



# Judicial local protectionism in China: An empirical study of IP cases



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## ABSTRACT

Based on an empirical study of intellectual property cases published in the *Bulletin of the People's Supreme Court of China (the PSC)* since 1985 as well as a large sample of intellectual property cases collected from five Chinese provinces filed during 1994–2009, this study finds that in first instance cases whether the plaintiff's residence coincides with the court's location has a positive and significant impact on whether the plaintiff gets a favorable ruling, after controlling for various plaintiff and defendant characteristics. As the findings are robust to various tests, they provide consistent evidence for the existence of judicial local protectionism in China.

On the other hand, no significant impact of plaintiff location on trial outcome is found in appeals rulings for the IP cases. Instead, the appellate courts are found to redress the local protectionism problem in the first instance rulings in the PSC cases, thus offering support for the argument that the case law developed by the *People's Supreme Court* aims at providing correctional mechanisms at the higher level to remedy the wrongs perpetrated at the lower level judiciary. The empirical results using the larger five-province sample, however, fail to find the rectifying effect of the appellate courts, suggesting that the goal of the PSC has yet to be achieved in many Chinese regions. These findings provide new insights for the relationship between law and development.

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## 1. Introduction

China's rapid economic growth in the past thirty years has attracted scholars from different fields to offer explanations and to study impacts, including experts who explore the relationship between law and development. But in contrast to China's stellar economic performance, its courts have long been at the receiving end of criticisms, especially as the country increasingly relies on the legal system to resolve various disputes. Lack of judiciary independence, overlapping jurisdictions, and low quality of legal professionals are among the major issues raised by critics, and the quality of rule of law is considered low by many (Orts, 2001; Lubman, 2006; Clarke et al., 2008). In particular, as a natural outcome of these legal issues, judicial local protectionism has remained prevalent over time and thus has attracted the attention from scholars in law, political science, and economics as one of the most serious problems plaguing the Chinese legal system (Chow, 2003; Zhang, 2003; Gechlik, 2005; Wang, 2008). The China

case thus seems to challenge the conventional wisdom on how law relates to development, as stated in the *Rights Hypothesis*, i.e., by providing property and contract protection, a well-functioning legal system is the key to a region's sustained economic development (North, 1990; Hall and Jones, 1999; Acemoglu et al., 2001).

In the current study, we examine the issue of judicial local protectionism by analyzing two samples of intellectual property cases adjudicated in China between 1985 and 2011, covering 23 provinces. In one sample, we use all the intellectual property cases included in the *Bulletin of the People's Supreme Court of China* between 1985 and 2011, whereas the other sample includes all the IP cases posted online for the five major provinces of Fujian, Shandong, Henan, Hunan, and Sichuan between 1994 and 2009. To preview our empirical results, we find that in first instance cases when the plaintiff's residence coincides with the court's location, their probability of winning the case is significantly higher than in a case when the plaintiff's residence is different from the court's location, and such findings are robust to different samples and different specifications. The second set of findings relates to the role of the appeals courts. We find no significant impact of plaintiff location on trial outcome in appeals rulings for the IP cases. Instead, in the PSC cases, the appellate courts are shown to redress the local protectionism problem found in the first instance rulings. The

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empirical results using the larger five-province sample, however, fail to find the rectifying effect of the appellate courts.

Compared to existing studies on judicial local protectionism, we not only give more direct evidence for the existence of judicial local protectionism using a larger and more representative sample of cases, but more importantly, we study appeals courts as well as first trial courts in reaching legal judgments and explore their different roles in impacting the problem of judicial local protectionism. As one sample includes cases selected by the People Supreme Court (PSC) for publication and circulation among lower level courts, our study also helps shed light on the role of the PSC in China's legal system and its development. Specifically, we offer support for the argument that the case law developed by the *People's Supreme Court* aims at providing correctional mechanisms at the higher level to remedy the wrongs perpetrated at the lower level judiciary. But there is also evidence that the admirable goal of the PSC has yet to be achieved in many Chinese regions.

Because we observe first instance trials, appeals rulings, as well as PSC's case selection decisions, our study allows a more comprehensive exploration into the functioning of different levels of courts in the Chinese legal system, which permits a better understanding of how law regulates economic behaviors during China's economic reform and social transformation. The observed attempt of the PSC in selecting and publicizing exemplary cases, where the appeals courts play the correctional role in rectifying the mistakes made by the lower courts, seems to provide support for an alternative theory linking law and development. Specifically, sustained economic development may induce the need for rule of law and thus legal development (Clarke et al., 2008).

