



**TRADE SUSTAINABILITY IMPACT ASSESSMENT
FOR THE NEGOTIATIONS OF A PARTNERSHIP
AND COOPERATION AGREEMENT BETWEEN
THE EU AND CHINA**

**Horizontal Study 2 of 2:
Intellectual
Property Rights**

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Table of Contents

1. Global Context	3
2. Baseline Scenario	4
2.1 EU Baseline	4
2.2 China Baseline	6
3. PCA Impacts	11
Bibliography	13

Index of Tables

Table 1: Successful Implementation of a PCA.....	12
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1. Global Context

Intellectual property is divided into two categories- Industrial property, which includes inventions (patents), trademarks, industrial designs, and geographic indications; and Copyright, which includes literary and artistic works. These rights are granted to creators and inventors to regulate the use of their products. Where the main purpose of these rights is to provide an incentive to promote worthwhile innovation in a variety of areas, such as technology and pharmaceuticals, a balance must be reached to ensure that these innovations are accessible by all. Hence, intellectual property rights are granted for a limited period of time.¹

One of the most prominent initiatives in intellectual property is the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), which was initiated during the Uruguay Round in 1994, and entered into force on 1 January 1995. TRIPs provides the WTO limited jurisdiction to enforce IPRs and obligates member nations to protect and enforce private IPRs.²

IPR is a relatively new field that is country-specific and is in its early stages of development in a number of countries, especially developing ones that have yet to fully acknowledge and realise the inherent benefits brought about by intellectual property protection. It is coming under greater scrutiny, especially in the area of trade and sustainable development.

¹ European Commission, Sectoral Issues: Intellectual Property http://ec.europa.eu/trade/issues/sectoral/intell_property/index_en.htm

² Intellectual Property Summary, Center for International Development at Harvard University

2. Baseline Scenario

2.1 EU Baseline

In the EU context, the legal basis for the intervention of the EC on intellectual property rights protection is set in Article 95 of the EC Treaty with the aim of harmonising the laws of the Member States on intellectual property and in Article 308 of the EC Treaty with the aim of creating a right that applies uniformly across the EU Single Market. The European Commission's focus on the "knowledge-based" aspects of the Single Market and its work is partly concerned with traditional instruments regulating the market, such as harmonizing the laws of Member States relating to industrial property rights to avoid barriers to trade. The aim is to create unitary systems for the protection of such rights with Community-wide effect through the filing of one single application for protection (Community trade marks, designs and patents). The Commission is also increasingly concerned with ensuring that the Single Market functions properly in the Information Society and the fight against Counterfeiting.³

Progress has thus far been made in the areas of trademarks, designs and models, copyright and geographical indications. More specifically, harmonization has occurred in areas relating to trademarks (Directive n° 89/104 of Dec 1988 and regulation n° 40/94 of Dec 1993) where a full Community Trademark registration system has been established; computer programs (Council Directive 91/250 of 14 May 1991) and databases (Directive 96/9 of 11 March 1996);⁴ Geographical Indications (Council Regulation 510/2006 of 20 March 2006); topographies of semiconductors (Council Directive 87/54 of 16 December 1986).

In the European context, the European Commission has been under significant pressure from companies and researchers to establish a uniform patent system. Currently, patents can be filed, in Europe, through the European Patent Office based in Munich, but such system is quite different of the European Trademark system. The Organisation of European Patent regroupes 34 countries, and each patent application needs to designate in which of these countries protection is claimed. In April 2007, the European Commission while waiting for an opportune time to introduce a single European Community patent, outlined a compromise that would start with a harmonised court system for patent lawsuits. With this dossier in place for 20 years, the Commission did not propose a legal text, instead, issued a communication that provides different suggestions for a possible blueprint, giving adequate autonomy to Member States to become engaged. The communication is based on a 2006 stakeholder consultation held by the European Commission, from which it has drawn "operational conclusions".⁵

³ European Commission (2007), "Industrial Property" http://ec.europa.eu/internal_market/indprop/index_en.htm

⁴ "European Commission Issues Communication To Unlock EU-Wide Patent Debate", Intellectual Property Watch, 4 April 2007

