

**IMPACTS OF PIRACY AND COUNTERFEITING  
OF AMERICAN GOODS AND INTELLECTUAL  
PROPERTY IN CHINA**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON TRADE, TOURISM, AND  
ECONOMIC DEVELOPMENT

OF THE

COMMITTEE ON COMMERCE,  
SCIENCE, AND TRANSPORTATION  
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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MARCH 8, 2006  
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**WEDNESDAY, MARCH 8, 2006**

U.S. SENATE,  
SUBCOMMITTEE ON TRADE, TOURISM, AND ECONOMIC  
DEVELOPMENT,  
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,  
*Washington, DC.*

The Committee met, pursuant to notice, at 2:35 p.m. in room SD-562, Dirksen Senate Office Building, Hon. Gordon H. Smith, Chairman of the Subcommittee, presiding.

**OPENING STATEMENT OF HON. GORDON H. SMITH,  
U.S. SENATOR FROM OREGON**

Senator SMITH. Senator Dorgan and I are jointly holding this hearing. We call it to order. This is the Subcommittee on Trade, Tourism, and Economic Development. I thank Senator Dorgan for suggesting today's topic. We will examine the impact piracy and counterfeiting in China has on U.S. businesses. I appreciate all of our witnesses who are here today for re-arranging their schedules to be here, and I want to give a special welcome to Andy York from Oregon who is here to talk about problems his business has faced in China.

U.S.-China economic ties have expanded greatly in the last several years. In 2005, total bilateral trade rose to an estimated \$286 billion up from only about \$5 billion in 1980. Today, China is the United States' third-largest trading partner and our fourth-largest export market. While U.S. exports to China have grown dramatically in recent years, so too have Chinese exports to the United States. Last year, the U.S. trade deficit, however, with China hit a record \$203 billion.

Experts will tell you that while staggering, this number also reflects goods produced by U.S. companies in China and then shipped to the United States and sold to American consumers. What is not reflected in this number is the billions of dollars that U.S. producers lose because of illegal reproduction of software, retail piracy and trademark counterfeiting in China. My staff, in fact, showed me some Zippo lighters that are ones genuine made there. And two others are counterfeit, but they make clear though made there, that they represent to be made in Bradford, Pennsylvania. Not honest, not good. The reality is that the Chinese are consuming U.S. goods, but they are not always paying for them.

According to the Congressional Research Service, counterfeit goods represent between 15 and 20 percent of all products made in China and account for about 8 percent of China's GDP. The Business Software Alliance estimates that in 2004, the rate of software piracy in China was roughly 90 percent. And for motion pictures, the rate of piracy was approximately 93 percent. In 2003, more than 66 percent of imported counterfeit goods seized by the U.S. Customs Service all traced back to China.

This December will mark the fifth anniversary of China's accession to the WTO. When China acceded to it, it promised to bring its intellectual property laws into compliance with WTO rules. However, actual enforcement of China's IPR laws remains a huge problem, and U.S. companies are still reporting large-scale counterfeiting and piracy of their products in China.

Well, I look forward to hearing from today's witnesses, and I'm pleased to turn the mike to Senator Dorgan.

**STATEMENT OF HON. BYRON L. DORGAN,  
U.S. SENATOR FROM NORTH DAKOTA**

Senator DORGAN. Well, Mr. Chairman, thank you very much, and thank you for agreeing to call this hearing. This is a very important issue. You and I may have some differences of agreement on trade, but I think we would share a concern, and that is the concern about growing trade deficits, not just with China, but with other countries as well and increased piracy and counterfeiting of American goods. I want to run through a few charts if I might, Mr. Chairman, and talk a little about where we find ourselves. First, these are our trade deficits with China, but if I put up a chart that showed our trade deficit generally, it would look about like this. Almost a third of our trade deficit is with China, but as you can see, it's growing and growing and growing and getting worse and worse and worse, and nothing ever changes. That's a \$202 billion trade deficit with the country of China last year. The second chart shows that China has not resolved critical deficiencies in IPR, Intellectual Property Protection Enforcement, and that comes from the U.S. Trade Ambassador's Office. Actually, in April of 2004, China committed to us to achieving a significant reduction in Chinese piracy. That was April 2004. April 29, 2004, our U.S. Trade Representative said that it not only didn't get better, it got worse. And so, what have we done? We said, well, then we're going to put you on a watch list. I mean, that's going to throw the fear of God into that country. All of a sudden, they're going to be put on a watch list. Let me just have the next chart. You will see that despite the promises by the Chinese, Criminal Intellectual Property Rights investigations in China have plummeted, have gone down—way down. And finally, the next chart. This shows that the majority of fake products or counterfeit products coming into the United States, 67 percent are coming in from the country of China. Let me point out, however, that China is not without its ability to deal with these issues. The Government of China—the Communist Government of China owns this particular logo. China will be hosting the Olympics. And so, they own this logo. And of course, there is some value in owning that logo. The Government of China owns it. All of a sudden, when that logo was created, some people on the

streets of China began peddling cups and banners and things with that logo. They began pirating and counterfeiting something owned by the Chinese Government. They shut it down just like that. I mean immediately. They had people arrested and off the streets. They wouldn't put up with piracy and counterfeiting on their streets when it came to pirating and counterfeiting something owned by the Chinese Government. Now finally, these two automobiles, a Chevy Spark and Chery QQ—as you will see, Chery is only one letter away from Chevy. This car—actually, the Chery QQ was a subject of a court action. General Motors filed an action against the Chinese saying that a Chinese automobile company had stolen the production designs from General Motors for this little Chery QQ car. This has been quietly settled out of court with no one understanding what the settlement is, but I show that for a reason. *TIME* Magazine says here come the really cheap cars. Chinese pirate companies have long been accused of illegally copying easy stuff like shoe polish and digital movies. Now, General Motors says the Chinese firm knocked off an entire vehicle, and Americans could soon start buying its cars. Since this new story, we've had two other new stories, significant ones, one following the auto show in Detroit, Mr. Chairman, recently saying that in 2007, Americans will begin buying Chinese cars shipped to this country. I want to make one point about that. In our last bilateral trade agreement, just to show that the issue is not exclusively pirating and counterfeiting, some of it is fundamental gross incompetence on the part of America's trade negotiators, in the last bilateral trade agreement, our negotiators agreed to do this with China. With respect to bilateral automobile trade with China, we agreed that any U.S. automobiles we would sell into China could be assessed a 25 percent tariff. Any Chinese automobile sold in the United States would be assessed a two and a half percent tariff. In other words, with a country with whom we had a huge trade deficit already, a country of some 1.3 billion people who are going to want to drive cars, a country that will have an automobile industry and is fast developing an automobile export industry, we decided it would be just fine if they imposed a tariff on bilateral automobile trade that is ten times the tariff that we would impose on a Chinese car coming to the United States. That is fundamentally incompetent. I—let me just finally say, Mr. Israel, I'm glad you're here. I'm going to have to be in and out a couple of times today, but I appreciated your statement. You do say, however, under the few positive developments in your statement, that President Hu publicly acknowledged the problem. Look, President Hu not only acknowledges it, he creates it. They understand it because they create the problem. It is a strategy. It is a Chinese strategy that this country doesn't have the nerve, the backbone or the will to confront. At least let's start on a baby step. Let's start on the baby step of dealing with piracy and counterfeiting. It's not a baby step in its impact. \$200 billion is what it cost American firms as estimated by the U.S. Chamber of Commerce in the past year. So, let's at least start there even if we have some other disagreements about the bilateral trade arrangement. As you can see, Mr. Chairman, having this hearing is very therapeutic for me, and I hope that we will have kind of an interesting time talking about the bi-

lateral trade relationship between the U.S. and China and what counterfeiting and piracy does to injure American interests. Our Intellectual Property Rights are being systematically injured every single day, and nobody frankly seems to give a damn. We talk and talk and talk, and at the end of these hearings, we do nothing. Let's hope perhaps, Mr. Chairman, with your leadership and with the Congress putting a spotlight on this, maybe times will be different. Thank you, Mr. Chairman.

Senator SMITH. Well, after this therapy, I hope you're feeling better.

Senator DORGAN. I'm feeling much better, but I'm hoping I'm feeling better after the testimony as well.

Senator SMITH. Well, thank you, Senator, and we have as our first witness, Chris Israel, who is the Coordinator for International Intellectual Property Enforcement, U.S. Department of Commerce. Chris, thank you for being here, and the mike is yours.

**STATEMENT OF CHRIS ISRAEL, COORDINATOR FOR  
INTERNATIONAL INTELLECTUAL PROPERTY ENFORCEMENT,  
DEPARTMENT OF COMMERCE**

Mr. ISRAEL. Thank you, Chairman Smith and Ranking Member Dorgan. I appreciate the opportunity to be here today to address the important issue of Intellectual Property Rights Enforcement and challenge, and I hope—I do frankly hope that my insight and assessment of some of the things the Administration is engaged in does provide an advancement in terms of the dialogue we're having and a bit more therapy. We can all certainly use it on this issue because it is an incredibly frustrating one.

I thank the Committee for its continued support and leadership on issues concerning the protection of American intellectual property.

My office works to leverage the capabilities and resources of the U.S. Government to promote effective, global enforcement of intellectual property rights. We have built a coordinated enforcement model that includes Trade, Commerce, Law Enforcement and Customs agencies. We certainly know the rising tide of counterfeiting and piracy in China has created enormous challenges for U.S. businesses. According to the U.S. Chamber of Commerce, the statistic that was certainly discussed, worldwide IP theft cost U.S. businesses approximately \$250 billion annually. In a 2005 survey of the U.S.-China Business Council, members listed IP enforcement as their greatest single concern. Our industry reports that infringement levels in China range from 85 to 95 percent for all copyright works, and in 2005, the value of copyrighted works that were pirated exceeded \$2.3 billion. In 2005, U.S. Customs reported that China was by far the leading source of counterfeit products that were seized at our borders, accounting for 69 percent of all seizures.

Today, I have brought a few examples of the counterfeit and pirated goods from China that were actually seized by U.S. Customs. These include pirated versions of well-known U.S. software, counterfeit pharmaceuticals and dangerously low-quality electrical equipment, which bears a counterfeit Underwriter's Laboratory seal. Though we recognize China has expanded their efforts, there



are still critical deficiencies in IP protection and enforcement. We certainly appreciate the recent statements made by President Hu, by Vice-Premier Wu Yi and others on improving IP enforcement in China. These are steps in the right direction, but we need to see more than just statements. It is crucial that China deliver on their commitments. The U.S. Government is working on many fronts to engage China on IP enforcement, and under President Bush's leadership, we have developed a proactive strategy being coordinated among a number of agencies. The Bush Administration's China IP Strategy is built on four pillars: one, bilateral engagement; two, the effective use of all of our trade tools; three, the expansion of law enforcement cooperation; and finally, direct work with our private sector. We are utilizing all of our resources to effectively implement our approach. First, we are working through the U.S.-China Joint Commission on Commerce and Trade, the JCCT, to secure bilateral IP commitments. In 2005, we negotiated a comprehensive set of commitments with the Chinese Government to reduce counterfeiting and piracy. These include increasing criminal IP prosecutions in customs enforcement, using only legal software in government offices and enterprises, shutting down illegal consumer markets in China and joining the World Intellectual Property Organization Internet treaties. The next meeting of the JCCT will take place in Washington on April 11, prior to the visit of Chinese President Hu. Second, we are making effective use of all of our trade tools. U.S. Trade Representative Portman recently announced the China Top-to-Bottom Review, which assessed the benefits and challenges in U.S.-China trade following China's first 4 years of membership in the WTO. Also, the placement of China on the Special 301 Priority Watch List articulates our specific concerns and indicates the significance we place on them. We are using every trade tool at our disposal in the WTO, and we consider all options to be on the table. We are awaiting China's final response to our TRIPS Article 63.3 request and are considering whether to file a complaint under the WTO dispute settlement process for inadequate protection of IPR. Third, we have begun to expand our law enforcement cooperation with the Chinese Government. Attorney General Gonzales has laid the groundwork, and our law enforcement agencies are working with their counterparts in China to share information, expertise and investigation techniques. And finally, we work actively with the Private Sector to address their concerns and learn from their experience. We are expanding the tools and remedies that we offer industry from recording their trademarks with U.S. Customs to educating small businesses and referring specific infringement cases to Chinese officials. In addition, they are critical advocates for progress in China as they are active participants in that market.

Mr. Chairman, the Bush Administration is committed to stopping intellectual property theft in China and providing businesses the tools they need to flourish in a global economy. China must deliver on their commitments and achieve measurable results as they look to take their place among the world's leading economies. As I work to coordinate the U.S. Government's IP enforcement efforts, and with your continued support and the partnership of this com-

mittee, we will be able to do even more to provide American businesses and innovators with the protection they need.

America's intellectual property is certainly one of our most critical competitive advantages. It's essential to our continued economic growth and to our technological leadership. We must take advantage of the opportunity to work together to better protect the knowledge industries of today so that we may continue to see the innovations of tomorrow. Thank you very much, and I welcome your questions.

[The prepared statement of Mr. Israel follows:]

PREPARED STATEMENT OF CHRIS ISRAEL, COORDINATOR FOR INTERNATIONAL INTELLECTUAL PROPERTY ENFORCEMENT, DEPARTMENT OF COMMERCE

Chairman Smith, Ranking Member Dorgan and members of the Committee, I am pleased to join you today to discuss the challenge of international intellectual property rights enforcement in China.

I want to thank the Committee for its continued support and leadership on issues concerning the protection of intellectual property. I look forward to the opportunity to work together to ensure that the heart of America's innovation economy, its intellectual property, is effectively protected around the world.

Combating piracy and counterfeiting is a top priority for the Bush Administration. This prioritization is evident in the leadership shown by President Bush. He has consistently raised IP enforcement with foreign leaders, placed the issue on the agenda of the G8 and made it a key part of the recent U.S./EU summit. He has also discussed our ongoing concerns with leaders of critical markets such as China and Russia. He has directed his Administration to address this issue actively, aggressively and with a results-oriented approach.

We are leveraging the capabilities and resources of the United States to promote effective, global enforcement of intellectual property rights. My office works to coordinate the international IP enforcement efforts of the Office of the U.S. Trade Representative, the Department of Commerce—which includes the U.S. Patent and Trademark Office and the International Trade Administration; the Department of Homeland Security—which includes Customs and Border Protection; the Department of Justice—including the FBI (Federal Bureau of Investigation); and the State Department, among others. Our combined efforts are extensive, and this allows us to bring even greater focus, energy and prioritization to our IPR efforts.

I appreciate the opportunity to discuss this leadership, to address the growing problem of counterfeiting and piracy in China, and the Federal Government's efforts to help protect American intellectual property and our industries.

#### **Leadership and Prioritization**

The reasons for the Administration's leadership on IP enforcement and for its prioritization are clear.

First, few issues are as important to the current and future economic strength of the United States as our ability to create and protect intellectual property. U.S. IP industries account for over half of all U.S. exports. They represent 40 percent of our economic growth and employ 18 million Americans, who earn 40 percent more than the average U.S. wage. The 2006 Economic Report to the President states that IP accounts for over  $\frac{1}{3}$  of the value of all U.S. corporations, an amount equal to almost half of our GDP. Quite simply, our ability to ensure a secure and reliable environment for intellectual property around the world is critical to the strength and continued expansion of the U.S. economy.

The enforcement of intellectual property rights also carries great consequence for the health and safety of consumers around the world. The World Health Organization estimates that 10 percent of all pharmaceuticals available worldwide are counterfeit. The U.S. Federal Aviation Administration estimates that 2 percent of airline parts installed each year are fake—or about 520,000 parts. And we have seen counterfeit circuit breakers that overheat and explode, brake linings made of wood chips and cardboard, and fake power cords. In the world of today's sophisticated criminal IP operations, if a product can be easily counterfeited, has an immediate demand and provides a good profit margin it will be copied. Consumer safety and product quality are concerns obviously not on the minds of global IP thieves.

Finally, the theft of American intellectual property strikes at the heart of one of our greatest comparative advantages—our innovative capacity. Through the applied

talents of American inventors, researchers, entrepreneurs, artists and workers, we have developed the most dynamic and sophisticated economy the world has ever seen.

And I truly believe the world is a much better place due to these efforts. We have delivered life-saving drugs and products that make people more productive. We have developed entirely new industries and set loose the imaginative power of entrepreneurs everywhere. And, we set trends and market best-of-class products to nearly every country in the world.

A thriving, diversified and competitive economy must protect its intellectual property rights. In the recent State of the Union, President Bush outlined the American Competitiveness Initiative (ACI). ACI strengthens the President's ongoing commitment to research and development. We are creating a business environment that encourages entrepreneurship and protection of intellectual property. And this Administration is doing everything that we can to open markets and level the playing field.

We value our heritage of innovation and exploration—it is not only part of our history; it is the key to our future.

And this future—a future of innovation, exploration and growth that benefits the entire world—rests on a basic, inherent respect for intellectual property rights and a system that protects them.

#### **Counterfeiting and Piracy in China**

The rising tide of counterfeiting and piracy in China has created enormous challenges for U.S. businesses. According to the U.S. Chamber of Commerce, worldwide IP theft costs U.S. industry approximately \$250 billion annually. In a 2005 survey of the U.S.-China Business Council, members listed IPR enforcement as their greatest concern. Our industry reports that infringement levels in China range from 85 to 95 percent for all copyright works, and in 2005 the value of copyrighted works that were pirated exceeded \$2.3 billion. In 2004, U.S. Customs reported that China was the number one source of counterfeit products that were seized at our borders, accounting for 63 percent of all seizures. And though we recognize that China has expanded their efforts, there are still critical deficiencies in IPR protection and enforcement.

As a result of China's continuing problems with IP theft, we posted our first IP Attaché in Beijing in 2004, and we will be posting 2 additional IP Attachés in China in 2006. In addition, since 2001, the U.S. Government has conducted well over 50 training and capacity building programs with Chinese Government officials.

U.S. Trade Representative Portman recently stated, "as a mature trading partner, China should be held accountable for its actions and required to live up to its responsibilities, including enforcing intellectual property rights . . . We will use all options available to meet this challenge." It can be said that, so far, China has not lived up to its responsibility to effectively enforce intellectual property rights.

In China, effective enforcement efforts are undermined by: a lack of sufficient political will, corruption, local protectionism, misallocated resources and training, and a lack of effective public education regarding the economic and social impact of counterfeiting and piracy.

Though the problems of IP theft are great in China, let me first mention a few positive developments.

President Hu publicly acknowledged the problem when he met with President Bush last September and again in November. Also, the recent statements by Chinese Vice-Premier Wu Yi on improving IPR enforcement in China and encouraging Chinese businesses to take greater steps to protect IP is definitely a step in the right direction. We also appreciate the Vice-Premier's comments on ensuring that the Chinese Government only uses legal software. The additional announcement, by the Vice-Premier, that the Chinese Government is setting up 50 reporting centers for IPR violations throughout China is good news, and we hope that these centers can be effective.

