

ROUNDTABLE
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**OWNERSHIP WITH CHINESE CHARACTERISTICS: PRIVATE PROPERTY
RIGHTS AND LAND REFORM IN THE PRC**

STATEMENT OF
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Thank you for inviting me here today to address the issue of intellectual property protection in China, particularly its status as a form of "property right."

Recognizing the Commission's role in monitoring compliance with human rights and rule of law in its implementing legislation, as well as its continued interest in WTO matters, the focus of my brief presentation will be on three topics: (a) the current state of protection of U.S. intellectual property rights (IPR) in China; (b) intellectual property (IP) and the rule of law in China; and (c) U.S. government efforts to promote IP protection and rule of law in China.

I would like to say at the outset, that the comments I am providing today represent my own opinion on these important issues. They should not be considered as an official statement of U.S. government policy. Some of the issues, such as the relationship between intellectual property rights in China and human rights or rule of law, are matters of long standing personal interest to me.

I. Protection of U.S. Intellectual Property Rights in China

The Office of the U.S. Trade Representative (USTR) noted in its December 11, 2002 Report to Congress on China's WTO Compliance (the Report), that apart from certain systemic issues, IP was one of three issues that "generated significant problems and warranted continuing scrutiny". The Report further stated:

China did make significant improvements to its framework of laws and regulations. However, the lack of effective IPR enforcement remained a major challenge. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

A key challenge for IP in China remains enforcement. USTR also noted:

Although China has revised its IPR laws and regulations to strengthen administrative enforcement, civil remedies and criminal penalties, IPR violations are still rampant. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak punishments. As explained by one trade association, “[e]ffective enforcement against [IPR] infringement in China is universally recognized as the chief concern of [IPR] rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continues to be excessively high.”

One may legitimately wonder if this isn’t “déjà vu all over again.” This year in fact marks the 100th anniversary of the first bilateral agreement regarding protection for intellectual property rights, the “Treaty for Extension of the Commercial Relations Between China and the United States”, (reprinted in *Treaties and Agreements With and Concerning China 1894 - 1919* (J.V.A. MacMurray ed., 1921)). This treaty granted copyright, patent, and trademark protection to Americans in return for reciprocal protection to the Chinese. Despite the 1903 treaty, China did not introduce a substantive copyright law until 1910, a substantive patent law until 1912, and a substantive trademark law until 1923. Moreover, although these laws appeared on paper, they offered foreigners very limited intellectual property protection, and IPR issues continued to persist into the end of the Qing Dynasty, into the Republican period, in later dealings with Taiwan, and later in our recognition of the PRC.

During the past few years, we have seen a quickening of the pace in China towards conformity of its IPR system with international standards. Since WTO accession, China has ambitiously promulgated, revised or annulled a large corpus of legislation, regulations, rules, etc. Yet despite these legislative efforts, U.S. industry is currently facing daunting challenges in China’s market to combat these illegal operations.

U.S. copyright industries report that they face piracy rates of over 90% in the Chinese market. They are suffering losses of approximately four million USD *per day* due to piracy. The International Intellectual Property Alliance details some of these piracy rates for 2001 in its Section 301 submission to USTR as 88% in motion pictures; 90% in sound recordings/musical compositions, 93% in computer software, and 92% in entertainment software, for total losses of \$1,506.6 million.

Economic analysis can be easily supported by sight observations. Counterfeit and pirated goods continue to be omnipresent in China. They are sold at the Xiushui Market, near the U.S. embassy, in the Luowu market in

Shenzhen, and other prominent venues, frequently in view of local authorities. Some industry officials estimate that 15-20% of the products sold under their labels are counterfeit. For certain products, it may be difficult in local markets to purchase legitimate goods. Pirated music, movies, motion pictures, video games and books have displaced legitimate sales, frequently before the legitimate product can achieve legal entry into the Chinese market. Pictured below is such a street near the Xiushui market, where a street dealer in DVDs and CDs may frequently be seen.



China's role as a manufacturer and consumer of pirated and counterfeit goods not only poisons the Chinese market for U.S. products. It affects our own market and third country markets. This was most evident in the mid-1990's, when China's exports of CD-ROMs of music and software were displacing U.S. exports, especially in Asia. After extensive bilateral discussions and agreements on intellectual property rights, China reduced its exports of pirate CD-ROMs.

