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## China's Intellectual Property Rights Provocation: A Political Economy View

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PERSPECTIVE

# China's intellectual property rights provocation: A political economy view

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**Abstract**

It is well recognized that intellectual property rights (IPR) violations are at the heart of the economic conflict with China. Little agreement, however, exists about the origin and solutions for this provocation. Broadly speaking, two prescriptions have been proposed: the natural evolutionary and the rule of law views. While both have merits and add to our understanding, they do not go far enough to address the more fundamental IPR policy issue: China has benefited from a rule of law overseas and a rule *through* law at home, manufacturing unfair advantage to its firms, many of which are owned and/or influenced by the government. While recognizing China's recent effort in improving IPR protection, we point out the intrinsic contradiction in the political economy of China between maintaining the one-party rule, on the one hand, and protecting IPR by an independent court, on the other. Understanding this tension in the application of IPR law can help the international community search for more effective policy options.

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## INTRODUCTION

In the debate on China's IPR violation issues, there exists a gap: no studies have delved into the political and economic system of China that fundamentally defines the issues. In this essay, we argue that the unique political and economic system of China, the party-state (described below), is the most important factor that has shaped and continues to shape the IPR issues for China. Without an adequate understanding of such a system, the discussion on China's IPR issues is not only incomplete, but also leads to unrealistic policies for the international community.

There are two prevailing and competing views on China's IPR issue. The first one, which we may call the "natural evolutionary" view, argues that China's path to IPR protection is similar to that of the United States historically and will evolve into a strong IPR protection regime as China develops more IPR itself (Peng, Ahlstrom, Carraher, & Shi, 2017). Such an approach implies that

the US, European Union, and other large economies should simply nudge China to comply with international law and implement regulation consistent with international standards. The second view, which we may term as the “rule of law” view, regards the systemic and severe violation of IPR in China as the result of disregarding the rule of law by the Chinese government, and the international community must pressure it to change in order to protect the global IPR market (Brander, Cui, & Vertinsky, 2017). This view implies that the rule-based countries should punish China for violating the rules and force it from the outside to comply or suffer the consequences. The two views differ in their assumptions about the pathology of institutional change and, thus, the appropriate policy response. Both views suffer from a narrow lens of Chinese IPR policy and insufficiently account of the active role taken by the Chinese communist party (the state) in creating a self-serving political economy.

Furthermore, a weakness that exists in most discussions of China's IPR is the failure to clearly distinguish China the country (people) from China the state. Most articles just simply state that China violates IPR. By “China,” do they mean the Chinese state, Chinese firms (and people), or both? In our analysis, we try to make it clear that when we refer to “the state” we are actually referring more precisely to “the party-state,” since the Chinese Communist Party (CCP) is the state. The debate between the natural-evolutionary and the rule-of-law views of IPR in China can be better understood if we analyze CCP's motivations and interests from a political economy perspective, which focuses on the preservation of the party's monopoly as its central goal (China International Publishing Group, Academy of Contemporary China and World Studies, & China Academy of Translation, 2019: 29).

## THE DEBATE AND CRITIQUE

### The Natural Evolutionary View and Our Critique

Broadly speaking, the natural evolutionary view is a subset of what may be called the “engagement” school (Bader, 2018; Shambaugh, 1996), which argues that even though China is ruled by a communist party that puts itself above the law and does not want to be bound by internationally recognized rules, as the Chinese economy grows, Chinese firms will get bigger and the Chinese

people will get richer. As early as in the late 1980s, political economists had begun to argue that it was conducive to China's institutional change for communist officials to be corrupt and get rich first, because once they were wealthy, they would want the legal protection for their property (e.g., Yang, 1988: 29). Following the evolutionary examples from Western democracies, these societal changes will unleash demand for more business and personal (including IP) rights leading to the adoption of a rule of law in business and ultimately democracy in politics. Based on this assumption, the mature democracies should not criticize the Chinese Communist Party too much, and instead, should encourage the party-state to engage in international business. China's entry to the WTO in 2001 paved by the Bill Clinton administration was a natural extension of this philosophy, expected to benefit American workers, consumers, and businesses (Lipton, 2018). By entering the WTO, China agreed to lower trade barriers and abide by the trading club rules of international business, including the protection of IPR.