In December 2005, a Beijing court ruled in favor of several luxury trademark brands in a suit to stop sales of knockoff handbags. In that case, the court ordered the owner of the Silk Street Market to pay damages and stop its vendors from selling the fake goods. This is an important ruling because the Chinese courts are finally holding landlords responsible for the illegal activities of their tenants.

In January 2006, Starbucks won a lawsuit against a local company that had adopted its Chinese name and a similar logo. The Shanghai court fined the company and ordered it to stop using the Starbucks' name and issue an apology in a local newspaper.

In January 2006, the chocolate company Ferrero Rocher won a lawsuit against a Chinese company that was producing a copycat version of its well known gold-

wrapped chocolates. The Chinese court ordered the company to pay compensation and to stop producing the copycat product.

Though these are good examples, the problems in China run deep, and we continue to work extensively with the Chinese Government on the issues of counterfeiting and piracy.

#### **U.S. Government China Strategy**

The U.S. Government is working on many fronts to engage China on IPR, and under President Bush's leadership, we have developed an effective China IP strategy. The Bush Administration's China IP Strategy is built on four pillars: bilateral engagement; effective use of our trade tools; expanding law enforcement cooperation; and working with the private sector. We are utilizing all of our resources to effectively implement our approach:

1. Working through the U.S.-China Joint Commission on Commerce and Trade (JCCT) to secure IP commitments;
2. Effective use of all of our trade tools:
  - a. The Office of the U.S. Trade Representative's China Top-to-Bottom Review,
  - b. Special 301 Report,
  - c. The World Trade Organization (WTO) TRIPS Article 63.3 request and consider filing a complaint under the WTO dispute settlement process;
3. Expanding Law Enforcement Cooperation with the Chinese Government;
4. Private Sector Cooperation.

#### **Joint Commission on Commerce and Trade (JCCT)**

Established in 1983, the U.S.-China Joint Commission on Commerce and Trade (JCCT) is a government-to-government consultative mechanism that provides a forum to resolve trade concerns and promote bilateral commercial opportunities.

Led on the U.S. side by the U.S. Secretary of Commerce and the U.S. Trade Representative, and on the Chinese side by Vice Premier Wu Yi, the status of the JCCT was elevated following the December 2003 meeting of President Bush and Chinese Premier Wen to focus higher-level attention on outstanding trade disputes. Of particular importance to this committee is the work of the U.S.-China JCCT Intellectual Property Working Group.

At the April 2005 JCCT session, the U.S. and China agreed to establish an IPR Working Group so that U.S. and Chinese officials, IP specialists, and law enforcement authorities could consult on specific problems and cooperate on a range of IPR issues. Through the IPR Working Group, we are working with the Chinese, helping them take concrete steps toward significantly improving IPR protection and enforcement.

President Bush has discussed the issue personally with Chinese President Hu Jintao, and President Hu made further commitments during a September 2005 United Nations speech. We need to see delivery on these commitments and achieve measurable results as China looks to take its place among the world's leading economic powers.

The next meeting of the JCCT will take place on April 11, prior to the visit of Chinese President Hu. As the JCCT meeting approaches, it is important to look at the status of the comprehensive set of commitments from the Chinese Government to reduce counterfeiting and piracy that were agreed to in the last meeting of the U.S.-China JCCT. These include:

- Increasing criminal IP prosecutions and customs enforcement,
- Expanding law enforcement cooperation,
- Using only legal software in government offices and enterprises, and
- Joining the World Intellectual Property Organization Internet Treaties.

Out of the many commitments so far, only a few have been completed.

The Chinese Ministry of Public Security established an IP unit responsible for overall research, planning and coordination of all IPR criminal enforcement. The unit serves under the auspices of both the Economic Crimes Investigation Division and the Social Order Division.

The Chinese Government recently put in place an IP Ombudsman, Yang Guohua, at the Chinese Embassy in Washington. I met with him a few weeks ago, and he has also begun meeting with U.S. rights holders.

The Chinese Government confirmed that the criminal thresholds in the 2004 Judicial Interpretation (JI) are applicable to sound recordings and that the JI makes ex-

porters subject to independent criminal liability. But there have not been any reported criminal cases using the new thresholds.

We also have quite a few commitments that are still in progress and others where there has been little if any movement.

By the end of 2005, China committed to use only legal software at all levels of government and to extend this commitment to large enterprises, including state-owned enterprises, this year. China claims to have completed its government legalization program, but U.S. industry says its sales data does not support this claim, and there is no other evidence to show that China has moved forward to purchase and use only legal software. In a recent interview, Commerce Secretary Gutierrez stated that the use of pirated software by China is “absolutely unacceptable” and that this requires more attention from the world community.

Also, as part of our discussions with the Chinese, we continue to raise the issue of optical disc piracy. China needs to take steps to eliminate all illegal optical disc production. Action especially needs to be taken against those “government licensed” optical disc plants in China that engage in this type of criminal activity. We consider this an important issue for our copyright industry, and apart from the significant economic damages, this type of piracy harms our cultural and creative innovative capacity.

China has also agreed to regularly instruct enforcement authorities throughout the country that copies of select films which are still in censorship, and not yet ready for distribution are deemed pirated and subject to enhanced enforcement. However, industry reports that progress on this initiative has been very uneven.

This memorandum of understanding (MOU) between China and the Motion Picture Association (MPA) protects only the 15 theatrical films actually released in China. Industry reports that little progress has been made on this initiative.

The Chinese legal system follows three routes: administrative, civil and criminal. U.S. rights holders place primary importance on criminal cases being filed against violators of IPR in China. In the last JCCT meeting, China committed to increasing the number of criminal prosecutions for IPR violations relative to the number of administrative cases. This is important because it would send a message to those who violate the law that they can not get away with just paying a fine—IP theft is a crime, and there will be criminal penalties.

China has also agreed to improve IPR enforcement at trade shows and retail and wholesale markets. The United States is working with China to: establish IPR monitoring centers at major trade fairs, set up a training program, and host a trade fair IPR enforcement seminar to educate U.S. and Chinese small and medium-sized enterprises (SMEs) on how to enforce their IPR at an upcoming trade fair. China also agreed to “clean up” Beijing’s Silk Street Market and other well-known consumer markets.

At the major consumer markets, it may appear at first glance that the Chinese have made some progress. In January, the Shanghai government announced its plans to shut down Xiangyang Market, that city’s biggest seller of fake goods. According to local reports, the Mayor of Shanghai stated that the market had damaged Shanghai’s reputation, because approximately 80 percent of the city’s counterfeiting and piracy originates in that market. But that market will not close until June 2006, and at that point, most of the vendors will be moving to other markets, including one, southwest of the city, in Longhua. These illegal markets which exist all over China, continue to operate openly and notoriously. They must be shut down or permanently be rid of infringing goods. The Chinese Government’s ability to take active steps to stop the sale and production of counterfeit Olympic products demonstrates that they have this ability.

Also, China is working toward accession to the World Intellectual Property Organization Internet Treaties. China recently sent a delegation to the United States to discuss the legislative steps necessary to accede to the WIPO Internet Treaties. We have problems with China’s draft legislative package and will continue to communicate our concerns to China. It is important China get this right, so that China’s protections move forward and meet the needs of the digital age.

The proliferation of fake pharmaceuticals also creates serious issues of health and safety. In China, there are certain factories that are categorized as unregulated “chemical factories” but they primarily manufacture the active ingredients for certain drugs. Our interest is to have these “factories” come under the supervision of China’s Food and Drug Administration (FDA), so that they can be monitored and regulated.

Additional issues include protecting undisclosed test data against unfair commercial use for pharmaceutical products. We also need to see clarification and improved coordination between China’s patent office and the SFDA to prevent generic drug

companies from infringing on pharmaceutical patents and producing patent infringing drugs.

### **Effectively Using All of Our Trade Tools**

We are making use of all the trade tools that we have at our disposal. As China takes its place as a player on the world economic stage, we expect that it will live up to its international obligations and uphold the rule of law.

#### *USTR Top-to-Bottom Review*

The Top-to-Bottom review assesses the benefits and challenges in U.S.-China trade following China's first 4 years of membership in the World Trade Organization. The Top-to-Bottom review announced several actions that will be implemented by USTR and other U.S. Government agencies; and I will mention a few of them here. First, USTR is expanding their trade enforcement capacity to help ensure that China complies with its trade obligations. USTR is establishing a China Enforcement Task Force to be headed by a Chief Counsel for China Trade Enforcement. Second, USTR is expanding its ability to obtain comprehensive forward-looking information regarding China's trade regime and U.S. trade policy practices by adding additional USTR personnel and establishing an Advisory Committee for Trade Policy and Negotiation (ACTPN) China Task Force. Third, USTR and the State Department are discussing expanding U.S. trade policy and negotiating capacity in Beijing to augment our current efforts and more effectively pursue top priority issues, such as protecting IPR. Having a trade negotiator on the ground is key. This individual will be in constant contact with American businesses and Chinese officials, working to help remove trade barriers, improve market access and improve IP enforcement.

Through USTR, my office and our inter-agency team, the Administration is improving coordination across the U.S. Government. We are regularly reviewing our strategies and assessing the progress that we have made so that we can continue to take the appropriate next steps.

#### *Special 301 Report*

China's placement last year on the Priority Watch List (PWL) reflects the significant level of concern that we have concerning China's problems with IPR protection, enforcement and market access. This ranking sends a global signal to our trading partners and to companies seeking to do business in China. It also sends a strong message to China that these concerns must be addressed.

#### *World Trade Organization Mechanisms*

In the fight against counterfeiting and piracy, we are using every trade tool at our disposal, and we consider all options to be on the table. As announced in its Special 301 Report last year, USTR filed a formal request under Article 63.3 of the TRIPS agreement (Agreement on the Trade-Related Aspects of Intellectual Property Rights), asking China to detail the specific efforts it has taken to enforce IPR, which includes China's application of criminal, administrative, and civil remedies for infringement cases that affect U.S. rights holders. We were joined in our Article 63.3 request by Japan and Switzerland, who also submitted similar requests at the same time. Though China's official response was less than forthcoming, we are working, alongside our trading partners and with the Chinese Government, to fulfill this request.

China's response will demonstrate whether it is serious about enforcing its IPR protections in a transparent open manner.

The United States is the only country that has brought a case against China in the WTO. And the U.S. Government is again left with no choice but to consider filing another complaint against China this time for inadequate enforcement of IPR. In this regard, USTR is working with industry to evaluate facts and develop the necessary information on this potential case.

### **Law Enforcement Cooperation**

Another major priority is to expand law enforcement cooperation between the U.S. and China. Progress is being made, and Attorney General Gonzales laid the groundwork for expanded law enforcement cooperation on IP cases during his trip to China in late 2005.

Our law enforcement agencies are already working with their counterparts in China to share information, expertise and investigation techniques.

The Department of Justice is looking to build on these existing efforts and develop even stronger bilateral IPR law enforcement cooperation.

The existing U.S.-China Joint Liaison Group (JLG) works to facilitate criminal justice cooperation and has already discussed criminal IPR enforcement on the plenary level.

The U.S. has requested that the Chinese agree to establish an IP law enforcement experts group through the JLG. Expanding our IPR law enforcement cooperation efforts would enable us to focus on developing joint IPR enforcement operations and improve cooperation on criminal investigations. In addition, our efforts, led by the Department of Justice, would focus on the operational aspects and training linked to China's criminal law enforcement efforts to address online piracy. Though a nationwide crackdown on Internet piracy has not begun, as China has committed to do, China has worked out a plan to focus on copyright violations involving audio-video and software products, including unauthorized using and sharing at Internet cafes and the illegal operation of websites.

Building on the joint U.S.-China law enforcement effort called Operation Spring, the U.S. and Chinese law enforcement authorities recently joined forces in Operation Ocean Crossing, successfully disrupting an organization engaged in the large-scale trafficking of counterfeit pharmaceuticals. The action resulted in numerous arrests in China and the United States and the capture of hundreds of thousands of fake pharmaceuticals.

As I stated earlier, China was the number one source of counterfeit products that were seized at the United States border last year. The Chinese Government needs to better equip its Customs Authorities to control the exports of counterfeit and pirated goods from China. An important step that China agreed to take at the 2005 JCCT is to adopt regulations that allow Customs to refer serious cases for criminal prosecution. China should also reinstate provisions in its Customs regulations to allow for fines up to 100 percent of the value of the seized goods. To take forward China's JCCT commitments on better customs enforcement, U.S. and Chinese Customs officials, subject to confidentiality concerns, will be cooperating on the exchange of infringement data and information on significant seizures. There will also be technical exchanges on risk assessment and regulatory improvements.

#### **Private Sector Cooperation**

Companies need to be aggressive advocates of their own IP. We are working actively with the business community for assistance as we go forward. They are our eyes and ears on the ground and know better than anyone how inadequate IPR enforcement affects their businesses. My office conducts active outreach with industry, and we want to hear their stories and find ways to use the data that they have collected in China. We will continue to work together to find solutions and lead enforcement efforts.

We are working with U.S. and international trade associations such as the American Bar Association, American Chamber of Commerce in China, Business Software Alliance, Entertainment Software Association, International Chamber of Commerce, International Intellectual Property Alliance, International Federation of Phonographic Industries, Motion Picture Association, National Association of Manufacturers, The Pharmaceutical Research and Manufacturers of America, Quality Brands Protection Committee, Recording Industry Association of American, U.S. Chamber of Commerce and the U.S.-China Business Council, to name just a few.

An important tool that we use is the IPR Case Referral Mechanism (CRM) which was created by the U.S. Government to facilitate the submission of individual U.S. company IPR cases through MOFCOM (China's Ministry of Commerce) to relevant Chinese agencies. Our inter-agency team reviews cases where the Chinese Government fails to provide adequate protection of IPR to U.S. businesses, and after an internal vetting process, sends approved cases to the Chinese Government to facilitate their resolution. Five cases have already been submitted to the Chinese through the Case Referral Mechanism.

Ambassador Clark Randt at our Embassy in Beijing holds an annual IPR Roundtable which brings together senior Chinese officials and U.S. business representatives. The Roundtable gives U.S. rights holders the opportunity to discuss the problems they are facing and find the solutions that they need.

Also, our Embassy and Consulate officers on the ground are a valuable asset for U.S. companies. They play a critical role as IPR "first responders," helping U.S. businesses resolve cases when their rights are violated.

We know that companies are conducting investigations into IPR theft and collecting data as they do business in China. But American companies should not have to be the sole investigators of IP crime in China. The Chinese Government needs to step up to the plate, conduct investigations and stop the crime of IP theft that is occurring in their country.

The Bush Administration's efforts to provide a secure and predictable global environment for intellectual property is driven by a commitment to foster U.S. economic growth, to secure the safety and health of consumers everywhere, and an abiding

respect for the great American innovative spirit that has driven our Nation since its founding and will determine our future.

**Strategy, Organization and Focus**

As this committee clearly understands, the problem of global piracy and counterfeiting confronts many industries, exists in many countries, apart from China, and demands continuous attention. With finite resources and seemingly infinite concerns, how we focus our efforts is crucial. I appreciate this opportunity to share with you the key areas which make up the Administration's overall Strategy for Targeting Organized Piracy. Through President Bush's leadership, we created a five-point plan.

1. Empower American innovators to better protect their rights at home and abroad.
2. Increase efforts to seize counterfeit goods at our borders.
3. Pursue criminal enterprises involved in piracy and counterfeiting.
4. Work closely and creatively with U.S. Industry.
5. Aggressively engage our trading partners to join our efforts.

By working more closely with other U.S. Government agencies, we implemented that plan, and we have made progress. I'd like to share with you some of the approaches that we are taking and the objectives that we have set to improve global IP enforcement.

Last month, under the leadership of my office and the White House, the National Intellectual Property Law Enforcement Coordination Council (NIPLECC) held its first principals meeting this year. NIPLECC brings together the leaders of the key operational entities within the Federal Government that are responsible for IP enforcement. At the meeting, we looked at better ways to coordinate our domestic and international IP efforts in order to ensure the effective and efficient enforcement of IP both at home and abroad. By establishing priorities and objectives at a senior level, we are reinforcing our day-to-day activities and ensuring that all of the agencies critical to the Federal Government's IP enforcement efforts are closely coordinated and committed to a common results-oriented agenda.

The Council is comprised of the Department of Justice (Assistant Attorney General of the Criminal Division), the Commerce Department (Under Secretary for Intellectual Property and Director of the Patent and Trademark Office and Under Secretary for International Trade), the Office of the U.S. Trade Representative (Deputy USTR), the Department of Homeland Security (Commissioner of Customs and Border Protection) and the State Department (Under Secretary for Economic, Business and Agricultural Affairs).

NIPLECC has made a number of valuable contributions since its creation in 1999, including the development of a comprehensive data base that includes all recent IP law enforcement training provided by the U.S. Government to developing and least developed nations as well as delivering legislative suggestions to improve national IP laws related to enforcement. However, there is unmet potential, and in my role as Director of NIPLECC, I look forward to working with this committee to ensure that we are maximizing the capabilities of NIPLECC.

A critical element in our overall coordination is the Strategy Targeting Organized Piracy (STOP!) Initiative launched by the Bush Administration in October 2004. STOP! has built an expansive interagency process that provides the foundation and focus for all of our efforts. This is the strategy that NIPLECC is implementing. STOP! is led by the White House and brings together USTR, the Department of Commerce, the Department of Justice, the Department of Homeland Security and the State Department.

STOP is the most comprehensive initiative ever advanced to fight global piracy where it starts, block bogus goods at America's borders and help American businesses secure and enforce their rights around the world. STOP! has made significant progress in the past year, and we are planning to build on this success. STOP! is an attempt to play offense in the global fight against piracy and counterfeiting.

Through all of these initiatives, we are achieving results, maintaining the commitment of senior Administration officials, institutionalizing an unprecedented level of coordination within the Federal Government and receiving attention around the world. The message that we are delivering is—that the United States takes the issue of IP enforcement very seriously, we are leveraging all of our resources to address it and we have high expectations of all of our global trading partners.

*To help American innovators secure and enforce their rights across the globe, we have new Federal services and assistance: We created a hotline (1-866-999-HALT), which is staffed by specialized attorneys who counsel businesses on how to protect*



their IP and work with callers on how to best resolve problems. In cases where the individual or company has properly registered its rights, its issue can then be referred to a trade compliance team that will monitor their case and work to see what next steps can be taken.

We also developed a website ([www.stopfakes.gov](http://www.stopfakes.gov)) and brochure to provide information and guidance to rights holders on how to register and protect their IP in markets around the world.

We created downloadable “IP toolkits” to guide businesses through securing and enforcing their rights in key markets across the globe. These toolkits are available at the [stopfakes.gov](http://stopfakes.gov) website, and cover countries such as China, Russia, Mexico, Korea and Taiwan.

In November 2005, Commerce Secretary Gutierrez announced, the China Intellectual Property Rights (IPR) Advisory Program. This program is done in conjunction with the American Bar Association, the National Association of Manufacturers and the American Chamber of Commerce in China. It offers small and medium sized U.S. businesses free IPR consultation with an attorney.