⁵ For further details, see Intellectual Property Watch [EU Policy, 17 July 2006](#) and [European Policy, 13 October 2006](#)

A single Community patent would mean that a patent granted one place in Europe would be valid in the entire community. Thus far, logistical issues, such as the cost of translation into all 23 EU languages, have been barriers to this region-wide initiative. However, efforts are made to agree on a limited number of languages (English, German and French). So far, there also has been no agreement on a draft plan for a centralised patent litigation system, but the 2007 communication outlines a hybrid model to first improve the patent litigation system throughout Europe and then aim for a community patent.⁶ However, instead of one centralised patent court as was proposed in the 2003 draft European Patent Litigation Agreement (EPLA), each member state would designate one specialised court. Not only would this system work for existing patent systems, but also would be set up in anticipation of the single patent system.

Amongst the key issues to be considered are outstanding questions on whether litigation in a national court relating to nationally granted patents would apply to other Member States as well. Alternatively, harmonisation of laws may come into effect only at the appeal level. A number of issues are still to be determined, but the main concern currently is to avoid a 'double system'.

Patent litigation, which varies from country to country, can be unaffordable to many companies, especially small and medium-sized enterprises (SMEs). The Foundation for a Free Information Infrastructure, representing 3,000 small-to-medium information technology firms and 8,000 IT professionals, suggested that this proposal is based on flawed assumptions and will make it easier for large US companies to sue small European IT firms.⁷ On the positive side, the Commission insists on independent judges, and acknowledges that the patent system as it stands today is largely unsuited for SMEs.

To complement the patent communication, a separate and comprehensive communication on a strategy on intellectual property rights is planned for 2008. This new document is also designed to address outstanding non-legislative and horizontal issues in all fields of intellectual property.⁸

As the EU and China become strong trading partners, the issue of IPR is of significant relevance and importance. The importance of IP to the trading relationship with Europe and China is increasing. IP is a regular and prominent feature of bilateral discussions. EU exports to China have been growing strongly in the past few years. In 2006, 21% of EU exports were to China, though the EU still exports less to China than it does to Switzerland. A study published by the Commission in 2007 reported that approximately €20 billion in trade opportunities are lost every year to EU businesses because of market access barriers in China.⁹ The EU-China trade deficit was expected to rise above €170 billion in 2007, widening by more than €2.1 billion in the past year.

⁶ "European Commission Issues Communication To Unlock EU-Wide Patent Debate", Intellectual Property Watch, 4 April 2007

⁷ Ibid

⁸ Ibid

⁹ "EU Trade Commissioner Mandelson in China November 23-28" EU Report, Brussels, 23 November 2007

2.2 China Baseline

China has proven to be a leading case of economic success in the last 30 years. It has gone from an economy mired in stagnation to one of the most vibrant since the start of the reform era that began in the late 1970s. China is undergoing expansive economic growth, more than doubling in the past decade to become the world's fourth largest economy. China shows particular strength in a number of key markets- it is now the third largest market in personal computers, the second largest market in telecommunications and the seventh largest market in healthcare.¹⁰ This spectacular growth is expected to continue.

China possesses considerable competitive advantage in the production and export of computer hardware. It is the world's largest platform of hardware production, accounting for approximately 70 percent of the world's hardware base. Software development and production in China, however, pales in comparison with its leading position in hardware production. Based on statistics from the year 2000, the size of China's software industry is only one-fifth of that of its hardware industry. This discrepancy is largely due to low labour cost.