For four out of the past five years, mainland China (not including Taiwan or Hong Kong) has been the top exporter of pirated and counterfeit goods to the United States, as measured by U.S. Customs statistics. The following are Fiscal Year 2002 seizure statistics from U.S. Customs:

Trading Partner	Domestic Value(USD)	% of Total
China	48,622,997	49%
Taiwan	26,507,356	27%
Hong Kong	3,959,258	4%
Pakistan	2,362,130	2%
Korea	1,825,265	2%
Indonesia	1,361,101	1%
Switzerland	1,274,645	1%
France	836,111	Less than 1%
Malaysia	721,979	Less than 1%
Kazakhstan	671,900	Less than 1%
All other countries	10,847,599	11%
Total FY02 Domestic Value	98,990,341	
Number of Seizures	5,793	

According to 2002 data, China accounted for 26% of U.S. Customs seizures and 49% of the value. Compared to FY 2001, the domestic value of goods coming from China increased by 83% and the number of seizures increased by 84%. In only one year of the past five, China slipped to the number 2 position in U.S. seizures.

U.S. statistics however do not document the full extent of harm caused by Chinese exports. Counterfeit goods in particular are exported throughout the world, depriving U.S. exporters of their legitimate markets. Chinese counterfeits and pirates are also a leading source of seizures in the European Union, Japan and many other countries. Industry reports that Chinese exporters have produced counterfeit aircraft parts, counterfeit car parts, and indeed whole counterfeit cars and motorcycles. Occasionally Chinese products may also be repackaged and sold by illegitimate distributors. Many of these cases are multinational in nature and can implicate U.S. companies or individuals. For example, in one major case prosecuted by the U.S. Department of Justice, the U.S. distributors of Long March Pharmaceuticals (Shanghai) had repackaged a bulk pharmaceutical product, gentomicin sulfate, not approved for the U.S. market for distribution in the United States. In April 1997, the distributor was fined a total of \$925,000, and its owner was sentenced to two years in prison and fined a total of \$75,000 for illegally importing counterfeit pharmaceuticals from China and laundering money in a kickback scheme. According to testimony before the House Commerce Committee, six patients in Denver alone suffered toxic reactions. See, e.g., statement of Patricia L. Maher, Deputy Assistant Attorney General, Civil Division, U.S. Department of Justice Before the Subcommittee on Oversight and Investigations of the Committee on Commerce, United States House of Representatives, at <http://usinfo.state.gov/regional/ea/iprcn/20001003.htm>; see also <http://www.usdoj.gov/opa/pr/1997/April97/146civ.htm>; <http://energycommerce.house.gov/107/hearings/06072001Hearing267/print.htm> (Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives One Hundred Seventh Congress, First Session, June 7, 2001, Serial No. 107-30).

The challenges are indeed enormous. As IP crime extends beyond national borders, the cooperation of Chinese colleagues in law enforcement and in IP protection is critical. Not only are the commercial losses unsustainable in an era of WTO accession and mounting trade imbalances, but IPR crimes also feed organized crime and can support terrorist elements. As recently documented by Jeffrey Goldberg in "Party of God" in the New Yorker (October 28, 2002), in some countries, such as Paraguay, Chinese counterfeit goods appear to be marketed through Hezbollah and other groups. See also Rosyln A. Mazer, "From T-Shirts to Terrorism-That Fake Nike Swoosh May Be Helping to Fund Bin Laden's Network" Washington Post, September 30, 2001, at page B2.

What does the future hold? History shows us that China has a long tradition of being a major innovator of new technologies, such as gunpowder, the compass, irrigation techniques, and movable type. Chinese inventiveness was well documented by former British Consul in Chongqing, Prof. Joseph Needham, in his monumental *Science and Civilization in China*. Looking to the future, China has indeed committed significant resources to revamping its laws, establishing a specialized IP court system, implementing specialized administrative agencies with power to fine infringers, and enacting and publicizing laws or measures that may extend beyond TRIPS minima.