Along with this line of reasoning, and encouraged by the collapse of communism in Eastern Europe, scholars of institutional studies have developed a genre of research on “institutional change,” which examines the rapid changes in the political, economic, and social (cultural) systems from communism to liberal democracy (Fukuyama, 1989). Starting around the late 1990s, institutional scholars (Li, Li, & Zhang, 2000; Qian & Weingast, 1997) had implicitly assumed that the change is one-way: from communist dictatorship and central planning to democracy and the free market. The question was not *whether* the change will occur, but at what *speed* and *how* it will occur. As far as we know, there have been no studies examining how and why a communist society in transition (to democracy and capitalism) may stall and even reserve the course in transition. No one thought the reverse was possible. Up until recently, the US policy vis-à-vis China was one of engagement with these theoretical considerations in mind.

The engagement and natural evolutionary view was challenged by the actual developmental path of the Chinese economy, from which a new form of state capitalism has emerged (Musacchio & Lazzarini, 2014). In the course of 20 years or so, the party-state and its officials have realized that it is actually beneficial to increase, not decrease, the party's control and to not embrace the rule of law so that they can continue to acquire more wealth



through power (and some can move their (ill-gained) wealth overseas for better legal protection). As for the developmental strategy, the party-state has been practicing an industrial policy that mobilizes resources to develop strategic industries, protecting them from global competition while enjoying the openness of the global market (Wen, 2019). Lipton (2018) wrote that "China has embraced a sort of *È la carte* globalization, adopting the rules and standards it finds most useful – like the ability to expand its companies and investments abroad – while discarding those that threaten its unique political and economic model."

The active participation of the state in the economy has eroded the boundary between state ownership and state influence (Buckley, Clegg, & Tan, 2005). The blurring distinction between government owned/influenced and private can be seen in the case of Huawei. The government steers economic activities directly through owning enterprises and indirectly through governance, funding, procurement, and incentives both within firms and outside. Chinese Internet companies have to comply with regulations that give monitoring and control to the authorities (Council of Foreign Relations, 2017). While all countries exercise some government directives in economic and security operations (The White House, 2019), the scope and scale of government intervention in China is more pervasive. For example, much of the investments abroad by very large Chinese firms are motivated by government directives (Alon, Wang, Shen, & Zhang, 2014). The government's totalitarian approach to policy means that in fighting trade wars, for example, China can use consumer boycotts, excessive and intrusive inspections, directives, and administrative holdups in customs instead of plain tariffs to selectively target firms, industries, and home regions (The Economist, 2019).

Theoretically, a country that is large and is ruled by an authoritarian state can close its market (but demands other countries to open their markets) and concentrate the whole country's resources into developing a few key industries (Wen, 2019). Once the state-blessed firm has achieved the economies of scale and low costs in a key industry, it can enter other countries to defeat its competitors there. The state can repeat the policy in all key industries to dominate these industries in the world (Fligstein & Zhang, 2009; Hudson Institute, 2018; Wen, 2019). Empirically, there are cases in China that fit this pattern. For example, both the Chinese railway and

telecommunications (service carrier) sectors are monopolized by the state and shielded from foreign competition. Under the state's support, the state-owned train maker, CRR, after heavily copying Siemens and Alstom, among others, has become the world's largest low-cost train producer and has expanded into many countries including the U.S. (Gu, 2019). In the telecommunications industry, China Mobile has expanded into more than 20 countries (Tencent, 2018). In the aerospace industry, the government quest for dual-use (military and civilian) technologies has led it to buy, steal, reverse engineer, codevelop/coproduce through forced technology transfers, and use cyber espionage in order to develop indigenous capabilities (Saunders and Wiseman, 2011).

On a more systematic level, the party-state has pursued two strategies: the *Made in China 2025* aimed at propelling China's high-tech and advanced manufacturing base to global leadership (Hickey, 2019), and the *Road and Belt Initiative* seeking to export its excessive construction and supply capability and acquire strategic assets by building roads, bridges, and sea lanes, financing large infrastructural projects, and selling their companies' products and services to many countries (Zhang, Alon, & Lattemann, 2018). Currently, China is perhaps the only country that can practice this type of industrial policy due to its size and scale, accumulated financial resources, and a governance structure that allows the state to command and control the economy. Under the strategy of the party-state-capitalism, China's economy has become the world's largest, with a GDP of \$23 trillion based on purchasing power parity (PPP) in 2017 (U.S.'s GDP is \$19 trillion in 2017) (CIA, 2019). While its per-capita income (\$16,700 in 2017, PPP-based) has well surpassed the \$6,000 per-capita income threshold for democratic transition based on worldwide statistics (Pei, 2012), democratization did not happen, and the rule of law is still absent.