However, China is gradually losing its comparative advantage in labour cost, as more countries in Southeast Asia, Eastern Europe and Latin America now can offer cheaper labour sources. Rising inflation and wage costs, coupled with rising commodity prices, is transforming China's manufacturing industry. Local and international firms manufacturing in China are either re-locating to areas of lower-cost basis – into China's more remote provinces or into southern or South East Asia – or realising the impetus to advance up the technology ladder to counter rising costs.¹¹ As Chinese and international companies consider re-location or technology product development, the protection of IP will be directly related to growing their investment. As an example, European multinational Adidas operates more than 250 factories in China with each clothing factory employing over 3,000 people on average and each shoe factory employing over 20,000 people on average.¹² The effect of the recent abolition of Chinese export rebates, the introduction of stricter environmental and labour laws and the increase in the minimum wage have all added to production costs. According to the Adidas head of Social and Environmental Affairs, William Anderson, “the message coming from local governments and to a lesser extent the central government is very clear, they're saying don't tell us about your problems, relocate”.¹³ This scenario confronting both Chinese and European companies will rely on greater IP protection as production methods and product technologies are further exported.

¹⁰Hunter, Kate Colpitts. “Here There Be Pirates: How China Is Meeting Its IP Enforcement.” *San Diego International Law Journal*, Spring 2007, p. 524.

¹¹ Garnaut, J., *Costly leap – pressure on the factory floor*, Sydney Morning Herald, 15 March 2008, <http://business.smh.com.au/costly-leap--pressure-on-the-factory-floor/20080314-1zip.html>

¹² Garnut, Ibid

¹³ Garnut, Ibid

To maintain its competitive edge, and maintain the rapid growth of its economy, China needs to upgrade the technological level of its exports.¹⁴ Therefore, confidence in IP laws and enforcement is one of the most important elements for encouraging innovative and inventive investment. This shift is expected to be central to China's revised intellectual property law to be adopted by the National People's Congress. China is the third largest trading market, but its high-technology products independently innovated only account for two per cent of its total foreign trade.¹⁵ Liu Jian, Division Director of the International Cooperation Department of the State Intellectual Property Office (SIPO) has described China at a crossroads, with the world's fourth largest manufacturing capacity needing to "create an innovation-orientated country" and not just a producer.¹⁶ "This is the main aim of the government's "National medium and long term science and technology development plan (2006-2020)" in which more than 20 ministries and departments and 2,000 experts are involved.¹⁷

Intellectual Property in China underwent significant changes just prior and after China's accession to the WTO in 2001. Over 147 laws concerning all facets of intellectual property have been amended, and out of the 343 paragraphs of the Working Party Report on China's accession, 55 cover trade-related IP rights.¹⁸ Greater transparency and visibility of the workings of all of China's administrative agencies, alongside standardisation of Chinese laws, policies and legal training, were part of the requirements as China joined the WTO.

China's IPR regime, in theory, is fairly sound. For example, governments and companies use international treaties as measuring sticks to enforce and protect their IPR in China. China signed the World Intellectual Property Organisation (WIPO) Convention in 1980, the Paris Convention for the Protection of Intellectual Property in 1984, the Berne Convention for the Protection of Literary and Artistic Works in 1992, and the Geneva Phonogram Convention in 1993. More recently, as a condition of joining the World Trade Organisation, China acceded to the Trade-Related Aspects of Intellectual Property Rights, or TRIPs.

Patent Law

China is in the process of amending the Patent Law of the PRC for the third time, further clarifying previous rules and regulations relating to intellectual property. Comprising 96 provisions, this new draft is more comprehensive than previous efforts in this area. The draft contains a number of amendments to the Patent Law which has existed since 1984. Some of the changes to the law, especially those concerning the medical and pharmaceutical industries,

¹⁴ Miao, Felix. "Protection of Intellectual Property Rights in Software Products and How to Accomplish a Technology Transfer Transaction in China." *Fordham Intellectual Property, Media and Entertainment Law Journal*. Autumn 2007, pp. 61-62.

¹⁵ Gerhardsen, T., *China, India discuss national IP strategies, local innovation*, Intellectual Property Watch, quoting Liu Jian, Division Director of the International Cooperation Department of the State Intellectual Property Office (SIPO) on 2 July 2007 colloquium held by the World Intellectual Property Organisation (WIPO), <http://www.ip-watch.org/weblog/index.php?p=676>

¹⁶ Gerhardsen, *Ibid*

¹⁷ Gerhardsen, *Ibid*

¹⁸ "Managing Intellectual Property in the Far East: China", Dr Ruth Taplin, KnowledgeLink Newsletter, April 2005

the wide reference to compulsory licences or the right to apply for a patent out of China are considered extremely controversial. Technology and parallel importations are also affected. According to WIPO's 2007 statistics, patent applications increased by eight-fold in 2007. But the increase in domestic patent applications applies more to Utility Models than to Invention Patents, which illustrates the real innovation capacity of Chinese industry.

