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INTELLECTUAL PROPERTY RIGHTS IN CHINA: GOVERNANCE CHALLENGES AND PERSPECTIVES

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# TABLE OF CONTENTS

- **Introduction and Summary** ............................................................................................................... 3
- **I. Definition and Economic Rationale of IPRs** .................................................................................. 4  
  - **I.1 - Definition** ........................................................................................................................... 4  
  - **I.2 - The impact of IPRs on economic growth in developing countries** .................................................. 5
- **II. The importance of IPR policy for China’s economic development** .................................................. 6
- **III. An overview of the IPR system in China** ..................................................................................... 8  
  - **III.1 - The Regulatory Framework** ............................................................................................... 8  
  - **III.2 - The Institutional Framework** ............................................................................................... 9  
    - a) Institutional framework at the national level ............................................................................... 9  
    - b) Institutional framework at the sub-national level ........................................................................ 10  
    - c) Institutional set-up for enforcement ........................................................................................... 11
- **IV. Governance Issues and IPR in Practice** ..................................................................................... 11  
  - **IV.1 - Governance Weaknesses** ................................................................................................... 12  
  - **IV.2 - Infringement** ...................................................................................................................... 15  
    - a) General information on the infringement phenomenon ................................................................. 16  
    - b) Analysis ....................................................................................................................................... 17
- **V. How to improve Enforcement?** .................................................................................................... 19  
  - **V.1 - Actions Taken by the Chinese Government** .......................................................................... 19  
  - **V.2 - Comments: Towards a Multi-Dimensional Enforcement Strategy** ............................................... 20
- **VI. Annex: A Brief Description of China’s Judicial System** ................................................................. 27
INTTELLECTUAL PROPERTY RIGHTS IN CHINA: GOVERNANCE CHALLENGES AND PERSPECTIVES

Introduction and Summary

1. Today, top leaders of the Chinese government have become fully aware of the importance for China to build a sound intellectual property right system. Indeed, Chinese leaders have realised that the protection of intellectual rights is crucial not only as a condition for foreign investment and technology transfer, but also for promoting Chinese innovation, which will determine China’s future competitiveness in the global knowledge economy. China has thus quickly developed in the past two decades a set of IPR laws and regulations that are today basically in conformity with international practice and standards. Relatively comprehensive IPR administration and judicial frameworks have also gradually taken shape. The main challenge for coming years is to improve upon the governance of the legislative, administrative and enforcement systems in order to make the existing laws more effective in stimulating innovation and protecting IPR.

2. The elaboration of the IPR system takes place in a broad context of construction of an institutional framework for market forces. China is simultaneously making progress on complementary fronts. This also means that the institutional environment that should support the IP system is not fully in place. For instance, China has yet to introduce an anti-monopoly law to curb abuse of IP rights. The recent amendments brought to China’s Constitution on the protection of private property will consolidate the legal basis for intellectual property. More generally, efforts made to improve the rule of law will benefit the management and protection of intellectual rights.

3. Within the IPR field, which is an extremely complex and highly technical domain, challenges nevertheless remain numerous. Rather than looking at all challenges facing China’s IPR system, this paper - being part of the China Governance Project - highlights and analyses some important governance issues that affect the effectiveness of the Chinese IPR regime in terms of stimulating research and innovation (insofar as innovation can be measured by numbers of patents), and the enforcement of IPRs.

4. This study finds that on the one hand China’s IPR system has not played fully its role in stimulating Chinese research efforts and in valorising results, and on the other hand, in spite of efforts taken to improve IPR enforcement, infringement of IPRs in China has been growing in the last years. Our analysis has identified the main governance weaknesses underlying these two interrelated phenomenon. These include the weaknesses in the regulatory framework, the lack of financial and human resources, the inefficient governance of the interface between research and patents, the weak deterrent effect of sanctions administered, the problem of localism and the complexity of the administrative organisational structure. The Chinese government has taken a number of measures to address these challenges. This paper suggests three supplementary directions of action that could contribute to improve the effectiveness of the IPR system in China: 1). to give full play to civil society actors, 2). to take measures to consolidate the political will for IPR enforcement locally, and 3). to reform the organisational structure of the administrative enforcement channel.

5. The paper is structured as follows. First, before analysing IPR governance issues, we present some key concepts and the nature of IPR in Section I, discuss why China needs to have a strong IPR system in Section II, and review the status quo state of the IPR legislation and enforcement in Section III. We then analyse the governance weaknesses that affect the effectiveness of the IPR system in Section VI. Finally,

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1 This chapter has been written by Irène Hors (OECD Public Governance and Territorial Development Directorate) and Gang Zhang (OECD Directorate for Science, Technology and Industry).
we review the measures taken by the Chinese government to address these challenges and propose some further complementary measures in Section V.

I. Definition and Economic Rationale of IPRs

6. Before we proceed to discussing governance issues of China’s IPR system, it shall be useful to introduce the definition of IPR, its nature, the economic rationale for IPR protection, and the principle relationships between IPR protection and economic development in the particular context of developing countries.

1.1 - Definition

7. Intellectual Property (IP) rights are commonly defined as the rights awarded by society to individuals or organisations principally over creative works. They give the creators the rights to prevent others from making unauthorised use of their property for a limited period. Main categories of IP include Industrial Property (functional commercial innovations) and Artistic and Literary Property (cultural creations), and further some recently emerging hybrids of the two referred to as Sui Generis systems, such as integrated computer circuits, plant breeders’ rights, database protection, etc. Box 1 provides a concise description of the main types of IP and the mechanism through which protection works for each type.

8. Knowledge is of the nature of public goods in that one person’s use of it does not exclude another’s, often at very low marginal costs and not limited by national borders. From the point of view of society, the more people use the available stock of knowledge the better off a society in the sense that more people can gain something at little or no cost. However, the other side of the coin is that if knowledge is used as public goods by anybody free of charge, there would not be enough economic incentives for making private investment in the creation of knowledge, leading to an underinvestment in knowledge, which society would suffer in the long run.

9. The economic rationale for protecting IPR is the need to address the failure of the market in ensuring sufficient private investment in the creation of new knowledge. It does so by granting temporary market exclusivities to IP owners to allow them to recoup the costs of private investment and to make a profit, which works as an incentive to encourage knowledge creation and technological innovation. Thus, IPRs are policy instruments that confer economic privileges on individuals and institutions for the purpose of contributing to the greater public goods. In other words, IPR protection is a means to an end, but not an end in itself.

10. At the same time, IPR protection comes with a cost to society. One part of the cost resulting from market exclusivities is the static cost to consumer in the form of price above marginal production cost. Other costs occurred to individuals and to society as a whole include the duplicative investments in R&D due to patent race and substantial enforcement costs associated with asserting and defending IP rights (Maskus 2005). As such, questions should be asked about what an optimal level of IPR protection is, how it should be structured, and how the optimal structure may vary with sectors and levels of economic development, etc.

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2 This section draws heavily from CIPR (2002).

3 See also Jones (2004) on this.

4 This is also based on the recognition that the social value of knowledge and technological inventions is often greater than private gains.
Box 1 - The Main Types of IPR

**Industrial Property**

*Patents:* A patent is an exclusive right awarded to an inventor to prevent others from making, selling, distributing, importing and using their invention, without licensing or authorisation, for a fixed period of time (TRIPS stipulates 20 years minimum from the filing date). In return, society required that the patent applicant disclose the invention in a manner that enables others to put it in practice. Patents applications are examined and granted by applying the criteria of **novelty, non-obviousness and utility/industrial applicability.** Utility models are similar to patents, but in some countries confer rights of shorter duration to certain kinds of small or incremental innovations.

