China and the Intellectual Property Dispute

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8/25/96
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INTRODUCTION

After years of failure with democratic revolution and tests of strength between various political forces, it was proven that the only way for China was the socialist way. A decade ago, China began a reform in which they hoped to accomplish the industrialization, commercialism, and modernization of production which many other countries have already achieved under capitalism. China has also been developing foreign economic and technical cooperation through its open door policy.

On May 31, China renewed its Most Favored Nation (MFN) Status with the United States. MFN status grants China trading status equal to that enjoyed by other nations. I will discussed it thoroughly in a later section. The area in which China has not received MFN status with the U.S. is over the debate for protection of intellectual property rights (IPR) and China’s continued piracy of American movies, recordings and computer software. According to the Business Software Alliance, 94 percent of all computer software in China is pirated, while virtually 100 percent of US audio-visual works in the country are illegal copies (The CBR Nov. 94, 17). The pirating of music CD’s has dropped but bootleg computer software is on the rise. American industry representatives say some CD’s have 60 to 70 software programs with full retail values of $5,000 or more, which in China sell for as little as $15 (Washington Post Feb. 18, 96 A29). Recent U.S. officials claim that losses from piracy are estimated at $2 billion a year.
Intellectual property protection has become critical to trade relations because the United States is eager to reduce its trade deficit with China, which stands around $30 billion, and China needs to curb its problem in order to clear its entry into the World Trade Organization.

Through a literature review, I will examine what has been done, what is most likely to be done, and what else should be done in order to protect the intellectual property of writers, artists, performers and software manufacturers in China.
What is Intellectual Property?

Intellectual property, in contrast to real property and tangible personal property, is a difficult concept to understand because it is highly abstract. Intellectual property consists primarily of ideas, symbols, names, and forms of expression (Cooper 6). Ways of protecting intellectual property include: patents, copyrights, trade secrets, trademarks and mask works.

Patents give the patent owner a 17 year span in which he/she has exclusive rights to make, use, license, and sell their invention. Copyrights protect the form of expression in a work and protect only against the actual copying of the form of expression. Trade secrets are private information that give the owner a competitive advantage. For example, the sauce on a Big Mac at McDonalds. Trademarks protect symbols associated with a specific product, like the Nike “swoosh”. Finally, mask works relate to semiconductor chips and how they are made. They are a new form of intellectual property protection and lasts 10 years.

The inventors and authors who are the creators have the option of determining whether to make their intellectual property commercial or keep it to themselves. They are able to control the commercial exploitation of their ideas or works.

In order for ideas to be “protectable” intellectual property, they must be embodied in a tangible object. This protects against people coming along and suing for stealing your idea when they never acted on it and you did. Once your idea is incorporated in a
tangible property, it then falls into the category of intellectual property and is protected.

Intellectual property rights may be summarized as follows:

- Ownership of *rights in ideas* as represented by the form of their protection (patents, trade secrets, and mask works);

- Ownership of *rights in the form of expression* of ideas (copyrights in original works of authorship, mask works);

- Ownership of *contract rights* related to the use and enjoyment of ideas and forms of expression (licenses of patent rights, trade secret rights, copyrights, and mask work rights); and

- Ownership of *rights in, and of contract rights* related to the use of enjoyment of, *symbols and names* used to identify other intellectual property, real property, personal property, or business entities (trademarks and trade names and licenses of rights to trademarks and trade names) (Cooper 8).

Pinning down a specific notion of intellectual property is not always easy. Now that we have a better idea of what intellectual property entails, I will show who regulates it and how the regulations are enforced.
Effective protection of intellectual property is essential for China if it plans to see
continued high growth in its trade with the rest of the world and high levels of foreign
investment in China. If the Chinese government cannot guarantee that the investor will
receive the full protection stipulated in China’s intellectual property laws and regulations,
no company will invest its resources in China.

