

International Intellectual Property Rights: Is China Serious About Enforcement?

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Introduction:

In discussions regarding international intellectual property rights (IPR), China is always at the forefront of controversy. When one mentions international IPR violations, China is the first country to come to mind. A walk through the streets of Beijing will validate China's problems with protection of intellectual property rights. Street vendors aggressively peddle "Rolex" watches, pirated DVD's, and "Mont Blanc" pens. There are shopping centers whose shops appear to be solely populated with vendors selling fake goods with logos from Polo, Oakley, Coach, Prada and many, many more expensive brand names. All of this seemingly illegal commerce is done openly without fear of consequence. The inaction of regulatory authorities sends a message that China is complacent, possibly even supportive, with regard to IPR violations. And maybe this is the case. Think of the revenues generated, the number of workers employed in manufacturing and dealing pirated goods. Possibly the enforcement of intellectual property rights could be too detrimental to the Chinese Economy.

But the other consideration relating to IPR enforcement has to do with whether Chinese commerce may increase if other countries knew that they would have protection within China. As China has opened up to multinational businesses producing goods and services within their borders, the Chinese economy has flourished. Many companies such as General Motors, Microsoft and General Electric have opened operations in China. However, many others have avoided China because of fears that their technology would be pirated. Would China be better off having the additional businesses bringing operations to China? Or, are the benefits of the pirating industry greater than the lost opportunities from legitimate foreign operators? Similarly, are the Chinese pirate operations also taking away from the legitimate Chinese companies?

Unbeknownst to many, China actually has stringent intellectual property rights protection laws in place. And they prosecute many violators of these laws. So, the question that we postulate is: Is China concerned about enforcement of IPR? In the following pages we will try to answer this and other questions regarding China's interests in enforcement of IPR laws. We will first give an overview of intellectual property, ensuring that the reader understands the various types of protected property. Then, we will look at some examples of blatant, large scale pirating of intellectual property. In contrast to these examples, we will look at China's efforts to enforce IPR. And finally, we will examine the advantages and disadvantages of IPR enforcement in China.

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Intellectual Property Primer:

Intellectual property tends to fall into the categories of inventions; literary and artistic works; and symbols, images, names and designs used in commerce. Inventions are typically covered in most countries by patents. Patents give an inventor exclusive rights to their inventions. This protection prevents others from making, using and selling a patented invention for a certain period of time, typically 20 years. In return for these protections, the inventor discloses to the public the details of the invention. This protection encourages the development and distribution of new ideas and technologies. Without the protection, key information behind inventions would be kept secret and would die with the inventor.

Literary and artistic works fall under copyright protections. Copyright is a legal term which describes the economic rights given to the creators of the works. These rights include the ability to reproduce their work, to make copies and to perform or display their “products” publicly.¹ Copyright protection typically covers the creator’s life plus 50 years.

Symbols, images, names and designs are covered by trademark laws. Trademarks are distinctive signs or indicators which identify certain goods or services of a specific person or enterprise. Well-known examples of such signs or symbols are the Nike “swoosh”, the Izod alligator, and the Levis jeans back pocket stitching. Consumers use these trademarks to identify the products or services they seek or wish to avoid. Trademarks must be registered throughout the world and never expire.

Protections for intellectual property rights date back to the 1800’s with the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Works. But coordination among countries to protect IPR was far from adequate until recent years. The first major collaborative IPR protection was the General Agreement on Tariffs and Trade (GATT), enacted in 1986. Efforts to improve protections between countries are ongoing.

Many countries work hard to protect intellectual property because doing so is advantageous to their respective economies. “Safeguarding these property rights fosters economic growth, provides incentives for technological innovation, and attracts investment that will create new jobs and opportunities for all ...citizens”² In a capitalist society, inventors and artists are financially rewarded for their efforts for long periods of time because of the protections granted them by copyrights, patents and trademarks. Without these protections, there would be less incentive to invent and create. Emblematic of the value of IPR to an economy, over 50% of the United States exports are dependent on some form of IP protection.³ Some would posture that China does not yet understand the value of protecting intellectual property. We will address this issue later in this document.

