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Determinants of high-royalty contracts and the impact of stronger protection of intellectual property rights in Japan

Sadao Nagaoka

Institute of Innovation Research, Hitotsubashi University, 2-1 Naka Kunitachi, Tokyo 186-8603, Japan

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This paper first reviews how Japan has strengthened the protection of intellectual property rights (IPRs), focusing on the expansion of the patentable subject matter, the restriction of the possibility of compulsory licensing, stronger deterrence against infringement and the introduction of the doctrine of equivalents. Second, based on the statistical analysis of sector-level panel data, it shows that (1) R&D intensity of domestic industry, trademark licensing, cross-licensing and, to a smaller degree, monopoly provisions are the significant determinants of the incidence of high-royalty contracts, and (2) Stronger protection of intellectual property rights looks to have increased the incidence of high-royalty contracts in the latter part of 1990s in the Japanese industries for which patent is important for appropriability. *J. Japanese Int. Economies* **19** (2) (2005) 233–254. Institute of Innovation Research, Hitotsubashi University, 2-1 Naka Kunitachi, Tokyo 186-8603, Japan.

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E-mail address: nagaoka@iir.hit-u.ac.jp.

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1. Introduction

Intellectual property rights (IPRs) protection in Japan has been significantly strengthened since the mid-1990s. This policy shift has certainly reflected international developments, in particular, the IPRs policy dialog between the Japanese and the US governments initiated within the framework of the Structural Impediments Initiative (SII) that culminated in an agreement in 1994, and the Trade Related Intellectual Property Rights (TRIPs) agreement in 1995. It also reflected the recognition by the Japanese policy makers of the increasing importance of intellectual property in the economy in which investments in intangibles had become very important.

This paper reviews such policy changes in Japan and attempts to evaluate their impact, focusing on the incidence of the high-royalty technology import contracts in Japan. More specifically, I examine whether the fraction of high royalty contracts has increased more in those sectors where patents play an important role in appropriating the return from R&D. In addition, I also inquire how this fraction is related to basic contract characteristics such as exclusive rights, cross licensing provisions, and the structure of IPRs specified in the contracts. Although these are straightforward questions to ask, they are still important ones, given that empirical studies of the determinants of licensing contracts are scarce.¹

In what follows, Section 2 reviews Japanese policy, focusing on the expansion of patentable subject matter, restriction of the possibility of compulsory licensing, stronger deterrence against infringement and the introduction of the doctrine of equivalents. Section 3 provides a brief overview of the major features of technology import contracts in Japan. Section 4 provides an analytical framework, and Section 5 provides the framework for the empirical analysis. Section 6 provides empirical results, and Section 7 concludes and discusses the implications.

2. Stronger intellectual property rights protection in Japan

2.1. Three driving forces for the changes

The Japanese government has significantly strengthened the protection of intellectual property rights (IPRs) since the early 1990s. The first major driving force for such changes was the TRIPs agreement in 1995. It requires member countries, among others, to make patent protection available for any inventions, whether products or processes, in all fields of technology, with only a few specified exceptions and to make the term of protection available for not less than a period of twenty years counted from the filing date.

The second driving force was the US–Japan agreement in 1994, under which both governments agreed to undertake three measures. The Japanese government switched to the post-grant opposition system from the pre-grant opposition system in 1994, and then unified the opposition system with the patent validity examination system in 2004. It also

¹ Some important empirical studies of licensing include: Taylor and Silbertson (1973), Caves et al. (1983), Davidson and Mcftridge (1984), Anand and Khana (2000), Arora et al. (2001).

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