Ensuring that China protects US interests in intellectual property rights is a
priority of the United States Trade Representative (USTR). It is his goal to make sure
that China and other U.S. trading partners implement measures to control intellectual
property violations. The current USTR is Mickey Kantor. The U.S. Deputy Trade
Representative is Charlene Barshefsky.

During President Clinton’s re-election campaign, Kantor has been acting on a new
"get tough" trade policy. His latest action of toughening enforcement of laws to stop
subsidized goods was an answer to criticism that President Clinton’s free trade policy was
costing jobs. He warned foreign governments that were not living up to signed accords
that "we will not tolerate a failure to honor agreements of trade law" (Reuters Jan. 96, 3).
Kantor also announced the establishment of a special senior trade post at the Commerce
Department, devoted exclusively to monitoring and enforcing America’s foreign trade
agreements. Needing U.S. support in its bid to accede to the World Trade Organization
(WTO), China agrees to do almost anything. The problem lies in China’s ability to act on
these agreements. Also, the U.S. is sometimes slow to demand compliance.
United States Trade Policy

One of the first approaches of US trade policy regarding IPR protection came under Section 301 of the 1974 Omnibus Trade Act. Under this act, the United States Trade Representative (USTR) can lodge a complaint against any country it believes is conducting unfair trade practices. The Special 301 provision of the law addresses trade problems specifically related to IPR violations by setting rules, requirements, and deadlines that ostensibly limit the executive branch's discretion in determining retaliatory measures - and the foreign country’s ability to delay or defer protecting US IPR (The CBR, July-August 1995, 21).

Since 1988, Section 301 has prompted many countries to enact IPR laws, although in some countries, these laws are formed merely to avoid trade sanctions. According to the USTR, China was one of the countries lacking commitment. The laws were there, but the absence of enforcement made the laws ineffective. The USTR then had China sign a bilateral Memorandum of Understanding (MOU) in January of 1992.

With the enforcement of China’s IPR laws still lagging, its failure to make commitments to bring under control the piracy of US products left the United States with no choice but to identify China as a “priority foreign country” and initiate a Special 301 investigation on June 30, 1994.

The Special 301 investigation can last as long as nine months according to the progress of the offending country. At the end of the investigation, the USTR must
determine if China’s IPR enforcement practices constitute an unreasonable or discriminatory burden on US commerce. If so, they must decide on an appropriate response. Under similar circumstances in 1991, the USTR published a list of Chinese products on which tariffs as high as 100 percent would have been imposed had China not adequately met US concerns by the time the tariffs were scheduled to go into effect (The CBR, Jan.-Feb. 1992, 5).

When China failed to stamp out piracy after the Special 301, the US implemented a Sino-U.S. intellectual property accord in February of 1995. It was called the Intellectual Property Rights Enforcement Agreement. The 21-page Action Plan agreement will be in effect in the next three to five years, and it calls for the Chinese to establish tough anti-piracy task and strike forces to crack down on piracy on all levels. It is a supplement to the current IPR legal structure, a result of the 1992 Memorandum of Understanding which committed China to application of international standards in copyrights and patents.

Among other matters, the agreement established new and effective rules for border enforcement; a copyright verification system for audiovisual products and CD-ROMs incorporating computer software; separate and detailed plans to clean up the audiovisual, books and periodicals, and computer software sectors; a nationwide training and inspection system designed to prevent infringement; and a nationwide educational program on IPR protection (Business America 10). U.S. companies are also permitted, for the first time, to establish joint ventures and produce, distribute and sell audiovisual
works in China. It’s an attempt for U.S. firms to gain confidence in China’s commercial environment and for China to gain access to advanced U.S. goods.

The task forces will be allowed to enter and search premises, review books and records for evidence of infringement, and seize suspected goods and materials (The CBR July 95, 23). They are also authorized to revoke the factory’s production permits and impose fines.

