Tariffs and Foreign Direct Investment in a North-South Product Cycle Model

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Abstract

This paper examines how Northern and Southern import tariffs affect innovation, foreign direct investment (FDI), and the Northern and Southern wages using a North–South quality-ladder model. The model assumes that imitation prevails in the South because intellectual property rights are not completely protected. We show the following results. An increased Northern import tariff raises the relative wage of the Northern labor to the Southern labor, but impedes innovation and FDI. In contrast, an increased Southern import tariff raises the relative wage of the Southern labor to the Northern labor, and promotes innovation and FDI.

Keywords: foreign direct investment, innovation, intellectual property rights protection