**Trademarks:** Trademarks provide exclusive rights to use distinctive signs (such as symbols, colours, letters, shapes or names) to identify the producer of a product, and protect its associated reputation. In order to be eligible for protection, a mark must be distinctive of the proprietor so as to identify the proprietor’s goods and services. The main purpose of a trademark is to prevent customers from being misled and deceived. Duration of trademark protection can vary, but a trademark can be renewed indefinitely.

**Trade Secrets:** Trade Secrets consist of commercially valuable information about production processes, business plans, clientele, and etc. They are protected as long as they remain secret by laws which prevent acquisition by commercially unfair means and unauthorised disclosure. However, there is no exclusive right to the process if it is discovered by fair means, such as reverse engineering (Maskus, 2005).

**Artistic and Literary Property**

*Copyright:* Copyright grants exclusive rights to the creator of original literary, scientific and artistic works. Copyright begins, without formalities, with the creation of the work, and lasts (as a general rule) for the life time of the creator plus 50 years (70 years in the US and EU). It prevents unauthorised copying, reproduction, public performance, recording, broadcasting, translation, and adaptation, and allows the collections of royalty for authorised use. It prevents copying, but not independent derivation, nor fair-use for scientific and educational purposes. Computer programs are protected by copyright in most countries.

*Source: CIPR 2002.*

1.2 - The impact of IPRs on economic growth in developing countries

11. The links between IPRs protection and economic growth is extremely complex and evidence on the benefit of IPR protection for economic growth of developing countries is far from clear. However, drawing on the existing literature, the Report by the Commission on Intellectual Property Rights (CIPR 2002) concludes on the main dimensions of the relationship as follows: 5

12. - IPR, Innovation and Growth: Based on the experiences of developed and the newly industrialised economies which suggest that the strength of IPR protection increases with economic development after countries having reached quite high income levels, the main conclusions of the Report are: i) for those developing countries that have acquired significant technological and innovative capabilities, there has generally been an association with “weak” rather then “strong” forms of IP protection in the formative

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5 Report makes clear distinctions between the least developed countries and technologically sophisticated developing countries, including China. The conclusions of the Report cited here are those specifically related to the technologically sophisticated developing countries.
period of their economic development. ii) In technologically advanced developing counties, there is some evidence that IP becomes important at a stage of economic development, but that stage is not until a country is well into the category of upper middle income developing countries.

13. - IPR, Trade and Investment: With a distinction made between the impact of IPRs on developing countries, and on the exports and investment from developed countries, the Report concludes that (i) there is some evidence that trade inflows into developing countries are influenced by the strength of IPR protection, particularly in IPR sensitive high technology industries, but the evidence is far from clear. (ii) For technologically more advanced developing countries, IPRs may be important to facilitate access to protected high technologies, by foreign investment or by licensing. (iii) It may be difficult to achieve a right balance for countries such as China and India where some industries have the potential to benefit from IP protection, but the associated cost for industries that were established under week IP regimes as well as consumers are potentially high.

II. The importance of IPR policy for China’s economic development

14. With the above background, we shall look informally at why China should need a good, appropriately strong IPR system suitable for its level of economic development.

15. IPR protection is an important condition for China to achieve its development strategy based on openness to and integration into the global economy and technology upgrading and innovation. For our purpose, we will focus on two major concerns. First, China, as a developing country, need to attract foreign investment and is dependent on the access to foreign technology for the technology modernisation of the Chinese economy. Various forms of foreign investments have been the major channel of transferring foreign technology into China in the past. In general, IPR protection positively influences the access to foreign technology and FDI. For example, using affiliate-level data on US based multinational firms, Branstetter et al (2004) find that collectively, improvements in IPR result in real increases in technology transfers by multinational enterprises. Similarly, Park and Lippoldt (2003) find that intellectual property rights (as described by an IPR strength index) positively influence FDI and moderately influence trade, with some variation by industry, depending on the risk of imitation and the importance of such factors as the market scale.

16. Since the 1980s, China has succeeded in attracting large amounts of FDI inflow, and it was the largest FDI recipient in the world in 2003. To a large extent, the past success may have been because of important factors, such as the low labour cost for manufacturing industries and the huge size of the Chinese domestic market. The so-called “market for technology” policy which attached technology transfer as a condition for approving foreign investment projects played also an important role in leveraging technology transfers occurred in the past (OECD, 2002). Such policy is no longer a feasible option any more after China’s entry into the WTO. At the same time, as China is aiming to attract high quality FDI, measured by the technological content of investment projects, improving IPR is of greater importance than in the past. Clearly, strength of the IPR protection is a crucial factor for foreign firms’ decision on what types of technology to bring to China. Firms, especially those in IPR sensitive industries, such as pharmaceutical, would bring the latest technology and production process into a country only if they trust that the country can provide secure and adequate protection for IPR, including trade secrete. 7

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6. The index is composed by using five indicators, i.e. membership in international treaties, coverage of patentability, and restriction on patent rights, enforcement and duration of protection.

7 As made clearly by the business representatives during the high-level Workshop on IPR and Economic Development in China: Meeting Challenges and Opportunities Following WTO Entry, Beijing, China, 20
17. Second, China needs a strong IPR system to promote R&D and innovation, in particular in the domestic firms. IPR issues are of growing importance to China, as it continues to modernise its science and technology system which future economic performance depends on. Since the Government adopted the strategy of “Revitalising the nation through science and education” in 1995, China has paid increasing attention to improving its national innovation system as part of the country’s overall development strategy. R&D expenditures have grown rapidly over the past decade or so, with gross domestic expenditures on R&D (GERD) reaching 72.1 billion Purchasing Power Parity (PPP) dollars in 2002 (OECD, 2004), up from 12.5 billion PPP dollars in 1991. GERD as a share of GDP climbed up from 0.60% in 1995 to 1.23% in 2002. While this level is significantly below that of OECD countries as a whole, at 2.26% in 2002, it exceeds that of some upper-middle income OECD Members, such as Greece and Mexico.

18. Protection of intellectual property is a key consideration for multinational enterprises, whose R&D investment and activities can actually play an important role in filling the gaps in R&D resource, scientific knowledge, and transferring tacit know-how and expertise in research methodology and management. The Ministry of Science and Technology estimated that R&D funding by overseas companies, i.e. including those from Hong Kong and Macau, China, and Chinese Taipei, accounted for between 15-20% of business R&D expenditures in China in the past year. Although FDI in R&D and technology services accounted for only 0.4% of accumulated contractual value of FDI until 2002, the increasing number of foreign-invested R&D facilities – from just a handful in the end of 1990s to some 600 in year – indicates that foreign R&D investments have grown quickly since China’s entry in the WTO. Interviews with managers of foreign companies revealed a widespread reluctance to locate R&D facilities in China in the recent past (Maskus 2005). Thus, a system of adequate IPR protect will further encourage the foreign investments in R&D, facilitating China to participate in and benefit from the globalisation of R&D.

19. IPR protection is increasingly important to domestic firms, as well, as they become more technology-intensive and as business accounts for a growing share of R&D. Promoting business R&D has been an important government innovation policy since mid 1990s. Consequently, there has seen a trend of increasing R&D spending by the Chinese enterprises, which accounted for 57.6% of total R&D expenditure in 2000. The share of R&D performed by domestic business enterprise sector has also increased from 40% in 1991 to 61% in 2002 (OECD, 2004). However, innovative Chinese firms are particularly affected by the trademark infringements, making significant impacts on the growth of this type of enterprise (Maskus 2005).

20. Parallel to increasing R&D spending, the Chinese government has carried out reforms of public research organisations (PROs), established high-technology development zones, developed successively several national plans for science and technology and created a number of key national laboratories such as those of the Chinese Academy of Sciences. Government measures have also been introduced to enhance R&D spending, innovation capability and appreciation of intangible assets, notably intellectual properties by the Chinese enterprises. To facilitate the technology transfer from public research to the private sector

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21 April 2004. See the summary proceedings of this workshop and a related event, in OECD (2005, forthcoming). See also Maskus (2005) on the hesitation of foreign companies in China to transfer advanced technologies into China because their concern over the effectiveness of IPR protection.

