

# Crackdown on Counterfeits

## China's Product Quality Law (1993)

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To support the unprecedented growth that China has undergone throughout recent decades and continue the expansion of the Chinese economy, the nation has undergone a series of policy reforms since 1979. This process has included the introduction of new regulations such as the Product Quality Law (PQL), first enforced in 1993 and amended in 2000. This essay will explore why the PQL was introduced, explain some of its key characteristics, discuss how the law is enforced, and consider the consequences of the PQL both on the broader economy and specifically for Western businesses.

## I. CATALYSTS OF THE IMPLEMENTATION OF THE PRODUCT QUALITY LAW

### A. The rise of the Chinese consumer

Today, China represents one of the largest consumer markets in the world, with household spending second only to the United States' and surpassing USD\$5610 billion in 2020 (The World Bank 2020). These numbers are notable not only because they position China as one of the world's most influential economies, but also because they represent a significant change from the state of China's economy mere decades previously. This section will discuss the emerging concept of consumerism in China and how this growth prompted regulations such as the PQL.

Prior to the 1990s, China languished in a relative “state of scarcity” which created a market where demand outstripped supply and market conditions were established by producers and sellers (He & Liu 2000, pp.1-2). Consumers therefore lacked the opportunity of choice when purchasing products, so the quality of the goods they could acquire was not a priority (Ip & Marshall 2014, pp.37-38). Rather, the market for lower quality goods thrived in the early years of Chinese economic development. As economic activity in China grew and the average level of disposable income saw a rise of 350% in rural areas and 900% in urban areas between 1978 and 1993 (National Bureau of Statistics 2018, p.59), this exponential rate of economic growth was matched only by an equally notable rise in the number of product quality complaints to consumer associations across the nation (Ip & Marshall 2014, p.40).

Prior to the implementation of the PQL, these complaints were addressed in a variety of manners, though often not particularly cohesively. Initially, some provinces established local associations designed to safeguard the interests of consumers within their own communities (ibid pp.38-39). Then, in 1984, the State Council facilitated the establishment of the China Consumers’ Association (ibid. p.39), though the protections this body sought to provide lacked a legal basis, limiting its effectiveness. The closest to established consumer protections within the legal system was thus contained within the Civil Law, which was not targeted towards consumers or market functions (Thomas 2014, p.757) and thus was largely insufficient.

Ultimately, these factors combined to foster a Chinese market in which low-quality products were prevalent, where consumers lacked the ability to ensure their products would function as expected, and in which pathways for recourse were typically not very accessible if a product was defective. To rectify these concerns, the Chinese Government moved to provide a range of consumer protections, including the PQL.

## **B. China and the global market**

Whilst the PQL indeed addresses consumer concerns in practice, it is often suggested that these benefits were secondary to the goals of encouraging foreign firms to conduct business activities with China. As such, to consider the reasons behind the enactment of the PQL, it is prudent to consider foreign pressures to strengthen the legal system in China as well as China's growing position in the global economy.

Historically, the Chinese legal system has typically been underutilised, and it had to be largely rebuilt following the Cultural Revolution (Ambler et al. p.112). As a result of this relative lack of established legal structures, the Chinese Government was concerned that foreign institutions may avoid conducting business activities in China due to a perceived high level of risk, which was detrimental to China's goals of increasing export volumes and increasing the country's economic growth (Ip & Marshall 2014, pp.40-42). If foreign businesses chose to manufacture products in China, there was no guarantee the inputs to their production would be of good quality, and if they were indeed defective, pathways for seeking redress were limited. The suite of laws that the Government introduced in 1993 thus addressed consumer concerns, but perhaps more importantly, provided a framework for dispute resolution to offset any fears foreign firms may have about the lack of guarantees in place to protect business transactions more generally.

## **II. KEY ATTRIBUTES OF THE PRODUCT QUALITY LAW**

### **A. Initial regulations (1993)**

As outlined in Article 1 of the PQL (中华人民共和国产品质量法 [Law of the People's Republic of China on Product Quality] 1993), the law seeks to "strengthen supervision and control" of and "define the

liability for” product quality and thus considers two categories of products: those that are actively being produced and finished defective goods that are circulating in the market. Chapter II of the PQL, which outlines the “supervision over product quality”, details how firms operating in China may be subject to “random checking” by either Local People’s Governments or State bodies under the State Council’s Department for Supervision over Product Quality (ibid. 1993). Chapter III of the PQL then discusses the “liability and obligation of producers and sellers in respect of product quality”, outlining the quality requirements for goods sold in China, and the penalties that can be applied in the case these requirements are not met (ibid. 1993). Importantly, the PQL does not only protect consumers but all parties involved in manufacturing processes, including companies that may purchase secondary goods as inputs. As such, the PQL considers product quality not from the perspective of consumers, but from that of “producers, sellers, and enablers” (Friedmann 2018, p.188).

