

Rule of Law in China: Chinese Law and Business

Enforcement of Intellectual Property Rights

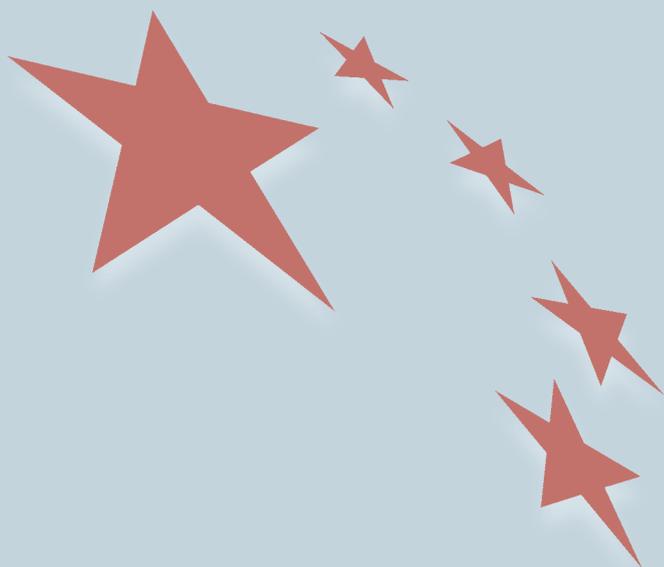
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Executive Summary

- This brief adopts a neo-institutional approach to derive some generalizations about how China's policies are enforced, why enforcement remains such a problem, and what foreign firms can do to meet the challenges provided by China's enforcement regime. In particular, the brief draws on the protection of intellectual property rights to illustrate the following.
- Formal administrative rank is an important shorthand for understanding the power relations between two or more bureaucracies and/or regional governments. This has an important bearing on enforcement.
- Given the chronically overstretched resources of the courts in China and the hierarchical structure of the administration, policy priorities are particularly susceptible to manipulation by unscrupulous commercial concerns.
- It is important to identify trends of decentralization, as well as more recent trends of centralization, to determine the power relationships in a given policy enforcement context.
- The scope of action of subordinate agencies is critically affected by the degree of dependence on, or independence from, superior or host units.
- Insofar as China's institutions remain in flux, personal power can replace institutional mandates with regard to ultimate decision making. It is, therefore, critical to identify the juncture at which individuals matter and to take that into account when evaluating a given enforcement context.

Enforcement of Intellectual Property Rights

Introduction

There is a growing body of China scholarship which recognizes recent changes within the Chinese body politic that aim for a more regulatory role of the state.¹ China's once Stalinist command economy has been transformed in the last generation into a freewheeling, often anarchic form of ultra-capitalism which has eschewed the mechanisms necessary to provide for social welfare. In recognition of this, in recent years, Beijing has attempted, with varying degrees of success, to restrict some of the more disruptive elements of economic reform by repositioning the role of the state such that it can reclaim a strong regulatory hold on the economic, commercial, and social functions of its myriad institutions.

However, the nexus for enforcement of a given law, regulation, or judicial decision in China is complex, in flux and largely hidden from view. In this policy brief, I will examine the mechanics of policy enforcement in China in order to demonstrate how foreign investors may overcome the challenges provided by China's enforcement regime.

The courts

The courts in China are subsumed under the jurisdictions of the local governments in which they are embedded, and as such, they act less as an independent branch of government than as yet another civil service bureaucracy. Whilst this follows a similar model to that of Japan, in China, courts suffer from a lack of experience on the part of those staffing them at all levels. Confidence in the judicial system and the relative prestige conferred upon the profession is therefore low; although the situation is gradually improving, it remains firmly under the control of the Chinese Communist Party, is institutionally weak and largely unable to enforce its

own decisions.² Local governments, which control the finances upon which the courts in their jurisdictions depend, often choose either to set aside or simply to ignore court rulings which conflict with their economic goals or other priorities.

Whilst some courts, such as that of the Shanghai municipality, are lauded as exemplars of the development of China's legal infrastructure, this can more convincingly be attributed to the need for local government to show improvement than to any actual virtue of the court in question.