¹ Field, Thomas, G., “What is Intellectual Property?” USINFO.State.Gov, January 2006

² Field, Thomas, G., Ibid

³ Field, Thomas, G., Ibid

Chinese Economic Development

To better understand China's dealings with intellectual property rights issues, it is important to understand their economy, both from a historical view as well as current. First, like any other country, China has been the source of many inventions throughout history. As examples, gunpowder and the compass are Chinese inventions. So, it is not as if they have never had any intellectual property to protect. However, for centuries all ideas were owned by the state. For decades of communist rule, all private property was banned. Therefore, for much of their modern history, the culture has not been one of protecting individuals' creativity or inventiveness.

Also, historically China has been a poor, labor intensive economy. The poorest countries allocate few resources to invention and innovation. Therefore, they have much less intellectual property to protect. As stated in the preceding paragraph, China has inventiveness in its history, but has been much less dynamic in this area than the more industrialized countries. Closed borders, communism, and poverty are not the breeding grounds for innovation.

However, China has evolved greatly in the last couple of decades, with changes continuing at breakneck pace. With these changes, income levels have improved, as have technical capabilities. "As incomes and technical capabilities grow to moderate levels, some inventive capacity emerges, particularly of the adaptive kind, but competition remains based on imitation and the majority of economic and political interests prefer weak protection"⁴ This statement may best describe where China has been in recent times: evolving into a strong economy supportive of IPR protections, but not yet there.

As the Chinese economy continues to evolve and strengthen, their protection of IPRs will most certainly follow. Most of China's new-found wealth is in the coastal and urban regions. Firms in those regions tend to be much more active in using IPRs and wishing to see protection of those rights. The poorer regions of the country, where innovation is not cultivated, are not interested in IPR enforcement, as much of their livelihood can be attributed to violation of IPR.⁵

As the Chinese economy continues to evolve, there will be more reliance on and support of intellectual property rights. This dependence on IPR will lead to better enforcement. In short, the Chinese economy has come far in a short time. They have much history and culture to overcome before protection of IPR becomes engrained in their economy. As we will discuss later, they have made great strides in development of policies, but enforcement is greatly lagging.

Pirating in China:

As mentioned in the opening section, China has a reputation for IPR violations. By various estimates, the IPR thefts cost affected countries billions of dollars. U.S. Assistant

⁴ Maskus, Keith E.; Dougherty, Sean M.; Mertha, Andrew; Intellectual Property rights and Economic Development in China Empirical Investigations on the Effects of Intellectual Property Rights, Chapter 11, pg 4

⁵ Ibid Chapter 11, pg 5

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Secretary of Commerce William Lash stated that U.S., European and Japanese companies had reported combined losses to Chinese piracy of at least \$60 billion in 2003.⁶ In what appears to be a significant step towards enforcing IPR violations, some of China's major markets recently signed an agreement with well-known international name brands including Louis Vuitton and Gucci. The agreement stated that these markets would not sell fake versions of their products. The agreement contained a "two-strike" policy, whereby vendors violating the agreement would first receive a warning and then would be evicted from the market. European Union Trade Commissioner Peter Mandelson hailed the new agreement and viewed the signing as a true indication of progress, stating "This initiative is highly significant and should be an important step to maintain confidence in these markets."⁷ However, in a brazen disregard for the new agreement, vendors at the famous Silk Alley market in Beijing were again selling the "knock-offs" within a week of the new agreement. The lack of enforcement seems to illustrate that the Chinese government is incapable or unwilling to control the rampant piracy within these markets.

However, Chinese authorities have warned vendors that they will not tolerate counterfeit 2008 Olympic products. A search for these products at one of the Beijing markets unveiled none of the Olympics merchandise, nor were vendors even interested in discussing Olympics products.