To assist the Chinese government in implementing the IPR agreement, several U.S. government agencies have provided training programs and technical assistance. Some of these agencies include the Department of Justice, the FBI, the U.S. Customs Service, and the Patent and Trademark Office of the Department of Commerce. Full implementation of the IPR Enforcement Agreement is important to our trade relationships overall. The true commitment is still in doubt; although the USTR immediately provided an English language version, Beijing apparently has no plans to issue a Chinese version.

Feelings towards the agreement and its effectiveness remain mixed. Chinese officials argue they are doing the best they can, while U.S. representatives feel that China is falling “far short” of its promises. I feel that China is doing just enough to satisfy the U.S.’s demands. What gets me is the nerve of the U.S. government to point fingers and say who is falling short on promises. That’s a prime example of the pot calling the kettle black.

During the past year, China punished 12 firms for copyright crimes. Among the companies nabbed were Beijing Video and Audio Corp., the Shanghai Video and Audio
Publishing House, Guangdong Provincial Phonograph Corp., the Nanjing Video and Audio Publishing House and the Shenzhen Video and Audio Corp. (Reuter Sept. 95, 4).

Pirated works found included films from the United States and other countries, including "Top Gun" and music of Hong Kong pop singers. Some of the publishing houses had falsified authorization papers. Deputy U.S. trade representative Charlene Barshevsky said, "among seven of the factories that were closed, all but one have been reopened, and while U.S. authorities are fairly confident that one (of the reopened factories) is clean, we have much less confidence that the other five are as well" (Washington Post B13).

China's many CD plants continue to be the main supplier of pirated works worldwide and the supply of pirated goods is greater today than it was one year ago (Reuters 23). Plans have been made to meet and acknowledge that this accord needs to be improved.
On May 31, 1996, President Clinton announced that he renewed Most Favored Nation (MFN) trade status for China this year. The President felt that continued interaction with China is the best way to help it become a constructive force for stability and prosperity in Asia and to advance our own American interests. The main requirement for renewal was that it will substantially promote freedom of emigration in China.

This renewal doesn’t give China a special deal, but confers trade status equal to that of other nations. It is not being granted as a favor to China. It gives them normal trade status. The reason behind the President’s renewal was based on a belief that China is in a critical turning point. It will help maintain our overall relationship with China in the months ahead. The engagement can help determine whether China becomes a destabilizing threat or a constructive force in Asia and the world (U.S. Newswire 2).

Substantial U.S. interests were at stake upon the renewal of MFN status with China. Revoking MFN would have severed our economic relationship with China. It would have raised average tariffs on Chinese imports from 5% to about 45%. U.S. exports to China support 170,000 American jobs and have been growing at a rate of 20% a year and any Chinese retaliation would imperil or eliminate these jobs (U.S. Newswire 3).

Revoking MFN would also set back efforts to promote human rights and democracy in China. Whether by telephone, fax, e-mail or daily contact, Chinese citizens
are receiving a greater understanding of American ideals of personal, political and economic freedom. Revoking MFN would cut links and set back a dialogue that is feeding China’s development for the next century (3).

Other countries were also dependent upon China’s MFN renewal, like Taiwan and Hong Kong. The economies of both of these countries are enormously dependent on trade between the U.S. and China. The trade between these two has contributed to Taiwan's and Hong Kong’s prosperity and strong democracies. For Hong Kong, a strong and vibrant economy is an important way of supporting its autonomy as it moves toward the transition to Chinese sovereignty (3).

Renewal of MFN does not mean consenting to Chinese policies or practices we oppose, but a tool to use in advancing U.S. interests.
Opposing Viewpoints

If China hopes to accede to the World Trade Organization, a successor body to the General Agreement on Tariffs and Trade, it must begin to follow the Trade Related Aspects of Intellectual Property Rights (TRIPS) guidelines set forth by the Uruguay Round (The CBR, March 95, 25). However, China’s progress towards these guidelines has been slow for three main reasons: a conception of IPR at odds with U.S. views, vested interests in maintaining the status quo, and the lack of a strong judicial system.