In considering the scope of the PQL, one must consider the definition of a ‘product’. Article 2 asserts that a product is a good that is manufactured or processed to be sold, further specifying that this term does not apply to construction projects. As such, the PQL uses a stricter definition of a product than similar legislation in other countries such as the United States (He & Liu 2002, p.2). The law further doesn’t cover the provision of services, further restricting the range of breaches that may fall under the jurisdiction of the PQL (Ip & Marshall 2014, p.45).

## **B. Amendments (2000)**

Leading up to the year 2000, China was focused on its aspiration of joining the World Trade Organisation (WTO), but the country remained hindered by the rampant production of counterfeit goods within the economy (Evans 2003). Therefore, to once again assure the international business community that Chinese products were not all cheap knockoffs, as well as to reduce any further financial losses due to

the production of counterfeit goods (Ip & Marshall 2014, pp.42-43), the State Council amended the PQL.

These amendments were comprehensive, resulting in two-thirds of the original 51 Articles being modified, with a further 23 Articles added (中华人民共和国产品质量法 [Law of the People's Republic of China on Product Quality] 1993). Importantly, the amendments largely focused on resolving issues associated with the enforcement of the PQL (Filei 2000). These include an emphasis on the legal responsibility held by any officials involved in the reporting process to address corruption and an explanation of the mechanisms available to officials for use in conducting investigations into product quality. Further, in Article 40 the entire production chain was to be made potentially liable for any defects, rather than just the producer and the seller.

### III. ENFORCEMENT

The largest weakness of the PQL is arguably its relative inability to be enforced, due to overlapping legislation, an unwillingness of Chinese consumers to engage in the legal system, and incentives for officials to turn a blind eye to product quality issues. These factors reduce the effectiveness of the implementation of the PQL, facilitating the product quality issues that remain prevalent in the Chinese economy to this day and directly impeding the ability of individuals and firms to seek redress if they are impacted by defective products.

China's regulatory process is well-described by Deng Xiaoping's philosophy of 'crossing the river by feeling the stones' (Raskovic 2018, pp.36-42). Most of the laws introduced towards the end of the 20<sup>th</sup> century were components contributing to an overall process, rather than ambitious pieces of legislation (Thomas 2014, p.772). As such, the scope of the PQL is not particularly broad, and must often be viewed alongside other regulations. Though this can be advantageous in allowing the creation of adaptable laws, it has also created the problem

whereby it can be difficult to decide when the PQL should be applied and when other legislation may be more appropriate (Sheng et al. 2015; Lovenworth & Dittrich 1996). Furthermore, this approach leaves gaps in the law, such as how foreign-related products should be held liable (Ding 2009) and how to address mental and psychological damages (Ip & Marshall 2014, p.41-42) under the PQL. This creates difficulties in the appropriate applications and thus enforcement of the PQL.

Furthermore, the shortcomings associated with the existing deficiencies throughout the Chinese judicial system affect the ability of the PQL to be enforced. These include a perceived lack of objectivity given the ties between the legal system and the State, a high potential for corruption, as well as low efficiency (Binding & Eisenberg 2014, pp.30-33). Further, Chinese people typically prefer to settle matters through mediation rather than formal legal proceedings (Ambler et al. pp.112-113) and many lack the confidence to stand up against a company in this manner (Wang 1998, p.155), so the PQL is likely underutilised. Finally, as these laws are relatively untested, there remain many aspects of the legal system that require further exploration (王 [Wang] 2021).

Finally, it is rarely in a local official's best interest to report any behaviour which breaks the PQL due to "local protectionism". This refers to the way officials will often choose to allow goods to be produced in breach of the PQL where industry brings economic benefit to the region (Kerns 2016, pp. 588-589; Wang 1998, pp. 155-156). This is particularly the case in the counterfeit goods industry, which is seen as crucial for the economic survival of cities such as Yiwu, as it provides thousands of jobs, satisfies consumer demands, and remains a significant source of income (Ip & Marshall, pp.42-43; Kerns 2016, pp.586-590). Although the amendments to the PQL in 2000 sought to reduce this behaviour (Ip & Marshall 2014, pp.42-43), these problems continue to permeate the Chinese economy today, particularly in the consumption of luxury products (Li et al. 2020).