The lack of Olympics merchandise indicates that the government does have the ability to curtail trade in pirated goods. However, they may not be willing. But it does seem like some progress is being made. One vendor stated that certain name brands such as Prada are not allowed in her market. She said that inspections were becoming more frequent. Vendors discovered selling the protected goods would have the goods confiscated and fines levied. As for the goods not protected, such as Ralph Lauren Polo shirts, the vendor stated that there was no enforcement by the authorities.⁸ Therefore, the vendors openly sell counterfeits of this brand.

Other more serious examples of intellectual property pirating involve pharmaceuticals. Pharmaceutical companies invest billions of dollars in research and development costs to create a relative few successful drugs. Because of these substantial up-front costs, exclusive patents are granted on drugs throughout the world. The exclusivity allows companies the time to recoup their development costs and make a profit. The protection process gives these companies an incentive to make the drugs.

By some estimates, 8 to 10 percent of the world's medical supply consists of counterfeit products. The World Health Organization estimates that approximately \$35 billion in counterfeit drugs are sold each year.⁹

Pfizer created the drug Viagra and opened a plant in China to produce the drug. Viagra was at the center of IPR controversy in China. Unlike the vast majority of countries, China does not allow any chemicals to be patented. Instead, they evaluate what a chemical is designed to do and allow protections of the drug's purpose. With Viagra, the drug's purpose is pretty clear.

⁶ Hu, Peggy B. and Gomez, Berta "Chinese Counterfeits Hurting Industry in China, Experts Say" USINFO.State.gov, May 19, 2005

⁷ "Piracy Still Strong in Beijing Markets, Despite IPR Deals" *Taipei Times*, June 12, 2006, pg 10

⁸ *Ibid.*

⁹ Pettypiece, Shannon "Pfizer Wins Viagra Case in China" *International Herald Tribune*, June 4, 2006

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However, after Pfizer filed for protection in China, the government tightened the rules, resulting in Pfizer not gaining protections, protections it had secured in countries throughout the world. As a result, dozens of companies were poised to copy Viagra's formula and sell the copied drug throughout China. Even while Pfizer's appeal was in process, counterfeit drugs were in the shops and markets of China. The fake drugs were in the same shape and color as Viagra. Some had different names printed on the pills, while others were identical. And the active ingredient of Viagra, sildenafil citrate, was also included in the fakes.¹⁰ While these fakes may have provided results similar to those of Viagra, Pfizer was not being rewarded for its development of the drug.

Additionally, the quality controls of manufacturing counterfeits are not monitored. So, the fake drugs could cause health risks. According to Deputy Commissioner of the FDA, Scott Gottlieb, "The result is risks to patients' health. Either risk to their safety directly if the products are dangerous, or risks from people suffering from complications from the many diseases that prescription drugs can treat today."¹¹ Inspections by Pfizer investigators found counterfeit drug labs with less than hygienic manufacturing processes in place.

Fortunately for Pfizer, they recently won their appeal, overturning the 2004 ruling by China's patent review board. Therefore, Pfizer has won the right to be the sole producer and distributor of Viagra in China. Per Pfizer spokesperson Paul Fitzhenry, "We see the decision as an encouraging development for knowledge-based companies like Pfizer who want to bring innovative products to the Chinese market."¹² While this speaks well to China's efforts to protect patents, only time will tell as to whether they enforce the ruling secured in their court system.

As a final example, let's look at the challenges of motorbike producers such as Yamaha, Suzuki and Honda. While passenger car manufacturers enjoy explosive growth in China, the motorbike producers are struggling to compete. One reason is the cheaper pirate bikes available to Chinese consumers. Yamaha estimated that just a few years ago five out of six Yamaha motorbikes sold in China were cheap imitations.¹³ So, consumers were quick to buy what appeared to be high-quality Yamaha bikes for prices that were 30% less than the price of originals. To make matters worse, these fakes were beginning to be exported to other markets, further undercutting Yamaha's market share and profitability.