Also, we are providing training for U.S. embassy personnel to be effective first responders to IPR issues in order to identify problems abroad and assist rights holders before fakes enter the market and the supply chain.

*Next, we need to increase our efforts to stop fake and counterfeit goods at America's borders:* Customs and Border Protection (CBP) has developed an online recordation tool for rights holders to record their trademarks and copyrights with them. Additionally, CBP has also begun implementing new risk assessment models and technologies to cast a wider, tighter net on counterfeit and pirated goods and to stop these goods from entering our borders.

We are working with our trading partners to share information and improve our capabilities to assess and anticipate risks. We have seen the results of this effort with the European Union. We have followed up on the U.S./EU Economic Ministerial held last year, where leaders of both governments committed to expand information sharing of customs data.

We are also working to build international support and rules to stem the flow of fake and counterfeit goods and keep them out of global supply chains. We have conducted outreach to Canada, the European Commission, France, Germany, Hong Kong, Japan, Korea, Mexico, Singapore and the United Kingdom laying the basis for increasing cooperation on IP enforcement. Outreach to other like-minded countries is underway.

*Law enforcement must play a leading role in dismantling criminal enterprises that steal intellectual property:* U.S. law enforcement agencies are also working closely with industry to gather information, develop cases and bring convictions against the criminals who steal their IP. We need to be as sophisticated and creative as the criminals. It is important that government and industry work together with coordinated efforts.

The U.S. Government (Department of Justice) has pursued numerous large-scale operations targeting criminal organizations involved in online piracy and trafficking in counterfeit goods. For instance, the Department of Justice (DOJ) has indicted the four leaders of one of the largest counterfeit goods operations ever uncovered in New England—broke up a scheme to sell more than 30,000 luxury goods—including handbags, wallets, sunglasses, coats, shoes, and necklaces, and found the materials to manufacture at least 20,000 more counterfeit items.

The Department of Justice led Operation Site Down, an international online piracy investigation culminating in the execution of over 90 search warrants and arrests in the U.S. and eleven countries abroad in June 2005. Operation Site Down dismantled some of the largest and most prolific high-level distribution sites preventing tens of million in further losses to the content industry. To date, 44 individuals have been indicted and ten convicted of felony copyright offenses.

As part of the STOP! Initiative, the Department of Justice formed an Intellectual Property Task Force to examine how it could maximize its efforts to protect intellectual property rights. In October of 2004, the Task Force Report was released and it included a comprehensive set of recommendations on steps that the Department of Justice could take to better protect IPR.

In addition the Department of Justice has executed measures to maximize law enforcement's ability to pursue perpetrators of IPR crimes. For example, we are increasing from 5 to 18 the total number of Computer Hacking and Intellectual Property Units in U.S. Attorneys' Offices across the country. This increased to 230 (two in virtually every U.S. Attorney's Office in the country) the number of specially trained prosecutors available to focus on IP and high-tech crimes. As part of the Task Force recommendations, the DOJ also appointed an IP Law Enforcement Coordinator for Asia, who is stationed in Bangkok. This individual will work with DOJ

officials in the Computer Crime and Intellectual Property Section and the Office of International Affairs to oversee their law enforcement efforts in the region.

The Administration proposed the Intellectual Property Protection Act of 2005 to strengthen criminal intellectual property protection, toughen penalties for repeat copyright criminals and add critical investigative tools for both criminal and civil enforcement authorities.

In addition, we have executed agreements to implement obligations of the U.S./EU Mutual Legal Assistance and Extradition Agreements. These agreements ensure cooperation regarding intellectual property crimes with Austria, Belgium, Denmark, Finland, France, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Netherlands, Portugal, Slovenia, Spain, Sweden, United Kingdom; and we have completed negotiations with the nine remaining E.U. countries—Cyprus, Czech Republic, Estonia, Germany, Greece, Italy, Malta, Poland and Slovakia.

*Working closely and creatively with U.S. industry:* As I mentioned earlier, we are conducting extensive outreach with U.S. industry and trade associations. Additionally, we are working with the Coalition Against Counterfeiting and Piracy, a U.S. Chamber of Commerce and National Association of Manufacturers led association—on the “No Trade in Fakes” program to develop voluntary guidelines companies can use to ensure their supply and distribution chains are free of counterfeits.

We are also conducting post-entry audits to identify companies vulnerable to IP violations and working with them to correct their faulty business practices.

*We are reaching out to our trading partners and building international support. U.S. leadership is critical and we are active on a number of fronts:* When U.S. Government officials meet with our global trading partners for bilateral and multilateral discussions, IP protection and enforcement are always top priorities.

This Administration makes IPR a priority when negotiating new free trade agreements as you saw most recently with CAFTA-DR (the United States-Central America-Dominican Republic Free Trade Agreement).

In January, we met with European Union Officials at the White House for a series of meetings to address global piracy. We are breaking new ground and have begun to expand our cooperation with the EU—focused on border enforcement, a strategy to address problems in developing countries and working with the private sector. Particularly with China, the EU announced that they will be posting an IP attaché in Beijing.

At the G8 meeting, President Bush secured an agreement from fellow leaders to focus on IP enforcement, and we plan on working with Russia on IP issues during their presidency of the G8.

At APEC last year, we secured an endorsement of a U.S.-Japan sponsored “APEC Anti-Counterfeiting and Piracy Initiative” to reduce trade in counterfeit goods and to combat online piracy, while increasing cooperation and capacity building. In close cooperation with industry and a number of U.S. Government agencies, USTR led this effort, which culminated last November in agreement by the leaders of APEC’s 21 member economies in a set of model guidelines to reduce trade in counterfeit and pirated goods, and to protect against unauthorized copies, and to prevent the sale of counterfeit goods over the Internet. We are currently working to implement and expand these model guidelines.

Also, the work of the U.S.-Russia IP Working Group remains a high priority, as the United States, through USTR, and Russia work to address a number of IP-related issues and steps that need to be taken.

Additionally, we have commissioned a study by the OECD (The Organization for Economic Cooperation and Development) to examine the impact of global counterfeiting and piracy. My office and our interagency team have held several meetings with OECD officials to follow-up and assist with this study. We are looking for sound, reliable and accurate information to be produced with this study, so that we may have accurate metrics that can be used effectively by our principals and by industry as we continue building international support to stem the flow of fake and counterfeit goods and keep them out of global supply chains.

Next, the U.S. has conducted several hundred IP training and capacity building programs around the world to improve criminal and civil IPR protection. To that end, the Administration has established a Global Intellectual Property Academy to consolidate and expand our training programs for foreign judges, enforcement officials and administrators.

We are continuing to expand our IP attaché program in China and positioning new attachés in Brazil, Russia and India. Having IP attachés stationed in these countries will enhance our ability to work with local government officials to improve IP laws and enforcement procedures in addition to assisting U.S. businesses to better understand the challenges of protecting and enforcing their IPR.

On the domestic front, we have education campaigns that take place across America to teach small and medium sized enterprises how to secure and protect their rights and where to turn for Federal resources and assistance. It is important to note that only 15 percent of small businesses that do business overseas know that a U.S. patent or trademark provides protection only in the United States. Companies need to make sure that they register for intellectual property protection overseas. We had an education program in San Diego and a China-specific program in Atlanta last week, and we have upcoming programs in Nashville, Columbus and Northern Virginia. These events help educate businesses on what intellectual property rights are, why they are important, and how to protect and enforce these rights domestically and internationally.

Mr. Chairman, the Bush Administration is committed to stopping intellectual property theft in China and providing businesses the tools they need to flourish in the global economy. As I work to coordinate the U.S. government's intellectual property enforcement, trade and education efforts; and with your continued support and the partnership of this committee, we will be able to do even more to provide American businesses and innovators with the protection they need. America's intellectual property is important not just for her national security, but it is also a necessary component in ensuring continued U.S. economic growth and technological leadership. We must take advantage of the opportunity to work together to better protect the knowledge industries of today so that we may continue to see the innovations of tomorrow. Thank you very much.

Senator SMITH. Chris, to Senator Dorgan's point about the enforcement that was seen as to the logo of the Olympics, do you know if that was done at a Federal level, a high level in China?

Mr. ISRAEL. My understanding, Mr. Chairman, it was done at a very high level in China. My understanding is that even prior to the final decision made by the International Olympic Committee to place the 2008 Olympics in Beijing, there was federal legislation, national legislation that was put in place in China to protect that logo, and a number of different manifestations of that logo, different products that would come from that logo. So, yes, it was done at a very senior level, a national level in China.

Senator SMITH. And most of this piracy, I assume, occurs throughout China and they would count on local enforcement of these copyright stealings, but apparently, it doesn't get that far with the local area.

Mr. ISRAEL. With regard to the logo?

Senator SMITH. If the federal government or whatever they call their central government—

Mr. ISRAEL. Central government.

Senator SMITH.—isn't directly involved there, is there just no local enforcement?

Mr. ISRAEL. Local enforcement is a huge challenge in China. I think it's certainly something that's been pointed—

Senator SMITH. Well, what stops it from your observation? Is it—

Mr. ISRAEL. With regard to the logo specifically?

Senator SMITH. No, I mean anything, stealing anything. Is it just local authorities that are complicit in it?

Mr. ISRAEL. That's part of it. I think we see at a local level the political pressure and will that's been exerted, and Beijing has a very hard time making it to the local level. You see local corruption. You see local protection of the points of production of these products. In remote areas of China, they employ a lot of people. They contribute to the local economy. So, transferring the commitments that we have seen made by senior officials in China to ac-

tual on-the-ground enforcement actions throughout, you know, the very diverse and large country is a huge challenge.

Senator SMITH. Well, President Hu acknowledges it's a problem and has demonstrated he can do something about it. What's holding him up from—what are you seeing? I mean, are you seeing any progress made?

Mr. ISRAEL. We're seeing some progress. I think if you look, there are some recent indications of progress locally and in a couple of court cases in Beijing. Starbucks won a trademark case late last year. There was a ruling against the landlord of a very notorious counterfeit market in Beijing last year, a case that was brought by trademark owners against that landlord. A European chocolate company had a favorable ruling in a Beijing court. So, I think we're seeing some anecdotal things occur. I think that those are relatively new. I don't know that those would have come out that way 2 or 3 years ago had it not been for a lot of concerted pressure on the Chinese. You're also seeing—according to the Chinese, they took about 2,500 criminal investigations of IP violations last year. That's something they reported. Those are their numbers, so there are challenges to addressing those. They are reporting increased activity regarding their actions on IP violations in China, and we're seeing some anecdotal progress. We're also hearing from some individual U.S. companies who are stepping up their own activities in China, developing their own enforcement strategies, developing cases, taking them to Chinese prosecutors and seeing some progress in that regard.

Senator SMITH. Let me—for all the investment there has been in China, my own sense is there would be a whole lot more if there were, in fact, some confidence in IP protections. And do you think that the Chinese leadership has an appreciation for what it's costing them? Obviously, we can quantify what it's costing us. Do they know what it's costing them?

Mr. ISRAEL. I don't know that they have a specific assessment of what it's costing them.

Senator SMITH. Do you think they appreciate it?

Mr. ISRAEL. In conversations that we have with them, they state their appreciation of it. If you—there are statements from Chinese leadership recognizing the need to protect intellectual property as a way to foster their own economic development and to spur an innovation-driven economy.

Senator SMITH. And as the Chinese economy develops and Chinese are actually producing their own intellectual property, are they enforcing that?

Mr. ISRAEL. I think that would be a big catalyst if there—as there does grow a domestic IP-based economy in China. The Chinese companies that are producing their own intellectual property, they, in a well-known case, recently bought the PC—the laptop PC business of IBM, and that's a very big investment in a very innovative company. It's hard for me to fathom that China wouldn't forcefully exert the intellectual property of companies such as Lenovo and others.

Senator SMITH. Well, I know I voted for China WTO, and I don't know that I would today knowing what I know now in terms of how this has played out. And I know we're going to be asked to

vote on Russia WTO, and frankly, they have a huge problem as well. And so, if that country cares about WTO, this Senator cares. And I'm only one, but they can't afford to lose many. And the whole world knows that the Schumer Amendment passed by a big margin. It didn't have my vote. It may have my vote next time. And so, time's running out, and we're sick of it. Senator Dorgan.

Senator DORGAN. Mr. Chairman, thank you very much. Let me begin by stipulating that the previous Administration was in office 8 years and did precious little to address this issue. You've been in office—this Administration's been driving for 5 years and have not yet filed a complaint. Senator Lindsey Graham and I have offered since the Senate resolution, asking that you file a complaint. We have also offered a piece of legislation saying we should withdraw our normal trade relations on a permanent basis and make it an annual basis, which creates the pressure on the Chinese. But let me ask directly why have you not taken action in 5 years to deal with this, especially because inasmuch as the fact that this deficit is growing and growing and growing exponentially?

Mr. ISRAEL. Well, as I stated, Senator, I mean, it certainly is an issue that—and a question that's open. It's on the table, and it's being considered by USTR, by Ambassador Portman and that we're working actively with U.S. industry and other stakeholders to address head on the question of bringing a dispute resolution case against China. It's under active consideration at this point.

Senator DORGAN. But why under active consideration if it's \$200 or \$250 billion a year? We know that it has gotten worse, not better after the 2004 promise by the Chinese. Why have you not taken action at this point?

Mr. ISRAEL. Well, you know, I think there have been a series of commitments made by the Chinese. We've given some time to see if those come to fruition. There is an active discussion with industry, and we need to take into account the views of American companies and how they think a WTO case would impact the marketplace in China, and there are a number of factors under consideration. And I think the challenges are more evident than ever, and the frustration certainly remains there.

Senator DORGAN. What's your time frame for making a decision do you think on whether or not you will file an action under WTO?

Mr. ISRAEL. I'm not in a position today, Senator, to discuss a time frame. I think it's obviously under the leadership of Ambassador Portman of the U.S. Trade Representative's Office. I'm simply not in a position to assess a time frame. I can tell you we are—one piece of information we're actively waiting for is the response to our Article 63 request that was made under the WTO for very specific information from China about their enforcement activities. I think that will be very useful information in the formulation of a decision as well.

Senator DORGAN. Can I tell you why I think action hasn't been taken? On the last day of employment at the U.S. Trade Ambassador's Office about 2 or 3 years ago, a fellow who on his last day gave a speech to a wheat group here in Washington, D.C., and he explained to the group that—whose interest was wheat sales to China, he explained to the group that the group inside the Administration that works on this, Trade Policy Group I believe it was,

which is a number of different agencies working together, had recommended that formal action be taken against China, a complaint filed against China with respect to wheat, and he said—but it was—that was denied—that recommendation to take formal action against China with respect to wheat trade was denied by the Administration because it would have been considered a “in-your-face” thing to do to China. And so, this fellow was unbelievably candid, I suppose, because it was the last day at work. You almost never get that kind of candid answer from someone who works in Trade or in any administration. But he said, you know, the fact is they sat around, decided action should be taken against China based on the facts, but then no action was taken because it was considered an in-your-face thing to do. Does that suggest, as I often think is the case, that trade policy, instead of being hard-headed economic policy is soft-headed foreign policy?

Mr. ISRAEL. Senator, I am unfamiliar with the facts on the wheat case. I think I would point to the very specific and public statements that have been made by USTR, including the out-of-cycle 301 Review of China last year where they stated clearly that all options are on the table. And it’s under active consideration, the question of whether to bring a dispute case against China, so, I think we’re assessing the input that we’re receiving from U.S. industry. We’re certainly assessing and making determinations about the type of progress we’re seeing in China and whether we think it’s on a trajectory to continue to improve and whether the best step is to make a WTO case at this point.

Senator DORGAN. Yes, I see some products on the table, perhaps from the next witness, but we could go through a lot of products. I understand China has reverse-engineered Viagra, and—

Mr. ISRAEL. Some of it here, actually.

Senator DORGAN.—I assume Pfizer is probably complaining to you about that and probably should. But you know something, my guess is China is not exactly shaking in their boots at the fact that you might, at some point, take action because the evidence from this country is we never take effective action. We never do that. And no matter where this line goes with respect to the trade deficit with China, it’s now \$202 billion in a single year. You think of the imbalance there. No matter where all this goes, no matter whether piracy and counterfeiting get worse or better after they agree to make progress, this country, by and large, sees its trade policy as foreign policy. Our trading partners all see it as hard-nosed economic policy. They will do to us what they can as long as they believe they can, and I believe the Chinese, not just based on this Administration, but based on a number of administrations, will believe forever that we don’t have the guts to take action. We’re not going to do anything. All we’re going to do is say that—President Hu recognizes the problem. Yes, I hope so. He creates the problem and manages the problem and makes it worse. I hope he recognizes it. I appreciate your coming here, and I don’t mean to diminish your work, but I would say this—the proof’s in the pudding. At some point, you either stand up—the Administration either stands up on behalf of American economic interest against what is clearly unfair trade, against counterfeiting and against piracy, or we just say none of this matters, and we’ll stop threatening because the

threats don't mean anything at some point. A threat only means something if people believe there's leverage and intent behind it. And so, Mr. Chairman, I have the numbers on how many people in Commerce are spending time enforcing our trade agreements with Japan and China and other countries. It's minuscule. As you know, it's 11 and 18 and so on. We are a country wholly uninterested in enforcing trade laws. We have never been interested in enforcing them. Why? Because we run it all through the State Department. We're worried we're going to offend somebody. And so, the result is we lose money, we lose leverage, we lose opportunity, and we lose jobs. So, Mr. Israel, again, I didn't mean to use you for the opportunity to make another speech, but I appreciate the work you do, but we need a time frame. We need a decision, and we need to understand that this country is willing to stand up for its economic interests.

Mr. ISRAEL. I would point to, and I certainly understand that, Senator, and I think the frustration is very well known. Chairman Smith, you mentioned Russia as well. I mean, there's certainly a good degree of pressure being felt on that relationship. Well, I was actually just in Russia last week and had a chance to raise a number of these issues. I would point to the fact that thus far, we're actually the only country that's brought a WTO case to, I think, against China. We were on the brink of bringing one regarding some craft liner board, I believe it's called, within the last couple of months, and the Chinese actually backed away from there, the posture that they had—that had elicited us to potentially bring that case. So, I think there has been some indication, certainly, that we are willing—more than willing to bring cases against China. And this is a—there are a lot of obvious calculations to this one, and they're being assessed.

Senator DORGAN. Mr. Chairman, if I might have one more minute, I did mention automobile trade with China. I should mention at the same time that 99 percent of the vehicles driven on the roads of South Korea are South Korean vehicles. Ninety-five percent of the vehicles driven in the country of Japan are Japanese vehicles. Last year, 730,000 Korean cars were shipped by boat to the United States to be sold in our marketplace. We sold 4,300 vehicles in South Korea, and the reason is obvious. They're not interested in American products competing, and I would urge you to take a look at the Dodge Dakota pickup experience in South Korea and then ask yourself whether it's China, Japan, South Korea or any number of others—if I had the time, I'd talk to you about them, whether we are standing up for our country's economic interests. The answer is a pathetic answer. The answer is clearly no. So, on bilateral automobile trade and a range of others who I take a look at, I say that only because of the announcement recently by Ford and General Motors about huge layoffs and closure of plants. Mr. Israel, thank you.