8. It is possible that GERD in PPP dollar may overstate the magnitude of China’s R&D effort. See Schaaper (2004) for a methodological note on measurement issue and a comparison between GERD in PPP and in current US dollar. Extension of the statistical scope for business R&D expenditure in 2000 explained part of the dramatic growth of China’s R&D expenditure before and after 2000.

9. It is to be noted that the composition of business enterprise sector in China is considerably different from that of the OECD countries, where private business units are the majority of business entities. Most Chinese enterprises that conduct R&D activities are state-owned companies, where research is funded by public resource in that sense.
and co-operation between PROs and enterprises, China amended the Patent Law and promoted the creation of technology transfer centres and technology markets.

21. Increasing R&D expenditure combined with systemic reforms has led to an increase in the number of patents applications in China, which increased almost three-fold, from slightly more than 100 000 in 1996 to more than 300 000 in 2003. Yet, more than three-quarters of the patents by Chinese inventors were not invention patents, per se, but design and utility patents, reflecting their weak innovative capabilities. In contrast, invention patents accounted for the majority, at 85%, of foreign applications. Patent statistics also indicate a low efficiency of Chinese enterprises R&D activities: for example, enterprise sector performed 60% of China’s total R&D expenditure in 2001, but received only 17% of the invention patents granted to Chinese inventors that year. Low awareness of the importance of patents was considered an important reason for such low level of patents owned by the Chinese firms (MOST, 2002).

22. China aims to become a technologically advanced nation in the 21 Century. To realize this objective it is critical that the government puts in place appropriate incentives for innovation and technology development and encourage broad diffusion of and access to scientific and technological advances. In this context, a good IPR system, which not only provides incentives for innovation, but also promotes technology diffusion, is called for. Furthermore, with a large public spending on R&D, publicly funded research forms the backbone of China’s national innovation system. It is particularly important for China to adopt the right IPR policies for communalisation of public research in order to boost its contribution to social and economic development.

23. Already towards the end of 1990s, it was observed that at the highest level, the Chinese government recognized the need for a workable IPRs system (Maskus et al 2005). Initially, the Government’s recognition on the importance of IPR protection was mainly prompted by China’s needs for improving investment conditions for FDI and for accessing advanced foreign technologies. This recognition has progressively evolved into a fuller understanding of the ultimate importance of IPR protection in the context of fostering China’s domestic innovation capability. This marked a very important strategic shift in the government’s thinking at the top level, which does not treat IPR policies as the instrument for protecting “other’s rights” in return for access to foreign capital and technology, but as a part of the fundamental strategy that will determine China’s long term competitiveness in the global economy. However, this understanding has yet to be adopted by governments at all levels and among the Chinese enterprises.

III. An overview of the IPR system in China

III.1 - The Regulatory Framework


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10. Chinese patent system grants three types of patents, namely invention patents, utility designs, and appearance design patents. The latter two types of patents contain little technology or process inventions.

11. IPR protection is one of the policies required to improve China’s innovation capacities. See OECD (2002) and Maskus et al (2005) for discussions on what other policy measures would be needed to boost the level of innovation activity by Chinese industries.

12. The importance of IPR protection to China’s social and economic development, and the issues related to the IPR policies on public research were addressed by the two OECD-China events on IPR organised in on 20-21 and 22-23 April, respectively in Beijing. See OECD (2005) for a summary of these events.
Copyright Law (1990 revised 2001). These laws are complemented by regulations such as those on the Protection of Computer Software (1991 and revised 2001), on the Protection of New Plant Varieties and on the Protection of Lay-out Designs of Integrated Circuits (2001). Furthermore, the Anti-unfair Competition Law promulgated in 1993 is used to provide a legal basis for protection of trade secrets and business know-how. These laws and regulations have established the legal notion of intellectual property right in China. The recent amendments brought to China's Constitution on the protection of private property consolidate the legal basis for intellectual property.


26. Accession to the WTO has motivated considerable strengthening of IPR protection in China. China revised its intellectual property laws and regulations, promulgating new regulations and abolishing old ones in an effort to bring the scope and strength of IP protection into conformity with the TRIPS Agreement. By the end of the first year of its transitional period, the WTO Council formed a positive opinion towards China’s fulfilment of its obligations, including with respect to the TRIPS clauses. Further in 2003, China continued the effort by introducing a number of regulations and administrative protection measures, such as the regulations on customs protection of IPRs, and implementation measures on copyright administrative sanction, and those on compulsory patent licensing and on the administration of patent agencies.

III.2 - The Institutional Framework

a) Institutional framework at the national level

27. Under the State Council, there are several administrations involved in the protection of intellectual property, each specialised in a different kind of right. The State Intellectual Property Office (SIPO) is in charge of patents (including integrated circuit layout design); the State Administration for Industry and Commerce (SAIC) of trademarks; the National Copyright Administration of China (NCAC) of copyrights; the Ministry of Agriculture and State Forestry Administration of new plant variety rights; the Ministry of Culture and State Administration for Broadcasting, Television and Movies of copyrighted works in the audio-video market and in broadcasting, television and movie sectors, respectively.

28. The State Intellectual Property Office (SIPO) (previously the Chinese Patent Office) is also responsible for the co-ordination of foreign related intellectual property affairs. For instance, in recent years, SIPO has represented China in WIPO and in the TRIPs Council reviews.

29. In 2003 SIPO became part of the State Council Leading Group for National Rectification and Standardisation of Market Economic Order (NRSMEO, 国务院 全国整 顿 和 规范 市场 经济 秩序 领导小组, guowuyuan zhengdun he guifan shichang jingji zhixu lingdao xiaozu). Some government
bodies are presented in this leading group. Fighting against counterfeit production and sales and the protection of intellectual property more generally are priorities on its agenda.

30. The National Office for Rectification and Standardisation of Market Economic Order (全国整顿和规范市场经济秩序领导小组办公室, or in short 整规办zhengguiban) is the Secretariat of this leading group. It is located in the Ministry of Commerce and led by a Vice Minister. This Office develops policy proposals to improve the market order; it coordinates rectification motions in specially targeted areas and supervises the investigations of cases of significant importance. It also organises the relevant government bodies to research and draft policies, laws and regulations concerning cracking-down of the local blockades and sectoral monopolies.

31. Very recently, China set up an IPR Protection Leading Group, led by Vice Premier Wu Yi.

b) Institutional framework at the sub-national level

32. All of the national level administrations listed above have local branch offices at the provincial, prefecture and municipal levels. National level administrations are responsible for policy-making and nation-wide policy implementation; for the examination, granting and registration of respective IPRs, and for the handling of infringement cases of major importance (cf. infra). Sub-national administrations are responsible for the implementation of national policies, the making of local policies and regulations and for the administration and administrative enforcement of IPRs in their jurisdictions. National level administrations are also mandated to guide the work of their local offices, and represent China in international cooperation and relations in their fields of responsibilities.

33. However, the Central government does not have a policy for a uniform IPR administrative structure at local levels: local governments can decide what organisational structure the local IPR administration should have in their jurisdictions. As a result, there is no uniform organisational structure of local branch system of these government agencies. SIPO has branches in all 29 provinces, autonomous regions and directly controlled cities. But in some provinces, such as Hebei, Shandong, Hubei, Hunan, Guangdong, and Sichuan, there are more than 10 sub-provincial branches in each province, while in Liaoning, Heilongjiang, Fujing, Jiangxi, Henan and Guizhuo, Sichuan, there are only a few sub-provincial branches. In the rest of Chinese provinces, there is no sub-provincial SIPO branch office at all. The setup of the sub-provincial judicial system for hearing IPR related litigations share the same feature: the numbers of intermediate courts that are specialised or authorised to judge IPR cases vary greatly from one province to another, and autonomous region, and among cities in terms of secondary and basic courts.