### The Rule of Law View and Our Critique

That the Chinese party-state does not follow the rule of law is the cause of IPR violation in China has been recognized by the second view, the rule-of-law view. While we agree that the rule of law is a necessary condition for fair engagement, we believe that the rule-of-law view needs to be expanded for the following two reasons. First, domestically, it does not go far enough to provide a broader and more fundamental understanding on the internal

institutional setting in China that presents an insurmountable obstacle for the country to adopt the rule of law. Second, internationally, it does not point out the party-state actually effectively and efficiently uses the rule of law to advance its interest globally. The evolving legal case of Huawei in North America provides an illustrative example: (1) Chinese officials, who do not allow China to have judicial independence, demand judicial independence in the case of Meng in Canada (Reuters, 2019), and (2) Huawei, based in China that does not allow firms to sue the government, constitutional review or checks and balances, sues the US government for the violation of constitution and checks and balances (Strumpf, 2019). Third, conceptually, in its arguments, the distinction between private and public players in China is not clearly recognized. As such, the issue cannot be understood to its full extent, and the policy response may be inadequate. Below we elaborate further our arguments, which we hope will enhance the discussion and understanding of the IPR issues relating to China.

### BEYOND IPR: CHINA'S POLITICAL ECONOMY AND RULE THROUGH LAW

So far, the discussion on China's IPR issue tends to be limited on the IPR protection per se: the players – to borrow the institutional theory's analogy (North, 1990) – domestic firms –violate the IPR of foreign firms, and the referee – the Chinese state – fails to enforce the law equally and fairly. The scope of discussion on this issue is insufficient because it fails to distinguish private action (violations by individuals and firms) and public action (violations by governments) in IPR violation (Hill & Hult, 2019) and that the distinction between private and public actions is fuzzy – the Chinese party-state is both a player and referee in the game.<sup>1</sup>

In countries of early developmental stage, the violation of IPR tends to be by private actors, which is commonly the result of the state lacking laws or the will to enforce them, or the result of the state favoring domestic firms over foreign entities, as in the IPR protection history of developed countries show (Ben-Atar, 1995; Hill & Hult, 2019; SÄiz & Castro, 2017). In newly independent America, facing British technology embargo, the government of the desperate infant nation encouraged and rewarded Americans to acquire foreign IPR, especially from Britain, legally or illegally (Ben-Atar, 1995). Peng et al. (2017) cited historical

research on US lack of IPR protection (Raustiala & Sprigman, 2012, 2013), especially in publications and entertainment (Lohr, 2002). Surowieski (2014) suggested that the US should not blame China for doing what it did with IP as it has itself become a scientific superpower through industrial spying, via direct observation, immigration of skilled workers with insider knowledge, smuggled machines, and pirated materials and technology. The U.S. used high import tariffs, government subsidies, assistance for skilled workers to migrate out of Britain (which was illegal according to British law), and industrial espionage (using only naked eyes of course) to jump-start the manufacturing industry in the U.S. The biographies of Alexander Hamilton also detailed how he directly intervened in “obtaining” industrial technologies from Britain, and how the US Patent and Trademark Office (USPTO) knowingly granted patents to those who “copied” the technology from Britain (McDonald, 1979).<sup>2</sup> The arguments on the historical US violations gave fuel to the evolutionary view, but historical comparisons have their limits.

In contrast to the USA, the global IPR acquisition by the party-state of China is a systematic effort that is large in scale and scope and involved an intelligence agency, the police force, and the military (Hickey, 2019; Wray, 2019). Evidence shows the party-state not only sponsors IPR theft and forced IPR transfer but also conducts them (Davis & Wei, 2019; Hudson Institute, 2018; Spegele & O'Keeffe, 2018; Wei & Davis, 2018).

Several cases demonstrate how the Chinese government rigs the outcomes on IPR disputes between Chinese and foreign firms. According to a *Wall Street Journal* report, when DuPont Co.'s Shanghai office reported suspected IPR violation by its Chinese partner to the Chinese authorities, the Chinese police raided DuPont's office, demanded passwords, printed documents, seized computers, and intimidated DuPont employees. Instead of helping DuPont to protect its property, the state uses “an array of levers to pry away American intellectual property” (Wei & Davis, 2018). In another case, the Chinese state orchestrated and funded the acquisition of a new satellite technology developed by Boeing though a startup in the U. S. with a made-up purpose to use the satellite to “improve web access in Africa.” However, the real intention was to steal the technology, which can be used in the space program. When the seller refused and brought the case to a U.S. court, the lawyers of the buyer said the U.S. court did not have



jurisdiction over a China-based company, and suing a state-owned firm in China “heightens the affront to China’s sovereignty” (Spegele & O’Keeffe, 2018).