Senator SMITH. Chris, I wonder if instead of the Schumer Amendment of—I think the duty was 23 percent. I don't know whether 23 percent was—

Mr. ISRAEL. 27, I think.

Senator SMITH.—or 27 percent or where that number was arrived at. How would it fit in WTO if we had a substitute amendment here that calculated the duty according to the level of theft?

Mr. ISRAEL. I don't know how exactly it would fit into the calculations of the WTO. I think if you play out what would likely happen under the scenario that we did bring a WTO case that went through the many years it would take to reach a final resolution after appeals and all the things that happen, the likely outcome would be the ability of the United States to levy a countervailing duty against China in what we estimate to be the impact that's being felt on the U.S. economy through counterfeits. So, I don't know if we did that proactively—if Congress did something like that proactively, I don't know what the assessment would be.

Senator SMITH. Would the Administration support it?

Mr. ISRAEL. It's something we'd have to certainly consider. I would be happy to—

Senator SMITH. Senator Dorgan says he can answer that. But I'm throwing this out because I just think a lot of us are looking to give you leverage to enforce American intellectual property that they have agreed to enforce as well, but clearly are not.

Mr. ISRAEL. Leverage is important, Senator, it's difficult in these situations, as you know, to always find leverage, always find ways you can play offense. I think we have—in our discussions with China and other countries where we see this as a problem, we don't hesitate to note the fact that the U.S. Congress is exceedingly articulate and forceful in its views about the protection of American intellectual property on behalf of the companies and workers in your states, and that is certainly something that's well understood, whether it's Russia, China and any number of other countries. And I think the ability of the Administration and the Congress to work together to develop any and all leverage we can come up with is a very positive thing.

Senator SMITH. Well, I throw that out because I think the mood in Congress has changed, not changing, it has changed, and I just don't think we can keep going on on this basis with these escalating problems. I think we have to do something for the sake of our own Nation's economic future and the integrity of our own laws and the respect of our own industries, not protectionism, but—

Mr. ISRAEL. Yes.

Senator SMITH.—protecting what our Nation is frankly best at, and that's new ideas, new products, new commerce that is transforming the world, but if it's just stolen, it's value is much diminished and our jobs are unfairly compromised. I believe in free trade, I don't believe in being a big sucker. We've been joined by Senator DeMint of South Carolina.

**STATEMENT OF HON. JIM DEMINT,  
U.S. SENATOR FROM SOUTH CAROLINA**

Senator DEMINT. Thank you, Mr. Chairman. I don't always agree with Senator Dorgan, but I share a lot of his concerns, and I'm coming from a different perspective because I have been a free trader from a state that's not very free trade and was a big part of helping to win the approval in the House of China getting into the WTO. I felt it was critically important that we put China in



a rules-based system. But as you know, a rules-based system is meaningless if we are not able to enforce the rules. And my concern is—I mean, you could double or triple the size of your department, but China is so big and growing so fast, there is no way at all that we can litigate all the violations that we—the only way it could possibly work is if it's leadership in China was committed visibly, forcefully and creating a legal structure in China that would stop this kind of pirating. We can't do one case at a time. We'll just be scratching the surface two decades from now. I know this question's already been asked, but I guess it's a two-part question at least, is first, if the leadership in China really wanted to do it, do they have the legal structure, the government structure, the cohesion to even do it, or is their industry, which is very international—it's public-private in many cases, it's government in some cases, is there any way to even enforce this, or was my idea that doing business and putting China in a rules-based system, was that a naive idea, that they don't even have the capability to follow a rules-based system in a country that large? And does it really—the second part of my question is what can we do on this side, and I know that you have created a position, an ombudsman, who took position in February who is supposed to be an advocate for American business. Again, that's one person against five billion. I don't know how much they can really do, but I would just like to have some assurance from you that you think there is a social and government mechanism in China that could even uphold the law if they wanted to. I'd like some indication from you. In working with them, do you really think there's any commitment at all for them to do that, or do we just need to back away from this idea that we can do business as two trading partners operating within the law? Is that a false idea?

Mr. ISRAEL. I don't know that, Senator, I can be 100 percent reassuring to you that the infrastructure is completely in place in China to enforce throughout the entire country, across all the range of localities and across all the depths of the industry that are there, the IP laws that are in place. I think that is the big question, the capability of the enforcement mechanisms in China to administer, forcefully and effectively, the laws that they've put in place is really where the challenge and the disconnect in China is. I do believe we've seen indications that there is significant political will in China to address this problem, and you asked the right question. What happens then? And what capacity is there in China to affect that political will and act on it? I think when you look at some of the larger cities, when you look at Beijing, when you look at Shanghai, there is a growing capability of the law enforcement infrastructure there. There's a recognition of the—and a better understanding of the intellectual property laws. There's more acceptance of them and willingness to take—to bring cases. They largely are still brought on behalf of Chinese rights holders and very rarely brought on behalf of foreign rights holders, let alone American rights holders, but in some of the larger jurisdictions, we are seeing some increased recognition of the problem and ability to deal with it. And then you very quickly get into the inter-lands of China, the outer areas of China, the outer cities, and it becomes exceedingly difficult for that political will, for that desire that has been ex-

pressed at a senior level in China to manifest itself in a efficient, predictable and deterrent intellectual property system, and that's what China committed to do when they joined the WTO. They committed to have a rules-based transparent deterrent IP enforcement system, and that simply does not exist in China right now.

Senator DEMINT. Well, I think we need to consider ideas such as Senator Smith mentioned. If some find penalties, I hate to mention the word terrorists or whatever, but if the Administration doesn't come up with the idea, I very much suspect that Congress will, and it may not be to my liking or yours, but we don't feel like the—that the United States now has the leverage or the will or the mechanisms in place to enforce the laws that are on the books. So, something's got to give, and its either got to come from your side or—I know it's going to come from ours because when folks from the protectionist side and the free trade side start getting together, I think there's probably nothing that we couldn't do. So, there are a lot of us who are pretty aggravated about it, and a wait and see what happens in 2 years doesn't suit.

Senator DORGAN. Senator DeMint?

Senator DEMINT. But I do—I appreciate you being here, too. And again, I don't mean to pile on, but I think it's time to put up the flags and say hey, we've got a problem.

Senator DORGAN. Senator DeMint, I actually refer to it as a fair trade and the free trade side.

Senator DEMINT. I see. Oh, OK.

Senator DORGAN. And then the protectionists, but Senator DeMint, you weren't here when I described, I think, what answers the—evidence that answers the question clearly. The ownership of the logo for the 2008 Olympics in China is owned by the Chinese Government. People in China began to counterfeit on the street corners, on glasses and cups and banners, and the Chinese Government shut it down immediately because they own that. These were Chinese people trying to counterfeit and pirate something owned by the Chinese Government. They clearly effectively shut that down. So, that demonstrates, at least to me, that they can, if they have the will, shut down that sort of activity.

Senator SMITH. Chris, I have a final question. If my colleagues want a second round, they can as well. I've read reports that in some cases, the piracy of counterfeited products are connected, in fact, to organized crime. These include optical disks, automobile parts, T-shirts, even toiletry products. Is this—is that for real? Is this a real problem, and what are your thoughts about the criminal nature of this organization?

Mr. ISRAEL. Very serious thoughts, Senator, I do think that there are sophisticated global organized criminal enterprises that are behind piracy and counterfeiting around the world. It's relatively low risk, and it's high return.

Senator SMITH. And it's in China?

Mr. ISRAEL. And it's in China. It's in other places as well. I do know that this is—that's a dynamic that obviously has our law enforcement agencies very focused on this. Our Department of Justice and our Customs agencies are exceedingly focused on this for that very precise reason.

Senator SMITH. Should we regard it as a national security issue more than just a criminal issue?

Mr. ISRAEL. I mean, our focus right now and the focus that we have and that I personally have, our office is to address this as a trade issue, as an economic issue. I would respectfully defer the questions of national security to those in a place to better assess the threats, the particular threats that they see regarding national security, but we do know, as you said, there are criminal and sophisticated organizations behind this. We're trying to be sophisticated and organized in our approach to combat them.

Senator SMITH. Well, for the record, according to the *U.S. News and World Report*, a counterfeit T-shirt operation funneled money to an Egyptian sheik to help finance the 1993 attack on the World Trade Center. So, that's why I asked the question. And obviously, that's a hot issue around here right now.

Mr. ISRAEL. Right.

Senator SMITH. Do you know anything about China's government-licensed optical disk plant?

Mr. ISRAEL. A bit, I know it's something we've raised frequently with them.

Senator SMITH. And are you aware of any involvement of that plant with organized crime?

Mr. ISRAEL. I'm not aware of any specific—right now, I think there are multiple plants. That's another problem. There's many many optical disk plants in China that are producing—

Senator SMITH. This is a specific one that is government licensed.

Mr. ISRAEL. OK. I would need to probably get a little more information and maybe get back to you with some precision on that.

Senator SMITH. Well, get some more information and I urge you to look into it.

Mr. ISRAEL. I will do that.

Senator SMITH. Need a second round?

Senator DORGAN. Thank you, Mr. Israel.

Senator SMITH. Thank you very much, Mr. Israel. We appreciate your attendance with us, and we'll call up now our second panel that consists of Mr. Franklin Vargo, who is the Vice President of International Economic Affairs at National Association of Manufacturers. And Mr. Andy York, my constituent, he is the Vice President of Leupold & Stevens. They have been in business since 1907. And if any of you are hunters, you have used their scopes. Our final witness will be Professor William Alford, Director of East Asian Studies at the Harvard Law School, and Mr. Alford will discuss the scale of the IPR problem in China and its potential implications on the world economy. Mr. Vargo, why don't we lead off with you and welcome. Pull the mike close to you so we can hear you.

**STATEMENT OF FRANKLIN J. VARGO, VICE PRESIDENT  
FOR INTERNATIONAL ECONOMIC AFFAIRS,  
NATIONAL ASSOCIATION OF MANUFACTURERS**

Mr. VARGO. Thank you, Mr. Chairman, Mr. Dorgan. The NAM is very pleased to testify today on one of the most serious problems that we're facing out of China. That is counterfeiting. We have other problems. We have a very, very undervalued currency. We

have problems of subsidies, but the counterfeit products are a very serious problem as well. Lots of people talk about the piracy of copyrighted products, CDs, videos, et cetera, but the counterfeiting of trademark products is a real problem with China as well. Just about everything gets counterfeited, not just American products, Japanese products, European products, and we have to parse the problem out. It's bad enough that so much of the products sold in China are counterfeit, but they don't stay within China's borders. They go around the world. They don't just affect large companies. Actually, large companies—the question's been asked is China getting better. In honesty, their laws are getting better. I think they're still deficient, but they're getting better, and some of the large companies that operate within China that have banded together in something called the Quality Brands Protection Commission, the QBPC, have learned how to work with the Chinese authorities, they've learned how to—they can hire their investigators. Things are getting a little better for them. But for the smaller companies, they just can't afford this. And I have an example here of some products. There's a great NAM member manufacturer in Fort Lauderdale, Florida, Uniweld Products. They make refrigeration testing equipment, and they have a big market in the Middle East where there are a lot of refrigeration and air conditioning products that's needed. So, their product—this is the genuine product here. It's a very high-quality product that is in very high demand. This is the fake Chinese product, exact same packaging, says made in the USA, has Uniweld's warranty card in it. Same sort of thing here, here we have the genuine product, and we have the fake product, made in the USA.

Senator SMITH. What are those?

Mr. VARGO. These are manifold testers, and these are refrigeration manifold testers. They are, as I said, a very high-quality product, but the market for their product in the Middle East is being ruined by these Chinese fakes. They're not a high-quality product. So, the company started noticing that they're getting a lot of warranty cards being sent in, they said geeze, you know, we're not selling that many products in that part of the world. So, they have been working with the authorities in the Middle Eastern countries to crack down and are getting some relief there, but they don't have the funds to hire investigators to go all around China and see where this is being made and to go through the civil process and then into a criminal process. So, we feel the laws in China are deficient. You know, the counterfeiting is a—ought to be a crime. Now, there is a threshold in China right now, and I'm not exactly sure what it is, but it's too high, the dollar value or the Yuan value of the goods that have to be seized. And also, the goods are valued not at the value of the genuine goods, but at the value of the fake goods, which is so much less. So, it's difficult to get criminal prosecution. So, to many counterfeiters in China, being caught is just a cost of doing business. There is a civil fine. They move the equipment, they go back into production. And we want them thrown in jail. We want them to be locked up, and we want to throw away the key and really make examples of them, not just a 6-month sentence or something, but years because it is a very serious problem. And there are some indications that the Chinese Government, cer-

tainly in Beijing, sees this as a growing problem and is trying to do more about it, but they really need to get at their laws. They need something—remember that old TV series “The Untouchables” and Eliot Ness. You know, they need a police strike force. Why should American companies or other companies have to hire investigators, find out where the crime has been committed and drag the police in. The Chinese police ought to be doing that. So, we need more from them. We need more out of China Customs. They ought to stop the stuff from being exported. If a container-load of stuff is being exported out of Shanghai or somewhere, and it says made in the USA, that ought to be a tipoff that something’s wrong here. We want U.S. Customs to do more. And they are doing more, but we still need more. And in third countries, particularly where we have trade agreements that provide more rights against transshipment, we want them to begin enforcing those agreements so we can really make a dent in the problem. And it’s not just a matter of hurting the bottom line, it’s a matter of the product’s brand reputation as well. But also, it’s a matter of health. If you get brake linings that are made of sawdust or you get fake airplane parts or fake auto belts or fake window glass that’s supposed to be safety glass and is not, this is a real safety problem. We have worked with the U.S. Government. We have worked with USTR and Commerce and others, and more is being done. We appreciate the STOP! Program. I think that Chris Israel’s position, we need to coordinate. There is so much disjointed effort within the U.S. Government. They’re doing better, but we need more resources to go into this, and we need to work with them more closely. I’d like to think that there was a magic wand we could wave that would just bring a WTO case. Bringing a WTO case is tough. The standard of evidence is very high. We really—at the NAM, we’re starting to talk with our companies and trying to get the evidence that would be necessary. And if we can accumulate a sufficient amount of evidence, we won’t hesitate to demand the U.S. Government bring a WTO case, but that’s a long process. You know, that’s 2 years. Then, you’ve got 15 months to come into compliance. And what’s the remedy necessarily? Are they going to say now we, you know, we’re going to line up 30 people and throw them in jail for life, and the problem is solved? The best way is to get the Chinese to recognize that they’ve got to do something about this. But failing that, and our patience is limited, failing that, we certainly want to see our WTO rights pursued. We appreciate your interest and your interest, the interest of the whole Senate and the House. We need to see that the Administration efforts are well funded. We need to do more for small companies who just don’t have the resources to deal with this problem. Thank you.

Senator SMITH. Thank you, Mr. Vargo.

Mr. VARGO. Oh, could I add one more point?

Senator SMITH. Of course.

Mr. VARGO. Mr. Chairman, we’re very very pleased at your introduction of S. 2134 because it’s not just a matter—we have to protect our intellectual property because it’s intellectual property that allows us to compete against lower-wage countries, but we have to continue to develop that technology. And your bill, and I hope it will be marked up soon and favorably, and we particularly like the

advanced technology program that you are trying to preserve and that as being necessary. So, I just want to express the gratitude of America's manufacturers. Thank you, sir.

[The prepared statement of Mr. Vargo follows:]

PREPARED STATEMENT OF FRANKLIN J. VARGO, VICE PRESIDENT FOR INTERNATIONAL ECONOMIC AFFAIRS, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Chairman and members of the Subcommittee,

I am pleased to have the opportunity to testify on behalf of the National Association of Manufacturers (NAM) this afternoon on "Piracy and Counterfeiting in China." We applaud the Committee's initiative in holding the hearing. The damaging impact of this illegal activity on U.S. industry and the general public is serious and growing. And if we don't get this problem under control, we are going to face severe consequences for our businesses, workers and the health and safety of our citizens.

The NAM is the Nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Protection of intellectual property rights has never been more important for U.S. manufacturers than it is today. Our companies and workers—whether in Detroit, Los Angeles, Atlanta or Houston—are competing in a global economy against rivals not only in well established industrial countries but also, increasingly, in emerging economies such as China, India, Korea, Taiwan and Malaysia. These emerging economies, particularly China, are rapidly expanding their industrial base on an extraordinarily large scale, taking advantage of low labor costs, a less burdensome regulatory environment, lower taxes and, in some cases, deliberate currency undervaluation.

America's ability to create and use intellectual property such as patents, copyrights and trademarks provides U.S. companies with a critical competitive advantage that helps to offset lower labor costs and other advantages that these emerging economies have. Consumers also benefit. The protection of trademarks and copyrights ensures that consumers of U.S. products, whether these products are life-saving medicines, critical safety components in automobiles or software used to manage complex industrial processes, have authentic products that will perform with the high standards and quality assurances of the U.S. producer.

In light of the importance of intellectual property rights (IPR) for manufacturers, the NAM has devoted considerable attention and resources to addressing their concerns. The NAM is co-chairing the Washington-based business Coalition Against Counterfeiting and Piracy (CACCP) that is seeking to raise awareness of international trade in fake products and promote stronger efforts by government and business to address the problem. We have lobbied for stronger enforcement measures against counterfeiting in U.S. legislation and more resources to strengthen cooperation with foreign governments, including the Chinese Government. And we are seeking to mobilize manufacturers to improve their own internal practices to prevent counterfeiting, for example, by strengthening their supply chain systems to prevent fake products from getting into the hands of suppliers and customers.

How big is the problem of global counterfeiting and piracy? It is already huge and, according to our members, is getting worse—and China appears to be the center of the biggest international counterfeiting and piracy rings. The estimate of counterfeit products most widely used by both industry and government is 5 to 7 percent of world trade or a volume of products valued at over \$500 billion annually.

Much attention has been given to the problem in China and other countries of the widespread pirating of copyrighted products, such as computer software, films and music. There is no question that this remains a serious problem, and despite the attention it has received, relatively little progress has been made. In China, for example, it is estimated that less than 10 percent of films and software sold on the market are authentic products.

The counterfeiting of manufactured products, however, is also serious and affects a broad spectrum of U.S. industries: medicines, auto parts, components for industrial equipment, personal care products, chemicals, sophisticated computer routers and aircraft parts. Counterfeit products, of course, result in financial losses to U.S. companies when they are sold in place of legitimate products. But they also are a very real threat to consumers. Examples of defective products include:

- Medicines that contain life-threatening ingredients or grossly inaccurate dosages
- Batteries that explode because of faulty manufacturing
- Brake pads containing sawdust

- Engine timing belts that break after only 1/5 the time of the authentic product
- Razor blades that don't shave despite the quality brand name
- Refrigeration testing equipment that wouldn't test properly
- Faulty consumer electrical products that had false testing marks of a well known U.S. testing firm
- U.S. brand name golf clubs that could break because of poor quality production

The volume of the counterfeiting and piracy in China, according to reports we receive, appears to be growing. But so is the sophistication of those engaged in illegal production. The packaging of counterfeit products has improved so much that even U.S. company marketing experts have difficulty telling the authentic product from the counterfeit one. Some pharmaceutical companies have told us that the only way they can determine whether a suspected counterfeit product is real or fake is by sending the item for testing at a company laboratory.