As with pharmaceuticals, these fake motorbikes were also putting consumers at risk. While the quality of many of the counterfeit parts has improved, certain aspects of the bikes are still inferior. Examples of substandard components that could put users in danger are those having to do with braking, accelerating and cornering. When counterfeits are allowed into the market, quality controls are at risk and, therefore, so are consumers' safety and protections.

So, imagine what must be involved in the manufacture of counterfeit motorbikes on a mass production scale. Such an endeavor would involve a full-scale factory with many machines and many workers. This is hardly the type of business that could be hidden in a small apartment

¹⁰ Perry, Kim "Intellectual Piracy in China" Online News Hour, October 13, 2005

¹¹ Pettypiece, "Pfizer Wins Viagra Case in China" [op.cit](#)

¹² Pettypiece, [Ibid](#)

¹³ Bremner, Michael and Hiroko, Tashrio, "Japanese Bike Makers Hit the Wall in China" [Business Week](#) Online, July 21, 2006

or the basement of a home. How could such a large scale operation go undetected by the authorities charged with enforcing intellectual property laws? These are the types of examples that make us question whether or not China has any interest in enforcement of IPR. So, what is China doing to improve IPR protection in China?

Chinese IPR Enforcement System:

There are two aspects to improving intellectual property rights in China or, for that matter, any country. The first is enactment of legislation in support of IPR. The second is in enforcement of the legislation. As we will see, China has made great strides in both areas, but it is in the enforcement arena that China is still failing. And without enforcement, laws carry little weight.

Clearly, intellectual property rights are a global issue. Inventions, works of arts and trademarks regularly cross borders in our global economy. As China has become an active participant in the global economy, it has made efforts to at least show that it is concerned with IPR. Along these lines, China has joined all of the major international IPR conventions. Examples include the Paris Convention of 1885, the Madrid Protocol and the Washington Treaty in 1989, the Berne Convention and the Universal Copyright Convention in 1992, the Patent Cooperation Treaty in 1994 and others. Additionally, China joined the World Trade Organization (WTO) in 2001, after 15 years of negotiation.

The WTO recognized the importance of protecting intellectual property rights among its member countries. In recognition of this importance, the WTO created the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The TRIPS agreement was created in an attempt to narrow the gaps in the way intellectual property rights were treated around the world by bringing them under one common set of rules. The agreement covers five broad issues:

- How basic principles of the trading system and other international intellectual property agreements should be applied
- How to give adequate protection to IPR
- How countries should enforce these rights adequately in their own territories
- How to settle disputes on intellectual property among members of the WTO
- Special transitional arrangements during the period when the new system is being introduced

Like all members of the WTO, China is required to comply with the TRIPS Agreement. However, China has had a difficult time adhering to the agreement. In February 2005, Erick H. Smith, President of the International Intellectual Property Alliance, addressed the U.S.-China

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Economic and Security Review Commission. In his testimony, he stated that the Chinese copyright laws were generally good and that the actions against pirates were good faith efforts.¹⁴ However, these actions proved to not deter the violators from continuing with their pirating activities. In essence, the law enforcement actions had no “teeth”.

Others’ observations support the fact that current enforcement does not deter the criminal acts. Criminal prosecutions are still rare and the fines too low to serve as much of a deterrent. According to Assistant Secretary of Commerce Lash, IPR violation fines were running at a mere .05% of the value of the piracy activity.¹⁵ To put this in perspective, if someone was caught in a \$100,000 pirating operation, their fine would be approximately \$50. In summary, these efforts at deterring IPR violations do not meet the standards set by the WTO’s TRIPS agreement.

While not meeting the WTO’s standards, the Chinese government has taken other significant steps to comply with global IPR requirements. They have created tougher domestic laws, increased enforcement activities, launched public information campaigns and cooperated with trading partners and organizations such as WIPO, the World Customs Organization and others. But again, it is the enforcement efforts that are lacking.