The Chinese state also uses a number of policies to facilitate IPR transfer. One is “adverse administrative approvals and licensing processes,” which the state uses “as a tool to extract...concessions, usually on technology.” Another is “burdensome and intrusive testing,” which is “a way of extracting information and technology,” according to White House National Trade Council Director Peter Navarro (Hudson Institute, 2018). In industries deemed “strategic” by the state, full ownership by foreigners is not allowed, and multinational companies are required to form joint ventures with local firms for production and distribution in return for advanced know-how and technology (O’Connor, 2019).

To understand why the Chinese state does that, we must go beyond IPR and look into the political economy of China. China is ruled by one party with an elaborate system of political, social, and economic controls (McGregor, 2010). Unlike the political parties in democracies, which are open to everyone without formal membership, the Chinese Communist Party is a Leninist party (Chou & Nathan, 1987) with the following characteristics: (1) it is based on the communist ideology, which gives the party the exclusive mandate to rule; (2) it relies on exclusive membership; (3) it is a highly centralized organization with a central committee, a politburo, and a general secretariat that holds unchecked supreme power; and (4) it has three key departments: the organizational department, the propaganda department, and the united front work department. Under these principles, the party designs and controls all of the functional and geographic sections of the governmental system, making the party the state. Economically, the party-state controls a large amount of the economic resources of the country through its orders and state ownership. For example, the party-state controls about 56% of the GDP through taxes, fees, and SOEs (in comparison, the U.S. government controls 32%) (IMF, 2019; National Bureau of Statistics of China, 2016, 2018). To maintain the one-party rule, the party cannot allow judiciary independence and various interest groups to be represented, such as the interest for better IPR protection. The party-state follows rule *through* law (or rule *by* law) as opposed to the rule *of* law, namely, the party uses the law subjectively and

selectively for the purpose of maintaining its rule. As pointed out by Rod Rosenstein, Deputy Attorney General of the U.S., in China “the law is an instrument of state power, a mechanism for rulers to maintain control and quash dissent” (U.S. Department of Justice, 2019).

To maintain its legitimacy, the party must keep economic growth at a high level. To achieve it, acquiring new technologies is imperative. The quickest way to do it is to obtain them from the holders of the technologies as opposed to developing them from scratch, which does not necessarily mean to obtain them illegally. However, given the fact that the party puts itself above any laws, compared to the rule of law-based states, the Chinese party-state is less concerned or restricted from using illegal means to obtain needed technologies.

Due to the secrecy of IPR violation and the reluctance of victims to report it for fear of retribution and embarrassment (Sullivan, 2019), comprehensive statistics of IPR violation related to the Chinese party-state do not exist, to our knowledge, but circumstantial evidence does exist. Studies using statistical data on China’s IPR issues tend to focus on patent application and dispute, because data on patents are easier to get (Bian, 2017; Prud’homme, 2019; Rassenfosse & Raiteri, 2017). The findings are mixed. Prud’homme (2019) argues that framing the IPR protection regime as strong or weak may not capture the essence of the issue, and proposes to use “foreign-friendliness” to measure the regional variation in IPR protection and risk for foreign firms within China, implying the arbitrariness of IPR protection in China. Rassenfosse and Raiteri (2017) found no evidence of discrimination against foreign patent applicants overall, but that “foreign applications in technology fields that are of strategic importance to China are four to seven percentage points less likely to be approved than local applications, all else equal” (p. 1). Bian (2017) found an overall high winning rate in patent infringement cases and higher winning rate for foreign patent holders, without specifying whether foreign winners have more merit in their cases or whether the Chinese government gave foreign entities preferential treatment. Patent application and disputes are one aspect of IPR protection. The IPR issue at the center of the current debate goes beyond the patent application rate or win rate in patent infringement and focuses on espionage, state-sponsored theft, and forced technology transfer.



According to Navarro, the Chinese state uses up to 50 measures to achieve six strategic goals: protect the Chinese market from competition in imports, expand the global share of markets, secure the core resources of the world, dominate traditional manufacturing industries, obtain advanced technologies, and develop emerging high-tech industries that will drive future growth and advancements in the defense industry (Hudson Institute, 2018). Adam Hickey, U.S. Deputy Assistant Attorney General, reported that since the *Made in China 2025* plan was published in 2015, the U.S. government has charged Chinese individuals and entities, most of which were directed or sponsored by, or related to the Chinese government, with IP theft, implicating at least eight of the ten sectors specified in the plan. “[S]ince 2011, more than 90% of the [U.S. Justice] Department’s economic espionage prosecutions (i.e., cases alleging trade secret theft by or to benefit a foreign state) involve China, and more than two-thirds of all federal trade secret theft cases during that period have had at least a geographical nexus to China” (Hickey, 2019).