How counterfeiters manufacture fake products to avoid detection has also become more sophisticated. One U.S. consumer products manufacturer found that the counterfeiters were producing parts of the product in six different locations stretching over 80 miles. Final assembly was performed at different locations depending on the risk of detection.

Much of the counterfeit production in China is consumed in the local market. But a substantial quantity is also showing up in markets around the world—Russia, Saudi Arabia, the UAE, Mexico, Canada, Costa Rica, Colombia, Uruguay and, of course, the United States. In one case, Chinese and French police worked together to intercept 800,000 units of counterfeit consumer products that were transiting Paris from China en route to Uruguay.

Small companies face particular challenges in dealing with counterfeiters. One small NAM manufacturer that makes refrigeration testing equipment was not even aware that its products were being counterfeited in China until it started getting requests for warranty coverage in Saudi Arabia with products that had phony serial numbers but looked nearly identical to the company's products. An investigation revealed that the products came from China, but the company doesn't have the resources to pursue the case there.

To qualify for membership in the World Trade Organization (WTO), China had to bring its domestic IPR laws into conformity with standards established by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). China's laws on defining intellectual property rights did in fact improve. But the enforcement of these rights still remains problematic.

On the positive side, the Chinese Government has been receptive to discussing U.S. business concerns and taking some actions. The NAM appreciates the high priority that U.S. Trade Representative Portman and Commerce Secretary Gutierrez, and their predecessors, have given to engaging their Chinese counterparts on counterfeiting and piracy. Discussions on counterfeiting and piracy in the 2004 and 2005 U.S.-China Joint Commission on Commerce and Trade (JCCT) were substantive and resulted in specific commitments on issues important for U.S. business. Key outcomes included:

- China's pledge to significantly increase penalties and crackdown on violators
- Commitment to expand the range of IPR violations subject to criminal (as opposed to solely civil) penalties and increase the number of criminal prosecutions
- Agreement to increase enforcement action by Chinese customs to stop the import and export of counterfeit products
- Assurance that Chinese Government entities would only use legal software
- Commitment to rid Chinese trade fairs of counterfeit products

These are all important outcomes for U.S. manufacturers. Chinese follow-through on these commitments, however, has been uneven. Significantly, China did issue a judicial interpretation that permits, in theory, more criminal prosecutions. Some companies report aggressive enforcement actions by national and local authorities when detailed evidence of counterfeiting was presented. In a number of cases brought to our attention, police reportedly undertook extensive investigations in several locations that resulted in the arrest of many suspects (e.g., a dozen in one case) and the confiscation of hundreds of thousands of counterfeit items. The Chinese Government claims that it has taken many enforcement actions that resulted in the closing of thousands of commercial establishments that sold counterfeit products.

In other positive developments, Starbucks announced earlier this year that it had won a trademark lawsuit against a Chinese coffee chain that was using its Chinese trademark. Luxury goods maker Louis Vuitton also scored a victory recently when

a Chinese court reportedly sentenced two men to prison for exporting copies of its perfumes. And in November 2005, General Motors reported that it had reached a settlement with a Chinese auto company Chery that GM says acquired its compact car designs and was producing automobiles identical to the GM model.

Yet despite these positive anecdotes and Chinese claims of many enforcement actions, companies continue to tell us that counterfeiting and piracy in China is rampant, growing and on a very large scale. Enforcement actions, even when vigorously undertaken, appear to have little effect on the overall level of production and sale of counterfeit products. Moreover, we continue to receive reports of counterfeit products from China finding their way to countries around the world. The reports indicate that the Middle East is a major market for counterfeit products and transit point to third countries.

Manufacturers in other countries have also experienced similar problems with counterfeiting and piracy in China. Counterpart business organizations in Japan, Korea and Europe have told us that their members are seriously concerned about the large-scale counterfeiting and piracy of their products in China and the sale of these products in the domestic market and abroad. The Korean newspaper *Joong Ang Daily* reported on August 22, 2005, that two-thirds of electronics shops in Beijing, Shanghai and Guangzhou were selling fake Samsung products and that 30 percent of auto parts marked "Made in Korea" in eight Chinese cities were found to be fake. Counterfeit Korean consumer electronic products from China have been found in Peru, Israel and Egypt.

Chinese authorities continue to assert that the number of enforcement actions against counterfeiters is large and increasing. The authorities, however, have yet to provide detailed information on the penalties imposed on those involved in the production and sale of counterfeit products or the actions taken to close down factories and commercial outlets engaged in the illegal activity. We are particularly concerned that China has not substantiated its pledge to significantly increase the number of criminal prosecutions for counterfeiting and piracy.

China's failure to provide this information after repeated requests led the United States to seek help from the WTO. On October 26, 2005, the U.S. Trade Representative initiated a special process under Article 63.3 of the TRIPS Agreement to request that China release more detailed information about its IPR enforcement efforts. The NAM supported this action. We are disappointed that, thus far, China has not responded positively to the request.

In the next several weeks, the Administration will have important opportunities to seek further progress on improving China's performance on IPR enforcement. On April 11, the JCCT will meet again in Washington to review progress on the bilateral trade agenda, including IPR enforcement. The participation of Chinese Vice Premier Wu Yi and our two senior trade officials—Ambassador Portman and Secretary Gutierrez—will permit a high-level exchange on key policy concerns and a detailed review of past commitments, which in our view have not been fully implemented. Then later in April, President Bush will be meeting with Chinese President Hu Jintao to discuss the overall bilateral relationship. We will be recommending that counterfeiting and improved IPR enforcement receive priority attention at both meetings.

Barring a significant improvement in China's performance on IPR enforcement, we see no alternative but for the United States to consider filing a complaint with the WTO and requesting that a dispute settlement panel determine whether China is living up to its TRIPS obligations. The apparent small number of criminal prosecutions, for example, suggests that China's IPR laws may not be adequate to ensure enforcement of companies' rights. Similarly, the unevenness in IPR enforcement among the different Chinese localities also seems to indicate that the national government has not effectively implemented the TRIPS agreement on China's behalf. The NAM is now exploring with member companies and organizations whether it would be possible to develop the kind of detailed information that would fully substantiate these claims in a WTO dispute settlement case.

The NAM, however, does not believe that business and government should leave resolution of the China counterfeiting and piracy problem solely to the WTO. Business needs to do a better job to raise awareness of the threat from international counterfeiting and the need to be pro-active to fight against it, for example, by improving company and industry practices on supply chain security. The NAM will be encouraging this through the CACP as well as its own member working groups.

U.S. agencies—particularly Commerce, State, USTR and Customs & Border Protection—need to continue strengthening their efforts to address counterfeiting and piracy in China and other countries. The STOP! Initiative has provided a good framework to do this. We are particularly pleased that more resources are now in place here in Washington and additional IPR experts are being assigned to U.S. em-



bassies, including Beijing. We would urge even more attention to how improved customs procedures in the United States and our trading partners can be used to prevent the import and export of counterfeit products.

Finally, we hope that Congress will also continue to support efforts to stop international counterfeiting and piracy. First, we ask that Congress ensure the enactment without further delay of the Counterfeiting in Manufactured Goods Act (H.R. 32). At the time I was preparing this testimony, we learned that the House had scheduled a vote on March 7 to approve H.R. 32, as amended by the Senate. We appreciate the Senate's earlier action on the bill. The legislation is important because it will make it easier to prosecute individuals engaged in the production and sale of counterfeit marks that are intended for use on counterfeit products. We had been pressing other countries to adopt similar legislation to fight counterfeiting, and the United States would set a poor example if it hadn't done so. U.S. anti-counterfeiting laws should be the gold standard, but we have a gap on counterfeit marks that must be fixed.

Looking ahead, Congress also needs to ensure that U.S. agencies have the resources to address a global problem that will have serious consequences not only for U.S. industry but the entire U.S. economy if it is not contained. The budget for the next few years will likely be tight. We shouldn't short change anti-counterfeiting efforts that are so important for U.S. economic interests.

Thank you for holding this hearing and giving the NAM the opportunity to present its views.

Senator SMITH. Thank you. Thank you very much. Andy York, thank you for coming from Oregon, and thank you for your great products for nearly a century now. You haven't been here that long, but your products have.

Mr. YORK. Not quite that long.

**STATEMENT OF ANDREW YORK, VICE PRESIDENT,  
LEUPOLD & STEVENS, INC.**

Mr. YORK. Good afternoon, Chairman Smith and Ranking Member Dorgan. I'm pleased to join you today to discuss the impacts of piracy and counterfeiting of American goods and intellectual property in China. I want to begin my testimony by thanking the Committee for your efforts to understand the impact that these activities have on American business, large and small, and I want to just take a few minutes to let you know how they're impacting our business, Leupold & Stevens. As you mentioned, we were founded in 1907. We're getting ready to celebrate our 100th year next year. We're a well-established manufacturer of rifle scopes, binoculars, spotting scopes and rangefinders, and we serve both the sports optics and tactical markets for our law enforcement and military. We are based in Beaverton, Oregon. We have been building rifle scopes since 1907. We have approximately 600 employees, and we're a fifth-generation family owned company. We registered the Leupold trademark in the United States on January 12, 1971. And since then, we have obtained registrations for Leupold in the European Union, Australia, New Zealand, Hong Kong and Japan. Frankly, we probably should have filed for a trademark in China decades ago, but probably like a lot of small businesses, we were unaware of the potential issues we would face in the Chinese market. It wasn't on our radar screen. And frankly, with the Tiananmen Square-related sanctions, rifle scope sales to the People's Republic of China are prohibited. So, it's not an active market for us. It became one on December of 2001, when we learned that SAM Optics (Nantung) Company Limited had filed in the People's Republic of China for the word Mark Leupold in English for goods manufactured and sold by Leupold & Stevens. We later learned that SAM

Optics had also filed to register 19 applications for 16 other company's marks in the sports optics and telescope market. These marks include BSA, Bushnell, Swarovski, Simmons and Celestron among others. We later learned——

Senator SMITH. Can I ask you a question?

Mr. YORK. Yes, sir.

Senator SMITH. You don't sell anything into China, though?

Mr. YORK. We do not. We source products in China. We do not currently sell——

Senator SMITH. It's prohibited, right?

Mr. YORK. It is prohibited. There is one potential sale that we are exploring right now with the police department, I believe, in Hong Kong.

Senator SMITH. Thank you.

Mr. YORK. So, their law enforcement people know us fairly well.

Senator SMITH. But you have never seen any upside to the China market?

Mr. YORK. There is not a lot of hunting in China.

Senator SMITH. Got it.

Mr. YORK. BSA paid \$25,000 to reclaim their mark from another company in China, Asia Optical, who had registered their mark, and we also learned from our council in China that recently, SAM Optics sold one of these marks that had registered for between \$50,000 and \$80,000. It is our perspective that this is a fraudulent intent, a case of fraudulent intent, to register the trademarks of other well-known international brands for the sole purpose of attempting to extort money from the rightful owners of these trademarks. We have been fighting a legal battle for close to 5 years now. We filed our own applications in both classes 9 and 13 in the People's Republic of China. We have cited the Trademark Law, the Paris Convention. We provided much evidence in the People's Republic of China to support our claim that Leupold is a well-known brand and is rightfully ours. The trademark office there refused our application. They rejected our opposition to SAM Optics in class 13. We have appealed that rejection, but it could take several more years to ultimately get a decision.

Senator SMITH. And are your products manufactured there, not by you, but your intellectual property. Are they being sold?

Mr. YORK. Yes, I'm going to tell you in a moment about some products right now, some counterfeit goods that are showing up in the international market for Leupold rifle scopes. I did want to pick up on a theme earlier. China is a member of the WTO. They've signed onto the World Intellectual Property Organization. They've acceded to the Paris Convention, the Madrid Agreement and Protocol, the Nice Agreement. They signed the Trademark Law Treaty. They supposedly patterned their trademark law after the TRIPS Agreement. However, it appears that there has been a breakdown in the interpretation and implementation of these standards into domestic law in China or a failure to effectively enforce those laws, most likely both. Further agreements must seek to ensure that provisions are incorporated into domestic law in China exactly as enacted in the signed international agreements. I want to talk to you now about counterfeiting operations in China. Leupold sources many finished-good products from China, including binoculars and

rangefinders. If we lose control of our mark, we are concerned that our exports from China to Leupold are at risk of being deemed counterfeit goods in China, and we would then be the counterfeiter. We find that very ironic. Leupold is also experiencing increased incidents of counterfeit goods, clones, replicas and knock offs of our tactical rifle scopes on eBay from sellers in the Hong Kong area. We are seeing these show up in the United States, the European Union in Australia, and we have reports from our distributors in Russia that those counterfeit goods are now showing up in the Moscow area as well. If we lose control of our market, we may face increased risk that these tactical rifle scope copies could be legally branded Leupold in the People's Republic of China. If they were confused with the real thing and used in the line of duty by our law enforcement officers or members of our military, the potential for failure and the resulting consequences would be significant. I wanted to let you know who uses our scopes and how they are used by the Department of Defense, the Department of Energy, the FBI, Border Patrol, Capital Police, Secret Service, and Homeland Security. Ninety percent of all local police departments in the United States, Special Forces and SOCOM. They are used to fight terrorism, both domestically and internationally, but I think it's the least that we can do for these folks that put their lives on the line everyday to ensure that the rifle scopes on their equipment are original equipment and not knock offs. I want to read to you, if I can, just—I know I'm going over here, one brief statement. This is a correspondence that I've initiated with one of the knock off sellers in Hong Kong. I think you have photos there that were provided of our Leupold Mark 4 LRT. It's a long-range tactical scope that our sniper teams use. It's a 3.5x10x40 product, and you have a picture there of a counterfeit good being sold on eBay. This is from a company called Sun Clear Trading, operating out of Shanghai where I was inquiring about my opportunity to import these goods into the United States, posing as a wholesaler. I was glad to have your e-mail. I sell a lot of scopes on eBay, and I export a lot of them to the U.S. in your own market. Most of my scopes are excellent quality with several tests of my customers. Leupold copy is the same appearance as the original. It can be used on the real fire weapon. Frankly, I can't guarantee the copy is 100 percent as good as the original. Of course, you have to buy one or two for a test. If you are satisfied with them, I can supply you a good wholesaler price. The M1 sample fee is U.S. \$100.

Senator SMITH. Where did that originate, that e-mail?

Mr. YORK. This is a direct correspondence from me to a seller on eBay.

Senator SMITH. So, you just—you've invited the——

Mr. YORK. Posed as a buyer.

Senator SMITH. Yes.

Mr. YORK. He's selling them for \$100. The real scope sells in the United States for a suggested retail of \$1,400 and as rightfully it should. These are scopes that are designed to survive 5,000 hits on the equivalent recoil of a 375 H and H Magnum and hold point of aim. The scopes that are coming—these counterfeit goods are a little more than toys, look-alike toys. So, it's very troublesome. It's very bothersome. You know, we're extremely concerned about this

trademark issue that we're facing there. It's exacerbated now by what appears to be a rapidly expanding counterfeiting operation, both in China, and also, we have reports that it's out of Japan as well. We're extremely concerned. We would like to thank you on behalf of Leupold & Stevens for addressing this situation, not just for ourselves, but obviously, for all Americans doing business in China. [The prepared statement of Mr. York follows:]

PREPARED STATEMENT OF ANDREW YORK, VICE PRESIDENT,  
LEUPOLD & STEVENS, INC.

Chairman Smith, Ranking Member Dorgan and members of the Committee, I am pleased to join you today to discuss the impacts of Piracy and counterfeiting of American goods and Intellectual Property in China.

I want to begin my testimony by thanking the Committee for your efforts to understand the impacts these activities have on American business, large and small. I would like to present to you today an insight into one such American company, Leupold & Stevens, Inc., and how piracy and counterfeiting are impacting our business. Your focus on these issues is greatly appreciated and we think it holds great promise that this Committee will identify and implement strategies that will lead to further refinement of international intellectual property standards and the corresponding domestic legislation where these international agreements, conventions and protocols are interpreted into the laws of the member countries.

Leupold & Stevens, Inc. is based in Beaverton, Oregon. We have been in business since 1907. As our business has grown, we have expanded our workforce to approximately 600 employees. Leupold is a fifth-generation family owned company. We pioneered the manufacture of waterproof riflescopes in 1947 and have steadily developed a worldwide reputation for building the world's finest hunting scopes, binoculars, spotting scopes and rangefinders, sold under the trademark LEUPOLD.

Over time, our brand has been built on the principle that every customer is entitled to a square deal. Leupold has become legendary for its rugged dependability, absolute waterproof integrity and lifetime guarantee. This is an old fashioned guarantee from an old fashioned kind of company: *If any Leupold Golden Ring product is found to have defects in materials or workmanship, we will, at our option, repair or replace it. FREE. Even if you are not the original owner. No warranty card is required. No time limit applies.* These are the building blocks that our brand and LEUPOLD trademark have been built upon.

Leupold & Stevens projects worldwide sales of well into the hundreds of thousands of units in 2006, totaling in the hundreds of millions of gross revenue dollars, for hunting scopes and related goods sold under the mark LEUPOLD. The trademark LEUPOLD for hunting scopes and related goods was first registered in the United States on January 12, 1971. Since then, Leupold & Stevens has obtained registrations for the mark LEUPOLD in the member countries of the European Union, Australia, New Zealand, and Japan.

Leupold sells its products to three unique markets; Hunting/Shooting, Observation and Tactical. Our riflescopes are used for hunting and target shooting all over this great country and, in fact, all over the world. Our tactical line of riflescopes is used extensively by law enforcement officers and by many branches of our military. Our troops in Afghanistan and Iraq rely on our riflescopes on a daily basis to complete their missions.

Aside from the U.S., we have distributors and/or representation in Austria, Australia, Belgium, Bulgaria, Canada, Czech Republic, Denmark, England, Finland, France, Germany, Holland, Ireland, Israel, Italy, Japan, Kazakhstan, Latvia, Mexico, New Caledonia, New Zealand, Norway, Poland, Portugal, Qatar, Romania, Russia, Serbia & Montenegro, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Ukraine and the United Arab Emirates. Although we source components and finished goods such as binoculars and range finders from China, we do not export riflescopes there due to Tiananmen Square-related Sanctions that are in place at the U.S. State Department. If market conditions in China and export laws were to change in the future, Leupold would consider expansion into this market just as we have done elsewhere in the world.

Before we begin to recount the history of what has transpired in regards to Leupold's efforts to trademark and protect our brand LEUPOLD in China, I do want to state for the record that Leupold has strong business partners in China. Most companies and authorities that we have dealt with in China and certainly those relationships and partnerships that are currently in place are based upon mutual re-

spect, trust, honor and proper business ethics. From Leupold's perspective, we find it most unfortunate that with such positive business dealings with our many partners in China that a single company could cause us such problems. What is more troublesome however is that with the extent of trade between China and the U.S. and all of the international agreements, conventions and protocols that China has acceded to, one would think that the PRC intellectual property laws would not allow such behavior. That has not been the case, at least from our experience over the past 5 years.