The United States has offered assistance to China to help them enforce their more stringent laws. Part of this assistance has involved providing technical support, including training for Chinese judges and officials. And the efforts appear to be helping. The country’s Supreme People’s Court has enacted new legal interpretations to lower criminal thresholds for IPR crimes. This translates into significant increases in the number of criminal and civil IPR cases.¹⁶ In the first eleven months of 2005, there were well over 3000 criminal IPR violation cases in China, an increase of over 28% from the prior year. Civil cases numbered nearly 13,000, an increase of approximately 27%. The country’s top judge and head of the Supreme People’s Court stated that the efforts against IPR crimes had to intensify in order to create a favorable legal environment for independent innovation.¹⁷ These are strong and encouraging words coming from the court system.

Beyond the court system, China has the most active trademark office in the world and an actively growing patent office. Additionally, there is an emergence of many Chinese IPR-related trade associations and the Chinese media is covering IPR matters more extensively than in past years. These changes are somewhat driven by Chinese rights holders. Clearly, as Chinese businesses have become more innovative, they have had a greater need for protection. So, while China may not be that motivated to protect the rights of foreign firms, it does seem to show more interest in protecting its own.

The single biggest challenge to enforcing IPR violations may have to do with China’s political and legal structure. The Chinese legal system consists of four levels of court, and only the Supreme People’s Court is national in scope. So, this leaves most of the enforcement in the hands of the locals, where much protectionism exists.

¹⁴ Smith, Erick H., Testimony Before the U.S.-China Economic and Security Review Commission, February 5, 2005

¹⁵ Hu, Peggy B. and Gomez, Berta, *op.cit.*

¹⁶ Hu, Peggy B. and Gomez, Berta, *Ibid*

¹⁷ Xinhua, China Tackles 3250 Criminal IPR Violation Cases in First 11 Months of 2005, People’s Daily Online, January 6, 2006

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China is comprised of 31 provinces. Each province has its own courts under the jurisdiction of the local government, which sometimes has a direct interest in ignoring IPR violations. Those factories that manufacture the pirated goods may even be owned by the local government. Regardless of whether the local government has a financial interest in the factories, they do have an interest in the social well-being of their jurisdictions. Social well-being is closely tied to employment of citizens. If many citizens are employed by businesses involved in IPR violations, there is a clear incentive to ignore the laws in favor of the employment of workers.¹⁸ “External pressure may lead to formal agreements in Beijing, resulting in new laws and official regulations, but it is China’s complex network of bureaucracies that decides actual policy and enforcement” says Andrew Mertha, author of The Politics of Piracy: Intellectual Property in Contemporary China. While the laws have been developed at the national level, the enforcement must be at the local level.

But, the local investigative police and prosecutors are paid by the local economy. This makes it difficult for intellectual property rights holders to get a fair hearing in a local community, especially when the plaintiff is from outside the local jurisdiction, which is usually the case. So, the laws are in place and a different approach is necessary in the enforcement. One suggestion is that those interested in enforcement of the laws work at the local level and use insiders. This approach has merit for two reasons. First, as we have seen with the protection of the 2008 Olympic logo, when China is motivated to enforce IPR violations, it can be effective in doing so. They are more interested when the enforcement is perceived as being in China’s best interests. If local bureaucrats are behind the enforcement, there is a better chance of success. Second, the local law enforcement officials are on the front lines of stopping pirating. If interested parties (those whose goods are being pirated) consider supporting and subsidizing the local law enforcers, the locals will have more incentive to stop the pirating activities. Currently, there is little incentive for local law enforcement to disrupt the IPR violation activities.

IPR Enforcement: Pros and Cons:

While China has made incredible strides in developing legislation against IPR as well as working with numerous international agencies to show their support for enforcement, the grim reality is that China’s record on IPR enforcement is still substandard. Pirating activity in China is still extremely prevalent. This would lead us to question whether China is really interested in enforcement. As we have seen, there are many Chinese workers who make their livelihood through businesses that violate IPR legislation. If these businesses are shut down, what would that do to the Chinese economy? Perhaps it is better to allow these businesses to operate and periodically “slap their hands” with minimal fines in order to appease the critics. Let us now look at both sides of this issue to determine whether China is in fact interested in reducing IPR violations.