China’s IPR violation has been noticed by both Democratic and Republican administrations in the USA. In 1992, President George H.W. Bush negotiated an agreement with China to improve IPR protection in China. Later, President Clinton’s administration raised the issue of piracy many times with China, but these efforts did not seem to work. “The pirates were just warming up. The next year, estimated software piracy jumped by about US\$100 million [from US\$225 million];...94 percent of all the packaged software in use in China was pirated” (Boxwell, 2018). In 2013, President Obama raised the issue of cybersecurity and IPR with Chinese President Xi. Obama “underscored the importance of working together... to address issues such as the protection of intellectual property rights.” According to his staff, “but his tone was not confrontational” (Chabrow, 2013) and, as the following comments by the Trump administration officials show, the violation has become systematically larger in scale and scope.

Christopher Wray, the Director of U.S. Federal Bureau of Investigation, stated that “China has pioneered a societal approach to stealing innovation any way it can, from a wide array of businesses, universities, organizations, and countries. They’re doing this through Chinese intelligence services, through state-owned enterprises, through ostensibly private companies, through graduate students and researchers, and through a variety of actors

working on behalf of China” (Wray, 2019). In describing the scale and impact of the Chinese state’s intelligence collection effort, Rob Joyce, a senior cybersecurity adviser at the U.S. National Security Agency, said other countries may be a “hurricane,” but “China is climate change: long, slow, pervasive” (Viswanatha & Volz, 2019).

### **THE FALLACY THAT CHINA’S IPR PROTECTION WILL IMPROVE AS MORE CHINESE FIRMS INNOVATE**

A major argument by the natural-evolution view is that as more and more Chinese firms develop their own new technologies and IPR, they will demand that their government better enforce IPR protection, and the government will realize that the benefit of doing it is greater than the cost, so that the government will improve IPR protection, which will benefit not only the domestic but also foreign firms.

This natural evolutionary view can be true for democracies, because as domestic firms develop more IPR, they will demand more protection through their representatives in policy-making. Furthermore, mature democracies go hand in hand with neutral and fair rule of law, so foreign firms tend to be treated equally as opposed to those in autocratic countries (U.S. Department of Justice, 2019). Indeed, that is what happened in the U.S. regarding the evolution of IPR protection. Its democratic system allowed and even encouraged the public participation in the IPR protection debate, which, along with U.S.’s economic development and global engagement, counter-balanced the discrimination against foreign IP holders, and facilitated U.S.’s evolution toward a strong IPR protection regime (Ben-Atar, 1995; SÄiz & Castro, 2017).

In the case of China, indeed, there are signs that as the Chinese economy develops, the government is making effort to better protect IPR. For example, China has been a member of the World Intellectual Property Organization (WIPO) since 1980. WIPO charter in the UN is to promote the protection of intellectual property around the world. Of the 11.8 million patents in the world in 2016, 2.8 million were in the US and 1.8 million in China (WIPO, 2017), which shows that China hopes to receive protection for its IPR worldwide. However, such an effort has limited results due to China’s political system internally.



In China, first, there are no systematic, open, and fair channels for the IPR owners to demand independent and impartial court for IPR, and the party has the absolute power to decide on such matters; second, the party-state has its own agenda in its policies, which may or may not choose to protect IPR at any particular time or industry. For example, if prosecuting a firm for IPR violation may reduce tax revenue and employment, or if the offending firm has a stronger relationship with the party than the victim, the party may decide not to proceed. Third, in general, stealing technologies is cheaper and faster than developing them. That the cost of stealing is higher as a country develops its own IPR is true if the government of the country applies IPR laws consistently to all IPR owners. However, if the government can selectively apply the law and favor certain (domestic or connected) owners, it can still allow or even encourage getting foreign IPRs illegally without hurting its domestic IPR owners. China has become the largest economy in the world with a per-capita income of \$16,700, but its IPR violation has not been noticeably improved. Citing senior U.S. Justice Department officials, a *Wall Street Journal* article reported that “more than 90% of economic-espionage prosecutions over the past decade...have involved China” (Viswanatha & Volz, 2019).

The best protection of IPR is by the rule of law, which the party-state rejects. In August 2018, President Xi said that the Chinese Communist Party must strengthen its leadership *over* the law. The party will not imitate other countries' models or practices. It will never follow the road leading to judiciary independence. In the “international battle front”, China must use laws as a weapon to fight against challengers. China will actively participate in the international rule setting. “We want to be the participant, initiator, and leader of global governance reform and development” (Mai, 2019). Since the party is above and dictates the law, the desire to strengthen IPR must be a party-led effort instead of following the rule of law. Furthermore, the party intends to project its governance internationally, causing concerns from other countries, as former U.S. President Obama commented on why the U.S. should participate in the Trans-Pacific Partnership, “we can rewrite the rules of trade...if we don't... China...will step into fill that void” (The White House, 2015).