Another problem has to do with the 'passing-off' of hitherto civil cases into the criminal law sphere of the People's Procuracy. After a great deal of reluctance on the part of the Public Security Bureau (PSB) and the People's Procuracy to intervene, the numbers have begun to slowly but steadily increase. In 1996, for example, 0.25 per cent of all trademark-violating cases were being prosecuted under China's revised Criminal Law. In 2002, the figure was between 2 and 2.5 per cent. Although this number is still small, it does represent a five- to ten-fold increase in five years.

There is an enormous disincentive on the part of the administrative enforcement agencies to hand over their cases for criminal prosecution. Commercial enforcement administrative units in particular have realized over time that the 'really big money' is not in exacting case fees and bribes from foreign clients, but from using the fines levied against counterfeiters to enhance their own official and unofficial operating budgets.

However, this does not mean that the PSB has been aggressively taking cases away from administrative agencies. Anti-counterfeiting work is regarded by the PSB as a swelling of responsibilities without a corresponding increase in budgetary revenues.

1. See, inter alia, Yang, D. L. (2004) *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China*. Stanford: Stanford University Press.

2. Lubman, S. (1999) *Bird in a Cage: Legal Reform in China After Mao*. Stanford: Stanford University Press.

Moreover, there is a perception that intellectual property rights (IPR) and other commercial cases are 'civil' in nature and do not have the gravitas of 'standard' criminal offenses. The PSB does not send cases to the prosecutor (and the Procuracy does not prosecute) unless chances for a successful conviction are 95 per cent or higher. Traditionally, the conviction rate was very high, and prosecutors are reluctant to risk diluting their success rate with cases that might not end in conviction.

To put these figures into context, it is important to compare them with the number of cases that are handled within China's administrative enforcement (*zhixing*) agencies. In 2003, for instance, there were 51,851 cases of trademark/anti-counterfeiting that were handled outside the courts (with 96 eventually turned over to the courts), 10,411 patent cases examined by administrative agencies and 9497 cases of copyright disputes handled by extra-judicial copyright bureaus. The total number (71,759) dwarfs the 8332 intellectual property cases handled by the courts that same year. To understand the reason for such a high percentage of cases bypassing the judicial system, it is first necessary to examine China's administrative apparatus, and the policy enforcement context.

Administrative rank

Although the Chinese political system may appear impenetrable to those unfamiliar with it, a nuanced appreciation of administrative rank is an important way in which many Chinese officials negotiate the political environment. Every single unit within China's political system has an administrative rank, the heads of which hold the same rank. In some cases such a ranking is fairly clear. For example, at the national level, ministries (*bu*), commissions (*weiyuanhui*), bureaus (*ju*) and offices (*bangongshi* or simply *shi*) each hold a bureaucratic rank that defines its power vis-à-vis other units. The relative importance of the substantive portfolios of these administrative units also bears upon the influence and power that they wield. Hence, although the Ministry of Education and the Ministry of Commerce enjoy the same official ranking, the latter has more influence. Some of

these ranks are in flux. Ten years ago, for example, commissions were a half-step above ministries, but their relative power has been eroded since then. A prominent exception to this is the state development and reform commission (*guojia fazhan gaige weiyuanhui*) has expanded its power to the extent that it is referred to by national officials as the 'small state council' (*xiao guowuyuan*).

Below the national level, there are at least two other dimensions worth mentioning. Firstly, spatially defined administrative units (i.e., provincial governments) share an equal rank with national, functional line ministries. Thus, a given province has the same official bureaucratic rank as a ministry. Like ministries, some provinces are considered more important than others. Gansu province, for example, a poor interior province, is less influential than the coastal economic powerhouse of Guangdong province.

Secondly, this division of administrative rank exists at all levels of the system. At the provincial level, the counterpart to the national ministry is the bureau (*ju*). However, although such information is not generally made public, there is a further division among these *ju* units. The highest is the first-tier bureau (*yi ji ju*), which has the same administrative rank as a national-level bureau (also named *ju*). The second-tier bureau (*er ji ju*) is a half-step below its first-tier counterpart. It generally has the same ranking as a prefecture³ (*zhou*) or municipal government (*shi*). The lowest of these three *ju*-level units is the county-level bureau (*xian ji ju*), though they are never referred to as third-tier bureaus (*san ji ju*), as this would be an insult to the officials working therein.