14 According to the IACC (IACC (2004)), this leading group also involves leaders from the Department of Market System Development in MOFCOM, the Industry Department of the National Development and Reform Commission, the Supervision and Inspection Bureau of the Ministry of Finance, the Legal Enforcement Supervision Office of the Ministry of Supervision, the Department of Turnover Tax of the State Administration of Taxation, the Department of Public Roads of the Ministry of Communication, the Ministry of Public Security, the Department of Market Standardisation Management of the State Administration for Industry and Commerce, the Department of Legal Enforcement and Supervision of the State Administration of Quality Supervision, Inspection and Quarantine. See the State Council’s announcement of the creation of this leading group and the composition of the group at: http://www.cas.ac.cn/html/Dir/2001/04/06/5744.htm

15 This reflected the increasing importance that the Central government has attached to the IPR enforcement. The 2003 Annual Governmental Report called for government agencies to “further strengthen intellectual property protection, combat and punish piracy and law infringement”. See Wang (2004).

16 See website of the Ministry of Commerce: http://zgb.mofcom.gov.cn/article/200306/20030600104554_l.xml
c) Institutional set-up for enforcement

34. China has a unique two-track system for the enforcement of IP rights, which is known in China as "two ways, synchronously operating" protection system (两条途径 协调运作 in Chinese). Under this system, the responsibility for IPR enforcement is shared between the Court and Procuratorate bodies, and the Ministry of Public Security, on the one hand, and the State Council IPR administrations mentioned in the above section, on the other hand. The latter also have the power to handle infringement cases, through the administrative enforcement mechanism.

35. When their rights are infringed or harmed, IPR holders can turn to the responsible administrative authority for settlement. This administration will investigate the complaint, and if infringement is found, it will order the infringing party to stop the infringing act, confiscate infringing goods and impose fines. If right owners are unsatisfied with decisions made by administrative authorities, they may seek redress by filing an "administrative litigation" (行政诉讼) against the settlement decisions at the court, which has the final say.

36. The alternative to this administrative enforcement channel is to launch either a civil or a criminal lawsuit with the judicial System. Broadly defined, China's judicial system consists of three parts: People's Court System, People's Procuratorate System, and the Public Security System. While the Procuratorate system has the role of a "state organ for legal supervision", which reviews and monitors the conducts of the public security forces and the court system; the security organ is part of the administrative system, which carries investigation, detention, preliminary hearings and arrest (see Annex for a brief description of the functions of the three parts of China’s judicial system).

37. China has been establishing progressively a specialised IP court system. Since 1993, dozens of the High Courts and the Intermediate Courts of some cities have established intellectual property tribunals. In 1996, the Supreme People’s Court set up the Intellectual Property Tribunal (now called the Third Civil Chamber), whose role is to handle major IP cases and provide guidance for and supervision of IP cases tried across the country. Currently, all High Courts of the 31 provinces and the Intermediate Courts situated in the provincial capitals, in the cities under the direct control of the State Council the and in the capitals of autonomous regions have established Third Courts for the civil judgment of IPR cases. A few Basic People’s Courts which receive significant IP litigation have also set up IP tribunals. In addition, the Supreme Court has appointed 48 Intermediate Courts as courts of first instance for the judgement of patent disputes. For trademark and copyright and other IPR disputes, more than 400 Intermediate Courts act as courts of first instance. A few Basic Courts in large cities are approved to deal with IPR cases, such as the Court of Haidian district in Beijing and the Court of Pudong district in Shanghai.

38. Another important enforcement actor is the General Customs Administration, which has been playing an increasing role in detecting and investigating and stopping the flows of infringing goods, according to the Regulations on the Customs Protection of Intellectual Property.

IV. Governance Issues and IPR in Practice

39. As it is the case in all policy areas, it is one thing to adopt a text that defines the general orientations of a country's policy, and it is quite another to see how these orientations are put into practice on the ground. Indeed, the definition of IPRs and their protection involve a whole spectrum of actors, from the top, where the IPR laws are designed and passed, to local offices, closer to the field and to other interests;

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17 China’s court system consists of four levels of courts: The Supreme Court, High Courts, Intermediate Courts and Basic Courts.
Organisations, with more or less resources, different mandates and powers, etc. The purpose of this part is to have a closer look at a selected number of aspects of the Chinese "IPR State machinery" mobilised for the development and maintenance of the IPR regime in China, and to show how its characteristics contribute to shape this regime in practice.

40. It first discusses the weaknesses in the governance setup, and then takes the problem from the other end, looking at the problem of IPR infringement in China, in perspective with the governance weaknesses.

41. We will apply the concept of governance as it is defined by the China Governance Project: “Governance” refers to how public policy-making is arranged and how public policies are implemented. Governance is "good" when these two processes (policy-making and implementation) ensure that constitutional or collective values are protected overtime. Public administration is not only important to public governance, it is a constituent pillar.

IV.1 - Governance Weaknesses

42. It would be beyond the means of this exercise to provide a systematic screening of the governance issues affecting the implementation of the IPR regime in China. More modestly rather, several governance weaknesses are identified and analysed successively, showing the impact of the regulatory framework, of organisational structures, of human and financial resources and of management practices on the practice of IPR.

- Consultations in the regulatory-making process

43. Chinese enterprises and other institutions have complained that competent intellectual property administrations did not extensively solicit opinions and comments when working out laws, regulations and policies. The insufficient public participation has led in some cases to inadequate protection standards. For instance, the TRIPS Agreement does not prescribe clearly the requirement on end-users of computer software; it allows WTO members to make their own provisions on the responsibility of end-users in accordance with their actual economic development. Yet the newly amended Chinese software regulations prescribe unnecessarily high protection standards for end-users; higher than those in Japan or in the Chinese Taipei. The lack of public participation in the regulatory-making process also affects enforcement. If actors judge the system unfair, they will be less inclined to endorse its rules. Participation also allows actors to better understand why certain decisions are taken.

44. Consultation with parties affected but also with other government departments and bodies can contribute to ensure the coherency of the IPR regime with other policy fields. Indeed, IPR regimes are a component of a broader policy mix, including science and technology, competition and trade policies, foreign direct investment and access to foreign technology, etc. that have a direct or an indirect influence on their design, implementation and enforcement. Since China has a dual economic structure with both a modern sector (e.g. R&D and modern industry) and an underdeveloped traditional sector, IPR policies have to meet the different needs for IP protection and work in harmony with policies that support the development of different sectors. In many OECD countries, such as the U.S., regular consultations with rights holders and others affected by the intellectual property rights are key to achieve and maintain the coherency of the IPR regime with other policy fields.

- Competition and IPR


45. Competition policy is a policy field which overlaps with IPR, and the immaturity of the competition regulatory framework in China today affects the IPR regime. Issues that arise at the interface between competition and IPR include the interdependence between competition and IPR laws and policies, competition issues in the context of bilateral and multilateral license agreements, and the potential abuse of IP rights when firms with significant market power refuse to grant competitors access to its IPRs. Along with its transition to a market-based economy, dealing with competition issues, with in particular the adoption of an antitrust legislation, have become a priority concern in China.

46. Another dimension is related to the fact that the offence of unfair competition cannot be referred to in cases that are close to IPR infringement, as it is generally the case, for instance in European countries. China adopted a law on unfair competition in 2003, but judges as well as the authorities refer to it only if the reproached facts correspond exactly to one of the 13 or 14 cases mentioned in the law. In Europe, such a law is useful to institute legal proceedings against a company that would for instance propose products very close to the ones produced by another company (same shape, same colour but not exactly the same product), thus trying to benefit from the latter's reputation.