We may be able to prove that as more Chinese firms develop more of their own IPR, it would be beneficial for them and maybe even to the Chinese

economy as a whole to improve its IPR laws and enforcement (let us assume that the party recognizes the benefit of doing so and further that it can be done under the party's rule). Using the institutional theory language, when there are potential increasing returns to institutional changes, some actors will do it (North, 1990). However, there are a number of key questions that need to be answered. First, it is clear that the leaders of the party-state fear that establishing the rule of law will end the party's authoritarian rule. So how should this be satisfactorily addressed for the party leaders so that they will establish the rule of law? Second, assuming the benefit is more than enough to benefit the Chinese economy as a whole and to buy out the party officials so that they would agree to the change, how could it be carried out? Since the party-state severely punishes anyone who challenges the party, who is going to carry it out?

Responding to the calls by its trading partners, especially the U.S., to change its unfair trade practice, the party-state has made great efforts to address the issue. In April 2018, Chinese President Xi Jinping said that “China will strengthen protection of international property rights” (Xinhua, 2018). In January 2019, the Supreme People's Court enacted a national appellate court for civil and administrative IP cases (Robinson, 2019), and the Standing Committee of the National People's Congress of China published a draft amendment to the Patent Law intended to enhance patent-owner's rights (Covington, 2019). In April 2019, President Xi reassured that “China will step up protecting the legitimate rights and interests of foreign owners of intellectual property rights, and prohibit the forced transfer of technology” (Xinhua, 2019).

It is very clear that these measures and statements from the party leader show that the party-state wants to improve its IPR protection. International media widely reported this positive development, but the most fundamental cause of the issue is not that China does not have written laws protecting IPR; it is that the party is above the law and uses law as a tool for its goal. Many of these written rules are just ink on paper. It is well known that some laws are not meant to be enforced, such as the rights to vote and to free speech printed in the Chinese Constitution. Furthermore, depending on its policy imperatives at any given time, the party gives conflicting signals.

Facing both the international pressure to make changes and the pressure from the party hardliners to resist, in December 2018, President Xi said: “For





those that ought to be changed or can be changed, we will change; but for those that shouldn't be changed or cannot be changed, we will firmly not change" (South China Morning Post, 2018). This implies that he or the party is the sole decider on what to change and not to change. In May 2019, in the late-stage trade negotiation with the U.S. and when the world expected the signing of an impending agreement, the Chinese government backtracked on almost all the terms upon it had agreed, including implementing stronger legal protections of IPR and enforcement verification mechanisms. Among the contentious issues were that the Chinese side wanted to keep the agreement informal rather than writing it down in a legal document, and they did not like to be monitored by the U.S. (Lawder, Mason, & Martina, 2019).

Summarizing these (conflicting) signals, we may conjecture that the party-state does want to change some of its unfair trade practices, such as resolving some IPR disputes in foreign entities' favor, but these changes have to be by the party's order rather than by a legal reform such as establishing an independent and impartial court or relying on outside monitoring (Tang, 2018). As the above quotation of President Xi indicated, if the party feels it can be changed, it will make some changes. However, without the rule of law, expedient change can be easily reversed when the pressure is alleviated.

Under the party's rule, improving IPR protection by adopting the rule of law, which would constitute a major step forward in China's institutional change, is out of the question, because doing so may threaten the party's rule, even though such a change may benefit China as a whole (RFA, 2019). While North recognized that the increasing returns to institutional changes may be blocked by vested groups so that some "discontinuous change" must be taken, such as revolution, he immediately wrote that "I do not provide a theory of revolution, which is an enormous literature" (North, 1990: 89).

### CHANGES DUE TO OUTSIDE VERSUS INSIDE PRESSURE

The rule-of-law view argues that "other countries should take action to pressure China to meet its IPR obligation" (Brander et al., 2017). While we agree with this, we further argue that without internal forces for the change, external pressure has rather limited effects. A logical deduction may help us better understand this. If the party-state allows its court to independently and impartially rule on IPR

cases involving foreign plaintiffs, the domestic victims of IPR violation will demand the same treatment, and other legal disputes may follow suite. As such, the trend will eventually threaten the one-party rule, as an independent judiciary may rule against it. Therefore, the issue is ultimately an issue of establishing the rule of law in China. For a change of this magnitude to occur, while outside pressure helps, inside forces must coalesce to initiate and carry it out.