In practice, this means that if one relies on a second- or county-level *ju* (or worse, a department [*chu*]-level *ju*, such as the provincial copyright administration), it should be appreciated that such a unit is regularly outranked, and therefore subordinate to other provincial-level units. The implication is

3. Prefectures are generally limited to areas with a high non-Han minority population.

clear: all things being equal, the lower the rank, the less likely the administrative unit will be able to enforce a given policy.

Commerce and enforcement priorities

Administrative units in China (including the courts) are chronically short of money. Indeed, given the budgetary scarcities faced by these units, they must make difficult decisions as to what responsibilities they will undertake, and which ones they will ignore. In some cases, political directives from above may be issued to pursue a given set of responsibilities, with the consequence that others are far less likely to be enforced.

At the grass-roots level, cadres are generalists, and must often choose from competing (and often conflicting) policy objectives in determining priorities concerning implementation, with the limited resources at their disposal. This decision is greatly simplified by the prioritization of these tasks by their administrative superiors. These priorities vary somewhat from region to region, but the most important almost invariably include economic development, tax extraction, the 'alleviation of poverty' and the implementation of the 'one-child policy' birth control programme. These policies are institutionalized within performance indicators under the 'cadre responsibility system' (*ganbu gangwei mubiao guanli zerenzhi*) and reinforced by the 'one-level down management' supervision system (*xiaguan yiji*).⁴

An increasing number of foreign companies have recognized that scarcity of resources is at the root of lax enforcement. They have sought to compensate for this shortfall as it pertains to intellectual property rights enforcement by underwriting many of the costs of enforcement including overtime pay, costs of destroying offending merchandise, rental of trucks as well as other types of side-payments: dinners, karaoke, and even late evening 'massages'. This has made a modest impact on commercial policy

enforcement in China since the mid-1990s. Sometimes it is possible to transform a situation of non-enforcement to one in which such policies suddenly become a priority for local enforcement agencies by underwriting the basic costs of enforcement.

Similarly, when pursuing claims under the Unfair Competition Law, it is important to understand the various commercial interests of the enforcement agents charged with implementation. The principal enforcement administrative agency is the Administration for Industry and Commerce (AIC). This is a gargantuan bureaucracy that has amassed, over time, a constellation of organizational interests and goals that are often contradictory. For example, insofar as unfair competition within China disadvantages foreign investors, this same unfair competition may substantially benefit the AIC. Much of the AIC's revenue comes from the host of management fees it levies on local businesses operating within a given geographical jurisdiction. If foreign competitors are undercut by local businesses, the AIC is unlikely to intervene, since it may receive a substantial part of its operating revenue from local businesses. This simple cost/benefit calculation must be taken into account as a first step in proposing any resolution of this type of unfair competition.

Centralization and decentralization

Whether power is exercised vertically or horizontally depends on the bureaucracy in question and has a significant impact on where the decisions to enforce a given policy take place.

Contrary to conventional wisdom, much of the Chinese state is significantly decentralized. Decentralization has always been a hallmark of China's governing apparatus (except during the first Five-Year Plan era, 1953–1957).

Chinese administrative units make a distinction between two types of political relationships: the distinction between a relationship governed by binding orders, and one based on non-binding

4. See Kevin O'Brien, K. and Li, L. (1999) 'Selective Policy Implementation in Rural China', *Comparative Politics* 31 (2): 167–186; interview with Chinese scholar, Shanghai, 15 June 1998; and interview with private investigator, Shanghai, 16 June 1998.

instructions. Any given political unit in China has the second type of relationship with numerous other units. But it has the first type of relationship with only one, its immediate 'superior'. A relationship based upon such binding orders is referred to as 'leadership relations' or *lingdao guanxi* (the other type is based on non-binding 'professional relations' or *yewu guanxi*). In China's largely decentralized political system, such leadership relations are often not with administrative superiors (described by the Chinese as 'leadership along a "line"', or *tiaoshang lingdao*), but with *local governments at the same administrative level* (or 'leadership across a "piece"', *kuaishang lingdao*).