Finally, our research on the cases published by the People's Supreme Court of China (the PSC) also provides materials for future studies on Chinese case law. Despite China's history in following the continental law tradition since the late Qing dynasty, case law has emerged as an increasingly important component of Chinese law. In theory, judges should strictly interpret the stipulations in existing statutes and regulations to reach their judgment in any law suit. But in practice, the People's Supreme Court in China have regularly selected legal cases to showcase the proper applications of both Chinese statutes and the PSC's own judicial interpretations of statutes, by publishing these cases in the *Bulletin of the People's Supreme Court of China* since 1985 and recommending them to lower courts as guidance in future cases. How important is this Chinese version of case law in reality? Our research on the PSC cases versus the five-province case sample can help evaluate the impact as well as the limitations of case law in China's legal development. More generally, the findings can help evaluate the role of case law in development in general.

The remainder of the paper is structured as follows: Section 2 reviews the related literature. Section 3 describes the court system and intellectual property laws in China, as well as the standards and procedures for selecting PSC cases and the role of these cases in influencing lower court rulings. Data sources and variable measurement are discussed in Section 4, while Section 5 presents estimation specifications and empirical findings. Section 6 concludes with a discussion on the implications of the empirical findings for economic theory and policy making.

## 2. Literature review

The current study most closely relates to the literature on judicial local protectionism, which is local protectionism in the judiciary, where the local courts abuse their legal power to protect local interests (Chow, 2003). Regarding the sources of local protectionism in China, scholars have provided the following explanations. First, the current arrangements of fiscal decentralization

lead to interest conflicts between the central government and local governments, where local governments have the incentive to promote their own regional growth at the expense of other regions (Lee, 1998; Young, 2000; Yin and Cai, 2001; Poncet, 2005; Bai et al., 2008). Second, the promotion tournament among local leaders, where their promotion prospects are linked with regional economic growth, provides additional incentives for local protectionism (Zhou, 2004; Li and Zhou, 2005).

Several features of the Chinese judiciary system further help explain why judicial local protectionism is a serious concern in the country. First of all, the lack of independence of the Chinese judiciary implies that the executive branch has the authority to make personnel and budgetary decisions for the courts. In addition, the locations of regional courts follow exactly the same administrative divisions as regional governments, which aligns one local court with one local government, giving the latter full control of the former (Zhang, 2003; Gechlik, 2005; Wang, 2008).

Scholars have also studied the impact of local protectionism. Young (2000) find that it has led to market divisions and distortions. Bai et al. (2004) argue that governments in regions with high profit industries or a larger state sector are more inclined to provide local protectionism, which lead to a lower degree of specialization in these same regions. Following the same logic, Hu and Zhang (2005) show that the trade barriers erected by local governments in protecting their own regional interests have reduced the gains from trade among regions, as all regions now set up their own independent economic structures, resulting in much overcapacity.

Due to lack of information, the above studies on local protectionism mostly rely on economic data to proxy the degree of protectionism (also see Naughton, 2003, for instance). On the other hand, most studies on judicial local protectionism are based on legal or political analyses, which tend to be strong in description but lacking in diagnostics. A small number of economic studies empirically examine judicial local protectionism in China. Chen et al. (2009) focus on listed firms entangled in legal cases and find that the stock prices of firms more likely to benefit from judicial local protectionism experience less fluctuation than those of other firms. Zhang and Ke (2002) adopt the approach of case analysis. Using a sample of economic legal cases from a basic court in Beijing, which were adjudicated during a 7-month period, the authors find that the winning rate of local firms (38.4%) is higher than that of non-local firms (25.9%).

The discussion above suggests that existing research on the patterns, causes, and effects of local protectionism suffers from two problems. First of all, most studies rely on regional economic data to explore the issues, thus can only provide indirect inferences regarding the existence and patterns of local protectionism (Young, 2000; Yin and Cai, 2001; Naughton, 2003; Bai et al., 2004; Hu and Zhang, 2005; Poncet, 2005; Bai et al., 2008; Chen et al., 2009). Relatedly, as such economic proxies can only indirectly measure protectionism, research findings oftentimes differ depending on what data and proxies are used in the study. Furthermore, these studies do not address judicial local protectionism specifically. The second problem relates to the small number of studies that collect direct evidence of judicial local protectionism using case analysis. The small sample of cases included and the narrow regional scope covered challenge the generality of their empirical findings. For example, with data limited to a single court in Beijing and the time period focused to a 7-month period, we will not be able make nation-wide inferences about judicial local protectionism based on the Zhang and Ke (2002) study. Neither can we study patterns and variations in protectionism across regions or over time.

In the sections below, we will attempt to address these two problems using two data sets. The first data set includes

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