In December 2001, Leupold & Stevens learned that an application for the word mark LEUPOLD, in English, had been filed in the People's Republic of China for goods including those manufactured and sold by Leupold & Stevens. That application, filed for goods in International Class 13, was owned by a company called SAM Optics (Nantong) Company Ltd., hereafter SAM Optics. Note that Leupold & Stevens has never had a relationship with SAM Optics in any capacity, either as a distributor, retailer, or manufacturing partner.

Following counsel's advice, Leupold & Stevens filed trademark applications in China in International Classes 9 and 13, covering all the Goods it manufactures and sells in order to support filings to oppose the SAM Optics application. The LEUPOLD trademark applications were filed on January 21, 2002.

In preparing evidence to oppose the SAM Optics LEUPOLD trademark application, Leupold & Stevens learned that SAM Optics had filed to register 19 applications for 16 other companies' marks primarily in the sports optics and telescope markets. These included such widely-known marks as CELESTRON, SWIFT, BURRIS, BUSHNELL, SWAROVSKI, SIMMONS, WALTHER, and BSA (See attached list of Marks). In January, 2002, at the Annual SHOT Show, a representative of Leupold, Fritz Kaufman, met with a representative of BSA, Roger Vallecorse, to discuss SAM Optics. Roger Vallecorse followed up that meeting with an e-mail to Fritz Kauffman, which I attach. In that e-mail, Roger Vallecorse offers to introduce Leupold to SAM Optics, who had assisted BSA with buying back its mark from another China company, Asia Optical, to whom BSA paid \$25K. Roger Vallecorse states that SAM Optics' motives in registering the marks referred to above are to prevent those marks from being registered by Asia Optical. Vallecorse, then, paints SAM Optics as a good guy—Asia Optical are the bad guys. Note that Vallecorse's e-mail was copied to both an officer of SAM Optics (Yin Zhu Hua) and the company lawyer (Guo Jun).

We later learned from our counsel that SAM Optics sold one of the marks (we do not know which one) for somewhere between \$50,000 and \$80,000 (USD). This is the kind of experience that awaits U.S. businesses seeking to register their trademarks in China.

SAM Optic's trademark registration pattern and practices were cited in the opposition filed by our counsel on April 20, 2002. That opposition was based on the bad faith of SAM Optics in seeking to register LEUPOLD, among other marks. The opposition cited Article 31 of the PRC Trademark Law, which states:

An application for the registration of a trademark shall not create any prejudice to the prior right of another person, nor unfair means be used to preemptively register the trademark of some reputation another person has used.

The opposition also cited Article 6bis (1) of the Paris Convention concerning protection for well-known marks, which states:

The countries of the Union undertake, ex officio if their legislation so permits, or at the request of an interested party, to refuse or to cancel the registration, and to prohibit the use, of a trademark which constitutes a reproduction, an imitation, or a translation, liable to create confusion, of a mark considered by the competent authority of the country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of this Convention and used for identical or similar goods. These provisions shall also apply when the essential part of the mark constitutes a reproduction of any such well-known mark or an imitation liable to create confusion therewith.

Shortly after filing the opposition to the Sam Optics application in Class 13, a second SAM OPTICS application for the mark LEUPOLD in Class 9, for additional Goods manufactured and sold by Leupold & Stevens, was published for opposition. Leupold & Stevens filed an opposition against that application as well.

Leupold & Stevens had diligently filed to oppose both PRC applications for the mark LEUPOLD, filed in bad faith by SAM Optics, and it had filed its own applications in the PRC to protect its own goods.

In October, 2005, the PRC Trade Mark Office refused Leupold & Stevens application for the mark LEUPOLD: in November 2005, the PRC Trade Mark Office rejected Leupold & Stevens opposition to the first SAM Optics application opposition on the following grounds: that Leupold & Stevens did not own a registration or application for the mark LEUPOLD in the PRC for the same Goods—which was incorrect; and, that the demonstration of trademark registrations, sales and manufacturing volume, affidavits of fame of the mark, were insufficient to prove that SAM Optics had filed in bad faith.

Leupold & Stevens is filing to appeal the rejection of its opposition to the SAM Optics mark for LEUPOLD in Class 13. According to our counsel, we will not receive a decision for 2 or 3 years. If Leupold & Stevens loses this final appeal, and if it loses its opposition against the Class 9 Application for the LEUPOLD mark owned by Sam Optics, Leupold & Stevens will have no recourse except either to pay whatever price SAM Optics sets for the registrations it has obtained in bad faith or run the risk of being prosecuted for infringement of its own mark, LEUPOLD, registered in China by SAM Optics.

This is obviously just the type of Fraudulent Intent that numerous international conventions, agreements and treaties have sought to prevent. China became a member of the World Intellectual Property Organization in 1980. China acceded to the Paris Convention for the protection of Industrial Property on November 14, 1984 and became an official member on March 19, 1985. China acceded to the Madrid Agreement for the International Registration of Trademarks on October 4, 1989 and to the Madrid Protocol on December 1, 1995. China acceded to the Nice Agreement concerning the International Classification of Goods and Services (ICGS) on August 9, 1994. China signed the Trademark Law Treaty (TLT) on October 27, 1994. Finally, China has patterned its intellectual property law after The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

While all of these efforts have contributed immensely to bringing China's intellectual property laws up to internationally accepted standards, a more basic question still remains: Do these international agreements go into effect directly upon signing or are they only implemented through the resulting domestic laws of those countries signing the agreements? In China's case, it appears to be the latter and it has been this translation or interpretation into domestic law in China that the original intent of these international standards seems to break down. What is possibly needed is stricter wording in these international agreements that treaty provisions take precedence over domestic trademark law provisions, and these treaty provisions must be *incorporated exactly as enacted in the signed agreements*.

It is clearly not ethical or acceptable that SAM Optics runs out and files trademarks in China for 19 well know international brands of optical equipment with the sole intent being to extort a ransom from those companies to purchase back trademarks which those companies rightfully own by internationally accepted trademark standards. Furthermore, it is absolutely not acceptable that China, after having agreed to these international standards, fails to implement them into law or to correctly apply those trademark laws which it has implemented. How can it be that after all of the work that has gone into setting these international standards that Leupold and Stevens, Inc. cannot register and protect the LEUPOLD trademark in China, even in the face of such a case of pure fraudulent intent by SAM Optics?

If Leupold loses control of the LEUPOLD trademark in China there are resulting potential consequences that we are concerned about. Leupold sources many finished goods directly from various manufacturers in China, including range finders and binoculars. If these goods are stopped for inspection at a point of export from China, with the name LEUPOLD on them, we are concerned that we may run the risk of being charged with attempting to illegally export goods branded LEUPOLD, a trademark that we would not own in China. Ironically, we could be viewed as the counterfeiter.

A similar concern exists in the fact that for some time there have been counterfeit goods coming from China that are being sold on eBay as Leupold clones, replicas or knock-offs. These products are marketed as being the same as Leupold tactical riflescopes but without the Leupold name on them. Whereas a true Leupold tactical scope may retail for over \$1000 (USD), these look-alikes will sell on eBay for about \$100 (USD). There are several sellers who apparently seem to be working out of the Hong Kong area.

Our concern is that if we lose control of the LEUPOLD trademark in China, these replica riflescopes could legally begin to appear with our name on them and from all outward appearances would look just like an original Leupold. Our Leupold tactical riflescopes are built to meet the demanding requirements of our law enforcement officers and military personnel. If these knock-offs are taken to be the real thing, which they definitely are not, they could be mistakenly purchased either new

or years from now as used equipment by customers who mistakenly assume them to be genuine Leupold tactical riflescopes. What would happen if these look-alikes then failed in the line of duty? This is a very grave scenario to say the least and the potential ramifications on Leupold are substantial. Everything we have built over the past century under the Leupold brand name would potentially be at risk.

I would like to conclude my testimony with a simple thought. Over 50 years ago, our company's founder, Markus Friederich Leupold declared that, "the customer is entitled to a square deal." That simple ideal has driven our company to always strive to do the right thing and take care of our customers. Mr. Chairman, after you read all of the international agreements, treaties and protocols, ask yourself a simple question . . . are American businesses getting a square deal when it comes to intellectual property protection in China? I can tell you that from Leupold's perspective we definitely are not. Thank you very much.

**List of PRC trade mark publications in the name of SAM**

No.	Registration No.	Class	Application Date	Publication Date	Trade Mark
1.	1268805	09	1997/12/13	1999/01/28	S M Device & 山姆
2.	1276318	09	1997/12/23	1999/02/21	西蒙斯 SIMMONS & Device
3.	1399305	09	1998/11/10	2000/02/21	经儿郎 (stylized)
4.	1710092	09	2001/01/22	2001/11/07	BURRIS
5.	1710093	09	2001/01/22	2001/11/07	LEAPERS & Device
6.	1710094	09	2001/01/22	2001/11/07	Millett
7.	1713943	09	2001/01/18	2001/11/14	ADCO
8.	1713944	09	2001/01/18	2001/11/14	NAIKAR
9.	1713945	09	2001/01/18	2001/11/14	WALTHER
10.	1713946	09	2001/01/18	2001/11/14	NORGONIA & Device
11.	1713959	09	2001/01/16	2001/11/14	BEC
12.	1738219	09	2001/03/28	2001/12/28	HAKKO
13.	1050254	11	1996/05/08	1997/04/21	S M Device & 山姆
14.	1702420	13	2001/01/02	2001/10/21	BSA (stylized)
15.	1702422	13	2000/01/05	2001/10/21	BUSHNELL
16.	1702423	13	2000/01/05	2001/10/21	SIMMONS
17.	1702427	13	2001/01/05	2001/10/21	CELESTRON
18.	1702452	13	2001/01/05	2001/10/21	LEUPOLD
19.	1702454	13	2001/01/16	2001/10/21	BEC
20.	1702456	13	2001/01/18	2001/10/21	NORGONIA & Device
21.	1702459	13	2001/01/18	2001/10/21	SWIFT
22.	1702460	13	2001/01/18	2001/10/21	ADCO
23.	1702462	13	2001/01/22	2001/10/21	SIGHTRON
24.	1702463	13	2001/01/18	2001/10/21	NAIKAR
25.	1702469	13	2001/01/22	2001/10/21	SWAROVSKI & Device
26.	1702472	13	2001/01/22	2001/10/21	BURRIS
27.	1702498	13	2001/03/28	2001/10/21	HAKKO
28.	1710448	13	2001/01/22	2001/11/07	LEAPERS & Device
29.	1710499	13	2001/01/22	2001/11/07	Millett

Fritz Kaufman

From: Shaganash@aol.com

Sent: Friday, February 08, 2002 1:19 PM

To: fkaufman@leupold.com; euppiano@leupold.com; mbierig@leupold.com

Cc: michaelguo@pub.nt.jsinfo.net

Subject: Leupold Chinese registration/Meeting with BSA Optics at SHOT.

Gentlemen,

Thanks for stopping by to visit with us on the last day of the show. I hope that you had a pleasant and uneventful return home.

RE REGISTRATION OF LEUPOLD NAME IN CHINA

Pursuant to our discussion, please allow me to confirm that Asia Optical (formerly Asia Optical Japan), under the direction of Mr. Misao Ozaki, registered the name

of BSA Optics in China and offered us the alternative of either purchasing all of our Chinese made goods through them or purchasing our name from them. Although I saw this as little more than legalized extortion, we felt it was best to negotiate and pay a USD 25,000 settlement which secured ownership of our name and allowed us to get on with business.

In China, we were represented by the president of one of our suppliers, Sam Optical's Yin Zhu Hua, and his chief counsel Guo Jun. They were quite helpful in this regard and I recall Mr. Yin indicating to me that he was going to register the names of all his current customers as well as other U.S. and European optics firms with the intention of blocking additional extortion/coercion attempts by Asia Optical.

Significant animosity remains today in the eastern provinces of China, especially Jiangsu where the Japanese military committed numerous atrocities on civilian populations. As such, it is likely that Yin's efforts to register the names of companies other than his customers' were not entirely altruistic in nature. In any case, I am sure that you will find him to be highly motivated to assist you in this regard. However, do note that today is the beginning of the Chinese new years holiday and most businesses and government offices will be closed through at least the end of the next week.

Ozaki's actions were completely reprehensible and if I may be of any further assistance, do not hesitate to call on me. After IWA, I will be in China for several weeks and not opposed to following up directly with Yin and Guo on your behalf.

With best regards,

ROGER J. VALLECORSE,  
VP Purchasing and Technical Services,  
BSA Optics

cc: Michael Guo (Guo Jun) michaelguo@pub.ntisinfo.net  
Yin Zhu Hua yinzuhua@pub.nt.jsinfo.net

Senator SMITH. Andy, have you ever had a warranty claim made to you for one of these counterfeit products?

Mr. YORK. I think probably—that would have come to my attention, so I am not aware that that has happened as yet.

Senator SMITH. How much quantity are you aware of that has come here with your brand on it from China?

Mr. YORK. You know, I just started into this really diligently last week in preparation for this hearing, and I searched on eBay from a couple of these sellers, and it looks like it's in the neighborhood of 500 tactical scopes per year roughly that I can track through that one channel. I don't have a good idea of how many may be coming in through different wholesalers.

Senator SMITH. Outrageous. Professor Alford.

**STATEMENT OF WILLIAM P. ALFORD, HENRY L. STIMSON  
PROFESSOR OF LAW; VICE DEAN FOR THE GRADUATE  
PROGRAM AND INTERNATIONAL LEGAL STUDIES; DIRECTOR  
OF EAST ASIAN LEGAL STUDIES, HARVARD LAW SCHOOL**

Professor ALFORD. Chairman Smith, Ranking Member Dorgan, thank you very much for inviting me to appear today. The infringement in China of American intellectual property is obviously very harmful to both the Americans and to Chinese. I know this firsthand. Parts of my book on intellectual property in China entitled *To Steal A Book is an Elegant Offense*, which comes from the old Chinese saying, have recently been reproduced in China without authorization and without attribution, and sadly enough, by one of China's leading professors of intellectual property law. I brought one copy of the book. You open it up, and there are parts of my book just used without any acknowledgment that they're from my book. You know, the problem is not that China lacks laws against



infringement. As the USTR and most observers have noted, China's laws, the formal laws on the books, are largely consistent with its international obligations, although as Mr. Vargo noted, improvements could be made. The real problem, the principal problem, instead is one of enforcement. You know, it's tempting to see this as only a matter of will, namely that if the Chinese Government, which after all, is not a democratic government, wants to, it can bring this illicit behavior to halt fairly quickly, or if it doesn't want to, that we in the U.S. then have sufficient pressure that we can bring to bear to force it to do so. Will or lack of will on the part of the Chinese Government clearly is very important. I wouldn't be honest if I suggested otherwise. Will, when it's there, accounts for some of the improvements such as, for example, the establishment in major cities courts of special intellectual property chambers and the courts that are among—they have among the most capable Chinese jurists. And lack of will, clearly, is evident than what we've heard already in the discussion today in the Chevy automobile matter, in the fact that there's a city called Yiwu in Zhejiang Province that's a major distribution center known far and wide, specializing in infringing products and the inadequate staffing of the Customs Service and the National Copyright Administration and so forth.

The Chinese Government clearly can and should do much more to ensure protection for intellectual property, and we in the U.S. should maintain the type of vigilance called for in the USTR's Top-to-Bottom Review. But I also believe that we need to understand that there are other dimensions to this problem that are important to take into account, not as an excuse for illegal behavior, but in order to come up with the most effective strategy possible for the U.S. Let me just mention a couple here.

The legacy of Confucianism, which was a dominant ideology in China before the 20th century, and of communism mean that intellectual property still remains a fairly novel idea for many of the people in China, and that there continues to be an insufficient sense that stealing a book is not elegant, but it's illegal. And we need also to appreciate that because of the weakness of institutions in China today, the problems of local favoritism, of inexperience, of corruption that have impeded the enforcement of intellectual property are not unique, but in fact, they're mirrored in virtually every other area of the law, including areas that Beijing cares about very much.

There were, for example, more than 75,000 instances of civil unrest in China last year. One could also look at Internet filtering where the Chinese Government is trying hard to constrain it, but is not entirely effective. As a result of all this, a strategy on our part that's premised entirely on foreign pressure or principally on foreign pressure and that envisions a relatively quick solution will not, I fear, suffice.

In addition to maintaining some pressure, we need to do what we can to promote rights consciousness in general in China and to help build better institutions in a stronger civil society. History, after all, tells us that intellectual property protection flourishes most fully in societies in which citizens have private expression and other such interests to protect, are keenly aware of their

rights, are able to band together to protect those rights and have well-developed institutions through which to vindicate those rights.

China has a long way to go on these accounts, but as civil society and private enterprise are beginning to emerge, we can see the beginnings of a domestic constituency that has its own valuable intellectual property and other interests to protect, a constituency that by advancing such interests, also serves to advance ours in ways that we as foreigners cannot do as directly or as effectively.

We are certainly correct to hold the Chinese Government to its word when it announces as the state council, the principal administrative arm of the Chinese Government, recently did that stronger intellectual property enforcement is crucial to the fostering innovation China needs for its growth. We certainly absolutely should hold them to their word, but I think it also behooves us to work as best we can to promote both the popular consciousness among the Chinese people generally and the domestic institutions in China that are necessary to make better protection of intellectual property rights—indeed, all rights a reality. Thank you very much.

[The prepared statement of Mr. Alford follows:]

PREPARED STATEMENT OF WILLIAM P. ALFORD, HENRY L. STIMSON PROFESSOR OF LAW; VICE DEAN FOR THE GRADUATE PROGRAM AND INTERNATIONAL LEGAL STUDIES; DIRECTOR OF EAST ASIAN LEGAL STUDIES, HARVARD LAW SCHOOL

Mr. Chairman and distinguished members of the Subcommittee:

I want to thank you for inviting me to appear. My name is Bill Alford and I am the Director of East Asian Legal Studies at Harvard Law School.

I have been studying the law of the People's Republic of China since before there was much to study (*i.e.*, in 1970), and I first began to focus on intellectual property issues there in the 1980s—initially as a practicing lawyer at a law firm in Washington representing American companies doing business in China, and subsequently as a scholar who has both taught in China (I was a co-founder in the early 1980s of the first academic program in American law in the PRC) and conducted research there. Indeed, my interest in writing about intellectual property law issues in China as a professor grew out of the challenges I had to deal with as a practitioner. What I would like to do today is to share with you some of what I have learned about the setting that gives rise to the problem of intellectual property infringement in China (the subject that brings us here), and to offer a few comments about its implications.

