



**PUBLIC HEARING ON THE IMPACT OF U.S.-CHINA TRADE  
AND INVESTMENT ON PACIFIC NORTHWEST INDUSTRIES**

**TESTIMONY OF  
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BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION**

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**I. Introduction**

The Business Software Alliance (BSA)<sup>1</sup> is pleased to participate in today's hearing on the impact of U.S.-China trade and investment on Pacific Northwest industries. BSA represents the world's leading commercial developers of software, hardware and Internet technologies, some of which are based in the Pacific Northwest and all of which are dependent on a fair, open and competitive global trading environment. My remarks today address concerns of the broader U.S. software industry, and highlight the impact of U.S.-China trade on our national economy.

The U.S. software industry derives more than half of its revenues from exports; thus, trade liberalization in China and elsewhere is critical to the industry's continued growth. Due to strong global demand for our products and services, the U.S. software industry has for many years remained a leading driver of economic growth in the United States as a whole (including the Pacific Northwest) and a major contributor of tax revenues and skilled, highly-paid jobs. In 2002 alone, software developers and other computer services industries employed nearly 2.6 million workers and contributed \$400 billion to the national economy.

Given the critical importance of market access to IT industry growth, BSA member companies have consistently supported the WTO's trade liberalization agenda and strongly advocated for China's accession in December 2001. As a condition of WTO

<sup>1</sup> The Business Software Alliance ([www.bsa.org](http://www.bsa.org)) is the foremost organization dedicated to promoting a safe and legal digital world. BSA is the voice of the world's commercial software industry and its hardware partners before governments and in the international marketplace. Its members represent one of the fastest growing industries in the world. BSA programs foster technology innovation through education and policy initiatives that promote copyright protection, cyber security, trade and e-commerce. BSA members include Adobe, Apple, Autodesk, Avid, Bentley Systems, Borland, CNC Software/Mastercam, Internet Security Systems, Macromedia, McAfee, Microsoft, SolidWorks, Sybase, Symantec, UGS and VERITAS Software.

membership, China committed to a program of extensive and far-reaching reforms that, among other things, require it to extend national treatment and improved market access to U.S. exports, protect intellectual property rights and initiate negotiations for accession to the WTO Government Procurement Agreement (GPA). Although China has implemented some of its WTO commitments, for example by strengthening certain IPR laws, it has not taken the steps necessary to create a fair and level playing field for U.S. software developers and other IT companies. As noted in USTR's 2004 Report to Congress on China's WTO Compliance, "China's implementation of its WTO commitments has lagged in many areas of U.S. competitive advantage, particularly where innovation or technology play a key role."

Of particular concern to the software industry is China's pending software procurement regulation, which would effectively prevent U.S. software companies from selling software products and services to the Chinese government, China's largest purchaser of IT products. When viewed in the context of China's 92 percent software piracy rate, this discriminatory measure would effectively close China's largest software market to U.S. competition. The U.S. software industry has already lost billions of dollars in export revenue due to rampant piracy and counterfeiting in China; a ban against government procurement of U.S. software would eliminate our industry's best opportunity to expand exports to China and set a dangerous precedent for China's procurement policies in other major economic sectors.

Moreover, we believe that severely restricting access of U.S. software makers to China's government procurement market will retard, rather than advance China's broader development goals. This policy will not only deny China's government the ability to use some of the world's most advanced software, it will undermine China's own efforts to encourage the active participation of U.S. software companies in developing a vibrant software economy in China.

BSA applauds the Administration's efforts to engage China's senior leaders in an attempt to resolve these and other trade issues. Vice Premier Wu Yi's commitment in 2004 to crack down on intellectual property theft, including software piracy in the government sector, is step in the right direction, and we urge the U.S. government to work closely with China to implement these IPR reforms in a timely manner. Also noteworthy is Premier Wen Jiabao's commitment to facilitate the increase of U.S. exports to China. The true test of this promise is whether China agrees to abandon discriminatory policies, including the proposed software procurement regulation, which would protect domestic industry at the expense of U.S. and other foreign competition. Such policies violate the spirit of openness that China embraced in joining the WTO and cannot be condoned. BSA thus urges the U.S. government to continue to press China to keep its public procurement market open to U.S. software products and to commence GPA accession negotiations. More generally, it is imperative that all Chinese practices and policies affecting software- and IT-related trade further the goal of increasing U.S. exports.

