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**The Developing U.S.-China Relationship: Analysis of
China's Weak Intellectual Property Rights Protection
and Enforcement**

Thank you for the opportunity to appear before the Commission on this most important subject. In 2000, my firm, GlobalOptions, was contacted, at the recommendation of a government agency, by representatives of a foreign-owned American defense contractor in California. They had reason to believe that the company's intellectual property was the target of foreign spies. Our extensive investigation conclusively established that their fears were well-founded and that the espionage was being conducted by agents under the control of China. What was interesting is that our conclusions surprised virtually no one in the government. All were acutely aware of China's illegal methods to acquire Western technologies and trade secrets, and to systematically violate patents, copyrights, and trademarks.

For decades China has been targeting Western technologies, initially seeking military and other secrets, but more recently concentrating much of its effort on technologies and intellectual property designed to drive its rapidly expanding economy.

In the late 1990s, Silicon Valley was known as "the valley of the spies" because so many foreign intelligence services were operating there, including many allied services. But the Chinese were, and remain, among the most prominent and aggressive nations engaged in systematic industrial espionage and intellectual property theft.

But the Chinese no longer have to troll the world to steal secrets because the world is coming to them. China has been called the world's factory floor. During the past decade alone, more than 300,000 foreign plants and factories have been established in China. Most are involved in the assembly of imported parts that are then re-exported to wealthier nations. Re-exporting goods from China now accounts for about 55 percent of its total trade.

Thousands of American companies are among those attracted by China's cheap labor and growing market for consumer goods. Based on population, China's market is three times larger than the European Union and four times the size of the United States. Its economy is growing at an average of 8 percent a year.

Many of the products are particularly vulnerable to reverse engineering, design infringement, and counterfeiting due to

inadequate protections in China of intellectual property rights. According to the U.S. Trade Representative's office, more than 90 percent of every form of intellectual property--from business software to music, books, and motion pictures--is being pirated by China.

Such piracy costs American companies, and therefore our economy, an estimated \$20 to \$24 billion a year, about ten percent of the trade between our two nations. The U.S. motion picture industry alone is losing about \$6.1 billion a year as a result of pirated movies, of which approximately \$300 million is the result of Chinese counterfeiting. Pirated films sell for as little as 60 cents to a dollar in China. Until recently, however, most counterfeit films were made locally for the Chinese market, but this trend is rapidly changing as the Chinese develop export markets for their pirated products. China is shipping illegal copies of the latest American movies to Hong Kong, Vietnam, Russia, and even Europe and the United States.

It has been said that the right to counterfeit goods is ingrained in China's culture. Former premier Deng Xiaoping promoted the philosophy of: "Let foreign things serve China." This perspective continues today and China generally views counterfeiting and other violations of intellectual property not as a serious offense, but as a major source of income, taxes, and employment.

As a member of the WTO and party to other agreements, China is legally required to protect intellectual property rights and crack down on violators. To this end, China has promulgated more than thirty laws to protect trademarks, patents, copyrights, computer software, technology transfer and licensing, and trade secrets. According to the U.S.-China Business Council, "China has created IP laws that generally adhere to international standards." This is hardly a ringing endorsement, and while the Chinese government is taking some steps to expand its legal protections and tighten enforcement measures, these measures have proven, to date, inadequate to stem the tide of widespread intellectual property piracy. According to the American Chamber of Commerce in Beijing, the problem is growing faster than government efforts to control piracy and increase enforcement of the laws already on the books.

American companies continue to push for more aggressive prosecution of violators and new administrative and government measures to address the problem, but the Chinese remain deaf to their entreaties. One of the things the government could do tomorrow, if it had the will, is to end its restrictions on the number of foreign films that can be exhibited in China and abolish what Motion Picture Association of America Chairman and CEO, Dan Glickman, has described as "confiscatory taxes on foreign home video and television content" that fuels the market for counterfeit American films.

Legal remedies

China's Public Security Bureau, the nation's principal police agency, has broad enforcement capabilities. They can make arrests and file criminal charges in the case of counterfeiters. They can also forcibly enter premises in cases where they suspect counterfeiting. However, law enforcement lacks zeal and criminal prosecutions have been, at best, spotty.

China's court system is only about two decades old and consists of four tiers, with the Supreme People's Court at the top, followed by the High People's Court, the Intermediate People's Court, and the Basic-Level People's Court. There are over 3000 local and county courts in China.

Unfortunately, China's laws are still applied arbitrarily and inconsistently, and often with little vigor. The courts have insufficient resources, including a lack of qualified personnel and calendar time to keep pace with the number of piracy cases. Judges are poorly trained and susceptible to bribes. Cases move slowly through the system and decisions vary from case-to-case and region-to-region.

At the local level there is little incentive to spend time and money prosecuting intellectual property cases. Judges are loyal to party leaders and more concerned about the local economy and jobs than enforcement of intellectual property rights. Decisions by lower courts are rarely overturned by intermediate and higher courts. Violators, when they are prosecuted, generally receive minimal punishment, which only encourages continued intellectual property piracy.

Despite these challenges, some marginal improvement has occurred. Beijing has the most modern and efficient court system. Courts in major cities such as Shanghai and Guangzhou are better than average. In 2004, there were 12,205 civil intellectual property cases adjudicated in China, a 32 percent increase over the previous year. The percentage increased again in 2005, although figures are incomplete.

The Motion Picture Association has brought, to date, ten civil actions in China relating to the pirating of Hollywood products, and received six settlements for a total of only \$94,000. As must be readily apparent to the Commission, such judgments, while setting some worthwhile precedents, do not begin to cover the costs associated with bringing the cases to court and hardly serve as a deterrent to counterfeiters.