Most of China's bureaucratic system (*xitong*) operates under this second type of decentralized (*kuai*) leadership relations as a way of ensuring sensitivity to local conditions when implementing policy. But since late 1998, there has been a trend towards centralizing some key commercial bureaucracies in China. In a centralized system, leadership relations for a given functional bureau (i.e., a county-level AIC) are with its functional superior (i.e., the municipal AIC), and not with the county government.⁵

In theory, centralized bureaucracies should be able to better enforce national-level decisions and mandates because they do not suffer from local government interference. In practice, however, this is less than clear, not least because the current trend is towards centralization only up to the provincial level. The relationship between the provincial-level government units and their national-level functional counterparts remains decentralized. Nevertheless, it is important to distinguish between decentralized and centralized bureaucracies in determining the likelihood of enforcing given laws and regulations, because the locus of power in decision making is located in very different places, depending on whether the bureaucracy in question is

centralized or decentralized. For example, in the case of a provincial-level decentralized enforcement bureaucracy, it is often useless to seek intervention from its functional superior in Beijing with which the provincial-level units only enjoy non-binding professional relations.

Administrative subordination

Those bureaucracies that are embedded in other, more dominant bureaucracies are, on balance, less able to enforce the policy with which they are charged with enforcing.

The case of the provincial-level copyright bureaucracy provides a particularly illuminating example of this problem and its impact on enforcement. The Provincial Press and Publications Department⁶ (*banquan chu*) is nestled within, and subordinate to, the Provincial Press and Publications Administration (*xinwen chuban ju*). The Press and Publications Administration makes all the decisions regarding personnel, budget and any additional ad hoc resources that are to be allocated to the Copyright Department (direct communication between the Copyright Department and the provincial government would be a significant breach of organizational reporting relationships).

This embeddedness forces the copyright enforcement agencies to be dependent on their host units, creating problems when the priorities of other units diverge from copyright enforcement. This dependence is virtually guaranteed by the impossibly low personnel allocations for copyright management: in China, only 200 people – one for

5. Mertha, A. (2005) 'China's "Soft" Centralization: Shifting *Tiao/Kuai* Authority Relations', *The China Quarterly* 184: 791-810.

6. This office title is often used interchangeably with the Provincial Copyright Administration (*banquan ju*). Both titles refer to the same office, an example of 'one organization, two distinct signboards' (*yige jigou liangkuai paizi*). The Copyright Administration is a calculated fiction to give the Provincial Copyright Department a nominally higher bureaucratic rank (a higher *ju* ranking instead of a lower *chu* ranking) and to give it, in theory, increased bargaining power in its dealings with other administrative units during the interagency bargaining process. Because the Press and Publications Administration itself holds the higher *ju* ranking, simply assigning one of its vice directors to represent the Copyright Department automatically upgrades the latter to a Copyright Administration'.

every 6,000,000 citizens – are engaged in full-time administrative copyright work. Because budgetary outlays are based upon personnel allocations, the operating budgets for the copyright agencies are correspondingly tiny. Any additional budgetary outlays are made to the Press and Publications Administration, which, at its own discretion, may request funds from the provincial government, which decides on a case-by-case basis.

In theory, the Press and Publications Administration allocates additional staff on a temporary basis from its other sub-units to compensate the Copyright Department's personnel shortfalls. In reality, such 'conscripted' activity is costly, and genuine coordinated activity is sporadic and ineffective. Mobilizing extra personnel from other Press and Publications offices raises preparation and coordination costs, incurs opportunity costs (by preventing staff from performing their regular duties) and increases inefficiencies brought about by intra-agency bargaining between the Press and Publications Administration and the Copyright Department, an exercise in which the latter is at a disadvantage. This dependence also underscores the Copyright Department's inability to undertake any sort of meaningful independent action. The result is that press and publications work often supercedes copyright enforcement.

Below the provincial level, the situation is even worse. Corresponding units of the Press and Publications Administration and the Copyright Department are merged within, and subsumed under, the bureaucracy headed at the national level by the Ministry of Culture. These sub-provincial units combine press, publications and copyright responsibilities with the local organizational goals of the Ministry of Culture's bureaucratic system.