In China private rights historically have been subordinate to what is considered to be in the public’s interest; whereas in our society, we respect individual innovations and private property, the Chinese view them as public goods. They feel that copying one’s work is a legitimate way to learn and share knowledge. Copying is not viewed as wrong. Brian Zizhen, a patent consultant with New China Consultants, once said about Chinese society “the problem is, the people don’t think of intellectual property as property like other property” (Washington Post Feb 96, A29).

A second problem for IPR protection is the fact that Chinese government officials have profited from allowing or even encouraging IPR violations. News reports suggest that 90 percent of government offices use pirated U.S. computer software, and that some officials are involved in ventures that illegally reproduce films, sound recordings, and computer software (The CBR July 1995, 21). Once again we see that it is in their own financial interests to ignore the importance of IPR and until they do realize it, it will
remain a source of friction.

Finally, the need for an improved, independently functioning judicial system also presents IPR problems. Although China's Patent Office has tried to augment the courts' ability to handle IPR cases by establishing a special intellectual property tribunal, personal relationships between judges, lawyers, and IPR offenders often impede unbiased rulings (22). Recently, in an attempt to curb this problem, information collected by foreign rights holders as evidence in infringement cases has been accepted. Previously, only information collected by government authorized investigators was permitted (The CBR, Nov. 94, 9).

Since China failed to become a "founding member" of the WTO, on Jan. 1 1995, due to an unwillingness to meet necessary protocol agreements, it asked the U.S. for help. China requested that the U.S. provide a written outline of the steps necessary to satisfy the requirements for entry. The U.S. provided China with a 13 page "road map" laying out the terms. The 13 page document, consisting of 25 categories, was handed to the Chinese in November of 1995 by Deputy U.S. Trade Representative Charlene Barshefsky.

This document identified areas where substantial disagreements still remain. Key points include:

Trading rights: China has proposed staged liberalization over eight years. Its negotiating partners want restrictions on the rights of companies to engage in foreign trade liberalized in three years. State trading
companies now dominate.

Non-tariff measures: China's offer of a phased elimination doesn't go far enough.

Price controls: China is under pressure to reduce categories where controls are applied.

Subsidies: China is being asked to provide greater transparency on export subsidies on agricultural products and to agree to their phasing out.

Safeguards: China remains adamantly opposed to any discriminatory safeguards in the protocol. Its negotiating partners want these safeguards to protect themselves against expected "surges" of Chinese exports of such items as textiles and footwear into their home markets.

Transition period: China is being asked to indicate which areas will require special transition periods.

(Scripps Howard 2).

China is also being pressed to make more adventurous commitments towards opening its service sector, including the participation of foreign banks, insurance companies and other service oriented businesses. This area is a key test of China's commitment to market liberalization.
In China’s Defense

The Chinese are desperately trying to prove their commitment to the agreement. They have blitzed the media with tales of crack downs on pirated goods. They even went as far as to invite journalists to watch an American made steamroller drive over 50,000 pirated laser disc and other audio products, crushing them to bits. This could also be seen as a snow job and a feeble attempt to cover up or take attention away from the problem.

One recent example, which China has publicized in order to show the IPR agreements effectiveness, involves a Taiwanese businessman. He had a large number of copies of Polygram, Warner, and 21 other companies’ CDs made on the mainland without authorization and had them sold in Hong Kong and Taiwan.

The reason the Chinese government has made such a big deal about this case was the outlandish fine he received. A Shanghai court, which handled the suit filed by the 23 companies, ordered him to pay 6.67 million HK dollars ($816,617) in compensation, 1.2 million yuan ($155,193) in fines, and 46,000 yuan ($6,000) in court costs (Xinhua 5). This was one of nearly 400 cases heard over the past few months by Chinese courts. The number of such cases has increased nearly 35 percent. Since the first law on intellectual property rights was passed in 1983, “China has been quick to establish a high level mechanism to protect them,” said Yang Jinqi and Jiang Zhipei with the intellectual property rights office of the Supreme People’s Court in an interview with Xinhua. The scope, time limits, investigative procedures, proof, and legal definition of intellectual
property rights as described in the Chinese laws are consistent with international laws (Xinhua 6).

