

**Prepared Statement of
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Before the
U.S.-China Economic and Security Review Commission**

*China's Enforcement of Intellectual Property Rights and
the Dangers of the Movement of Counterfeit and Pirated Goods into the United States*

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INTRODUCTION

Co-Chairmen D'Amato and Houston and additional Commission members, I am pleased to join you today to speak about China's compliance with its World Trade Organization commitments regarding intellectual property rights and the actions the Office of the U.S. Trade Representative is taking to improve intellectual property rights (IPR) protection and enforcement in China.

In my last appearance before this Commission two months ago, I focused my remarks broadly on China's economic development, its record on WTO compliance, and the steps the U.S. Government is taking to ensure China lives up to its WTO commitments for the benefit of American companies, farmers, and workers. Having just released the USTR "Top to Bottom Review of U.S.-China Trade Policy" in February, I was able to outline our view that U.S.-China trade relations are entering a new phase in which greater accountability on China's part and greater enforcement on the Administration's part are needed.

As I mentioned at that time, the area of intellectual property rights is especially significant among the enforcement challenges we are facing in our bilateral trade relationship with China. While China has made noticeable improvements to its framework of laws and regulations, the general lack of effective IPR protection and enforcement continues to damage U.S. businesses. For example, industry sources estimate that 2005 piracy levels in China across all lines of copyright business are 85 to 93 percent, indicating little to no improvement. Internet piracy is increasing and end-user piracy of business software and other copyright materials, such as books and journals, are key concerns. The share of IPR infringing products of Chinese origin seized at the U.S. border increased to 69 percent in 2005 from 63 percent in 2004, while the total value of the IPR infringing goods from China decreased to \$63.9 million in 2005 from \$87.2 million in 2004. China's share of infringing goods seized at the border is more than ten times greater than that of any other U.S. trading partner.

Today I would like to offer an update on the U.S. Government's efforts to deal with the problem of IPR enforcement in China based on events that have taken place since I last appeared before you, specifically addressing the IPR-related results of the April 11, 2006 U.S.-China Joint Commission on Commerce and Trade, and the release of USTR's 2006 *Special 301 Report* on April 28. I will also review USTR initiatives developed to strengthen IPR protection and enforcement in China. Our overall priority is to see China achieve the "significant reduction in piracy and counterfeiting" that it committed to in 2004. Through our initiatives, we seek to achieve the dual objectives of solving specific, immediate problems and encouraging the long term transformation of China into a more rules-based, open economy. As I stated two months

ago when I last made a statement to this Commission, I believe that the key to achieving those objectives is treating China as a fully accountable stakeholder in the international trading system and insisting that China play a constructive role commensurate with its economic heft and responsibilities as a WTO Member.

1. 2006 JCCT and Visit of President Hu

Protection of intellectual property topped the list of issues that we raised with Vice Premier Wu Yi on April 11 at the annual meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT). The elevated JCCT, co-hosted by the U.S. Trade Representative and Secretary of Commerce, has proven to be a successful vehicle for resolving trade issues with China. For example, during the last two JCCT meetings in 2004 and 2005, China postponed its software procurement regulations after we expressed WTO concerns, it suspended its proposed mandatory encryption standard for wireless computer networks, and accelerated U.S. companies ability to import, export, distribute and sell their products in China without going through Chinese state trading companies.

This year, a great deal was at stake. Our trade imbalance is worse, and many of China's IPR problems are too. Holding the JCCT on April 11, before the visit to Washington, DC of President Hu Jintao on April 20, gave China a timely opportunity to demonstrate in concrete terms to the American people its commitment to following the rules of international trade and to mutually beneficial trade relations with the United States. Our approach yielded measured progress. At the JCCT, China committed to addressing a number of U.S. trade concerns in three areas: enhancing access of U.S. companies and farmers and ranchers to the Chinese market; improving protection of intellectual property rights in China; and moving toward a transparent and market-oriented system of government procurement in China.