The division of the three sets of responsibilities is often skewed in favour of the priorities of the Culture bureaucracy, particularly the local Cultural Market Management (*wenhua shichang guanli*) units. These units are charged with supervising the cultural market, which encompasses films, live

performances, books and periodicals, audio-visual products, arts and crafts and fine arts, gaming establishments, restaurants and karaoke parlours, and recreation centres in China. The specific targets of Cultural Market Management enforcement are anti-Communist Party, anti-government or overtly pornographic products within the cultural market. Only a very small percentage of copyright-violating merchandise falls into these categories; pirated works deemed 'nonpolitical', such as most motion pictures (even those depicting gratuitous violence or sexual situations), computer software and video games are given a low priority as far as enforcement is concerned.

When we compare the relatively robust anti-counterfeiting infrastructure discussed previously to the almost non-existent copyright enforcement apparatus, it is no wonder that rates of enforcement diverge accordingly, as demonstrated in Figure 1 on the next page.

Unofficial or quasi-official power

Although the foregoing has focused on institutions, their inadequacies mean that personal power considerations remain salient to enforcement in contemporary China. Identifying these concentrations of power is difficult, but not impossible. In doing so, we are able better to understand patterns of enforcement that are not adequately accounted for by the various institutional dimensions outlined above.

An illuminating example is the replication of leadership small groups (*lingdao xiaozu*) for IPR at the local level. When there is a broad policy involving coordination between a large number of administrative actors, it is often the case that a leadership small group (LSG) is formed. The role of the LSG is to coordinate policy among these units. The LSG consists of ministry and bureau chiefs and is led by a premier or state councillor. Having busy professional lives, those officials rarely meet in this capacity, with day-to-day business being handled by the LSG office. Often, the person holding this office does not officially have much power (only heading an office, *shi*, after all). But since s/he is representing a vice-premier or state councillor, their informal power is actually quite robust.

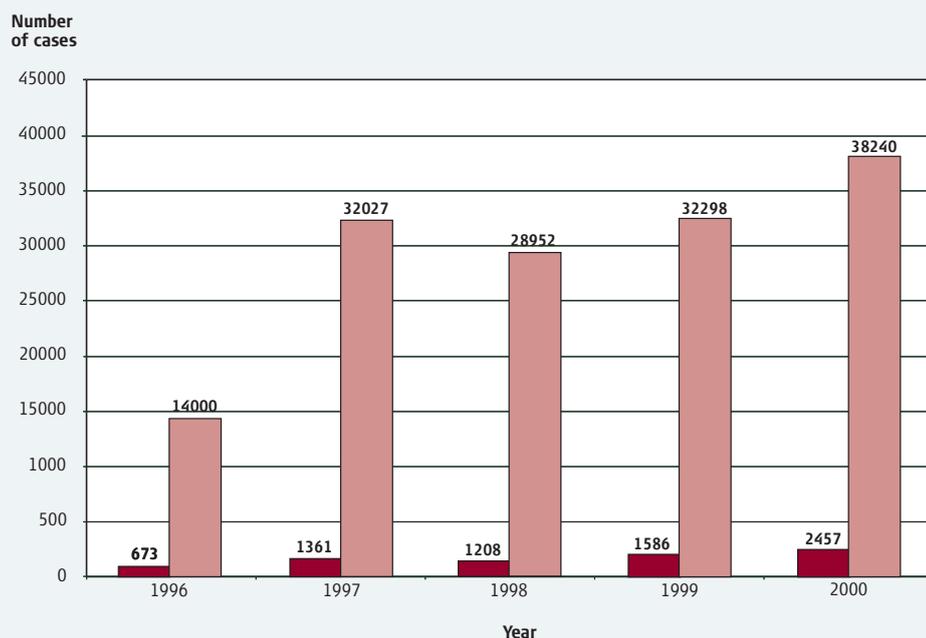


Figure 1
Administrative enforcement
of copyright and trademark,
1996–2000

Sources: Mertha, A. (2006) 'Policy Enforcement Markets': How Bureaucratic Redundancy Contributes to Effective IPR Policy Implementation in China', *Comparative Politics* 38 (3): 295–316.