To do so is not to offer an apology for it. The scale of the problem, as we all know, remains massive, and harmful to Chinese and Americans alike. Beyond economic harm, fake medicines and counterfeit auto and airplane parts, by way of illustration, have the potential to cause grave, if not fatal, injury. Indeed, at a much less important level, I am a victim myself. Significant parts of my book on the subject—entitled *To Steal a Book is an Elegant Offense: Intellectual Property Law in Chinese Civilization*<sup>1</sup>—have recently been reproduced commercially without authorization, attribution or compensation—by no less than a professor of intellectual property at one of Beijing's leading universities!

Rather, I want to discuss the broader context because I believe that understanding it is crucial if we are to appreciate the nature of the problem and what part our government might play in addressing it.

China today has a fairly complete set of intellectual property laws—most observers agree that in terms of law on the books, China for the most part has met its obligations under the TRIPS agreement of the World Trade Organization. As the United States Trade Representative noted less than year ago in announcing the results of its “out-of-cycle review” of China vis-à-vis intellectual property matters, “China's central government has made largely satisfactory progress in bringing China's IPR laws and regulations into line with China's WTO obligations.”<sup>2</sup> To be sure,

<sup>1</sup>Stanford University Press (1995).

<sup>2</sup>United States Trade Representative, “Out-of-cycle Review Results,” posted on the USTR website, April 29, 2005 (last visited March 6, 2006). It should be noted that at the end of this review, the USTR elevated China to its Special 301 “Priority Watch” list because these laws

there are calls for a number of further refinements, including stiffer penalties and greater ease of action against wholesalers and re-sellers of infringing items,<sup>3</sup> and the Chinese Government has announced that it is contemplating some noteworthy provisions—including possibly simplifying the patent application and examination process, increasing penalties for infringement, and establishing specialized intellectual property courts.<sup>4</sup> But still, by and large, China's laws are, on their face, not the principal problem.

What China lacks is uniform, effective enforcement of those laws, resulting in the large intellectual property infringement both in China and in the export market that brings us here today.

It is tempting, of course, to view this as a matter of will—or lack of will—which has implications for how we would want the U.S. Government to approach the matter. People who hold this view basically believe that if the Chinese authorities were willing to crack down and enforce their laws with sufficient vigor, the problem would largely go away. The logical concomitant of that is that our government ought to be marshalling its energies to bring as much pressure as possible to bear on the Chinese authorities to do just that. And indeed, the U.S. Government has been endeavoring to do just that over the past decade and a half, threatening, during the first Bush Presidency and the Clinton years, to impose what, at the time, would have been the most substantial trade sanctions in U.S. history.

Will is certainly not irrelevant. On the positive side, the importance of will clearly is evident in the fact that China has established specialized intellectual property chambers at the intermediate court level in many major urban centers and has chosen to staff these chambers with some of the Nation's best trained and most capable judges, including many with advanced degrees. And it is better than not that the State Council—the primary administrative entity in the Chinese Government—has recently unveiled a comprehensive 15-year blueprint for scientific and technological development that makes the argument that China needs better legal protection to foster the innovation necessary for continued economic growth.<sup>5</sup> On the negative side, will—or the lack thereof—clearly helps explain such things as the government's toleration of things like the Chery automobile, the city of Yiwu (in Zhejiang) whose economy was heavily dependent on its being a distribution center for infringing goods, and the fact that the National Copyright Administration continues to be inadequately staffed (having some 200 persons for enforcement issues nationwide).

And yet we would be mistaken if we think that we are here dealing only with a matter of will and that if we bring enough pressure to bear, we can effect the type of change we would like to see. As mentioned, the U.S. has tried that in Republican and Democratic administrations alike to limited avail. There are, I would suggest, very fundamental challenges that are a product of China's history, her present institutional structure, and her course of future development that we need to heed if we wish to enhance the prospects for intellectual property protection in China—and particularly if we hope to contribute to building a China in which more is done through the private sector and through civil society than through the state.

History ought not to be an excuse for inadequate adherence to international obligations nor is it all-determinative—Hong Kong and Taiwan are Chinese, after all, and they each seem to have addressed their infringement problems more effectively—but nor can history be ignored if our goal is a realistic strategy. As I discuss in the beginning of my (pirated) book in detail, there was essentially nothing comparable to our idea of intellectual property protection prior to its introduction by the West in the early 20th century. Confucianism, the pre-eminent ideology in pre-20th century China, venerated the past and extolled its emulation as a way for individuals both to understand its lessons and demonstrate their respect for it. In the words of the Confucian *Analects*, the seminal text of Confucianism, "The Master [Confucius himself] said 'I transmit rather than create; I believe in and love the An-

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were not adequately enforced. The view that China now has a reasonably complete body of intellectual property law at the national level is shared by others. Scott M. Flicker and Matthew S. Dunne, in "China has Stepped up IP Enforcement Recently," *The National Law Journal*, May 9, 2004, indicate that "China is a party to every major intellectual property convention and treaty, and its laws and regulations are mostly up to the rigorous standards imposed by . . ." the WTO's TRIPS agreement. Also, Alex Scott with Andrew Wood, for instance, in "Intellectual Asset Management," *Chemical Week*, January 18, 2006, describe "China's IP regulations . . . as now among the toughest in the world," citing Ian Harvey, "chairman of the Intellectual Property Institute (London) and former CEO of pharmaceutical technology transfer company British Technology Group (London)."

<sup>3</sup>Joseph Simone, "SPC and SPP Issue New Criminal Liability Standards for IP Crimes," *China Law & Practice*, February 2005.

<sup>4</sup>*Xinhua*, "China to Revise Patent Law," November 24, 2005.

<sup>5</sup>*Xinhua*, "China to Accelerate Implementation of National IPR Strategy," February 9, 2006.

cients.’”<sup>6</sup> More practically, the emperors who ruled China prior to the 20th century were, indeed, concerned about unauthorized publication but for the purpose of controlling rather than promoting private expression.<sup>7</sup>

Western ideas of intellectual property rights were introduced early in the 20th century but, unfortunately, much of what was introduced then was done via threats, and intended chiefly to protect foreign property—which has meant that it was and, to some degree, continues to be, readily associated in many Chinese minds with foreign impositions rather than understood as useful for China’s own development.<sup>8</sup> Furthermore, the chaos that characterized much of the first half of the 20th century and the impact of Marxism that marked much of the next three decades, meant that it was not until the 1980s—scarcely more than a generation ago—that one began to see the introduction of modern ideas of intellectual property in China, and even now, for many citizens, these remain novel ideas.

Compounding the task of grounding intellectual property in China is the nature of that nation’s institutions today more generally. We tend to think that because China is not a democracy, its leaders have the ability fully to assert their will as they wish. It would, however, be more accurate to say that even in areas about which they care deeply—such as endeavoring to control the flow of information—their efforts fall well short of what they would like to accomplish. Beijing can and does assert itself with regard to the Internet or the Falungong, often with considerable impact, but still, coercion ultimately is no substitute for effective institutions that run on their own and enjoy popular support. It is hard to think of an area of Chinese law today that routinely operates as intended. The problems of local favoritism, insufficient expertise, and corruption that aggravate enforcement of intellectual property rights also crop up across the board in Chinese legal affairs.

Appreciating the relevance of history and of institutions underscores why pressure alone, especially if principally from outside, is not enough. External pressure has a role (and it would be naïve or disingenuous to suggest otherwise) but I doubt that we (even working with our allies) possess sufficient pressure to get the Chinese authorities to embrace policies that they otherwise would not be inclined to follow and which, in any event, they still lack the institutional infrastructure fully to carry out. Moreover, even if we did possess such pressure, I believe that we are better advised to be at least as concerned with enlisting the support of, and enhancing the capabilities of, non-state actors as we are with encouraging officialdom to exert more control, particularly when it comes to publication and other media of expression.

If we want to create a better climate for intellectual property protection in China, we need, in addition to the type of external vigilance called for in the well-crafted “Top to Bottom Review” of the USTR,<sup>9</sup> to do what we can to promote better and broader public understanding there of rights generally, and to help build better institutions—even as we appreciate that these entail long-term processes and that their ultimate shape will (and should) rest primarily with the Chinese people. With respect to rights, this means not only working to educate people about intellectual property rights but about rights more generally, for, as I argue in my book, it seems unrealistic to expect that people will heed complex abstract rights of foreigners if they are not accustomed to asserting their own fundamental rights.

This also means that there ought to be more support—from our government and from private sources alike—for programs that foster the development of legal institutions and the growth of civil society, such as, but not limited to, the State Department’s rule-of-law initiatives, as well as efforts more specifically tailored to intellectual property. Contrary to the conventional wisdom, a greater attention on the part of the business community to issues of human rights is likely to advance, rather than impede, the realization in China of important economic objectives such as greater protection for intellectual property rights.

The reason for this is that there is a far closer correlation between a strong civil society and strong intellectual property protection than there is between a strong state and strong intellectual property protection. Put differently, intellectual property protection flourishes in states that nurture free expression and free association. This ought not to be surprising when you think that in such states, citizens have more private expression and other private interests to protect, have a greater rights consciousness, are better able to band together to protect their interests, and have more in the way of rights-protecting institutions on which to call.

<sup>6</sup> Arthur Waley, trans., *The Analects of Confucius*, Book 7, Chapter 1 (1938).

<sup>7</sup> Alford, *To Steal a Book is an Elegant Offense: Intellectual Property Law in Chinese Civilization* (1995).

<sup>8</sup> Id.

<sup>9</sup> United States Trade Representative, “U.S.-China Trade Relations: Entering a New Phase of Greater Accountability and Enforcement: Top-to-Bottom Review,” February 2006.

We are seeing early evidence of this in China. As civil society and private business have started to emerge, we are seeing the beginnings of a domestic constituency with valuable intellectual property and other interests of their own to protect. As *Chemical Week* magazine observes, “China’s efforts to increase IP Protection is linked to the fact that the country has increasingly more IP of its own to protect.”<sup>10</sup> Indeed, in 2004, some 95 percent of infringement litigation was initiated by PRC plaintiffs. This phenomenon has the potential to diminish the idea that intellectual property is something foreign at the same time that it is creating allies in the effort to improve enforcement, as the Quality Brands Protection Committee (comprised of foreign-invested firms) has been discovering as it works informally with Chinese companies to seek better protection.

But lest we make too much of this, we need be mindful of two caveats. The first is that even as we see the role of non-state actors growing, we ought not to underestimate the ongoing role of the Chinese state. One hopes that the State Council’s call for more attention to the legal protection of Chinese innovation can be turned to the protection of intellectual property rights in general, but we should also remember that Chinese authorities have also of late been expressing concern that intellectual property rights may account for what some see as an excess flow of royalties out of China.

And second, we do need to appreciate that the very same economic changes that are nurturing potential allies, by definition also have the potential to make them strong future competitors. The *Chemical Week* story quoted above also states that “Chinese patented technologies will soon begin to enter the global market, with electronic goods coming in the next 5 years and pharmaceuticals in up to 15 years, he [Ian Harvey of the Intellectual Property Institute (London)] says. ‘China is on the verge of becoming a major technology and IP generator, creating a tidal wave of patents likely to wash over the U.S. and Europe’s shores in the next decade, enabling China to dominate significant technology areas,’ he adds.” Indeed, we are already beginning to see Chinese companies thinking about how to use intellectual property law, anti-trust law, their economic power, and, of course, the assistance of the state, to protect and advance their own interests against leading foreign companies as well as domestic competitors at home and even abroad.<sup>11</sup>

In any event, I do hope that these modest observations are of some use to you, and I stand ready to try to answer any questions you may have about them.

Senator SMITH. Professor, I’m going to ask this for my own edification. I understand why the legacy of communism would leave the notion of ownership as a fairly weak concept in the civics of China, but you also represented that the teachings of Confucius were similar? Well, I’m just curious.

Professor ALFORD. Sure.

Senator SMITH. What did Confucius say that said that this stuff doesn’t matter?

Professor ALFORD. Right, so I offer this not as an excuse. After all, we can look at Hong Kong or Taiwan and see that Confucian-oriented societies can reach much more effective levels of intellectual property protection than the PRC mainland itself, but Confucian ideology celebrated the past, that people were to find the content of the moral norms, the way they were supposed to behave, by looking to the past, by imitating, by emulating the past, by copying the past, not a slavish copy, but borrowing from the past and putting their imprint on it. And so, the idea that there would be strong private property interests in the expression of ideas wasn’t something celebrated in Confucianism. Also, to the extent that the Chinese state before the 20th century regulated publica-

<sup>10</sup>Alex Scott with Andrew Wood, “Intellectual Asset Management,” *Chemical Week*, January 18, 2006.

<sup>11</sup>An example would be the recent suit by Netac, a Shenzhen producer of flash memory external storage drives, in Texas against a U.S. company alleging infringement of a U.S. patent. AFX News Limited, “China’s Netac Files IPR Lawsuit Against U.S.-based PNY Technologies—Report,” *Forbes*, February 16, 2006.

tion, it was not, again, to protect private property interests in it, but to suppress a heterodox, to suppress dissident publication.

Senator SMITH. But to your—

Professor ALFORD. It's not an excuse—

Senator SMITH. Yes.

Professor ALFORD.—Senator Smith.

Senator SMITH. Well, and to your point, Hong Kong and Taiwan certainly are evidence that whatever the Confucian legacy, it certainly is not ultimately an impediment to the rule of law as it relates to private property.

Professor ALFORD. Agreed, agreed.

Senator SMITH. I'm actually encouraged from what you said about the point that as an economy develops there and people are allowed to own property, that perhaps attitudes are changing, but you may actually have hit on the root of this problem in terms of local conduct toward the property of others, that there's a real cultural education that has to go on before people will just automatically respect the notion of property of others.

Professor ALFORD. Again, I offer that not as an excuse or justification for behavior that is inconsistent with obligations that the Chinese Government has undertaken voluntarily, but I do think it is part of what explains why it is so frustratingly slow.

Senator SMITH. But you're seeing change?

Professor ALFORD. Well, I don't want to overstate it, but we see some change—some change. I mean—

Senator SMITH. I actually think that that's fairly threshold, that there would be that change if there's going to be effective enforcement beyond just the Chinese Government getting more engaged in as big a country with as large a population as they have.

Professor ALFORD. I think that's right. I think it's ultimately not realistic too soon that the Chinese Government can do it all by itself, and I'm not sure that I personally would want that to be the case. I'm not sure I'd want to encourage the Chinese Government to, as a general matter, make its presence even more felt in the lives of ordinary people everyday. In other words, yes, they do need to enforce their laws far more seriously than they have in this—in other areas, but I think a better long-term strategy is in addition to try to help cultivate civil society, better rights consciousness so that Chinese citizens, Chinese actors, Chinese companies will also be pushing for similar goals.

Senator SMITH. Well, thank you to Mr. Vargo and Andy. A question, Senator Dorgan and I can come up with a bill that calculates the amount of theft and that determines the duty. Would you support—would your organizations support that? And Andy, would you want to see that money given to the companies that have been the victims or go into the Federal Treasury?

Mr. YORK. I think it'd be something we'd want to look into. I'm fairly confident we'd support that kind of legislation. I think that would be a good move. As far as where the dollars go, if it was shut down, and the piracy and the counterfeiting was shut down, I don't really see how it's costing our company, at that point, any additional dollars. I think that there are probably some better uses for that money in our economy right now that this money could be used—

Senator SMITH. You just want it to stop?

Mr. YORK. I'd like it to stop—

Senator SMITH. OK.

Mr. YORK.—and I did want to make one comment about, the receptivity to the government in China to change, and this is hearsay. This is from another seller on eBay, but they do say that this brand new Leupold Mark 4 M3 clone version illuminated mil-dot optical scope was made for the China military army. And so, I don't know. That would be something we'd want to look into and find out just really how receptive their government really is to knock-off products if, indeed, they're purchasing knock-off products for their own use.

Senator SMITH. Do you think they are purchasing that?

Mr. YORK. Well, I—this buyer claims that. They could just be making a marketing claim here, but I think it'd be something we'd want to investigate and look into.

Senator SMITH. Sounds to me like that would be a dumb thing if they're as unreliable as you just described.

Mr. YORK. Yes, I think it would be.

Senator SMITH. Mr. Vargo?

Mr. VARGO. We want to solve the problem. I have a hard time seeing how that particular approach would be helpful because it's so difficult, first of all, to identify where the counterfeit products are or value them, and if we could find that, whether there are other things that we could do that would be a lot easier. I would like to see us spend a lot more effort and put a higher priority on the part of our customs service and other customs services and just stop the trade, and I do think there's more that can be done there. I don't think that either we or China have put enough emphasis on the role of China customs here. A lot of our effort has gone into working with them on their laws. And as Professor Alford notes, there has been a payoff from that. And there is a gradual change there, and we can see a growing number of prosecutions, but it's still very slow. In our view, the most effective way to handle this problem would be to intercept the goods at the border, and that is where we are putting more emphasis with the U.S. Government now.

Senator SMITH. Well, I think we would share your belief that the best thing to do is to stop what's happening, but it seems to me from what I've heard today, we don't have a lot of tools other than long WTO processes and warm, fuzzy words about there's a problem. In the meantime, there's wholesale larceny taking place. And interdicting it at the border is fine if it's our border, but if it's going to other places in the world, as you have pointed out—

Mr. VARGO. Right.

Senator SMITH.—these products, we have no ability to stop that.

Mr. VARGO. Mr. Chairman, we haven't put enough emphasis there. I was just looking at some things on the Internet as I was preparing to come before you today and noticed that in Saudi Arabia, for example, the Saudi Chamber of Commerce has just set up an anti-counterfeiting task force because they're very concerned by what they see as 30 percent of the auto parts in Saudi Arabia being counterfeit and substandard and also noting that this affects

the legitimate customs collections and revenues of the Saudi Government, and so it is for other governments as well.

Frankly, from our point of view, there hasn't been enough emphasis on working with the customs forces of countries around the world, and we think that that would be one of the most effective things that could be done—certainly not the only one, but we want to see a lot more done there.

Senator SMITH. Good point. Senator Dorgan.

Senator DORGAN. Mr. Chairman, thank you. I was thinking a bit about Ronald Reagan's old story about the child that sees a pile of manure and then thinks there must be a pony somewhere. We talk about—I'm not suggesting any testimony was a part of that description.

[Laughter.]

Senator DORGAN. We talk about improvement of laws and the growing number of prosecutions, but Mr. Vargo, you just talked about the growing number of prosecutions. In fact, we do trade agreements, that I have voted against, with other countries that have perfectly fine laws. They just don't enforce them at all. So, having better laws or even having laws that relate to this is completely irrelevant unless they are enforced. Second, the issue of growing prosecutions on piracy and counterfeiting in China is a myth because, as I showed you on the chart, prosecutions are diminishing, not growing. And from the 2004 admonition by this country to China to the April 29, 2005, statement by USTR, things got worse, not better.

So, I mean, I understand that everybody, when we talk about this, wants to try to say a little something positive because there's so much negative, but boy, there's precious positive, and it should not include there are more prosecutions because I think the evidence suggests just the opposite. Mr. Vargo?

Mr. VARGO. Well, Senator, from what we hear from our companies, I would have to disagree. Now, it's still very small, and it is still a benefit to the companies that can really afford to do their investigations, but in that respect, it does seem to be getting a little better. But this, you and I are on the same page with the vast bulk of it.

