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BUSINESS**Counterfeit goods in China****Mind games**

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China is moving forwards, and backwards, on intellectual-property protection[Get article background](#)

IT IS a triumph of sorts. The counterfeit Louis Vuitton, Chanel and Hermès handbags, Rolex and Omega watches, and DVDs that once filled the stores in the vast Lo Wu City shopping mall in Shenzhen's bus and rail complex have disappeared. Throngs of officers patrol to ensure they do not return. It is a clear statement of intent at a crossroads famous for selling knock-offs just over the border from Hong Kong.

Any sense of change, however, lasts for only a few moments. The shop windows are devoid of counterfeits, but Lo Wu City's notoriously pushy sales representatives approach every shopper and whisper what is really available in their stores. Enter a special kiosk and a wall of dresses is pulled back, or handbags pushed aside, to reveal a library of catalogues. Bags from Louis Vuitton, Chanel, Prada, or Hermès? Take your pick. Watches? Choose between Rolex and Omega. Point at a selection, and it will be handed over in a room up the back staircase, behind a tattoo parlour, in a nearby warehouse, or even, for the ultra-unadventurous, back in the shop.

So go anti-counterfeiting efforts in Shenzhen and, by extension, in China as a whole. There are visible signs of progress, often the result of extraordinary efforts; and grating signs of retreat and cynicism. In a recent survey by the Quality Brands Protection Committee, an industry association made up of 181 multinational companies, 28% said problems relating to the theft of intellectual property have eased; a slightly larger amount said things were getting worse. The rest say there is no change—which is, given the starting point, not encouraging.

The situation varies from one industry to another. Pharmaceutical companies seem to be pleased by raids in which large quantities of counterfeit drugs have been seized, but fakes remain abundant. These often look perfect but lack the therapeutic ingredients. Difficulties in securing, extending and enforcing patents continue as well. But there are grounds for hope in part because the Chinese government, appalled by deaths from fake drugs and hungry to develop sophisticated industries, seems to be taking the problem seriously.

Mobile-phone manufacturers have become increasingly vigilant about copies and also seem to be getting results. Motorola, the industry's number two, says border guards in Shenzhen and Guangzhou have stopped people 75 times in recent months for carrying counterfeit products; police have conducted 14 raids on factories, and other government departments have carried out a further 65. In August a big raid on a factory led to the seizure of fake Motorola, Nokia and Sony Ericsson phones worth 3m yuan (\$400,000) and the detention of 12 people. Another case earlier this year led to three convictions.

Now for the bad news

But even here, progress is not clear. Chinese government statistics show that the number of criminal cases relating to intellectual property fell by 35% in 2006. And the rules surrounding investigations and prosecutions are cumbersome in the extreme. Each case must normally begin with an investigation by government agencies whose authority is tightly circumscribed. They cannot, for example, go into homes—so that is, not surprisingly,

where fake goods now tend to be produced and stored. Only products worth more than 50,000 yuan can be passed on to police; so counterfeiters limit inventory to just below this point. When arrests are made, they are typically of small fry. The process can be painfully bureaucratic and requires complainants to have a nuanced understanding not only of Chinese law, but also of the subtle levers within the government and the justice system.

Even successful brand-owners recognise that they are at best controlling a problem, not eliminating it. Sellers on online auction and trading sites use carefully chosen expressions to indicate that they are offering counterfeit goods. Local prefecture officials are less interested in abstract property rights and legal nuances than they are in firms creating jobs.

And in some cases the government seems quite happy to look the other way. Piracy of films and music, in particular, is rampant. The small signs of improvement—a slight reduction in the number of pirated DVDs and CDs sold on the street—are overshadowed by new websites offering Hollywood's entire library. Somehow China manages to do an excellent job of blocking internet content that might cause political problems, but is unable to stem the flow of pirated foreign films and music.

As part of its terms of entry to the World Trade Organisation, China agreed to allow 20 movies to be imported annually. The film industry says it thought this would be a floor, but it has become a ceiling. A government edict that foreign firms can retain only 13% of box-office receipts, far too little to justify promotion for anything short of a blockbuster, further undermines the case for providing films legally, and has the effect of encouraging piracy.

The lively academic debate inside China about whether intellectual property already enjoys too much protection may well have provided an excuse for lack of action. This argument was particularly easy to make when Chinese products were less sophisticated. As Chinese prowess grows, however, the cost of not having property rights has started to become more apparent. The availability of free foreign movies and television has certainly held back development of a domestic industry. And Chinese firms increasingly have technology, brands and content they want to protect.

Patents filed by Chinese companies overseas were up by 58% in 2006; in the number of patent applications China now ranks third, behind America and Japan. Senior government officials, who have repeatedly stated that they want China to create advanced products, have realised that no one will create anything without some guarantee of protection. Calls for stronger protection have hitherto come from America and the European Union, but Chinese firms would benefit too.

For their part, Chinese consumers seem to be taking a greater interest in non-pirated goods. Trains leaving the station next to the Lo Wu City mall arrive at Tsim Sha Tsui station in Kowloon. Not far away, it is common to see mainland Chinese residents forming long queues to buy genuine versions of the counterfeit products that are on offer back in Shenzhen—for 100 times the price.