With regard to IPR, some of the key results from our recent JCCT meetings included:

- enforcement actions by China against plants that produce pirated optical discs;
- new rules that require computers to be pre-installed with licensed operating system software;
- agreement to cooperate to combat pirated goods displayed at trade fairs in China;
- a commitment to intensify efforts to eliminate infringing products at major consumer markets in China, such as Silk Street Market in Beijing; and
- a commitment to ensure the legalization of software used in Chinese enterprises and to take up issues of government and enterprise software asset management in the JCCT IPR Working Group.

However, as the Administration has repeatedly stressed, the value of the JCCT is not only in the commitments that China makes, but in the actions that it subsequently takes to implement these

commitments. During his remarks on the South Lawn on April 20, President Hu restated his commitment to take new steps to strengthen the protection of intellectual property rights.

We take President Hu at his word, and we are working aggressively to follow up with our Chinese counterparts to ensure that we have full and timely implementation of the commitments made at this year's JCCT and that concrete actions are taken to implement President Hu's pledge. I traveled to Beijing late last month, along with Department of Commerce counterparts, to discuss next steps to fulfill China's JCCT commitments. My discussions with Chinese agencies yielded positive results, including discussion of cooperation on optical disk piracy and software asset management for government offices and state-owned enterprises. Our primary sub-cabinet level forum for exchange on IPR issues is the JCCT IPR Working Group, established at the 2004 JCCT. This forum provides opportunities to discuss in a detailed and full manner, including at the expert-to-expert level, specific IPR issues with our Chinese counterparts, including China's implementation of its JCCT commitments on IPR. The United States is looking to China, e.g., for full and timely implementation of its commitments to stamp out optical disk piracy and completely eliminate the use of pirated software in government and large enterprise offices, and both of these topics will be discussed in the next meeting of the JCCT IPR Working Group. The United States also uses the JCCT IPR Working Group to discuss customs and border protection issues with China, in order to address the influx into the United States of Chinese IPR infringing products.

2. 2006 Special 301 Report

On April 28, USTR released its Special 301 annual report on the adequacy and effectiveness of IPR protection provided by trading partners around the world. Concerns regarding China feature prominently throughout the report.

While USTR recognizes and appreciates the incremental steps China's leaders have taken at the JCCT and through China's recently adopted 2006 IPR Action Plan, the report concludes that China's infringement levels remain unacceptably high and its enforcement efforts inadequate. As a result, USTR announced that China will remain on the Priority Watch List, and the United States will step up consideration of WTO dispute settlement options. The report also emphasizes the need for authorities at the sub-national level in China to more effectively establish and sustain proactive, deterrent IPR enforcement. To address these challenges, USTR announced that it will scrutinize IPR protection and enforcement at China's provincial level through an unprecedented special provincial review to be conducted in the coming year.

The Report identifies inadequate IPR enforcement as one of China's greatest shortcomings as a trading partner. Rights holders report that enforcement efforts, particularly at the local level, are hampered by poor coordination among Chinese Government ministries and agencies, local protectionism and corruption, high thresholds for initiating investigations and prosecuting criminal cases, lack of training, and inadequate and non-transparent processes.

Most of all, China suffers from chronic over-reliance on toothless administrative enforcement and underutilization of criminal remedies. This is in part because China maintains volume and value thresholds that allow commercial scale violations to escape criminal procedures and

penalties. China's own 2004 data showed that it channeled more than 99 percent of copyright and trademark cases into its administrative systems and turned less than one percent of cases over to the police. In 2005, the United States pressed China to address its over-reliance on administrative enforcement, and at the July 11, 2005 JCCT, China agreed to increase the number of criminal prosecutions for IPR violations relative to the total number of IPR administrative cases. Unfortunately, there has been no sign yet of a significant shift in emphasis toward criminal enforcement.

As the title of this hearing makes clear, the export of infringing products from China is of grave concern worldwide. The U.S. Customs statistics cited above make clear that an increasing share of infringing goods seized at U.S. borders are being exported from China, and these counterfeits include many products that pose a direct threat to the health and safety of consumers in the United States, China and elsewhere, such as pharmaceuticals, batteries, auto parts, industrial equipment, and toys. The Report calls on China to aggressively prosecute exporters of infringing products.