¹⁸ Everding, Gerry, “War on Intellectual Property Theft in China Best Fought at Local Level, Suggests New Book” Washington University in St. Louis News & Information, September 6, 2005 (Review of The Politics of Piracy: Intellectual Property in Contemporary China by Andrew Mertha)

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Arguments Against Enforcement:

China is a country with much poverty. And the opportunities are few for those living at subsistence levels. But, counterfeiting trade has created an opportunity for the poor to raise their standard of living. It is estimated that millions of Chinese workers are dependent on counterfeit trade. Counterfeiting is deeply entrenched in the Chinese economy. Piracy provides an opportunity for jobs and economic freedom that might not otherwise exist for the poor.¹⁹ To close down the businesses whose major products are counterfeits would be very harmful to the Chinese economy. Were China to ever get serious about enforcement, it would have to do it slowly over a number of years and would need a plan for employing displaced workers. It is important to know that even though workers are producing counterfeit products, many are still learning the skills necessary to work in reputable businesses.

Another argument against enforcement is that product costs in China could skyrocket. Most Chinese are not in a position to pay “full fare” for Polo, Rolex, Nike or other brand names. If forced to pay full fare, it is possible that some of the higher end brands may not have much of a market in China, although residents of the major cities probably have enough means to purchase these brands. Unless concessions were made by the brand name companies, most Chinese citizens would not be able to afford the original products.

A third argument against stricter enforcement is that many Chinese believe that IPR laws are in place for the foreign companies wanting to benefit from China’s labor intensive economy. In reality, it is mostly countries such as the U.S., Germany and Great Britain that are pushing hardest for the IPR enforcement. Unless the Chinese feel that the presence of these multinational businesses will improve China and its people, the authorities may continue to look the other way with regard to enforcement. This may be one reason that some multinational companies are opening up operations geared towards products and services for the Chinese people. One example would be General Electric. At least some of their China manufacturing operations are producing products specifically for the Chinese people, as opposed to exporting to the West. General Motors partnership with Shanghai Motors is another example of an operation with the intent of creating products for the Chinese market. One wonders whether these companies may be getting more attention and support with regard to IPR enforcement.

A related argument could be made that China does not need more industrialization. With a labor market that could begin to shrink due to the one child rule of the last several decades, the country may have a difficult time supporting more businesses when the workers from the one child era begin to retire from the work force. Another argument could be made from an environmental standpoint. The Chinese environment is already quite polluted and may become more so if more stringent IPR enforcement attracts even more manufacturing to China. Both of these arguments are relatively weak, but are presented here in the interest of thought provocation.

Arguments for Enforcement:

There are many arguments in favor of greater enforcement of the Chinese IPR rules and adherence to the WTO TRIPS agreement. While some of these arguments may be made in a

¹⁹ Heim, Kristi “Inside China’s Teeming World of Fake Goods” [The Seattle Times](#), February 13, 2006

self-serving way by Westerners, there still seems to be long-term benefits to China increasing the enforcement of IPR.

The first argument in favor of greater enforcement is that, as stated earlier in this document, China has a history of innovation, but it is being greatly hampered by their current IPR environment. China's own inventors and entrepreneurs have the same risks that the multinational companies incur: that their ideas will be taken. Therefore, the incentive to innovate in China is hampered. Instead, there are incentives to leave China and go to more IPR-friendly environs. According to Mark Cohen, the U.S. Patent and Trademark attaché to China, "When piracy is reduced, the experience of many countries and regions is that the principal benefactors are their own firms."²⁰ Even with a relatively lax enforcement environment, the improved IPR laws seem to be driving more Chinese innovation. In 2004, there were 1,782 international patent applications filed by Chinese innovators. While not a large number, this was a 38% increase over the 2003 applications and the highest rate of increase for any country.