- Regulatory framework at the local level

47. Local regulations are to implement national policies and legislations and / or to complement them. For example, the Patent Law states in general terms that abuse of power and malfunction by state functionary can be prosecuted for criminal liability; The Regulations for the Protection of Patent Rights adopted by the People’s Congress in the Xinjiang Autonomous Regional specify four types of situations: i) covering up or indulging other people to falsify patents; ii) in the patent dispute mediation process, take side to favour one party, while violating the legitimate rights and interests of the other party; iii) leakage of litigant's technical secret or business secret; and iv) use duty position to demand or receive bribery from other people. Local regulations are in principle more concrete, implementable, and adapted to local social and economic conditions. Even if these are normally based on national legislations and central government policies, local regulations are sometimes in conflict with central government regulations. The National People's Congress and the State Council should normally play a supervising role, but the large volume of sub-national legislation makes this task difficult to achieve.

48. There is also a lack of transparency of the regulatory framework at the local level, noted for instance by the US government who reports that many local authorities are reluctant to provide copies of their local rules or regulations regarding IPR as well as any local enforcement decisions. China committed to "make available to WTO Members, upon request, all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange before such measures are implemented or enforced". Yet, the Chinese government argues that the provision of requested information is in itself a huge task, given the quantity of legislations. It should be noted that Chinese firms and citizens are confronted to this lack of transparency just as much as foreign firms.

- Prosecution and sanctions

49. Today, it is very difficult to launch a criminal lawsuit. Access to the criminal prosecution channel is not easy and the process is much longer. A large percentage of criminal cases are based on referrals from

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21 China's transparency commitments appear in Part I (General Provisions), Section 2 (Administration of the Trade Regime) of the draft protocol of accession, the latest (and presumably final) version of which is in WTO document WT/ACC/CHN/49 dated October 1, 2001. China's draft protocol has additional special provisions in it.

22 See WTO (2003c).
administrative agencies. But the decision of orientation to the criminal channel is based on a financial threshold which is loosely defined, thus leaving important discretion to the administrative officers. In addition it is not always easy to prove that the moneys involved are higher than a certain amount, especially when the case starts with the seizure of only a lot of products. In addition, experience shows that the local police rarely takes cases of counterfeiting without a strong support from the Ministry of Public Security in Beijing. In a recent case for instance, officials from the Ministry of Public Security came from Beijing for a criminal procedure to be initiated in Guangzhou, leading to the arrest of several persons.

50. Criminal prosecution, if successfully pursued, indeed can result in higher sanctions with a stronger deterrent effect than civil prosecution. Civil prosecution leads to the condemnation of legal persons, with rather low fines. It is not very difficult to empty and declare bankrupt the company accused of counterfeiting, while moving the production lines in other company. It happens that businessmen caught once for infringement don't stop there; fines become another tax-like cost for doing business. Reasonable condemnations of real persons can be more dissuasive as criminology shows that when the risk becomes too high, wrongdoers turn to other activities. For instance, in France, counterfeiters can be prosecuted at the same time in a civil and a criminal tribunal, leading sometimes to very deterrent sanctions.

Organisational Structure of the Administrative Enforcement Channel

51. One of the weak points of the administrative enforcement channel is the complexity of its organisational structure and the lack of a well-functioning co-ordination mechanism. Indeed, cases of infringement often present several dimensions: for instance patent and trademark. But, as described previously, patents and trademarks are dealt with by separate government bodies. This organisational separation inevitably wastes resources and affects the efficiency of administrative enforcement efforts. In the US, it is one same office, the Patent and Trademarks Office, which covers both patents and trademarks; Same thing in Russia, with the Federal Service for Intellectual Property, Patent, and Trademarks.

52. Another weak aspect of the organisational structure is the overlapping authority and lack of coordination among various administrative enforcement bodies. For instance, in the context of brands protection, amongst the Administrations for Industry and Commerce (AIC) Trademark Division, the AIC Economic Supervision Division the Technical Support Bureaus (TSBs), customs, the Public Security Bureaus (PSB) Social Order Divisions, the PSB Economic Crimes Investigation Divisions (ECIDs). This complex and overlapping structure makes work more complicated on the one hand, and contributes to create loopholes in protection, on the other hand. One common example of the resulting problems is the difficulty in promptly transferring criminal cases from the TSBs to the ECIDs, notwithstanding the fact that the relevant standards for criminal investigation and prosecution have clearly been met.

Financial and Human Resources

53. The judicial bodies and administrative authorities for intellectual property administration and protection have insufficient financial and human resources. The significant increase in the number of IPRs registered in China (cf. supra, growth rate around 20-30% per year) has put further pressure on resources. This lack of resources affects particularly the local level.

54. Financial resources of local IPR administrative authorities are allocated by the Provincial government. Most of the local IPR administrative authorities have an operational budget but no funds for law enforcement. There are only a handful of provinces in which local governments give higher attention to intellectual property protection and thus allocate resources to the administrative entities for law enforcement. Yet, even in this case, these resources are only provided on a provisional manner. In this

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23 See reply of the Chinese government in WTO (2003c), paragraph 46.

context, administrative fines sometimes become important resources for local administrations. This therefore creates an inbuilt incentive for administrations to keep cases in their enforcement channel.\textsuperscript{25}

55. The lack of competent human resources for IPR has also become a serious bottleneck that affects the quality of intellectual property administration and law enforcement. This problem has also a strong regional dimension: poorer regions have administrative authorities of less capacity. It thus often happens that cases are not properly handled or prosecuted because the administrators or judges in charge do not really understand the litigation procedures. Also, the capacity of judicial bodies for law enforcement is limited in some localities.

- Management of Research

56. Weak links between research management and IPR management impede making the most of research efforts in terms of creation of IPRs.\textsuperscript{26} This issue does belong to that of IPR policies, but as that of competition, it affects significantly the functioning of the IPR regime.

57. Government administrative departments in charge of science and technology plans, but also universities, public research institutions and enterprises all lack IP management system and agencies. Researchers and programme managers are not used to take advantage of the IP system and protect the legitimate rights and interests of the investors and their organisations. To create incentives for research results, the management of public research programmes traditionally relied on an award system, instead of encouraging for the application and exploitation of patents. Indeed, personnel management systems in universities and scientific research institutions link professional titles and treatment to the number of publications and awards. As a result, research efforts are directed towards publications and the pursuit of awards, rather than towards the production of applicable and independent intellectual property rights. Let us note though that it is only recently that OECD countries have been reforming IPR policies related to universities and public research organisations, to better connect science to innovation and IPR.\textsuperscript{27}

58. On the private sector side, some Chinese enterprises give up patent applications because they have little confidence in that their rights will be protected. Others do not know clearly how to make full use of their own intellectual property rights and protect their legitimate rights and interests. This lack of awareness and capacity contributes to weakening the IPR system overall.

\textit{IV.2 - Infringement}

59. The governance weaknesses described above affect the creation and the protection of IPR, and the ultimate goal of stimulating the production and use of new knowledge. In this sub-part, we take the problem from the other end and focus on the problem of IPR infringement, as it is the most visible consequence of these governance weaknesses.

60. Before turning to its analysis, we briefly give general information on the IPR infringement phenomenon.

\textsuperscript{25} If theoretically an administrative punishment does not preclude a subsequent criminal enforcement for the same act, in practice it is infrequent that criminal enforcement comes after administrative punishment. See response of the Chinese government, WTO (2003c), paragraph 55.

\textsuperscript{26} The productivity of research efforts in terms of patents is also affected by the fact that there are often duplication of work between research programmes and that these are not enough focused on really innovative topics at the frontier of knowledge.

\textsuperscript{27} See OECD (2003) and also OECD (2005) Part II.
a) General information on the infringement phenomenon

61. Despite government efforts, concerns remain about the enforcement of IPR protection in China. In fact, enforcement problem in China has become a greater concern than the IPR legislation to foreign and Chinese stakeholders. Recent studies found that the effect of criminal and administrative enforcement was insufficient to deter the level of IPR infringement activities in China (QBPC, 2004, DRC, 2003, and Maskus 2005).