## **II. The Chinese Government's Proposed Procurement Preferences Will Severely Restrict U.S. Exports and Increase America's Trade Deficit with China**

### ***China's Discriminatory Software Procurement Regulation Would Severely Limit U.S. Exports of Software Products and Services and Set a Dangerous Precedent for other U.S. Industries***

The Chinese government procurement market represents one of the most significant growth opportunities for the U.S. software industry and the global IT industry as a whole. The Chinese government is the primary purchaser of software in the world's largest emerging market for IT products. According to a recent study conducted by IDC, a leading IT research firm, the market for packaged software in China grew 19.5 percent in 2002 to reach \$1.62 billion. IDC predicts that the market will continue to grow at a compound annual rate of 25.8 percent, making it a \$5.1 billion market by 2007. This explosive demand for software and other IT products will be fueled in significant part by government IT procurements, including China's proposed multi-billion dollar E-government initiative. In 2003, for example, government procurement of software products and services totalled \$608.4 million.

BSA is thus deeply concerned about China's plan to close its government procurement market to U.S. software and other products and services. In 2002 China enacted a law requiring with limited exceptions that its government purchase only domestic goods, services and public works. This law is applicable to every services and goods industry from which the Chinese government procures and has very significant ramifications for all U.S. industries seeking access to China's government procurement market.

China has indicated that it will issue implementing regulations on a sector-by-sector basis and has decided that software will be the first area subject to the new law. As proposed, China's software procurement regulations would severely restrict the ability of American (and other non-Chinese) software companies to sell to the Chinese government. The draft regulation establishes a two-tiered preference system - the first tier for "domestic" software and the second for qualifying "foreign" software, with domestic software heavily favored in the procurement process. To qualify as "domestic" software, a product must be made and primarily developed in China, and the copyright must be owned by a Chinese entity. To qualify as eligible foreign software, the software provider would need to satisfy as-yet unspecified levels of investments in China, R&D expenditures, outsourcing of work, and tax payments. It is our understanding that government agencies will need to get a waiver for each procurement of eligible foreign software.

If enacted, these onerous requirements would impose far greater barriers to the procurement of U.S. software by Chinese government agencies than U.S. law imposes on government procurement of Chinese software and services. In a market where over 90 percent of software is pirated and the Chinese government is by far the largest purchaser of legitimate software, such a discriminatory procurement regime would effectively close the door to many, if not all, U.S. software companies - or for that matter, any non-Chinese company.

Because U.S. software companies derive more than half of their income from exports, the Chinese procurement preference will have an immediate and significant economic impact on the United States. We estimate that the policy could result in a \$100 million decrease in U.S. exports to China. These are not theoretical concerns; we are already seeing the effects of China's restrictive procurement policy in the marketplace, even though the regulations haven't been promulgated. Last November, after being rebuked by a central government official for purchasing non-Chinese software, the Beijing municipal government cancelled a substantial order for American software. Since then, the Xinjiang and Shanxi provincial governments have followed suit, announcing substantial purchases that have been awarded almost exclusively to Chinese suppliers. Thus, China's decision to close or greatly restrict its government procurement market to much of the world's best software products is already translating into lost jobs and tax revenues for the United States economy.

BSA is also concerned that such a regulation would set a dangerous precedent for other U.S. industry sectors. Given the broad scope of China's 2002 public procurement law, there is every reason to believe that the proposed software regulation is merely the first of a series of measures that will ultimately close to foreign competition all sectors of procurement that China considers strategic to its economic development. A discriminatory procurement regime of this type would deny U.S. industry a vital export market and exacerbate the U.S. trade deficit with China.

***China's Procurement Regulation Violates the Spirit of its WTO Commitments and Serves to Protect its Domestic Industry at the Expense of U.S. Economic Interests***

China's plan to close its government procurement market to software and other U.S. products and services would clearly violate the spirit of China's WTO commitments. In its WTO accession agreement, China committed to initiate negotiations for accession to the WTO GPA "as soon as possible." Not only has it failed to honor this commitment, its proposed procurement regime rejects each of the fundamental tenets of the GPA, namely openness, transparency, fair competition based on merit, equality, and accountability. It would also violate Premier Wen's commitment to increase U.S. exports to China.

