderate. When masking technology or licensing is incorporated into the model, however, some protection of IPR may be optimal for South even if the trade costs are not moderate.</p>
<b>Keywords</b>	intellectual property rights (IPR), absorptive capacity, imitation, foreign direct investment (FDI), licensing, masking, oligopoly, North-South trade model
<b>JEL</b>	F12, F13, D43