62. All types of IPRs, patents, trademarks and copyrights, are vulnerable to infringement. Counterfeiting is the frequent form of infringement. Quasi all types of products are subject to counterfeiting in China: batteries, razors, medicines, shampoo, cigarettes, auto-parts, industrial valves, vision wear, apparel, air compressors, portable tools, power strips, extension cords, footwear, etc. In most cases, the counterfeited product does not present the same quality as the original. This may create serious health or safety hazards in the case of products such as medicine, or windshields (see Box 2).

Box 2 - Infringement and safety

Reports by China Consumer Association (CCA) revealed that cases involving serious bodily harm and death to consumers caused by counterfeits occurred to a devastating degree towards the end of 1990s. For example, 672 cases of serious injury were reported in 1997 and 1214 cases in 1998. Some 35 cases in 1997, and 70 in 1998, involved permanent injury, and cases involving death increased from 19 to 33 between these two years.28 It should be noted that the majority above cases were counterfeits of Chinese domestic products. For example, of the 33 deaths and 1214 serious injuries reported in 1998, 27 deaths and 1,000 injuries can be traced to counterfeit rice wine in Shanxi Province in North China (QBPC 2000). A recent assessment of the food safety standards by CCA revealed that on average 76.6% of food products checked during 1999 and 2003 by the quality control agency met the quality standards. Manufacturing of fake products and counterfeiting were identified as main threats to food safety.

63. The potential losses from counterfeit and piracy and the resulting economic impact can be significant, although the exact magnitudes of these losses and damages are difficult to assess. According to a survey conducted by the Development Research Centre of the State Council in 2001, the value of counterfeit goods in market circulation in China was estimated to be between 160 and 200 billion yuan (i.e. 19 to 24 billion US$). A survey of members of Quality Brand Protection Committee (QBPC) conducted in mid-2003 revealed that, despite obvious progress on many fronts in the anti-counterfeiting work, the problem was viewed by QBPC members as having remained the same or deteriorated in the past years. On average, counterfeits occupy an average of 25 percent of the markets inside China for QBPC members’ brands29.

64. An important part of the counterfeit and pirated goods are exported and sold on foreign markets. The QBPC survey confirms that exports of counterfeit products from China are likewise increasing, and over 80 percent of QBPC members have characterized their problems with such exports as “serious”. Data from seizures at foreign borders indicate that China is the world's first source of counterfeit and pirated goods. For instance, the U.S. Department of Homeland Security's Bureau of Customs and Border Protection reported the seizure of 2056 shipments from China containing counterfeit and pirated products, with a value of over US$62 million. These Fiscal Year 2003 statistics place China at the top of the list of

countries as the source of infringing goods stopped at the U.S. border. Other sources say that China's share of the world's trade of counterfeit and pirated goods would continue to increase annually.

65. The International Intellectual Property Alliance (IIPA) estimated that the losses of the US copyright based industry (CBI), including motion movies, records and music, business software applications, entertainment software, and books was in the order of 2 585 million US dollars in 2003 in China due to piracy, an increase of more than 36 percent over 2002. Except for books, which had an estimated piracy level at 40 percent, piracy levels of all the other US CBI sectors were above 90 percent in the respective Chinese markets, according to this source.

66. To analyse the problem of infringement in China, as in other contexts, it is interesting to distinguish between different situations of infringement. Governance weaknesses and the resulting ineffective enforcement system create opportunities for potential infringers of IP. The infringers of IP are not all the same: they may have different motivations, different business profiles and different types of links with the local business authorities. As we will further develop in part V, responses to these various infringement situations should differ accordingly.

67. In the following paragraphs, we introduce ways to distinguish between different types of infringement situations, thus decomposing the infringement problem into several sub-problems.

68. In some situations, the infringer is not aware of the rights of the owner and naïvely uses the property without being conscious of infringing a rule. There can be two reasons for this "naïve infringing". The infringer may not be aware of the IPR system. By essence, IPRs define an individual property, a notion intimately linked to market systems. The idea that a useful innovation or even that a brand's image or label cannot be used freely is not obvious and straightforward for most of ordinary Chinese people. Moreover some Chinese interlocutors oppose the IPR system with the elements of the Chinese culture, according to which, as only the great is copied, it is an honour to be copied, and a petty reaction to feel offended. Another possible reason is when property or the related rules are not clearly defined. Indeed, rules always leave a margin of interpretation. There is therefore an irreducible zone of situations in which the implementation of the rule will not be straightforward. In addition, defining precisely when patent abuse starts is a regulatory problem difficult to solve.

69. In all other situations, the infringer is aware of infringing a property, but assesses that the costs and/or the risks of sanction are negligible, in view of the benefits. Infringers thus take advantage of possible regulatory loopholes (for instance, a Chinese car manufacturer had put on the market a product borrowing for its front the design of a certain foreign brand car, and for its rear the design of another foreign brand car, thus taking advantage of a regulatory loophole on partial design); or of the ineffectiveness of the enforcement system. The different governance weaknesses discussed above - loopholes in the regulatory framework, the administrative organisational structure, the lack of resources, the lack of integration of IPR objectives in research and company business policies -- all contribute to this ineffectiveness of enforcement efforts.

31 See WTO (2003a).
32 Of course, it is difficult to draw the line between situations where infringers would be really naïve about IPR rights, and situations in which infringers would be putting forward contextual or cultural arguments to minimise their fault.
70. Infringement sometimes takes place with a more or less active complicity of local leaders. Indeed, while the Chinese leaders at the top are convinced of the need to develop a sound IPR regime, some leaders at the local level, in practice, do not always adhere strictly to these views. In such situations, local officials may turn a blind eye on infringing practices or even interfere with the enforcement of IPR regulations to protect the infringing local enterprises. To give an example, the Japanese government reported in the framework of the WTO review of the TRIPS agreement that when some Japanese companies had requested the seizure of counterfeit goods, local authorities had refused to seize goods because they had been produced by a major local company.  

71. The main motivations driving local leaders to tolerate infringement of intellectual property rights can be of different types. The loose compliance of local leaders to national IPR laws and regulations can be related to the pressure on the local government to meet economic growth targets, the fulfilment of which being an important determinant in the evaluation of local officials’ performance, and for career promotion. The local official’s interest in protecting infringing local firms can in some cases be related to even corruption where protections are extended for a return of personal interest. But this loose enforcement can also be guided by collective interests, when local leaders judge that the local, short-term benefits of a strict IPR enforcement are exceeds the costs.

72. - In situations of "local protectionism", local officials seek primarily to develop the local economy and to maintain local employment, against competitors based in other provinces. This leads for instance to situations in which local leaders will influence the court rulings in favour of the local defendants.

73. - Local leaders may consider that the competitiveness of the Chinese export companies based on low labour costs is reduced or even lost, when these have to pay high licensing fees for foreign technologies or other loyalties. Technological transaction costs increases can affect technology use, transfer and dissemination. As the credit system and the credit environment are still under construction, it is difficult for companies to overcome the barriers thus created. These short-term observations create incentives to free ride and not implement efficiently IPR policies.

74. - Local leaders may consider that a company producing goods of similar quality and at cheaper prices, copying an original product, serves the interest of local consumers. A typical such company would be for instance a company founded by local governments 10 years ago, which has a fully formal façade and pays taxes, but that will combine perfectly legal operations with operations in the margins of legality in terms of obeying the IPR regulations.

75. - Local leaders may also consider that the protection of property rights related to foreign culture products is not a priority in the Chinese context. They would thus not mobilise a lot of efforts to nail down the "fly by night" types of companies that usually provide copies of DVDs, software, etc. operating at a small scale, with few fixed assets.