A second argument in favor of tighter enforcement is that China's continued development could be at risk. According to the Organization for Economic Cooperation and Development (OECD), an international organization committed to democratic government and the market economy, lack of protection may lead to reduction of foreign direct investment. If the multinational companies fear that their technology or trade secrets will be pilfered, they may look to more IP-friendly countries, such as India, for their expansion activities.²¹

A study in support of greater IP enforcement in China indicated that a 10% decrease in China's software piracy rate could add \$120 billion to the China economy over a four year period. Of course, the Chinese would need to figure out how to transition the pirates from their illegal activities into legitimate work that will earn them a similar living to that which they are accustomed in counterfeiting. To successfully transition to a stronger IPR environment, China will have to figure out ways to employ those who lose their livelihood.

A third advantage of stronger enforcement will be the strengthening of exports or at least protection of the existing export business enjoyed by China. Importing countries will lose confidence in China if there is too much counterfeiting of their products. Counterfeiting typically involves lower quality. For the importer, this could translate into higher legal costs due to consumer injuries or complaints. Additionally, product liability and warranty costs may climb. Along these same lines, if the Chinese do not improve their trade practices with regard to IPR, other countries may begin to invoke new or higher tariffs on Chinese products. U.S. Senators Lindsey Graham (R S.C) and Charles Schumer (D., N.Y.) are sponsoring legislation that would impose across-the-board penalty tariffs of 27.5% on Chinese goods unless China improves its practices.²² In addition to enactment of tariffs, the U.S. may also consider filing trade cases against China before the WTO.²³

²⁰ Hu, Peggy B. and Gomez, Berta, op.cit.

²¹ Hu, Peggy B. and Gomez, Berta, Ibid

²² Watson, Sheila "Intellectual Property Violations Concern China Traders", Charleston Regional Business Journal, March 20, 2006

²³ Watson, Sheila, Ibid

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Finally, lack of enforcement of IPR rights translates into less revenue claimed by corporations and individuals. In turn, the government has less income reported for which taxes can be collected. As an example, cigarettes typically have relatively high taxes imposed on them. Many governments use at least a portion of these taxes to pay for health care costs related to smoking. The rest of the taxes go to supporting the country's infrastructure and providing services to citizens. If cigarettes are counterfeited, the government is losing revenues and therefore unable to provide higher levels of social spending..

Summary and Conclusion:

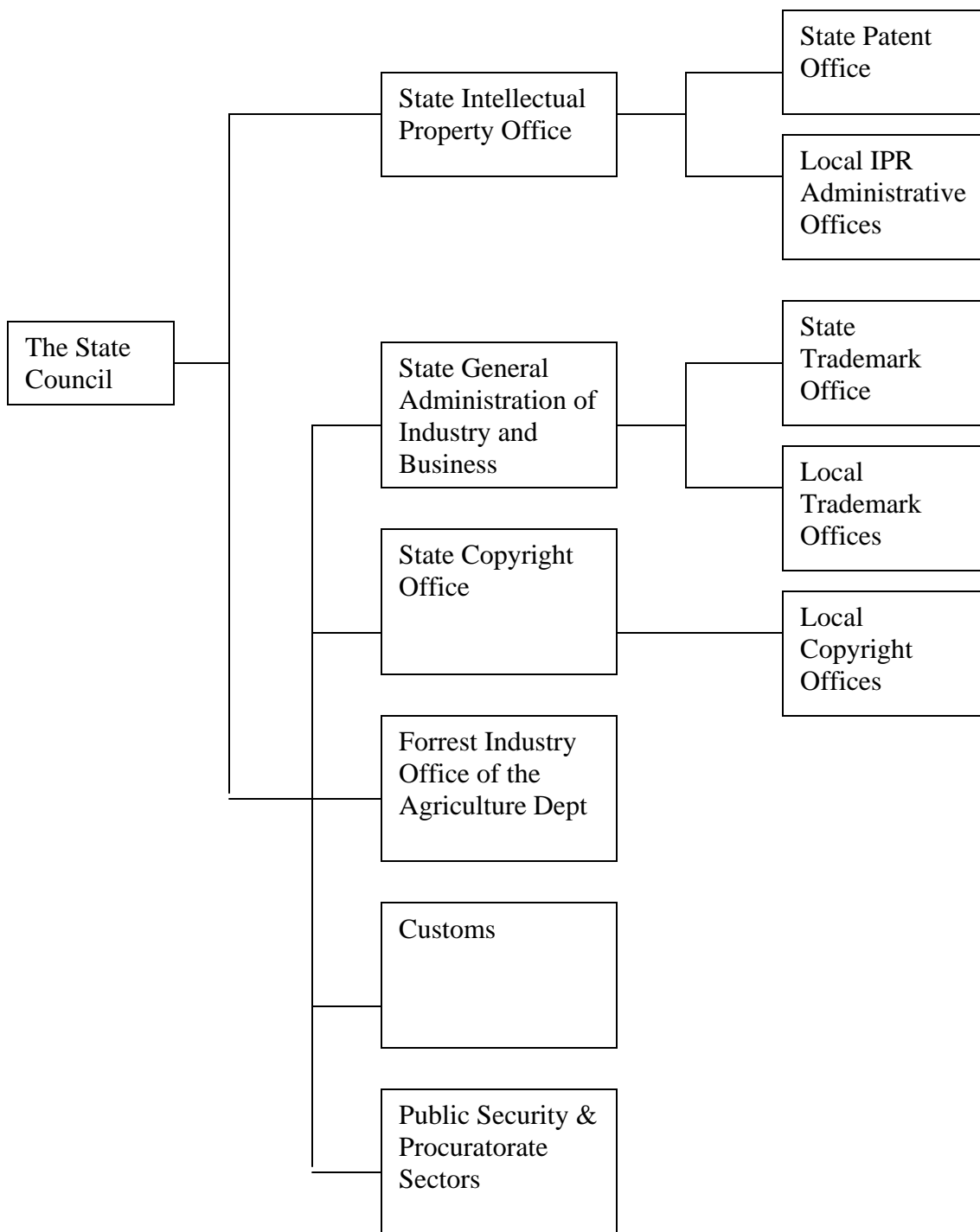
A visit to China reveals just how rampant the IPR violations are. Street vendors and markets exist that sell only fake products. An immeasurable number of Chinese are employed in the counterfeiting industry. What is very apparent is that the sellers of counterfeit goods have little or no fear of legal repercussions against their trade.

China has made great strides to enact laws in support of intellectual property rights. They have joined the World Trade Organization and other organizations that renounce IPR violations. And the Chinese legal system is prosecuting more violators of the IPR laws. But, enforcement of the laws is no where close to where it needs to be to change the realities of the Chinese counterfeit industry. Laws without enforcement will not change the habits of pirates.

The counterfeiting industry is so entrenched in the Chinese economy that it will be very difficult to significantly reduce (complete eradication would be impossible). The clean up of IPR violations will take many years to accomplish. But it will occur. Capitalism is still a very new concept to China. But they are advancing at a brisk pace. With capitalism there will come more creativity and wealth. And China will develop more and more creative and profitable businesses with a significant stake in intellectual property protections. China will take care of their own, much like they have protected their 2008 Olympic logo. But will they protect the multinational firms with the same fervor? If those firms can show the Chinese how the Chinese benefit from IPR protections, then they will have a greater and greater interest in enforcement of IPRs. And with the counterfeiting operations having become so proficient at their craft, these workers should be able to be integrated into the legitimate businesses that will grow as counterfeiting shrinks. Change will not happen overnight, but the advantages for China to enforce IPRs far outweigh the disadvantages of not doing so.

Appendix A

China's Organizations Dealing with IPR ²⁴



²⁴ Organization for Economic Cooperation and Development, "Promoting IPR Policy and Enforcement in China" Summary of OECD-China Dialogues on Intellectual Property Rights Policy and Enforcement, April 2004