Beijing Administration for Industry and Commerce Sign: "Model Market for No Counterfeit Trademarks, 2001"

There are many signs that intellectual property is becoming more important to China. In 2002, for example, China became the leading country in the world for receiving new trademark applications. In 2001, there were nearly 10 times as many Chinese applications for trademarks in China compared to foreign (229,775/23,234). Markets for legitimate applications of intellectual property are beginning to grow. Although imperial China lacked a system of IPR, IP protection is not completely anathema to Chinese culture. Taiwan, for example, was the third largest foreign region applying for patents in the United States in 2001 (after Japan and Germany).

The prospects are not, therefore, completely bleak. Although piracy is an enormous challenge, Chinese and foreign companies are investing in software and scientific development in China, frequently through science and technology parks, such as those administered by China's Ministry of Science and Technology. Chinese authorities also recognized that they are being deprived of tax revenue through piracy and counterfeiting, and that these activities erode respect for rule of law. Chinese consumers complain at least as bitterly as American companies of fake and shoddy counterfeit goods. Criminal prosecutions, although small, are also increasing. China's leadership has also taken note of many of the problems, although the focus primarily tends to be in counterfeiting and not in copyright where Chinese industry has a smaller interest.

Open markets and deregulation have the unfortunate side effect of creating greater opportunities for counterfeiters and pirates to ply their wares. They may respond more quickly than police or government agencies that are not as well prepared for these types of crimes.

To address wide scale piracy and counterfeiting, a multi-faceted approach – including criminal law, civil law, government, business and non-profit organizations, as well as public outreach and international cooperation – is required. Piracy and counterfeiting are worldwide problems and international cooperation remains critical.

II. Intellectual Property and Rule of Law Efforts

I believe that intellectual property is the most vulnerable to ineffective legal systems of all such property rights. Being intangible, it is a right that is defined by law and easily undermined by lawlessness.

It is important to recognize that China does not lack for intellectual property laws. What China mostly needs is deterrent enforcement of its laws. China has a vast administrative apparatus which levies fines for patent, trademark, copyright, semiconductor layout design, trade secret, trade dress, defective products, illegal use of the Internet, counterfeit tobacco, counterfeit drugs, etc., all of which implicate IPRs. There are national and local laws, rules and regulations on IPRs. Courts and the procuratorate may issue their own interpretative rules. Agencies may issue their own guidance, sometimes in conjunction with other agencies. A frequent issue in dealing with IPRs in China is determining what national or local law, rule, regulation, interpretation, decision, guidance, notice, decree, order, interpretation etc. applies and is in actual effect.

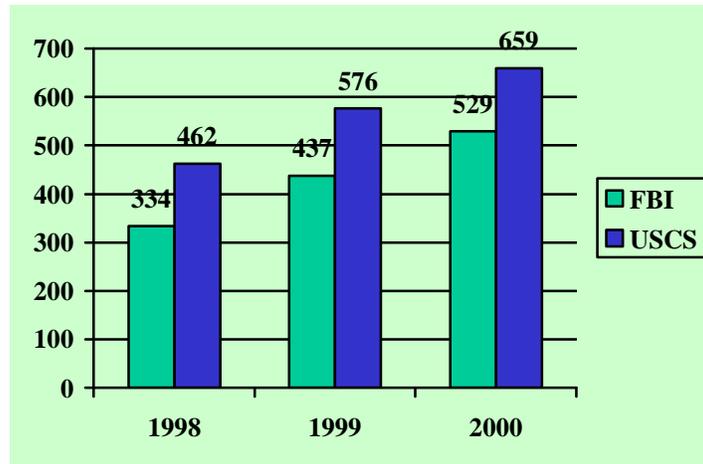
On the enforcement side, the lion's share of activity is conducted by administrative agencies which have enforcement authority. According to China's TRIPS Council submission, for example,

there were 41,163 trademark law violation cases in 2001. Infringers were ordered to pay the right owners damages of RMB 3,343,400 in total and there were 86 cases transferred to criminal procedures. In respect of enforcement of the Copyright Law, in 2001 copyright administrative authorities accepted 4,416 cases in total, among which 4,306 cases have concluded with rulings. Among those concluded, 3,607 cases ended with imposing a fine upon the infringers; 633 cases ended with mediation; and 66 cases were transferred to criminal procedures.

By comparison, the actual number of civil cases was far smaller, and civil cases involving foreigners was far smaller still. In fact criminal IPR cases

investigated under China's criminal copyright and trademark provisions may be a smaller number than those that are prosecuted in the United States, where piracy and counterfeiting rates are less.