In the late 1970s, when the party-state started opening up, it followed Deng Xiaoping's strategy of "taoguang yanghui" (韬光养晦), which has been translated by the Chinese official media as "hide one's capabilities and bide one's time" or "hide one's ambitions and disguise its claws" (China Daily, 2010). The implicit intention of the strategy is to dominate the world once the party-state is ready. The strategy had worked well to the party-state's advantage, facilitated by the engagement policy of mature democracies. Around 2013, when Xi Jinping assumed the leadership, evidently the party-state began to feel that it was ready to show its claws, which has alerted the world, prompting many in the Chinese government that the showing is premature. Evidence shows that the party now wants to go back to "taoguang yanghui." For example, "Made in China 2025" has been banned from media by the party. This further indicates that the party-state's recent promise to improve its IPR protection for foreign entities may only be biding its time.

Another issue relating to the external pressure is the asymmetrical nature of the issue. A major challenge in the frictions between democracies and totalitarian states is the former's right is totally restricted in the latter, and the latter enjoys its full legal rights in the former, as shown in the criminal investigation of ZTE and Huawei in the U.S. and Canada. Regardless how controversial the cases may be, the contrast between following the rule of law and using the law as a tool is clear. The investigated parties from China enjoy the full legal rights, the best law firms, and free media coverage with competing views. While comparable cases in China are kept secretive and in which the charges tend to be arbitrary and in retaliation against any foreign countries who criticize or take legal actions against Chinese government, firms, or individuals for alleged wrongdoings, as pointed out by the Deputy Attorney General Rosenstein (U.S. Department of Justice, 2017, 2019; U.S. District Court, 2019) and shown in the National Public Radio report (Sullivan, 2019).



How has the Chinese party-state been able to enjoy such an unfair practice for so long? A card game that one of the authors uses in his strategy class (introduced by Adam Brandenburger and Barry Nalebuff (1997) can illustrate this point. The teacher holds the 26 black cards and hand out the 26 red cards to 26 students. A deal (a pairing) between a black card and a red card will be worth \$100, and an unmatched card will be worthless. Accordingly, each of the 26 students comes to the teacher in turn to make a deal on how the student and the teacher can split the \$100. Since an unmatched card is worthless for the student as well as for the teacher, the students have the same bargaining power that the teacher does. Furthermore, it would be logical to assume that the students and the teacher would split the \$100 equally. However, the teacher then publicly throws away two cards and begins the negotiation. Realizing that two of them will have no match, the students are desperate to make any deals with the teacher. In many deals, the teacher only agrees to give the student \$1! The Chinese party-state, monopolizing the access to China, makes it clear that some of the foreign countries or firms will not have access to China. Realizing that, foreign states, firms, and individuals tend to avoid criticizing IPR violations in China for fear of being denied access to China (Working Group on Chinese Influence Activities in the United States, 2018).

### CONCLUDING REMARKS

In the global history of IPR protection and violation, China stands out for the following reasons. First and foremost is its political system in which the Communist Party intends to rule forever. This makes it categorically different from the IPR protection evolution of most democracies, especially the U.S., in which the democratic participation played a key role in adopting the global standard for IPR protection. Second is its size. When the U.S. was an IPR violator in the late 18th century to the early 19th century, its economy was small, accounting for about one-fiftieth of the world's GDP (Drabble, 2019). China today accounts for about nearly one-fifth of the world's GDP, at \$23 trillion (CIA, 2019), of which the Communist Party controls about 56%. The combination of these two factors makes the impact of China's IPR issue beyond any country in the history and evolution of IPR protection or violation.

Based on our examination of China's case, we may have the following implication for other

emerging markets in which IPR violation is or may potentially be an issue. First is the importance of the political system. As discussed by others (Brander et al., 2017) and us, the rule of law is key, and a logical extension of this point is that in order to develop and safeguard the rule of law, the democratic political system is necessary. Second, the degree of globalization is important. The more globalized a country is, the more impact its IPR violation will have, both domestically and internationally, as the case of China shows. Third, the size of the country's economy matters, as we discussed earlier. In sum, in descending order, a democratic and small country that is highly globalized may improve its IPR protection the fastest, as compared to a big, undemocratic country with little globalization (in the case of China, it is a big, undemocratic country with high globalization).