Trademarks

The current Trademark Law came into effect in October 2001 with implementing regulations taking effect on 15 September 2002. China's Trademark Law was first adopted in 1982 and subsequently revised in 1993 and 2001.¹⁹ The new Trademark Law extended registration to collective marks, certification marks and three-dimensional symbols, as required by TRIPS. China has a 'first-to-file' system that requires no evidence of prior use or ownership, leaving registration of popular foreign marks open to third parties.²⁰ However, the China Trademark Office has cancelled Chinese trademarks that were unfairly registered by local Chinese agents or customers of foreign companies.

Despite taking significant steps towards strengthening its IPR regime, China's trading partners in Europe and the US have reason to be concerned. Despite and because China has signed IPR-related treaties, it has found itself the subject of complaints lodged against it in the WTO. The United States filed a WTO complaint against China on 10 April 2007, charging that China tolerates continuous IPR violations. The European Commission has joined the consultation process and has not ruled out taking its own action under the auspices of the WTO.²¹

Two reasons explain why IPR violations remain rampant, despite existing initiatives to deter IP theft. First, the legal regime surrounding IPR is riddled with loopholes and ambiguities that facilitate virtually uninterrupted IP theft. Secondly, even where the laws are clear, enforcement has proven elusive.

China has challenged this assertion putting forward statistics, showing the amplitude of its anti-counterfeiting efforts. Official figures suggest that administrative and criminal authorities have increased their efforts to tackle IP violations in China. In 2005, the Administrations for Industry and Commerce undertook over 49,000 trademark-related investigations. More than 37,000 formal cases were commenced, including 6,770 related to foreign trademarks – a 23% increase since 2005. The Administrations for Industry and Commerce also transferred 236 cases to the Public Security Bureau for criminal investigation. In 2005, the Public Security Bureau accepted 1799 criminal cases involving IP infringement, an increase of 52% and made 2119 arrests, an increase of 56%. Approximately 2700 persons were jailed in 2005 for IP-related

¹⁹ Embassy of the United States Beijing, China, December 2005 http://beijing.usembassy-china.org.cn/protecting_ipr.html

²⁰ Embassy of the United States Beijing, China, December 2005 http://beijing.usembassy-china.org.cn/protecting_ipr.html

²¹ Intellectual Property Watch (July 2007) "EU Seeks Stronger IP Enforcement At Every Level," <http://www.ip-watch.org/weblog/index.php?p=705&res=1280&print=0>. See also the "Trade Sustainability Impact Assessment of the Negotiations of a Partnership and Cooperation Agreement between the EU and China – Global Analysis Report." Draft – August 2007, 5.3 Intellectual Property Rights (IPR) Protection (pp. 38-39).

crimes. During the first six months of 2006, the Customs Authority also prosecuted 1076 IP-related cases and seized 39 million infringing items worth more than US \$8.5 million. Despite these results, the Office of the US Trade Representative continued to identify China as one of the most serious IP offenders in its Special 301 Report, issued in April 2006.²² And both EU and US Customs rank China as the first country of origin (over 85%) of infringing products seized at their borders.

The main issue, therefore, is not so much the quantity of the anti-counterfeiting actions taken by China, but the efficiency and level of deterrence of such actions. According to lobby groups representing Microsoft, Walt Disney and Vivendi SA, who were acting behind the initiative taken by the US, China's copying of movies, music and software cost companies \$2.2 billion in 2006 sales.

Concerns about China's IPR regulations in relation to the area of piracy fall into three major categories, two of which concern IPR in general and not only copyright.