USTR also remains concerned about various aspects of China's 2004 customs regulations and implementing rules, which were intended to strengthen border enforcement and to make it easier for rights holders to secure effective enforcement at the border. For example, disposal of confiscated goods remains a problem under the implementing rules, which appear to mandate auction, rather than destruction, of infringing goods not purchased by the right holder or used for public welfare.

The *2006 Special 301 Report* singles out four Chinese "hot spots" – Guangdong Province, Beijing City, Zhejiang Province, and Fujian Province – where there appears to be an acute need for authorities to begin and sustain proactive, deterrent IPR enforcement. USTR believes that focusing on the need for improvement at the provincial and major city level will shine a spotlight on specific problem areas and create a basis for improvement; this is the objective of the special provincial review that will be taking place over the coming year. This year's report also includes a new section that highlights notorious markets, including both on-line websites, such as Baidu.com, and traditional marketplaces, such as Silk Street Market in Beijing and Xiangyang Market in Shanghai.

III. Next Steps

An important priority of the Administration is to assist U.S. businesses to ensure they are competing on a level playing field with China. According to a 2006 survey conducted by the American Chamber of Commerce in China, 41 percent of U.S. companies in China believe counterfeiting of their products increased in 2005 and 55 percent were hurt by violations of intellectual property rights. We will continue expanded outreach to the business community to ensure that their China-related concerns are addressed. For example, through the "Top to Bottom Review," USTR recently established a China Task Force under the Advisory Committee for Trade Policy and Negotiations to receive regular, strategic advice on U.S. trade relations from U.S. industry.

The special provincial review announced in the *2006 Special 301 Report* will inform USTR's Special 301 report next year, as we continue to monitor China's actions to meet its commitment

to significantly reduce IPR infringement levels, including actions China takes under its 2006 IPR Action Plan. Results are what matter to us, and this will entail continued dialogue and enhanced cooperation through the JCCT and other mechanisms. We will continue to utilize the JCCT IPR Working Group mechanism to bring experts from China and the U.S. together to discuss specific IPR issues, and will promote deepened law enforcement cooperation. USTR is also establishing a senior trade position at the U.S. Embassy to foster enhanced dialogue and pursue U.S. trade policy interests in China.

While dialogue and cooperation are our preferred means of dealing with China on trade issues, we will not shy away from using dispute settlement at the WTO when we feel China is not living up to its commitments. As we have repeatedly told China's leaders, we see WTO dispute settlement as a tool utilized to avoid politicizing trade issues, and we will continue to consider WTO cases as appropriate to bring China into compliance with its trade-related obligations when dialogue proves not to be an effective means for resolving our concerns. Having two separate tracks – dialogue and dispute settlement – helped to create a favorable environment for a successful JCCT and Hu visit this year. By pursuing WTO dispute settlement on China's treatment of imported auto parts, it took a very contentious issue out of the JCCT mix, allowing us to achieve more success on the remaining JCCT issues.

With respect to IPR, we have stepped up consideration of our WTO dispute settlement options by intensifying our work within the U.S. Government and with the affected industries to compile data and lay other necessary groundwork for a possible case. Within USTR, we have now established a China Enforcement Task force to develop enforcement initiatives, including potential WTO cases, co-led by our Acting Chief Counsel for China Enforcement and our Deputy Assistant U.S. Trade Representative for China Enforcement. We are determined to hold China accountable just like any other WTO Member. We have two criteria for assessing whether to bring a case. It must be winnable, and it must be the most effective means for addressing the underlying concern.

CONCLUSION

The Administration is working its two-track approach of dialogue and enforcement to ensure China becomes a "responsible stakeholder" in the international economic community commensurate with its economic weight. On IPR issues, China has a long way to go, and the stakes are high. But this is not an issue that the United States faces alone. The first WTO Trade Policy Review of China in April made clear that the multilateral community is also concerned about the lack of effective IPR enforcement in China. We will continue to work with our trading partners and U.S. industry to ensure China addresses this problem and ensure that China meets its WTO and bilateral commitments. Thank you for inviting me to join this hearing today and for your continued attention to this pressing issue.