We work with an investigative firm with offices in China that regularly conducts investigations for Western companies that

suffer from intellectual property violations. One of the company's clients manufactures a top-quality kitchen appliance in China that sells for about \$300 in the U.S. The product design was stolen and now is regularly counterfeited and sold on the black market for as little as \$25 to \$50. According to the investigation by the investigative firm, 80 percent of all the counterfeit versions of this appliance seized around the world originated in China. To stem the counterfeiting, which is costing the company millions of dollars, the company has succeeded in getting Chinese authorities to conduct more than one hundred raids against illegal manufacturers of the appliance. Despite this massive effort, the counterfeiting continues unchecked.

Defensive Measures

In addition to closing down counterfeiting and infringing operations and prosecuting those responsible, American businesses in China must adopt strict security measures to protect intellectual property. The following recommendations have been offered by the U.S.-China Business Council. They reflect the hostile environment and extreme measures the Chinese will take to steal intellectual property. American businesses in China are advised to:

- 1) Compartmentalize production processes and design products so they are difficult to copy;
- 2) Keep vital designs and most recent technologies in home countries;
- 3) Share IP information on a need-to-know basis;
- 4) Run background checks on key hires and include non-compete and non-disclosure agreements;
- 5) Conduct due diligence on suppliers and distributors;
- 6) Track computer data flows and file transfers;
- 7) Place IP protection clauses in all contracts and agreements.

The measures above are simply defensive measures and certainly will not solve the problem. At best, they will simply make it harder for the Chinese to steal Western technologies and intellectual property.

As noted previously, civil actions, especially lawsuits, are generally a waste of time in piracy/counterfeiting cases. Not only are companies forced to essentially develop all of the information in a case and package it, but the likelihood of recovering appreciable damages is next to nil. It is also virtually impossible to shut down violators and, in the rare exception when it does occur, the company just changes its name and sets up shop in a new location. And if civil suits are difficult, it is even more difficult to secure criminal and administrative action.

What Can Be Done?

The real need is for China to learn respect for "foreign things." To achieve this it may be necessary to take drastic steps. First and foremost, the U.S. must make piracy and brand infringement the central issue in terms of Sino-American economic relations. China benefits more from this relationship than does the U.S., just as it benefits far more from trade with the U.S. than the U.S. does from trade with China. In 2005, the U.S. exported just under \$41 billion worth of goods to China and imported \$243.5 billion, resulting in a trade deficit of nearly \$202 billion. China accounts for more than a quarter of the U.S. trade deficit, which reached a new record in 2005, and is this country's largest bilateral deficit. China's Vice Minister of Commerce, Liao Xiaoqi, has tried to spin these embarrassing statistics by claiming that "China's low-priced quality products have saved American consumers over \$600 billion over the last ten years and \$100 billion in 2004 alone." What Liao conveniently overlooks is the number of American firms put out of business and jobs lost in this country as a result of the massive importation of Chinese goods.

Accordingly, the Chinese government should be informed that its trading relationship with the U.S. is dependent on a drastic reduction in piracy and counterfeiting, and a corresponding increase in the zeal with which it protects intellectual property of all kinds. China is not living up to its obligations as a member of the World Trade Organization (WTO) and should be sanctioned or suspended from the organization until it brings its IPR regime into compliance. China's Most Favored Nation (MFN) should also be called into question.

As the theft of intellectual property is a global problem, so the solution must be global in its reach and scope. The federal government should view piracy/counterfeiting, wherever it occurs, as theft which harms American workers and our economy, and use its intelligence resources to monitor those engaged in such activities and to assemble evidence that can be used in prosecutions and to pressure offending nations. Consideration should be given to the creation of a new federal agency, with police powers and intelligence capabilities to spearhead the effort against global intellectual property thieves. Agents of this new agency should monitor the internet and attend the Chinese Export Commodities Fair in Canton and other trade shows to identify and record copyright, trademark, patent, contract, and service mark violations and the theft of trade secrets. Suspect communications should also be monitored and other intelligence and police methodologies applied to enforcement procedures.

An international watch list should be assembled by the Government, and those on the list should be tracked and monitored, and, if the opportunity arises, arrested and brought to the U.S. to stand trial. To facilitate this, extradition treaties should be updated and refined to give more weight to the extradition of intellectual property violators, who are now often exempted because their transgressions are not crimes of violence. Companies, individuals, and financial institutions associated with piracy and counterfeiting should be barred from doing business in the U.S. or with American firms anyplace in the world. As with terrorists and other criminals, they, and their relatives, should be denied visas to visit this country or have access to our government institutions. More attention should also be devoted to gathering information about terrorist organizations that engage in intellectual property violations or benefit from the sale of counterfeit goods.

Conclusion

In the final analysis, what we have been doing isn't working. It is time to stop talking and to take meaningful actions to bring intellectual property pirates, counterfeiters, and trade secret thieves to heel, and China is an excellent place to begin. Our nation continues to lose tens of billions of dollars every year to IP criminals, dollars that could be used to create jobs here at home, contribute to the nation's tax base, and offset our growing trade deficit. We are currently at war with international terrorism but we are also menaced by threats to our economic well-being. The terrorists that struck at the World Trade Center towers and the Pentagon on 9/11 knew only too well that our political and military power is based on our economic power. If we do not aggressively protect our economy then we will surely be more vulnerable to foreign terrorists and other military threats from abroad, some of them from nations growing stronger by stealing our intellectual property and industrial secrets.

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