## IV. CONSEQUENCES OF THE PRODUCT QUALITY LAW

### A. The domestic economy

Considering the broader economy, although the PQL has many loopholes and weaknesses in its enforcement, the legislation has positively influenced the Chinese economy in many ways. For instance, though Chinese goods have historically been perceived by Chinese consumers to be low quality, this perception is now shifting, particularly amongst young consumers (Jin et al. 2018). This has positive implications for China's future economic growth. Further, the PQL has the unintended consequence of promoting corporate social responsibility in China, which should have positive implications for the quality of Chinese business society (Ying 2011). Finally, as the price of labour continues to rise in China, many economists believe that the country has to an extent approached its Lewis turning point, whereby the country is losing the comparative advantage it has held in manufacturing since its industrialisation, and thus needs to pivot towards the production of higher-value products to maintain sustainable economic growth (Raskovic 2018, pp.109-110). Indeed, the low quality of many Chinese exports has been perceived as a barrier to growth in export volumes (Zhang & Jin 2015, p.132), so the PQL has helped reduce these concerns. These subsequent increases in product quality have also been shown to improve the quality of life for all members of society (Xu & Liu 2020, p.4).

Indeed, the nature of product quality improvements and their relationship to economic growth is not linear, but circular; economic growth itself promotes increases in product quality as supply chains are condensed, firms are able to import more kinds of intermediate goods, and more of these intermediate goods can be imported from high-income countries (Zhou et al. 2021). Therefore, the existence of the PQL has allowed the general quality of products in China to improve

indirectly through facilitating trade and thus spurring economic growth, putting further upwards pressure on product quality.

## **B. Foreign business**

Foreign firms stood largely to gain from the introduction of the PQL in China. The standards outlined in the legislation, despite being relatively novel in the Chinese context, are heavily influenced by existing product quality standards throughout the rest of the world, particularly in Europe and the United States (Raposo & Morbey 2015; Chen & Tam 2010, pp.16-17; He & Liu 2002). As a result, it is unlikely that a foreign company will be in breach of the PQL based on not complying with national or international standards, and typically domestic firms suffered more from safety or quality issues (Williams 2000, pp.269-270). Thus, the PQL was largely welcomed by foreign businesses wishing to operate in China.

Nonetheless, Western firms which engage with the Chinese market do face a range of risks as a direct consequence of the PQL and should carefully consider their relationships with other firms in China. For instance, a foreign business may become a target for action under these regulations, particularly in cases of “speculative litigation” where consumers act against wealthy foreign firms in the hopes of receiving a high payout (Williams 2000, pp.265-270). This is particularly prudent given that Article 43 of the PQL allows the recipient of a defective product to pursue either the seller or the producer for compensation, with no duty for the plaintiff to correctly identify which party is liable for the defects (中华人民共和国产品质量法 [Law of the People’s Republic of China on Product Quality] 1993). That is, opportunistic plaintiffs may take legal action against the party they perceive to have the strongest financial status, irrespective of actual legal liability, opening large multinationals to the risk of having to make a payout due to the errors of another party (Zhao 2002). Although in such a case, by Article 40, the company would have the right to recover the settlement from the party which is liable (中华人民共和国产品质量法 [Law of



the People's Republic of China on Product Quality] 1993), this can be a complicated process with no guarantee of fee recovery.

Similarly, although not explicitly stated within the PQL, it has been held that a company that labels a product with its name, trademark, or other distinguishable markings could also qualify as a manufacturer in a product liability case, even if that company is not otherwise involved in the productive process (Chen & Tam 2010, p.17). As such, brand owners need to be aware of who they subcontract to manufacture their branded products. As the Chinese consumer becomes more aware of their rights and the obligations of companies, the risk of negative media fallout and the possible associated loss of face increases (Zhao 2002, p.595; Wang 1998, p.155). Essentially, this means that foreign companies need to carefully consider the reputation of other businesses they operate with to reduce their risk exposure. To protect foreign businesses that operate in China, it is often recommended that they take out appropriate product liability insurance in both China and their home country (Chen & Tam 2010, p.17).

## V. CONCLUSION

Ultimately, China's PQL, first introduced in 1993 and amended in 2000, provides producers, sellers, and consumers with the assurance that any party involved in a business transaction can seek recourse if they are sold a defective product. This benefits these parties directly and promotes a safer business environment with the hopes of attracting foreign businesses. However, whilst there have been improvements in product quality across the economy generally, foreign companies have benefitted from these reassurances, and consumer perceptions around product quality in China may be beginning to shift for the better, the PQL remain ineffectively enforced and thus has limited influence. Going forward, further strengthening the supervision of the PQL would allow the aims of these regulations to be more successfully achieved.

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