



Thursday, August 30, 2001

Pirates stalking WTO entry

BUSINESS SCHOOL by EDWIN LUN-CHEUNG LAI

Stealing books is a decent crime - ancient Chinese saying

While the West is excited and upbeat about the imminent entry of China into the World Trade Organisation, many observers are still sceptical about the extent to which China is going to honour the promises it made in its application.

Most business people in Hong Kong and the West are interested in measures which open the markets to foreign direct investment or lower the trade barriers.

Many have overlooked the importance of China's obligation regarding the protection of intellectual property rights (IPR) that comes with China's entry into the WTO.

Through an agreement called trade-related intellectual property (TRIPS), the WTO stipulates that its members adopt a set of universal IPR standards - basically those of the West as of 1995. It encompasses protection of many areas, such as patents, trademarks, copyrights, trade secrets, plant varieties and integrated circuits. It requires all WTO members to treat foreign entities the same way they do domestic ones with regard to IPR protection.

I believe the West should worry less about China's promises on market access and trade barriers than about those on IPR.

Why? Because there is one key difference between market access and IPR protection - China has incentive to greatly increase foreign access to its markets but no incentive to fully adopt Western IPR standards.

Lowering trade barriers or allowing a freer foreign presence in the market, typically provides better products or services at lower prices, thus benefiting consumers.

However, they also typically hurt domestic suppliers in the short run.

For example, trade liberalisation of the car sector would lower import tariffs so that Chinese consumers would be able to buy Toyotas and Fords much more cheaply.

But it would hurt China's inefficient car-makers.

Economic theory tells us that there would be net gains to trade liberalisation even in the short run. In the long run, trade liberalisation can spur competition and improve efficiency of domestic firms.

As a result, China has an incentive to liberalise trade and foreign investment, even unilaterally.

Not so for strengthening IPR. Stronger IPR hurts consumers, who have to pay higher prices because of the increased market powers of the IPR holders.

It hurts domestic imitators, who may learn to produce a product more easily by mimicking than by re-inventing the wheel. And it hurts businesses which use the protected products as intermediate goods in production.

This is not to deny that stronger IPR has a beneficial side. It encourages more foreign direct investment in knowledge-based industries, and it spurs indigenous innovative efforts, ranging from scientific research to arts and entertainment.

However, as long as China's innovative capability is much lower than that of the West, it is not in its national interest to protect IPR as stringently as happens in the West.

China would be better off free-loading on the innovations of more advanced nations.

Do foreign investors really worry about weak IPR protection in China?

A survey I conducted indicated firms which relied more on patents to successfully compete in China were less willing to transfer the newest technology to China through joint ventures with a local firm, subcontracting to a local firm or licensing to an unrelated local firm.

Foreign firms that relied on trademarks to compete in China were less willing to adopt the most effective technology even in wholly owned subsidiaries.

It shows weak IPR protection does hurt direct investment and technology transfer. But the incentive not to protect IPR is even stronger.

To get an idea of how much China relies on imitation of foreign products, consider the following examples.

According to a December 1999 report by Zhengquan Shibao, 90 per cent of bio-engineering products in China were copies of foreign products, while 99 per cent of the 3,000 varieties of medicines made in China since the 1950s were imitations. Of the 873 varieties of medicines produced in China in recent years, 97.4 per cent were imitations.

Because of the lack of incentive, the only way to make China abide by the TRIPS agreement is when foreign investors threaten to withdraw from China, or foreign countries threaten to retaliate by trade sanction.

For example, a country whose firms' IPR are violated in China can impose punitive tariffs on Chinese imports. This implies the enforcement of IPR in China would be more passive and piecemeal, and less systematic than in the West.

There are also practical problems for China to enforce an IPR regime - the cost of enforcement is very high at this stage of economic development. A well-established system requires not only a set of good laws, but also sufficient qualified judges and lawyers, law enforcement personnel (corruption makes enforcement harder), and not least, education of the masses.

Achieving all these is costly and takes a long time. All things considered, implementing a stringent intellectual property system in China is a long-term process. As with establishing the rule of law, it requires not just the laws, but also a competent enforcement and judiciary system and, most of all, the education of the Chinese people.

Meanwhile, those who believe intellectual property rights are "inalienable rights" of the innovators have to bear in mind that all IPR protections are a matter of degree. And it may not be in China's best interest to fully implement Western IPR standards at this moment.

It is more likely China would enforce IPR on a more selective basis, for example focusing on infringements that affect the incentive for direct investment of key technology, or sectors where Chinese technological capabilities are stronger.

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