76. The weak enforcement at the local level is a result of the organisational and resources structure at the local level: as described earlier, local administrative entities in charge of enforcement are dependent on the local government through their budget and carrier management of the staff. The judicial entities are not independent either. As links often exist, through Party structures, between enterprises and local government officials, the IPR enforcement system is vulnerable to the influence of local government interventions. The overlapping mandates of different executive administrations involved in IPR enforcement and the confusion that sometimes result also contribute to creating opportunities for interference.

33 See WTO (2003c).
V. How to improve Enforcement?

V.1 - Actions Taken by the Chinese Government

77. Chinese authorities acknowledge the need for stronger enforcement, and have been taking various measures for this purpose. Quoting SIPO's Commissioner, Mr. Wang Jingchuan: "Protecting intellectual property is not only the necessity for China to comply with its promises made in its accession to WTO, but also the needs of expanding opening-up and introducing foreign investment and advanced technologies. Above all, it is also the inherent demand of the country in its economic development and comprehensive social progress."

78. China recently revised its major IP laws and regulations, such as the Patent Law, the Trademark Law, the Copyright Law, and the Regulations on Protection of Computer Software. It also formulated and promulgated the Regulations on Protection of the Layout Design of Integrated Circuits. Those laws and regulations expand the scope and force of protection of intellectual property. They also increase the rights of right holders and intensify the force of judicial and administrative law enforcement.

79. In 2003 a number of regulations and administrative protection measures were promulgated to increase protection, such as the Regulations on Customs Protection of Intellectual Property Rights, the Implementing Measures on Copyright Administrative Sanction, the Measures on Implementation of Compulsory Patent License and Measures on Administration of Patent Agencies. In addition, China has also amended or abolished some other regulations or rules not consistent with the WTO rules.

80. As mentioned previously, an important step was the entry of SIPO in the National Office for Rectification and Standardisation of Market Economic Order in 2003. Combating counterfeit production and sales, and protection of intellectual property became a priority on the work agenda of this leading group in 2004. A further step taken in this direction was the creation of State Council IPR Protection Leading Group, led by Vice Primer Wu Yi, later in 2004.

81. Also, on the occasion of the 2004 "World Intellectual Property Day", nine Chinese governmental agencies under the State Council (including the Ministry of Public Security, the Ministry of Culture, SIPO, SAIC, the Quality Supervision Office, the Copyrights Administration Bureau and the Customs General Administration) jointly launched a week-long nationwide campaign in April 2004 to raise the awareness on IPR protection.

82. The Government is also well aware that the further enhancement of enforcement necessarily calls for a greater role played by the judiciary channels. In view of this, the Government is taking the necessary steps to lower the threshold for criminal penalties in the judicial execution of the IPR laws. The Supreme People’s Court and the Supreme People’s Procuratorate have been drafting a new juridical interpretation that will clarify and relax the criteria for transferring IPR cases to judicial channels for enforcement.

83. China's has also taken various measures to address the bottleneck of the shortage of qualified personnel. First, on-the-job training programmes for IP management and enforcement staff at various levels of government have been organised sometimes through co-operation with international organisations or foreign governments bilaterally (see for examples in OECD 2005). In addition, Chinese officials and professionals have been sent abroad for study visits. Particular attention has been attached to enforcement personnel, notably through exchange of experience with counterparts in the United States and the European Union. Second, training efforts have also been developed towards enterprises. For instance, to provide guidance to enterprises for their IP management and to foster their awareness of IP, various administrative

departments for IP and the industry associations have co-organised workshops for enterprises. Third, more than 70 universities and colleges in China are now doing intellectual property researches or offering IP courses. A complete intellectual property degree education mechanism including double-degree, master degree and PhD degree education, has taken shape, providing competent and specialized workforce.

84. To improve the governance of the interface between research and patents, the government made two major amendments in the Patent Law to give the public research organisations the legal status to own the IP generated by their research, and then to grant researchers right to own IP rights of their research through contractual arrangements with their institutions. However, lack of understanding of the importance of IPR and shortages of skills required for IP management and technology transfer resulted in an inadequate implementation of the government IPR policies in Chinese PROs and universities.

85. To address this situation, several other steps were taken by SIPO. SIPO has launched in 2001 the Promotion Project for the Implementation of IP Strategy. IP demonstration programmes are presented in cities, science and technology parks, enterprises and industrial sectors. SIPO has approved 28 cities for the city IP system pilot programme, five pilot zones for the high-technology IP system, six pilot bases for industrial patent projects, 60 pilot enterprises, and 73 pilot projects for the commercialisation of patented technologies. For example, enterprise experimental work should mainly start by strengthening IPR administration and protection, guiding enterprises to establish patent management frameworks and to perfect management institutions. This mainly includes setting up the IPR management bodies, effective allocation of personnel and organisation, utilising patent information, and putting official innovation policies into practice. SIPO has also promulgated relevant documents, such as Guiding Principles for City Patent Demonstration Work to Promote Technological Innovation and Administrative Regulations for Enterprise Patent Work (draft). Also, the Long-term and Mid-term Plan for Science and Technology under promulgation includes IPR policies.

86. Enforcement statistics confirm that progress has obviously been made on many fronts. In 2003, the number of trademark counterfeiting and infringement cases investigated and prosecuted by the trademark authority increased by 13% over 2002, the number of false patent cases and patent falsification cases investigated by SIPO increased by 67% and 41%, respectively, over 2002, the number of copyright infringement cases dealt with by the copyright authorities increased by four fold over 2001, and the number of IPR infringement cases detected by the Chinese customs increased by 32% in 2003 over the previous year. The number of IPR cases heard by the judiciary system also increased in the recent years.

87. Yet, in spite of these progresses, many Chinese and foreign enterprises included in the DRC survey on counterfeiting (DRC 2003) considered that the problem had remained the same or had deteriorated in the past years. The following sub-part will discuss how to improve the current situation, through governance changes.

V.2 - Comments: Towards a Multi-Dimensional Enforcement Strategy

88. Enforcing IPR could be compared to an arm-wrestle between the State and those that benefit from infringement. The State opposes efforts of control and sanctions to the interests of the infringers. This simple comparison leads to three simple conclusions for the efficiency of IPR protection in China.

89. The stronger the interests linked to infringing, the more efforts authorities will have to put into enforcement. It is likely that the pressure linked to infringing interests decreases with economic development. Not because the gap between static costs and dynamic costs related to IPR decreases with economic development -- it would be difficult to say. But rather because economic development brings more alternative possibilities for development. Also other reform measures that have the effect of reducing the immediate costs of IPR protection for companies and consumers can also contribute to facilitate
protection, as it would make it easier for these actors to stay within the system. For instance, policies to strengthen the credit system that would support licensing of technologies go in that direction.

90. An enforcement strategy should remain closely related to the ultimate goals of IPR protection, differentiating in this the different types of intellectual property. The idea is not to pursue a strong IPR regime per se, but to serve particular purposes, e.g. of fostering research and development, to nurture literary creation, etc, for economic and social development. In this respect, the approach should be tailored to the current Chinese context. If, in theory, IPR protection contributes to foster R&D, in practice in the current Chinese context, IPR protection will not lead overnight to a spectacular increase in research results. Therefore enforcement targets should be adapted to feasible objectives. For instance, it might be advisable to pay particular attention to the protection of utility models. Also it could make sense to think sector per sector and to link the IPR policies to other policies aiming at creating an enabling environment for businesses. This should not mean that IPR protection should be neglected in some sectors and ensured only in those where China is an IPR producer. Rather the idea is to build progressively an IPR culture and an IPR system.

91. In this arm-wrestling situation, the State will be stronger if it manages to solicit support from allies: i.e. those groups that benefit from IPR protection. This includes of course the IPR owners but, maybe more importantly, the citizens, the consumers that benefit from the existence of new knowledge, or the reliability of trademarks.

