Piracy Helps

for software, and that eventually goes to the software company's bottom line. In the end, both software companies and consumers benefit from less stringent piracy protection.

China's personal computer market is small, with annual sales of just half a million units in 1995. This represents less than 1% of total world personal computer shipments, which are put at close to 60 million units. But China's market is expected to grow at a rapid clip; sales of computer units are expected to increase around 40% annually for the next few years.

That, however, depends on the continuation of piracy. The average software package represents one month's wages for the average Chinese worker. This means that complete eradication of piracy would limit demand for software and for hardware, much of which is imported from the United States.

The reason Mr. Gates smiles when he comes to China is that he knows that at a certain stage in the industry's development, piracy can help software developers set the industry standard, which will lead to market domination in the future. This benefit accrues primarily to the current industry leader, in this case Microsoft. The propagation of software, pirated or not, can be one of the best ways for a firm to strategically build up its market share and lay the seeds for future harvest. The mistake that Apple Computers made was to keep its software proprietary for far too long; Netscape Communications, on the other hand, freely allows users to download its software.

To be sure, though piracy helps with market penetration, further development of the market requires a sound legal system that owners of intellectual property can rely on once their standards have been adopted. Therefore, it is in the long-term interest of software publishers to encourage China to develop a strong and transparent legal framework that provides effective protection of intellectual property.

Building such a system is much more important, and much more difficult, than simply shutting down a few plants where pirated CD-ROMs are manufactured and raiding a few more shops selling illegal copies. Once a legal system is set up, market participants will have an incentive to protect their own rights and to bring the violators to justice. Building such a system is not in conflict with the objectives of the Chinese government. If the Chinese government wants its domestic software industry to take off, it must eventually enforce laws that protect intellectual property.

There are indications that the Chinese government is looking down the line. In a court case earlier this year, a Beijing-based software firm was ordered to pay $1.6 million in compensation for pirating the copyright of a domestic competitor. This amount was the largest ever awarded in a software copyright-violation case in China. Such development shows a healthy tendency and should be encouraged.

There are many measures that can be taken to accelerate this process. It will be constructive to provide legal expert assistance to help China further develop the legal framework to protect intellectual property. Threats, such as the imposition of trade sanctions, may be counterproductive. Such actions certainly hurt Chinese consumers and may damage the long-term interests of U.S. software companies.

The friendly conversations Mr. Gates had with Chinese leaders and university students were probably more helpful to the long-term welfare of his company than anything Mr. Kantor can achieve with his present demarche.

Mr. Ng is a professor of management at the University of California, Los Angeles, and a visiting professor at Hong Kong University of Science and Technology. Mr. Wu is an assistant professor of economics at Hong Kong University of Science and Technology.