And I don't think their laws are adequate. I think that counterfeiting is a criminal act, and the states and the provinces should be prosecuting it, and clearly, they are not.

Senator DORGAN. One of my thoughts about this for some time, and I may be right or wrong, I don't have the foggiest idea, is that the National Association of Manufacturers and the U.S. Chamber of Commerce, just to name two, two of the more prominent, very significant, prominent organizations have never really pushed to say we want action. They do talk, both of them talk about these things, but really stop short of getting to the starting gate here of wanting to push.

And one of the reasons I've thought about that is, that perhaps your membership includes a fair number of firms that do business here and also have moved plants to China and other countries and really don't want our country to take action. Am I—disabuse me of that if I'm wrong.



Mr. VARGO. I will disabuse you because certainly, we have large companies, small companies, we have importers, we have exporters, we have companies that produce in China, companies that produce around the world. On average for our large members, two thirds of their production is here in the United States, and one third is around the world.

But the companies large and small are affected by counterfeiting, and we have not pulled back at all. Again, if there was some magic wand that we think could be waved, we would demand it. Now, we are looking at a possibility of a WTO case, but we're also—the NAM is a very pragmatic organization. We want to focus on what would really make a difference, and that brings me back to the one thing on customs where you could really make a difference.

And again, the laws in China, we are seeing more prosecution. I just noticed it for the first time that a retailer was prosecuted under the criminal statutes in China for selling counterfeit golf equipment.

But this is still very small, you know. And if we let it go at the rate that it is going, it's much—we don't have that kind of patience. And as you see, the trade deficit is getting worse and worse, and one figure you may not be aware of is that the U.S. deficit in manufactured goods worldwide grew about \$55 billion last year with the whole world. \$40 billion of that growth came out of China. Only \$15 billion came with the rest of the world. So, it's a very serious problem. Counterfeiting is part of it. Believe me, currency is a very big part of it, and there are other reasons as well.

Senator DORGAN. Right. I'm not so sure that—you said we don't have the patience. I'm not so sure our patience isn't biblical. I'm not so sure we don't have the patience of Job. Let me show you. I only went back to 1996, but I was actually on the House Ways and Means Committee when Sam Gibbons and others were saying you know, we have a \$5 billion trade deficit with China, and we're going to fix that. I said no, it's going to get much, much worse. No, no, we're going to fix it, they said. It's going to get fixed with this issue. But if I went back further, I'd show you the origin of this. But the fact is all the way along here we keep thinking—now this is the imbalance in trade, but you can trace, it seems to me, counterfeiting and piracy just with these lines as well. I'm not so sure we don't have patience that really is straining the American public. The reason you can't hold a meeting about trade any place in the world anymore without having 10,000 or 20,000 people show up in the streets is because I think people understand what's going on, and they're furious about it, and it relates to their jobs. And all of the institutions are worried about taking or suggesting any definitive action because it will upset the—my colleague, Senator DeMint, said it perfectly. He describes it as protectionists and free-traders, which is a perfectly worthless description.

That is not the choices, protectionists and free-traders. It is those of us who want to be engaged in trade, that we believe it is fair between our countries and those who will not accept unilateral free trade agreements that are not mutually beneficial. The basics of a trade agreement must be mutually beneficial, especially bilateral and multilateral agreements. So—I really regret, Mr. Chairman, I

have a 4 o'clock event that I have to be at, but I wish I had time to talk to Professor Alford and to thank Mr. York.

Mr. York, you've come a long way, but you have demonstrated the issue of counterfeiting in a very dramatic way, a product that you create and you sell, and the knock-off is an extraordinarily cheap imitation. And so, how do you compete? How do you compete with the \$100 knock off if the real thing with real quality costs \$1,400? The answer is you can't compete.

And Professor Alford, you haven't come quite as far, but good plane service, I guess, between here and Boston. I appreciate your work, and I think you've demonstrated with your book as well what happens. You wrote the words, and someone in China decides to copy them and sell them as theirs. I mean, that's piracy and counterfeiting. And so, I thank all of you on the panel, and I especially want to thank Senator Smith. I said when we started we may not come at this from the same point in the compass, but I think in many ways, it doesn't matter whether you're a so-called free trader or a fair trader. At some point, you conclude that what is happening is now unsustainable and that our country has to stand up for its economic interests. If you set up conditions in which we must compete, and we can't, then shame on us. But if you set up conditions in which the competition is fundamentally unfair to those who risk their capital and the workers who go to their jobs everyday, and they can't compete because it's unfair, then shame on us for not taking action.

So, that's the point. So, Mr. Chairman, thank you very much for agreeing to hold this hearing. I think it has been very constructive.

Senator SMITH. Thank you very much, Senator Dorgan, and I've got a 4 o'clock as well, but I have one more question. Andy York, you said in your testimony that you do business in lots of different countries.

Mr. YORK. Yes, sir.

Senator SMITH. And Europe, was that one of them?

Mr. YORK. Europe, I could read you a list. It's very extensive.

Senator SMITH. OK, but it's all over the world?

Mr. YORK. It's all over the world, yes.

Senator SMITH. Do you have these problems anywhere else?

Mr. YORK. As I said, we are getting feedback from our distributor in Moscow that he's being impacted with counterfeit goods—

Senator SMITH. OK.

Mr. YORK.—coming from China as well, and I know that there are—these same sellers, that are working out of Hong Kong, are listed with sites in Australia and in the European Union as well.

Senator SMITH. So, before anybody else seeds the WTO on our vote, you'd want us to deal with that, wouldn't you?

Mr. YORK. It would be very helpful, yes. It's not just an issue in the United States, it is a global issue.

Senator SMITH. Can you name any other country or region where you're having a problem?

Mr. YORK. Those are the only ones that I have concrete evidence of at this point.

Senator SMITH. China and Russia.

Mr. YORK. China and Russia, and I know that we're getting—that they're selling products into Australia and the European

Union. I assume that it's much larger than that. I think if you're a counterfeiter, I don't know why you'd try to restrict your markets.

Senator SMITH. I don't know either, but we have to stop them. Gentlemen, all of you, you have added measurably to the Senate record today, and our understanding of what you're up against, and we pledge out best efforts to do something about it and apply pressure where we need to because it's wrong and ought to be stopped. And this is wrong, and we'll do our level best to stop it and get more action than we've had to date.

With that, we're adjourned.

[Whereupon at 4 p.m., the hearing was adjourned.]



## A P P E N D I X

PREPARED STATEMENT OF HON. DANIEL K. INOUE, U.S. SENATOR FROM HAWAII

It amazes me that the movie industry, one of our only industries that can claim a positive trade balance, lost \$280 million to piracy and counterfeiting in China last year, and it is losing an additional \$100 million more each year. That is astounding. No one can disagree that piracy is rampant, it is a problem with real consequences, it shows little sign of abating, and it requires much stronger enforcement efforts.

However, there is an odd and troubling irony to this problem. Piracy has become such a large part of the Chinese economy that eliminating it could lead to economic problems elsewhere in the world, including here in America. Piracy accounts for 8 percent of China's GDP. If that were abruptly erased, the impact could be widespread.

To date, China has not lived up to the agreements it made to join the World Trade Organization (WTO). We realize that China will not be compliant overnight. However, the Chinese Government should have made far greater progress by now.

I would like to hear more from our witnesses today about the realities we are facing. What must be done to stop the counterfeiting and speed up the compliance?

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUE TO  
CHRIS ISRAEL

*Question 1.* In 2004, the USTR, the DOC, the Department of Justice, and the Department of Homeland Security (DHS) released an initiative called Strategy Targeting Organized Piracy (STOP!). The initiative benefits innovators and manufacturers that have been negatively affected by piracy and counterfeited goods by exposing criminal networks, stopping trade of pirated goods at U.S. borders, and helping small businesses secure and enforce their rights in overseas markets. The MPAA estimates that its members lost \$280 million to Chinese piracy, up from \$180 million in 2003. Increases of \$100 million per year in piracy losses will swallow our movie industry whole if left unaddressed. The problem is only getting worse. What is the STOP! Initiative going to do to get this problem under control?

Answer. Stopping copyright piracy, including motion picture piracy, is an important goal of the STOP! Initiative. The problem of global piracy and counterfeiting confronts many industries, exists in many countries and demands continuous attention. As part of STOP!, the Bush Administration is taking steps to increase our efforts to seize counterfeit goods at our borders and aggressively engage our trading partners to join our efforts.

With China we recognize that though they have expanded their efforts there are still critical deficiencies in IPR protection and enforcement. The Administration has an IP Attaché on the ground in Beijing, who will soon be joined by additional IP experts, to work with U.S. rights holders and the Chinese Government to stop illegal optical disc production and piracy. A key element of the Bush Administration's IP strategy with China is bilateral engagement, which is conducted primarily through the U.S.-China Joint Commission on Commerce and Trade (JCCT). As part of our JCCT discussions with the Chinese, we continue to raise the issue of optical disc piracy and make it clear that China needs to take steps to eliminate all illegal optical disc production. Also, China has agreed to regularly instruct enforcement authorities throughout the country that copies of select films which are still in censorship, and not yet ready for distribution are deemed pirated and subject to enhanced enforcement. And the Chinese Government recently signed a memorandum of understanding with the Motion Picture Association (MPA) to protect the 15 theatrical films released in China. However, we understand that much work remains on both of these initiatives and we plan on pushing these issues, among others, at the upcoming JCCT on April 11th and as part of our ongoing initiatives in STOP. We plan on continuing to work with the motion picture industry, and are leveraging our resources to actively address the issue of copyright piracy.

*Question 2.* Please describe the specific services that the STOP! Initiative provides to small businesses that have piracy issues in China.

Answer. To help American innovators secure and enforce their rights across the globe, the STOP! Initiative has put in place several new Federal services and assistance: Including, the STOP hotline (1-866-999-HALT), website (StopFakes.gov) and a China-specific IP toolkit. In November 2005, Commerce Secretary Gutierrez announced, the China IPR Advisory program. This program is done in conjunction with the American Bar Association, the National Association of Manufacturers and the American Chamber of Commerce in China. It offers small and medium sized U.S. businesses free IPR consultation with an attorney. Each of these programs under STOP! helps provide businesses with the resources and assistance they need to level the playing field and deal with potential piracy issues in China.

*Question 2a.* How many American businesses use the services provided?

Answer. The Bush Administration's extensive outreach efforts have allowed us to reach countless American businesses and help to empower American businesses with the tools they need to secure and enforce their rights at home and abroad. In the first 3 months of 2006 the StopFakes.gov website received over 20,000 visits. In FY 2005, the STOP Hotline received over 950 calls and, so far, during the first quarter of FY 2006 we received over 550 calls. During our four 2005 IP Road Show events, in Salt Lake City, Phoenix, Austin and Miami we had a total of 740 SME representatives in attendance.

*Question 2b.* Have small businesses made more suggestions for assistance they would need in China, and if so what were they?

Answer. We are working actively with the business community for assistance as we go forward. They are our eyes and ears on the ground and know better than anyone how inadequate IPR enforcement affects their businesses. My office conducts active outreach with industry, and we want to hear their stories and find ways to use the data that they have collected in China. We will continue to work together to find solutions and lead enforcement efforts.

In China we currently have an IP attaché in Beijing and plan on adding an additional attaché in the near future. The Administration's attachés enhance our ability to work with local Chinese Government officials to improve IP laws and enforcement procedures in addition to assisting U.S. businesses to better understand the challenges of protecting and enforcing their IPR in China.

Another important tool that we use is the IPR Case Referral Mechanism (CRM) which was created by the U.S. Government to facilitate the submission of individual U.S. company IPR cases through MOFCOM (China's Ministry of Commerce) to relevant Chinese agencies. Our inter-agency team reviews cases where the Chinese Government fails to provide adequate protection of IPR to U.S. businesses, and after an internal vetting process, sends approved cases to the Chinese Government to facilitate their resolution. Five cases have already been submitted to the Chinese through the Case Referral Mechanism.

Also, Ambassador Clark Randt at our Embassy in Beijing holds an annual IPR Roundtable which brings together senior Chinese officials and U.S. business representatives. The Roundtable gives U.S. rights holders the opportunity to discuss the problems they are facing and find the solutions that they need. Our Embassy and Consulate officers on the ground are another valuable asset for U.S. companies. They play a critical role as IPR "first responders," helping U.S. businesses resolve cases when their rights are violated.

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RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. DANIEL K. INOUE TO  
FRANKLIN J. VARGO

*Background:* The National Association of Manufacturers (NAM) has made a submission to the U.S. Trade Representative (USTR) on Chinese violations regarding the protection of Intellectual Property (IP) and the growing counterfeiting problem. The NAM had pushed for the USTR to engage in more formal actions through the World Trade Organization (WTO) to force the Chinese to increase enforcement of the laws it has on its books.

*Question.* The Chinese have had difficulties in integrating its citizens into a market-based economy. Counterfeiting has become a source of employment for the poor. It has been estimated that counterfeit goods constitute about 15-20 percent of all products made in China and account for approximately 8 percent of China's gross domestic product (GDP). If the Chinese enforced IP protections as it should, it could potentially create economic chaos. How do the Chinese solve this problem quickly without creating economic dislocation?

Answer. China is undoubtedly the largest source of counterfeit and pirated products in the world today. Anecdotal information suggests that fake products are displacing billion of dollars in legitimate sales in China and a substantial amount of sales in third-country markets, particularly in developing countries. Fake products cover a wide range of sectors from pharmaceuticals and consumer health care products to auto parts and testing equipment. Copyright experts estimate that over 90 percent of the software sold in China is counterfeit.

We often hear that the reason Chinese authorities, particularly at the local level, do not crack down more forcefully on counterfeiters is because China needs to generate as much manufacturing employment as possible to absorb excess labor flooding into the cities from rural areas. Counterfeit production, it is claimed, offers the opportunity to employ some of this excess labor. These views, however, ignore the many negative consequences of unchecked counterfeiting for the Chinese economy.

- Failure to curtail counterfeiting and protect foreign brand names is hurting China's own efforts to move up the value chain and develop its own brands that can be sold at quality-brand prices, for example, as Lenovo, the owner of IBM personal computer maker technology, is seeking to do.
- Counterfeit products made in China, often of inferior quality and below required technical standards, damage the overall reputation of Chinese manufactured products and gives them lower status in the market place.
- Unchecked counterfeiting discourages foreign investment. We hear frequently from manufacturers that they limit their investment in China out of fear that advanced manufacturing technology will be stolen or used in counterfeit production. Foreign investment in China has reached record levels but could be even higher if brand names and other intellectual property were more effectively protected.
- Proponents of counterfeiting also overlook the costs to Chinese consumers of counterfeit products. Fake pharmaceutical products pose enormous health risks for Chinese consumers and, according to Chinese press reports, result in thousands of deaths every year. Consumers face other hazards from: fake brand-name batteries that explode due to improper manufacture; counterfeit car parts (*e.g.*, brake pads and timing belts) that do not function because they don't meet accepted international technical standards; testing equipment (*e.g.*, for refrigeration equipment) that provide faulty results; razor blades that don't shave; and personal care products that contain harmful chemical ingredients.

Over the past 20 years, the Chinese economy has undergone a dramatic transformation from a centrally directed, state-controlled system to a more market-oriented model that encourages large-scale shifts in employment between sectors. In the process, millions of workers employed at state industrial enterprises were displaced. While closing plants engaged in counterfeit production could well cause some localized and short-term dislocations, China would also benefit from the positive economic effects of protecting intellectual property and brand names. Chinese workers have demonstrated a remarkable resiliency and adaptability to economic change and opportunity. It is by no means clear that the disruption from enforcing intellectual property rights would be more severe than other economic changes that have occurred in recent years.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUE TO  
WILLIAM P. ALFORD

*Background:* Professor Alford contends that two of the hurdles to Chinese adoption of western style intellectual property (IP) protections are the differing historical paradigms of how IP protections were used and cultural differences. The Chinese were forced to accept Western legal concepts after the Opium Wars in the 1840s and had to accept western IP concepts as a condition to join the World Trade Organization (WTO), even before the Chinese themselves internally changed its approach to protecting IP. Copyright statutes only recently appeared in the Chinese legal system, with the National People's Congress adopting legislation in 1990. Present day efforts to apply economic pressure on the Chinese, through threats of tariff sanctions, may force them to pass Western-type patent, trademark, and copyright legislation, but it will not ensure compliance and enforcement of such laws so long as they are perceived as outside impositions. Professor Alford sees this as one of the main reasons for Chinese reluctance to adequately enforce the protections on the books.

*Question 1.* I understand that the Chinese think it improper to give an individual “ownership” over a concept that was likely built through contributions from the community. Furthermore, the country’s recent history with Communism and ownership of real property, much less conceptual property, is foreign.

China’s entrance to the WTO was predicated on protection of intellectual property rights in accordance with the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). While China did overhaul its legal regime so as to be facially compliant with TRIPS, it did not improve enforcement. Can the Chinese overcome the views of its own people to comply with the WTO TRIPS mandates?

Answer. Thank you, Senator Inouye, for this probing question. You are, of course, correct that China did commit itself to the level of intellectual property protection called for in the TRIPS agreement when it joined the WTO. And you are also correct that China did, indeed, revise its laws so as to be compliant with those obligations.

Enforcement does, indeed, continue to be a very serious problem, as the testimony of each panelist today indicates. I think that it is important to understand the impact of history and culture—but by that I am not suggesting it is an excuse. After all, China’s government has taken on certain obligations and should be expected to live up to them.

Intellectual property law was not, as I try to show in my book, an indigenous idea in China. Ideas, though, about the nature of property in general have begun to change in important ways during the past quarter century in China. If we want further to promote respect for intellectual property, I think we need a multi-faceted approach. External pressure alone will not work and I, for one, am not sure that I want the U.S. using whatever influence we have to strengthen the hand of the Chinese Government vis-à-vis its citizens. I think it is important that we do what we can to strengthen civil society there so that Chinese citizens will have more reason to and more vehicles through which to seek to protect rights, including intellectual property rights. If we want our IP protected, we need a domestic constituency there for rights protection generally. It can’t really be done for us (that is, foreigners) alone or for IP alone.

*Question 2.* How did other Asian countries with a history of poor Intellectual Property (IP) protection, like Japan and Taiwan, manage to overcome their historical barriers to come to protect IP vigorously?

Answer. The experience of Japan and Taiwan bear out my argument about how respect for intellectual property grows. Foreign pressure alone was not enough (though it surely had a role). Serious change has come about as civil society and democratic political institutions—and a domestic private constituency for intellectual property law—have grown. Taiwan is an especially good example of this. Prior to its democratization in the late 1980s, Taiwan was notorious for its failure to adhere to its international intellectual property obligations. Since that time, the picture is much improved (though some challenges remain there and in Japan, as is also the case here in the U.S.). Again, there is a certain common sense to this—that as citizens have more to protect by way of rights generally, and more vehicles through which to protect it, the quality of protection will be greater than in a situation of greater state limits on rights and on citizens’ capacity to organize themselves and to vindicate their rights.