First, excessively high legal thresholds for launching criminal procedures offer a safe harbour for pirates and counterfeiters. Under China's Criminal Law, piracy of copyrighted works and counterfeiting of trademarked goods are subject to criminal procedures and penalties only when the authorities find the amount of piracy or counterfeiting to be "serious", "especially serious", "relatively large" or "huge". These terms were defined in a joint regulation issued in April 2001 by the Supreme People's Procuratorates and the Ministry of Public Security, by reference to threshold amounts stated in terms of value, profit, or number of pirated or counterfeit copies. Although the threshold was lowered in December 2004, by a joint Judicial Interpretation of the Supreme People's Court and Supreme People's Procuratorates, the threshold remains a major "safe harbour" problem. Furthermore, the value thresholds are first calculated according to the price indicated by the counterfeiter of the pirated or counterfeit product (even if such price is obviously very low and uncontrollable) and the price of the corresponding legitimate product is only referred to when the counterfeiter does not provide any price. Hence, the lower the price of the pirated or counterfeit product, the more the infringer could see or offer for sale without fear of criminal prosecution. Such high enforcement standards make it impossible to prosecute many commercial infringers of IPR.

Second, under the rules of China's Customs Regulations and Implementing Measures, Customs authorities are allowed to release seized goods back into channels of commerce, for instance through auctioning the goods following removal of infringing features such as fake labels. This is contrary to Articles 46 and 59 of the TRIPs Agreement, which provide that these goods are ordinarily required to stay out of commerce.

²² "China and Hong Kong: Recent Developments in Intellectual Property" by Cedric Lam and Janet Wong at Dorsey & Whitney LL, 2007

Thirdly, (this is specific to copyright) China's copyright laws deny copyright protection to imported works waiting for approval to enter the Chinese market whereas domestic works do not require such pre-distribution review. During the review period, unauthorised persons are able to put copies of works on the market without infringing copyright and thus without incurring civil and criminal copyright liability. Compounding problems in the violation of copyrights are the ease with which digital media can be copied. Between these ambiguous and rarely enforced laws, pirated media now dwarfs the availability of legal, legitimate media.

The relative inefficiency of China's efforts against IPR violations does not only affect its capacity to innovate and sustain the growth of its economy, it also causes China huge losses. According to the Chinese Development Research Centre, counterfeiting is a US \$16 billion industry in China. Large multinationals have estimated that ten to fifteen percent of their Chinese revenues are lost each year to counterfeit products.

The damage caused by counterfeiting largely spreads beyond the borders of China. While the majority of the products counterfeited in China remain inside the country, increasing amounts of pirated goods are exported to foreign markets. This international trade relies on sophisticated distribution networks, which are often run by organised crime syndicates along the same trade routes used for narcotics.

This is particularly true for drugs, which is one of the worst and most dangerous type of counterfeiting. According to global public health officials, the production and sale of counterfeit drugs has begun to spread across national borders and, in some cases, is contaminating authentic drug supplies. Estimates of counterfeits range up to more than ten percent of the global medicines market and account for more than US \$32 billion in annual sales. Studies suggest that over half of the pharmaceuticals sold in China, Nigeria, Thailand, Cambodia and Indonesia are counterfeit. The worldwide spread of these drugs is staggering. Approximately one-third to half of packets of artesunate tablets, life-saving anti-malarial drugs recently bought in Southeast Asia, were fakes and did not contain a single active ingredient. A total of 192,000 Chinese patients are reported to have died in 2001 from fake drugs and, in the same year, Chinese authorities closed 1,300 factories while investigating 480,000 cases of counterfeit drugs worth US \$57 million. In 2004, Chinese authorities arrested twenty-two manufacturers of grossly substandard infant milk powder and closed three factories after the deaths of over fifty infants.

3. PCA Impacts

A focus of the Partnership and Cooperation Agreement in relation to Intellectual Property Rights should support the development of the institutional framework for IPR enforcement in China. The IP institutional infrastructure in China has progressively developed into a rule-based and increasingly open system, however, progress can be expanded in the areas of furthering transparency and strengthening predictability within the institutional infrastructure. Intellectual Property is administered by government regulations and government agencies are established to address IP violations. China's government agencies that encourage reporting and connect with enforcement agencies are difficult to navigate for European companies. For example, of the fifty centres of China's Service Centres for Intellectual Property Enforcement only three centres in Beijing, Jiangsu and Ningbo have websites in English.