China feels its efforts are greater than most reports lead us to believe. An American lawyer once blamed education as the main problem with the Chinese legislation. “Though there are 11 courts for enforcing intellectual property protection, most of the judges have at best a high school education” (Washington Post A29). China went on to spend a great deal of time training the judges in these courts. The Supreme People’s Court is establishing special courtrooms to provide training and supervision for local courts. They even have plans to set up intellectual property colleges.

The problems with intellectual property rights has brought more business for lawyer-sleuth Li Changxu. Li Changxu started a firm called the China United Intellectual Property Protection Center. He employs 60 people in 20 cities across China. Li’s firm investigates possible counterfeit operations for firms who suspect foul play. Recently, he received a list of suspected counterfeiters from the Royal Dutch/Shell Group affiliate in China. Li’s investigators staked out and watched the firms comings and goings. They discovered that the factory was buying used Shell barrels, washing them, refilling them with inferior engine oil, then selling them under Shell’s name. Li’s firm turned over videotaped evidence to Chinese prosecutors, who closed down the factory, confiscated the goods and fined the firm more than $100,000 (Washington Post Feb. 18, 96 A29).

With all this building in the future, some feel it’s just a smoke screen and that China still has work to do with the structure internally in order for it to make any great
contributions to the cause. Cases have often been tampered with by departments and local governments, so the independent trial mechanism must be improved (Xinhua 6).

The selling of much of the pirated products suggests that Chinese authorities are making an effort at the retail level; however, the significant availability of pirated goods indicates that Chinese authorities have yet to crack down on the infringing manufacturing sector. Asked by Craig Thomas (R-Wyo.), why the Chinese were cracking down on retailers while leaving manufacturers alone, Deputy USTR Barshevsky replied that the Chinese army and other powerful officials or agencies may have ownership interests in the factories, making them politically immune to attack (Washington Post Nov. 30, 95 B13).
China’s Counter Retaliations

On May 15, 1996, the United States Trade Representative announced the imposition of trade retaliations on China’s export products to the U.S. due to a lack of efforts made toward IPR protection in China. This imposition included products such as textiles, garments and electronic products valued at three billion U.S. dollars.

China’s response came from Article 7 of the Foreign Trade Law of the People’s Republic of China. It states that, “should any country or region apply discriminatory prohibitions, restrictions or other similar measures in the field of trade against the People’s Republic of China, the People’s Republic of China may, dependent upon the actual circumstances, adopt corresponding measures against the country or region” (Xinhua News 4A). Thus China plans to take corresponding counter retaliations.

Following the U.S.’s May 15 announcement, the Chinese Ministry of Foreign Trade and Economic Cooperation issued the following statement:

I. With the approval of the Customs Tariff Commission under the State Council, in addition to normally-collected import tariffs, an extra 100 percent special tariff shall be levied on the following import commodities originating from the United States:

1. Agricultural and animal husbandry products, such as cotton, frozen beef and mutton, chicken, aquatic products, fruits, western ginseng and foodstuffs;
2. Vegetable oils and fat, such as bean oil, peanut oil and rape seed oil;
3. Vehicles and their spare parts, such as large and small passenger buses, sedan cars, station wagons, cross country vehicles and their spare parts;
4. Telecommunications equipment, such as wire or wireless telephone sets, pagers and their spare parts; program controlled telephone equipment; and
5. All kinds of cameras, game players, game cards, audio cassette recorders, tobacco and cigarettes, alcohol drinks, cosmetics and camera films. (Xinhua News 5A)

Other restrictive measures such as suspensions would be placed on U.S. imports of movies, television programs, cassette tapes, compact discs, and laser discs. China would also suspend the handling and examination of applications filed with China’s Agriculture and Chemical Administration by U.S. firms.