US FEDERAL IP INVESTIGATIONS OPENED



Source: Computer Crime and Intellectual Property Section, USDOJ

Respect for intellectual property rights, the most vulnerable of property rights, promotes respect for rule of law and promotes development of accountable administrative, civil and criminal legal systems. While it may be theoretically possible to have a legal system that does not recognize intellectual property rights, I do not believe it is possible to adequately protect intellectual property rights in the long run without an effective and fair legal system. In the past certain U.S. efforts regarding intellectual property rights protection were criticized by some academics, such as Prof. William Alford, as “devot[ing] considerable diplomatic capital to secure concessions that fail meaningful[ly] to speak to the chief impediments to the development in China of respect for legality and, through it, of a greater commitment to the protection of intellectual property rights.” (*To Steal A Book Is An Elegant Offense*, p. 118). I believe such criticism is misguided.

The relationship between IP and rule of law was recently underscored at a roundtable on intellectual property rights held at the U.S. Embassy in Beijing in October 2002, where Ambassador Randt, addressing industry concerns over national treatment and corruption in China's IPR system, clearly stated that the issues are intertwined in the Embassy's mission to promote both human rights and protect U.S. intellectual property rights. Industry also recognizes that without effective rule of law, intellectual property rights will not be accorded the full protections they are due. As an industry spokesman noted in hearings held by USTR in preparation of the December 11, 2002 Report:

[W]e all recognize that this is a process that will take time, and patience. The institutional, legal, and regulatory changes demanded of the Chinese are extraordinary, reaching in most corners of their economy, and complicated further by a highly decentralized administrative structure covering a vast, diverse country.

The TRIPS agreement itself, as well as the Working Party Report of China's WTO commitments, contains the seeds of these rule of law issues, in such key issues as transparency of rule making and judicial decisions, and in notions of proportionality of criminal offenses. These issues in fact, are a key part of this Commission's mandate. See P.L. 106-286, Sec. 302(c) 2-4, 6. Legal systems that administer light administrative penalties against IP criminals, while imposing harsh sentences on young people distributing DVD's on bicycles, corrode respect for rule of law and for IPR. While campaigns against piracy can result in focused gains for IPR, long-term systemic changes likely depend on an effective legal system. Proportional penalties imposed against violators by an independent judiciary, serve rule of law and IPR needs. By addressing issues such as rights of accused in criminal IPR cases, or the need for administrative transparency in rulemaking and review of patent and trademark applications, both rule of law and IPR protection objectives are served.

As we seek more effective enforcement of China's IPR laws, civil, criminal or administrative, we must also be mindful of other U.S. government policy goals in promoting a legal system that meets international standards of fairness. These goals are complementary, not inconsistent. Effective law enforcement can be a double-edged sword. With China's increase in domestic rights holders, there is a growing likelihood that U.S. companies may find themselves on the wrong end of enforcement actions, frivolous or otherwise. Thus, it is in the interest of the U.S. government, as well as U.S. companies doing business in China, to promote the development of a legal system in China that fairly protects the rights of all parties and has reliable fact-finding processes.

In discussing enforcement of intellectual property rights with Chinese colleagues I have been especially heartened by their interest in such matters as: sentencing guidelines for the proportionate and predictable determining of criminal penalties; discovery and pre-trial exchange of information; role of specialized courts in intellectual property enforcement; authority of courts to implement international obligations, such as the TRIPS agreement or to "fill in the gaps" in administrative rule making; standards for issuing preliminary injunctions or ex parte measures; protections against abuse of intellectual property rights, or against abuse of civil or administrative process; responsibility of lawyers to the judiciary; the role of lawyers in protecting confidential information in patent or trade secret cases; increasing technical legal exchange; the role of intellectual property in promoting technology development and transfer; protecting content over the Internet and protecting computers against hacking; ensuring that local

administrative agencies and their enforcement efforts comply with national standards; and related issues.

I can also say on a personal note, that Chinese counterparts respond favorably to constructive criticism of their IPR system, and that we have an obligation on behalf of our rights holders and in the interest of the Chinese people to constructively raise these important issues at every relevant venue.