BSA and other industry groups have urged the Chinese government not to adopt these domestic software preferences or, alternatively, to define eligible "domestic" or "foreign" software in a way that permits unlimited competition by U.S. software companies. Senior U.S. trade officials have also raised this issue repeatedly with the relevant Chinese authorities. It remains unclear, however, whether these messages have been heard by China's political leadership. The Chinese government appears determined to promote its domestic software industry through discriminatory government procurement policies. Software developers worldwide are concerned that China will maintain this protectionist course, unless the United States and its major trading partners take specific action.

In a recent letter to President Bush, BSA joined with a broad cross-section of IT and other U.S. industry leaders to urge that immediate steps be taken to delay implementation of the software procurement regulation pending mutual agreement of a software procurement framework that is open, inclusive and non-

discriminatory and that allows U.S. and other foreign software makers to compete without restriction in China's government procurement market. We request that the U.S. government – in cooperation with the European Union and other governments around the world – take all necessary steps, including continued work to promote China's accession to the GPA, to preserve market access for all U.S. companies to China's very important government procurement market. Time is of the essence, as China may move ahead to implement final regulations at any time.

### **III. Rampant Intellectual Property Theft Continues to Close the Chinese Market to U.S. Software Exports**

#### ***Rampant Piracy Has Stalled Growth in U.S. Software Exports to China and Cost U.S. Companies Billions of Dollars in Revenue***

Intellectual property rights yield many benefits, including innovation, economic growth and job creation. By ensuring that authors and inventors can realize a financial return on their investments, IP protections produce the incentives and resources necessary to develop innovative products and technologies. In turn, these new innovations contribute to economic growth through increased employment and tax revenues.

Three years after its accession to the WTO, the Chinese government still has not implemented all of its IP obligations. Deficiencies in its law are compounded by the failure to allocate adequate resources to effectively enforce the rules that are currently in place. The result is not at all surprising: continued widespread piracy and counterfeiting. A July 2004 IDC report concluded that 92 percent of the software used in China has been illegally copied, the highest piracy rate of the 86 countries included in the survey. China is also the world's leading producer and exporter of counterfeit software, each year flooding global markets with millions of pirate copies. Piracy on such a massive scale has significant ramifications for the U.S. software industry and our national economy, costing U.S. firms billions of dollars in revenues annually and depriving American workers of many thousands of jobs.

Rampant piracy has effectively stalled growth in U.S. software exports to China, despite China's escalating use of computer and software technologies. Consider that in 1996 China was the sixth largest market for personal computers and the 26th largest for software; it is now the second largest market for personal computers but still only the 25th largest market for software. This growing gap between hardware and software sales is the inevitable consequence of a market that does not respect intellectual property rights or reward the significant investment required to develop and market innovative software products.

China's failure to protect and enforce intellectual property rights has also hindered its ability to grow a domestic software industry (a problem that China is attempting to cure through protectionist and discriminatory industrial policies). According to an earlier IDC report, a ten percent reduction in piracy could help the Chinese IT sector grow nearly fourfold in four years. Against this backdrop, China's recent efforts to enhance IP protections are a welcome – if insufficient – step in the right direction.

### ***China's Recent Commitments to Reduce Piracy and Strengthen its IPR Regime should be closely Monitored and Enforced***

In recent years China has taken intermittent steps to acknowledge the value and importance of IP rights. For example, in 1999 the State Council ordered all government ministries to use only legal software (an order that was never adequately monitored or enforced). In addition, the National Copyright Administration and other agencies have moved to implement a national Circular on IPR Protection that deals with software piracy and related issues. Such measures were due in part to China's entry into the WTO. In its 2001 Protocol of Accession to the WTO, China agreed that all of its IP laws would fully comply with the Agreement on Trade-Related Aspects of Intellectual Property Rights and Trade in Counterfeit Goods (TRIPS) upon accession.