■ Copyright ■ Trademark

In the case of the IPR LSG, the national level office was headed by Duan Ruichun, who was particularly adept at cultivating the indirect power of his appointment. As a result, he was able to make the IPR LSG an institution that was more powerful than its official ranking would suggest. This was not lost on the US negotiators who assumed that, given the power of this office at the national level, its counterparts at the local level would be similarly adept at coordinating enforcement. Unfortunately, this conclusion missed an important point: there was no institutional mechanism to replicate the power of Duan Ruichun among his counterparts at the local level. As a result of missing this personal dimension, US negotiators were surprised at the particularly poor level of IPR enforcement at the local level. Insofar as power is personal, it is less likely to be replicated in other parts of the system, and enforcement is likely to be highly variable.

Another example of the salience of personal power is that of conglomerates (*jituan*), which often bridge the gap between politics, policy and commerce. The case of hydropower is particularly instructive. In 1996, the Ministry of Electric Power was 'quasi' abolished (it was finally abolished two years later) and in its stead arose the State Power Company of

China (*Guojia dianli gongsi* or *Guodian*).

Former cadres of the Ministry of Water Resources were now working for Guodian. But it was considered to be too unwieldy to be managed.

Thus, in 2002, Guodian assets were redistributed among five electrical power companies, the directors of which have the administrative rank of a vice-minister or provincial vice governor (*fu bu ji*). Although they are formally of vice-minister rank at the national level (*fu bu ji*), the officials directing these corporations personally have ministerial rank (*bu ji*). The director of Huadian is Zhang Gong, whose previous posting was the vice-governor of Jiangsu Province. The director of Huaneng is Li Xiaopeng, the son of former premier Li Peng. With such backgrounds of their officials, these corporations are more powerful than their formal ranking suggests.

The awareness of these considerations can be extremely helpful in gauging where, when, and under what circumstances the enforcement of a particular policy is more or less likely. Insofar as the enforcement of a particular policy is in tension with the preferences of one of these powerful individuals, enforcement is likely to be problematic at best.

Conclusion

Any policy in China, regardless of its content, is likely to face the problems and complexities outlined above. Businesses conducting operations in China need to be aware of the five dimensions governing enforcement, and to utilize them in assessing the likely degree of enforcement of a given policy; or in seeking assistance from Chinese officials in matters of enforcement. As China transforms its

authoritarian, coercive apparatus into one of economic and commercial regulation, these institutional and personal dynamics and dimensions are becoming more relevant. This brief is intended to act as a road map of the institutional structures and processes that can appear as opaque to the outside observer as they are essential to that same observer's ultimate success in engaging with China.



The Foundation

The mission of the Foundation is to study, reflect on and promote an understanding of the role law plays in society. This is achieved by identifying and analysing issues of contemporary interest and importance. In doing so, it draws on the work of scholars and researchers, and aims to make its work easily accessible to practitioners and professionals, whether in government, business or the law.

Rule of Law in China: Chinese Law and Business

The main objective of the programme is to study the ways in which Chinese law and legal institutions encounter and interact with the social environment, including economic and political factors, at local, regional, national, and international levels.

The Foundation's perspective in pursuing this objective is that of entrepreneurs considering investment in China, the lawyers advising them, executives of an international institution or non-governmental authority, or senior public officials of another country. The combination of this objective and our particular perspective constitutes a unique approach to the study of the role of law and its relationship to other aspects of society in China.

Andrew Mertha received his PhD from the University of Michigan in February 2001 and joined the faculty at Washington University in July in the same year. Since 2002, he has been the Earle H. and Suzanne S. Harbison Faculty Fellow. His research and teaching interests have included international trade, policy implementation/enforcement, and bureaucratic politics/political institutions, particularly within the context of contemporary China. His current research project concerns the politics of hydropower in China. He lived in China for almost seven years, beginning in 1988. His book, *The Politics of Piracy: Intellectual Property in Contemporary China*, was published by Cornell University Press in 2005.

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