92. Industrial associations can be crucial allies. Chinese enterprise associations are beginning to play a role, role which should be further strengthened. Industrial associations can play three types of functions. First, they can work as self-disciplinary organisations by soliciting member companies to sign intellectual property protection agreements. Such agreements call for the adoption of internal rules, encouraging both innovations geared towards IPR creation and respect of existing IPRs. For example, the Wenzhou Lighter Association and the Shunde Furniture Association in Guangdong organised local firms to establish protection treaty of IPRs. Second, industrial associations can help solve intellectual property disputes. For example, under the authorisation of some local enterprises, the Chinese Audio and Video Association negotiated with foreign owners of the IP rights (such as 3C and 6C) on patent licensing fees. Third, industrial associations can serve as a bridge between government and enterprises, bringing information on latest regulatory developments to members and providing guidance in the regulatory and decision-making processes.

93. Foreign chambers of commerce, associations and law firms have been extremely active in advocating for strong IPR protection and in providing support to companies and sometimes to the government. The Chinese government has been working already very closely with the Quality Brand Protection Committee, and this relationship should be continued and the co-operation with the Chinese government should be expanded to local levels as well.

94. As mentioned already, other civil society associations could also play an important role in enforcing IPR policies. This is especially true to fight against infringing situations of criminal infringement (cf. Box 2), i.e. when consumers are deceived on the products and that this puts them in danger. For instance, consumer associations can express their support to build political will locally for the protection of IPRs. One could also imagine that associations could play a role in educating citizens on how to check whether products are original ones or fake, through simple quality tests.

95. State authorities can try to maximise this leverage effect of allies by supporting the creation of non-governmental associations around special interests. It is indeed important that the governance structure allows the expression of different groups of interests and that checks and balances prevent local leadership to be captured by a group of actors benefiting from infringement. In the area of patents, further valorising
the results of public research would also contribute to create a group of interests in support of IPR protection. And of course, consultation with stakeholders should be encouraged in the policy and law making processes. Recently, Beijing Municipal Government, which held hearings with Beijing people on the new traffic regulations, and subsequently revised some clauses of the new regulation based on the results of the hearing, set a good example in this respect. This practice should be adapted to the IPR rule making processes.

96. From this point of view also, economic development is likely to facilitate enforcement of IPR, as more Chinese firms becoming IPR owners, these will increase the pressure for stronger protection and the resulting political will.

97. This is well reflected by the fact that, in recent years, some local governments in relatively developed regions and high-technology industrial parks have come to realise the importance of IP protection for development. These rely on enhanced IP protection and management to promote their local brands, improve the investment environment and sharpen local competitiveness. They encourage patent application and have adopted various measures to strengthen enforcement, including increasing the resources allocated to IP administrative departments for that purpose.

98. But localism continues to pose serious obstacles to IPR protection, as noted for instance by the Quality Brands Protection Committee (QBPC) in its 2003 annual review. In its response to criticisms on this issue from other member countries in the WTO TRIPS Review Mechanism, the Chinese government stressed that it has always been engaged in fighting localism. To this end, the State Council adopted in April 2001 the Provisions on Prohibiting Regional Blockage in Market Economic Activities. QBPC encouraged the government "to examine new ways to tackle protectionism and create a more stable foundation for enforcement work", including "the targeting of 'black spots' for anti-corruption investigations and the establishment of hotlines that will allow IPR owners and members of the public to report suspected cases."

99. The organisational structure of the administrative enforcement channel contributes in fact to sometimes loose enforcements at the local level. Indeed, as described previously, the administrative departments and the courts in charge of enforcement are too dependent on local government and therefore too vulnerable to their interferences. This is primarily a matter of financing and of human resources management. The complex organisational structure of the administrative departments involved in IPR protection also contributes to this problem. Indeed, the resulting co-ordination problem reinforces the role of the local leadership as the only entity capable of solving problems that may arise.

100. Therefore, a possible solution could be to reorganise the administrative enforcement channel, by creating an enforcement agency that would deal with all types of IPR. While this agency would still be funded by the local governments as part of the local administration machinery, it should be made relatively independent by having it placed directly under the supervision of the highest local government leader. This would allow solving the co-ordination problems between departments; it would clarify the funds budgeted for enforcement; and it would also make it easier to strengthen the weight of enforcement bodies and increase their independence vis-à-vis local pressures. Such a restructuring option could be considered as an important policy research topic in the context of further strengthening the IPR protection in China.

101. It is interesting to note that China restructured the tax system by making it an independent vertical organisation, separate from the local governments. The fact that a similar restructuring is not considered for the IPR enforcement system may partly reflect a lower priority given by the Central government to IPR protection.

36 See WTO (2003c), paragraph 51.
enforcement than to the tax revenue collections. Partly, it should be related to the resource constraint in financing a centrally structured IPR enforcement system. Since the current decentralised system is financed by the local government budgets, it would add the expenditure of the Central government budget to fund a centralized system. Whether the Central government will decide to allocate the needed resource to create an independent system would depend on whether benefits of such system for China as a whole would exceed the cost of it. Given the current level of China’s economic development stage, it would seem unclear how the benefits would compare to the cost. However, before the benefit exceeds the cost of creating an independent IPR enforcement system, other restructuring measures should be pursued to improve upon the enforcement systems.

102. In summary, despite significant progress in the development of IPR policies and enforcement, further challenges lay ahead both in the short term and long term for China to improve and enforce its IPR legislation. While accession to the WTO has given rise to new opportunities for the Chinese economy, it has also exposed Chinese firms to greater international competition under the WTO rules, including TRIPS. This means that the Government and Chinese industry need to learn as quickly as possible how to play by the new “rules of the game” not only in respecting others’ IPRs but also to strengthen the competitiveness of Chinese industry in the global market. In the long run, the challenge is to design and adapt IPR policies to accommodate changing needs and requirements. IPR policy will need to support not only foreign direct investment and transfers of foreign technologies, but also encourage domestic R&D and innovation, and technology diffusion. The large size of its economy and the still low and uneven levels of economic development coupled with a very weak awareness of IPRs by government officials, enterprises and the vast Chinese population make it no easy task for the Government to meet these challenges. Steps to improve governance of the IPR system and in general will be important for China to manage both the short-term and long-term challenges.
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VI. Annex: A Brief Description of China’s Judicial System

103. Broadly defined, China's judicial system consists of three parts: People's Court System, People's Procuratorate System, and the Public Security System. The Court system and the Procuratorate system, which are under the People's Congress, are on an equal footing with the administrative system, i.e. the government under the State Council. The security organ is part of the administrative system.

104. The people's courts are judicial organs exercising judicial power on behalf of the State. China practices a system of "four levels and two instances of trials", whereby a case should be finally decided after two trials. This means a judgment or order of a first instance must come from a local people's court, and an appeal can be made only once to the people's court at the next higher level. However, the People's Procuratorate may present a protest to the people's court at the next higher level.

105. People's Procuratorates are "State organs for legal supervision", and in relation with the courts and the public security organs, they have the following reviewing and supervision functions: i) to review cases investigated by public security organs and to determine the approvals of arrest, prosecution or to exempt from prosecution; ii) to exercise supervision over the investigative activities of public security organs to determine whether their activities conform to the law; iii) to initiate public prosecutions of criminal cases and support such prosecutions; to exercise supervision over the judicial activities of people's courts to ensure they conform to the law; and iv) to exercise supervision over the execution of judgments and orders in criminal cases and over the activities of prisons, detention houses and organs in charge of transformation through forced labour to ensure such executions and activities conform to the law.

106. The security organs which include Ministry of Public Security, the Ministry of State Security and the Ministry of Justice are parts of the administrative system under the State Council. While the Ministry of Public Security and Ministry of State Security perform the function of justice such as criminal investigation, detention, preliminary hearings and arrest, the Ministry of Justice is in charge of prison, lawyer, notary and people's mediation. The Ministry of Public Security is charged with the responsibility of investigating illegal and criminal activities related to IPRs infringement.