Most studies on institutional changes in communist or formerly communist countries normatively assume that the change is in the direction from communism to democracy, the rule of law, and the free market. Few question the direction, and most study the speed and steps of the change. What happened in the course of the reform and opening up in China since the 1970s has put such an assumption into question: after 40 years of reform, democracy and the rule of law did not take root in China, the party's control on the political, economic, and social institutions has been strengthened by the newly gained wealth. The implication of the reversal to the issue of IPR is that, domestically, the party-state forces foreign firms to transfer their IPR to domestic producers, and internationally, the party actively participates in the rule-setting and takes advantages of the rule of law in its favor. In view of this, we call for new studies on institutional change that examine the reversal institutional change or stalled institutional change. One direction is to extend the institutional duality framework based on the case of China in which the dictatorial government of a large country may enjoy its lawless rule in its home and takes advantage of lawfulness globally to advance its interest, where the size of the country in question is particularly important since the dictatorial government of a small country does not have enough impact on the world.

Facing the increasing influence from the party-state of China, a group of China experts in the U.S. wrote a report titled *Chinese Influence & American Interests: Promoting Constructive Vigilance*, in which they recommended three broad principles that



should serve as the basis for protecting the democratic values and the rule of law: transparency, integrity, and reciprocity (Working Group on Chinese Influence Activities in the United States, 2018). We believe the three principles are also appropriate for the international business community in dealing with the IPR issue with China. Transparency will not only expose cases of violations related to China but also encourage victims to step forward to take action. Upholding integrity is important because due to the lack of law and a high level of corruption, doing business in China can undermine the integrity of foreign firms, weakening their ability to fight against IPR violation. Demanding China to be reciprocal is reasonable and effective. For example, the international community should be able to disseminate knowledge of IPR protection in China. In this regard, international business journals should make a special effort to highlight and discuss the issue and disseminate the rule-of-law's view on the issue to the audience worldwide including the ones in China.

The fact that China heavily relies on global trade and must do business in other countries can be viewed as a positive factor in China's possible change toward adopting the rule of law. An effective way for a country to pressure China to follow the rule of law is to use the law in its own jurisdiction against violators, including the ones from China. For example, the EU and U.S. courts have been successfully taking legal actions against MNCs that violate laws; prominent cases include Apple, Facebook, Google, HSBC, Samsung, and Uber. As for countries whose governments directly engages in illegal IPR acquisition from other countries, victimized countries should go one step further to consider using trade-related sanctions according to the rule of law to pressure the offending government to change.

From a game theory perspective, Platteau (1994) laid out the conditions under which public ordering in a free market society can be maintained. An important condition is the existence of what he called "general morality", in which "honest people are willing to sanction breaches of honesty conventions even when their own interests have not been harmed by the observed breach" (Platteau, 1994: 765). Expanding his argument, we argue that, in order to maintain IPR in the global market, member countries need to be willing to oppose any country's IPR violations even when they face retaliation from the violator. In other words,

improving IPR protection needs to be a collective effort of the world.

Given the size of China's market, and the strong retaliation by the party-state toward anyone who criticizes it, most foreign governments and firms, especially the small ones, choose not to confront it for IPR violations. This leads to the classical "prisoner's dilemma" alluded to in the card game above (an effective way to mitigate the dilemma is for all the 26 students to band together to bargain with the teacher). Facing the unfair trade issues with China, many countries hope that someone else can lead the effort and they will (quietly) support it. The only country that can lead the effort appears to be the U.S., which has played the role of the de facto leader in the effort. The U.S. government is demanding China to make "structural changes" including stopping the state's sponsoring of IP espionage and forced technology transfer (Lynch, 2018), but at the most fundamental level, the structural changes may lead to the establishment of the rule of law and democratization. From a game perspective, for the U.S. to push China for the change, there is a considerable cost because the party-state may resist and retaliate. If China makes structural changes, initiated either by the party-state or some other groups, there would be great payoffs for China as whole, for the U.S., and for the world, in the long run.

If, fearing losing power, the party-state rejects the changes, there will be a danger that the party-state may make China more isolated from the international community. The party-state may keep its absolute rule over China, but China as a whole, the U.S., and the world may face a cold economic (and political) war in the long run. An alternative is for the U.S. not to demand any changes in China. Then the world trade situation remains in status quo, the Chinese party-state continues to practice its unfair trade policy, and all we can do is to hope that the natural evolutionary view is correct that the party-state will, miraculously, adopt the rule of law as the Chinese firms grow stronger and invent additional new technologies.

## NOTES

<sup>1</sup>We acknowledge that too strong IPR protection may hurt the dissemination of technologies and thus hurt economic development – we thank one of the anonymous reviewers for pointing this out. However, discussing the degree to which China should



protect IPR is not the focus of this essay. Our discussion focuses on the enforcement of IPR protection or violation given the degree of legal IPR regime, be it strong or weak.

<sup>2</sup>We would like to thank one of the anonymous reviewers for pointing these aspects of American history.

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