III. USG Efforts to Promote Intellectual Property Protection

Many industry representatives would like to see a more active U.S. presence on intellectual property matters in China. There have been many such efforts under way by both the private sector and the government. All major U.S. IP trade associations are active in China to some extent. Many NGO's which have a general rule of law orientation have also recognized the intersection between IPR and rule of law issues. Franklin Pierce Law School ran a summer institute on IPR with some USG assistance at Tsinghua University this past summer. George Washington University Law School and John Marshall Law School also have extensive contacts with Chinese IPR students and experts. The Quality Brands Protection Committee, the United Nations Development Program, the copyright industries such as the Motion Pictures Association, and others have also run successful IPR programs. There may be many other programs of which I am not as aware. I have already mentioned Ambassador Randt's very successful roundtable in which various industry groups raised their concerns over China's IPR environment; the Embassy, USTR and other agencies, are also involved in other efforts to enhance the IPR position in bilateral discussion. The Embassy in Beijing has also recently developed an action plan to help address IPR issues, which should help to more successfully protect and promote US interests in China.

Among recent U.S. government programs, the USPTO, in conjunction with the International Intellectual Property Institute, George Washington University Law School and the Court of Appeals for the Federal Circuit hosted a number of Chinese judges this past summer at a conference on capacity building for specialized IP courts. The Commerce Department ran two IPR training programs last year in China, as well as a program on technology transfer, in addition to hosting Chinese delegations on various matters, including several from the Shanghai WTO Consulting Center or in meetings of the APEC/Intellectual Property Experts Group or at WIPO. I was privileged to be the guest of the Japan Patent Office this past December as a speaker in an IPR enforcement program it ran in Beijing.

We are looking for further cooperation with other governments and with China on such programs. Where circumstances have permitted, we have also reached out to localities, to universities and educational institutions, and to

Chinese entrepreneurs. Last year, I participated in a successful program led by Deputy Under Secretary of the Technology Administration of the Department of Commerce Ben Wu on IPR with the science and technology parks administered by the Ministry of Science and Technology, which entailed reaching out to these groups.

We have the resources to deliver targeted and effective training programs. There are a number of Chinese speaking IPR experts in the United States Government and the private sector who are familiar with China's legal system and I believe, have been quite successful in building bridges by delivering programs quite effectively in Chinese without interpretation or translation. This approach also helps to instill greater confidence and respect from Chinese colleagues.

The European Union and European Patent Office ran a well-organized, well-funded multi-year IPR capacity building program in China which ended in December 2001. A focus of many industry groups and government organizations recently has been criminal enforcement of intellectual property, including cooperation with Chinese counterparts. Certain rule of law initiatives, such as those involving rulemaking transparency by the Asia Foundation have the potential for clear collateral benefits to IPR protection. Because the TRIPS agreement itself has certain transparency obligations, these programs may also fruitfully begin their analysis by looking at international obligations and practices for transparency in an IPR context.

Because of the widespread deterrent effect which criminal prosecution has, as well as the general lack of awareness of police officers and prosecutors in many countries of IPR crimes, training law enforcement officials, including Customs officials, is of increasing importance to addressing the deficiencies in China's IP system and in advancing the rights of Chinese and Americans alike. The U.S. Sentencing Guidelines, for example, have elicited considerable interest from Chinese colleagues as they provide a reasonable, fair and proportional method for determining sentences for IPR infringers, which is consistent with international practices, and I believe also advances our needs for rule of law. It is likely this year that there will be an increased emphasis on IPR criminal issues through training and consultations with our Chinese counterparts.

Another emerging issue of some importance is protection of copyright over computer networks, especially the Internet. As we all know Internet usage in China is increasing dramatically. Copyright protection over the Internet, as well as other forms of digital issues involving copyright are important international challenges which all countries are forced to deal with, and which increasingly require international cooperation and coordination. While China's recently revised copyright law and other regulations and interpretations do consider the impact of the Internet on copyright protection, the U.S. government would like China to fully accede to the WIPO Internet Treaties (WIPO Copyright Treaty and

WIPO Performances and Phonograms Treaty) and more vigorously coordinate and enforce copyright in digital formats. I believe that training in this area, conducted by various U.S. agencies (such as USPTO, the Copyright Office, and the Department of Commerce) and private organizations is also of considerable importance.

Thank you and I look forward to your questions.