Capacity building within the institutional infrastructure in China also remains a priority to encourage companies to report and utilise the legal remedies provided by Chinese law. Confidence in the enforcement of intellectual property laws is a key factor in foreign investment and market expansion activities. The positive implications for business growth and economic activity in both Europe and China should provide a clear incentive to support China's institutional framework and institutional capacity as part of the PCA.

The lack of business confidence in China's IPR framework will potentially have a long-term and negative impact on the EU-China trading relationship. Consistency in enforcement is required to prevent companies from placing limits to entering or expanding operations in China. An avoidance of market opportunities due to IPR concerns will limit opportunities for European companies to further grow their business in China and for China to move up the technology and productivity ladder essential for its long-term economic development. Inconsistency in the disposal and/or destruction of products that violate the rights of IP owners should be addressed to increase confidence levels.

Coupled with enforcement consistency is the limited level of deterrence provided by China's legal system for IP violation. Damages paid in successful civil damages in China are often measurably below the loss incurred. Maximum penalties alone and the lax enforcement of penalties generally are arguably a non-deterrent to the profit potential from IPR infringement activities. In addition, the extent of the illegal activity required for commencement of criminal proceedings in China (threshold mechanism) is high in terms of the levels of severity or illegal gain received.

Intellectual Property Rights administration is fundamental to strengthening the EU-China trading relationship. Business partnerships, business promotion, sourcing, manufacturing, sales and distribution, research and development and licensing are all adversely impacted by ongoing IPR infringements. When business regards IPR issues as a liability on a balance sheet as opposed to an asset, trading relationships will be adversely impacted. The PCA has a clear

role to play in supporting governance and institutional strengthening in China. The several high level EU-China dialogues and the EU-China Project on the Protection of Intellectual Property Rights (IPR2) funded by Europe and China have prioritised IPR measures in these areas, however, enforcement consistency and the correlating increase in business confidence is crucial to strengthening the economic relationship.

The role of technology in supporting sustainable development and a transition to a low carbon economy is well-established. Similarly well-established is the notion that countries cannot act in isolation in achieving sustainable living standards. Investment in research and development is supported by IPR protection and a causal link exists between IP and innovation in environmental technologies. A two-speed IPR agreement for environmental technologies between developing and developed countries, similar to the two-speed agreement established for carbon reduction timetables, is unlikely to facilitate China’s transition to sustainable development. The two-speed carbon reduction timetable balances environmental impacts with other Millennium Development Goals associated with economic growth and poverty alleviation. The current stage of China’s development and the country’s public and private investment capabilities, positions IPR as an economic growth generator in China, supportive of research and development to support the role of technology in sustainable development. A two-speed IPR agreement on environment technologies will potentially impact adversely on innovation and investment in this sector in China and will potentially imbalance China’s attainment of Millennium Development Goals. The PCA should strengthen IPR cooperation to facilitate the government priorities in both Europe and China in the area of sustainable development.

Intellectual property protection encourages cultural development and awareness. The PCA negotiations should recognise the positive social impacts of growth in cultural knowledge and cultural industries. Investment risk in cultural industries is reduced by the assurances that an effective IPR system can provide protection against violations. The wider and long-term Europe-China relationship will benefit from strong cultural industries and the positive social impacts derived from accessing respective markets.

Table 1: Successful Implementation of a PCA

Indicator	Existing Conditions	Scenario Impacts		Policy Options	
		Overall Direction Magnitude	Equity	Reversibility	Capacity to change
Economic	0	↑	⊖		M
Imports	-	↑	⊖	N	M
Exports	++	=	⊖	N	M
Social	0	↑	⊖		H
Health Care Delivery	+	↑	⊖	Y	H
Environment	-	↑	⊖		H
Biodiversity	-	↑	⊖	Y	H
Institutional	-	↑	⊕		M
Science and Technology	-	↑	⊕	Y	M

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