Despite these efforts and assurances, China has yet to rectify fully the many defects in its IPR laws and enforcement regime or to dedicate the resources necessary to combat widespread piracy. As a result, China's piracy problem continues seemingly unabated. In response, the U.S. government and the Chinese government, whose delegation was headed by Vice Premier Wu Yi, determined to elevate the importance of the issue at the 2004 meeting of the Joint Commission on Commerce and Trade (JCCT). Following these meetings, the Chinese government committed to "substantially reduce piracy levels" and to undertake a series of actions to achieve this goal. In particular, China committed to (i) ease administrative burdens for criminal sanctions, (ii) continue and intensify a national campaign against IP infringing activities, (iii) implement new customs regulations, (iv) accelerate efforts to join and implement the World Intellectual Property Organization Internet treaties, (v) ensure government use of legal software, and (vi) conduct public education campaigns about the importance of IP rights. These commitments, while welcome, are long overdue. As the United States Trade Representative concluded, "[Such] actions are critical in light of the rampant counterfeit and piracy problems that plague China's domestic market, and because China has become a leading exporter of counterfeit and pirated goods to the world."

### ***Widespread Piracy Will Continue to Halt U.S. Software Exports unless China Strengthens Criminal and Administrative Penalties for all Commercial Copyright Violations***

BSA welcomes China's recent promises to enhance IP protections. At the same time, simply adopting new laws is not enough; experience has shown that strong enforcement is necessary to reduce piracy levels and to reap the concomitant benefits. The U.S. government should therefore continue to press Chinese officials for greater and more meaningful IP enforcement. More specifically, BSA urges the U.S. government to demand the following improvements to China's IPR regime:

- ✓ **Extend criminal liability to enterprise end user piracy.** China's 92 percent software piracy rate is largely attributable to serious deficiencies in its criminal laws and procedures, which have made it virtually impossible to obtain criminal prosecution of piracy offenses. Among other serious problems, the relevant provisions of China's criminal code - Articles 217 and 218 - do not treat corporate end user piracy as a criminal offense, despite its devastating effect on software industry revenues and growth. China's

failure to extend criminal remedies to enterprise end user piracy violates its WTO-TRIPS obligations and should be rectified immediately.

- ✓ **Reduce and clarify criminal thresholds.** In late December, the Supreme People's Court and Supreme People's Procuratorate released amended Interpretations of Articles 217 and 218 of the criminal code which lower the thresholds for establishing a criminal copyright violation. We are in the process of reviewing the Interpretations, but our initial evaluation is that the thresholds are still too high, particularly because the phrase "illegal income" is unclear and in certain cases (e.g., enterprise end user piracy) may be difficult to prove. Ultimately, the real test will be whether the amended Interpretations lead to meaningful criminal enforcement of IPR violations in the near future.
- ✓ **Increase administrative penalties.** Due to the lack of meaningful criminal penalties, software companies must rely on civil and administrative actions to enforce their rights. Civil actions, though occasionally successful, are hampered by the vague nature of Chinese intellectual property law and exceedingly burdensome procedural requirements. Administrative actions can be brought by the National Copyright Administration of China (NCAC) and local Copyright Administrations (CAs). In our experience, however, neither the NCAC nor the local CAs has the resources or interest to exercise this authority, preferring instead to "educate" organizational end users. And when administrative actions are taken, fines are rarely issued. If the Chinese government is serious about reducing piracy, it must provide these agencies with adequate training and resources, and empower regulators to impose deterrent administrative sanctions.
- ✓ **Legalize the government sector.** BSA and its member companies are heartened by China's JCCT commitment to legalize software use within the public sector, which represents China's largest consumer of software. Moreover, the Chinese government's recognition that audits are necessary to achieve this goal is a good sign that real change is afoot. These assurances are of limited value, however, if China proceeds with its domestic software procurement regime. If government institutions are prohibited from purchasing legitimate U.S. software products, legalizing China's public sector will do nothing to help those U.S. software companies that have lost billions of dollars in revenues over the years to government piracy. The U.S. government should therefore ensure that China does not undermine its JCCT commitments with procurement preferences that close the country's vast procurement market to U.S. competition.

All of these steps are necessary to address unacceptable piracy rates in China that cost the U.S. software industry billions of dollars in lost exports and stifle the development of a domestic software industry. No single step is sufficient on its own. The goal, of course, is to reduce piracy rates in China. Ultimately, China's progress on this issue must be measured against that goal, not against the completion of any particular step along the way.

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BSA appreciates the opportunity to participate in today's hearing, and we look forward to an ongoing dialogue regarding these important issues. For further information, please contact Jesse M. Feder, tel. +1.202.530.5123, e-mail [jessef@bsa.org](mailto:jessef@bsa.org).