This list was to go into effect on the day the U.S. sanctions against China became effective. It is not hard to see why the U.S. changed its mind about imposing the sanctions against China, shortly after this list was published. This was only a hard blow to the U.S.’s fight for IPR protection. The U.S. was now giving into China’s demands, instead of the other way around.
Long Term Goals

While addressing present concerns regarding piracy and IPR protection, measures aimed at creating institutional structures and enforcement capabilities are also in the works. The long term goals include three elements. None are foolproof, but each sets a foundation for further development.

First, is the institutionalizing of IPR protection. The State Science and Technology Commission was formed to establish IPR policies and the overseeing of their implementation. Provincial and local levels of these committees will also be coordinated. These groups, comprised of representatives from the National Copyright Administration, State Administration for Industry and Commerce, Patent Office, Customs Administration, and local police units, will form task forces to implement legislation and regulations and carry out enforcement efforts (The China Business Review, July-Aug. 1995, 21). The actual effectiveness of these task forces will rely heavily on the local officials' willingness to carry out orders.

The next step for protection came from the United States and its providing assistance to China's Customs agency to help monitor border transfers of suspected pirated goods. Customs officials are allowed to make final determinations of infringements and forfeitures at the border without due process. Holders of IPR are still required to bear any border enforcement costs, which may entail paying for the investigation and posting a bond equal to the value of the confiscated goods (The CBR,
July-Aug. 1995, 23). Whether effective enforcement will be applied if the IPR offender offers local officials a higher sum remains to be seen.

Finally, measures are to be taken in order to make it easier to identify pirated goods. A “unique identifier” must be imprinted by all legitimate manufacturers of CDs, laser discs, and CD-ROM products, and any company failing to comply with this requirement will be punished (The CBR July-Aug 1995, 24). Companies reproducing or publishing foreign originated works will have to register their contracts and obtain a registration title and permit through the Chinese government. Factories not having these permits, identifiers, and licenses will be closed.

China is relying on these terms because they will meet most of the TRIPs related requirements for the World Trade Organization accession. The path of full IPR protection in China had many steps, but its success will depend on how well they are implemented and enforced. As long as Chinese society places the public interest over private rights such as IPR and as long as government and other officials accrue economic benefits from infringement, its effectiveness cannot be guaranteed (The CBR July-Aug 1995, 24).
CONCLUSION

Over the past year, several important changes have occurred in IPR enforcement. Because of President Clinton's renewal of Most Favored Nation status, and China's saying the time is "ripe" for entry into the WTO, things are on the move.

The U.S. government has taken many steps to help the Chinese improve their IPR enforcement system. U.S. agencies have sponsored training and education seminars in China that featured experts from the U.S. Customs service, the Department of Justice, and the Patent and Trademark Office. U.S. industry has also stepped up activities to improve intellectual property protection in China. Groups such as the Business Software Alliance, the Motion Picture Association of America, and the Recording Industry Association of America have sponsored seminars and provided funding for Chinese enforcement efforts and agencies.

These steps, however, are preliminary. The problem of piracy of intellectual property persists. Nonetheless, with the exertion of political will and effort, China can successfully curb infringement. The enforcement agreement should represent a win-win situation for the United States and China. By protecting the rights of intellectual property owners in China, U.S. firms will gain confidence in China's commercial environment and Chinese firms will gain greater access to high-quality, technologically advanced U.S. goods and services that are critical to China's continued economic development (Business America 10).
We should look forward to working co-operatively with our Chinese colleagues in the intellectual property field and to seeing an early resolution of our concerns over protection and enforcement. The governments and industries of both nations, and all of their trading partners, will be the beneficiaries.
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