UNFAIR TRADING PRACTICES AGAINST THE U.S.: INTELLECTUAL PROPERTY RIGHTS INFRINGEMENT, PROPERTY EXPROPRIATION, AND OTHER BARRIERS

HEARING

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UNFAIR TRADING PRACTICES AGAINST THE U.S.: INTELLECTUAL PROPERTY RIGHTS INFRINGEMENT, PROPERTY EXPROPRIATION, AND OTHER BARRIERS

THURSDAY, JULY 19, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 10 o'clock a.m., in room 2172 Rayburn House Office Building, Hon. Ileana Ros-Lehtinen (chairman of the committee) presiding.

Chairman ROS-LEHTINEN. The committee will come to order after we clean up my spilled Cuban coffee. The order will stay here for about 6 months it is so strong. After recognizing myself and the ranking member, Mr. Berman, for 3 minutes each for our opening statements, sorry, Chris, I will recognize for 3 minutes, the chair and the ranking member of the Subcommittee on Terrorism, Nonproliferation, and Trade.

I will then recognize any members who seek recognition for 1 minute and then we will hear from our witnesses, and without objection, sirs, the witnesses prepared statements will be made a part of the record. Members may have 5 days to insert statements and questions for the record and the chair now recognizes herself for 7 minutes.

It wasn't that long ago that we could watch other countries grappling with their economic difficulties with considerable detachment and relief that we were largely insulated from their troubles. Those days are long gone. As our economy has become increasingly integrated with that of the world as a whole, and as millions of jobs in this country are now based on exports, our economic future and prosperity are tied to events on distant continents.

The unending crisis in Europe, the economic slowdown in China, and the sharp reduction of the growth rates in an increasing number of major countries means that the global economy is already facing strong headwinds. That will impact us in many ways and none more so than the threat to exports and the jobs that they support. Even in good times, our exporters often find their paths blocked by an endless array of obstacles erected by foreign governments that range from quotas, licenses, discriminatory regulations, to currency manipulation, limits on investment, and mandated technology transfer.

Some of these barriers are the products of antiquated ideologies or just plain ignorance, and the temptation to erect barriers to foreign business in order to support domestic industries is a strong one in every country, especially in times of economic stress. Those policies have had the affect of reducing the overall welfare of their own citizens while rewarding favored businesses with high profits they otherwise could not earn. But we bear the cost as well, and not only in terms of lost sales.

In fact, it has been the resistance of countries such as Brazil and India to further liberalization that has led the Doha Round of global trade negotiations hostage for over a decade. As a result, high barriers remain for services, agriculture, and many other products where the U.S. leads the world. But in addition to these familiar obstacles, U.S. exporters face even greater challenges from predatory policies by foreign governments. The most prominent is the theft of intellectual property.

Governments do steal intellectual property for their own use, but a far greater problem is their knowing toleration of widespread theft in their societies to the point of actually encouraging it. China is the most egregious example, where the U.S. Trade Representative estimates that 99 percent of all music downloads from the Internet is done so illegally. The International Intellectual Property Alliance estimates that the loss to U.S. companies from copyright violations of records and music alone amounts to more than $0.5 billion annually.

Pirated copies of American movies that have just been released in the U.S. are commonly on sale in the streets of Beijing and other cities within days, openly marketed under the benevolent gaze of the otherwise fearsome police. Despite years of promises by Beijing to crack down on violators, and despite a succession of formal commitments to do so, the theft of intellectual property remains epidemic. Beijing claims that it is virtually powerless to stop its citizens from using the Internet for illicit purposes.

However, that same regime devotes massive resources to controlling the Internet, including eliminating or blocking vast quantities of information that it finds objectionable, with little hesitation to use swift and harsh methods to enforce its commands. And yet it also claims with a straight face that it cannot prevent the unlimited theft of intellectual property from sites that operate openly and with unrestricted access.

But intellectual property theft is only one of China's vast array of unfair trade barriers that include, among others, state-owned businesses using government power for their own ends, illegal subsidies of domestic companies, discriminatory regulation, a bureaucracy impenetrable to outsiders, currency manipulation, and a legal system that is all but worthless in enforcing contracts.

China may have the worst record in unfair trade barriers, but U.S. firms face many other challenges around the world. One example is the expropriation of American property by foreign governments, especially by leftist governments. From the beginning of his reign, Venezuelan strongman Hugo Chavez made clear his intent to seize control of key industries, such as telecommunications, and has deliberately targeted American companies. For example, Chavez forced Verizon to sell its 30 percent ownership of Venezuela's telecommunications giant CANTV with the government taking control of the balance of shares at bargain prices.

And he has used his power to bludgeon major oil companies into forced sales and renegotiations of contracts that total several billion dollars. China and Venezuela are among the most outrageous and shameless predators, but they are far from alone. Unfortunately, we have only limited tools with which to create a level playing field for U.S. companies and provide them with protection. The most proven method is through enforceable free trade agreements with responsible countries.

Our network of free trade agreements has created enormous opportunities for U.S. exporters, the most recent being with the agreements with Columbia, Panama, and South Korea. But that remedy cannot be effectively used at present in large part because the expiration of the President's trade promotion authority has made the negotiation and approval of new trade agreements almost impossible. If we in Congress want to do more than talk about creating opportunities for U.S. exporters, especially at a time of economic difficulty, we must restore the President's authority to negotiate enforceable agreements that will enable our entrepreneurs to compete effectively and to create the jobs so many Americans are desperately searching for.

Although the image of the international marketplace as a place of civilized exchange, of trust, and sanctity of contract is often an accurate one, there will always be those in other countries who wish to use the power of the government to erect barriers against U.S. companies and individuals, and even to subject them to criminal behavior. In such a world, we must ensure that the executive branch vigorously uses the tools it already possesses to deal with those countries that openly prey on U.S. businesses, including strong and unilateral measures to penalize governments which refuse to uphold their commitments and agreements.

Only by doing so can we guarantee our economic security in an ever more integrated world where enormous opportunity is coupled with many challenges, and thereby ensure that the U.S. will always remain the most prosperous nation on Earth. I now recognize the ranking member, my friend, Mr. Berman, for his opening statement.

Mr. BERMAN. Thank you very much Madam Chairman for scheduling this hearing and in my opening comments I am going to just sort of say what you said, but probably not as well. Violations of intellectual property rights in international trade are important aspect of a large global problem. According to a study commissioned by the International Chamber of Commerce, piracy and counterfeiting cost legitimate businesses $455 billion in 2008. By 2015, that number is expected to increase $1.2 trillion. And nearly ¾ of global IPR theft winds up in world trade flows.

The latest USTR Special 301 report lists 40 countries on our IPR watch lists. Of these, notable on the priority watch list are countries such as Russia, where we are currently evaluating the extent of their enforcement efforts in conjunction with our review of their status under PNTR, and Canada, where we acknowledge important improvements recently, but they continue to lag behind international norms for a developed economy.

Not surprisingly though, China dwarfs other countries in violations of U.S. intellectual property rights. The USTR reports that

Chinese violations run the gamut of all forms of IPR; patents, trademarks, copyrights, and trade secrets. Worse, USTR reports that the Chinese Government is abetting some of these violations by compelling foreign companies to transfer intellectual property to Chinese companies as a condition of licensing and regulatory approvals. These policies exacerbate patent infringement, trademark counterfeiting, and outright theft of trade secrets.

IP violations are also a national security threat. The Defense Departments procurement system is being inundated by counterfeit and pirated parts. To deal with this problem, DoD, NASA, and other agencies have launched a drive to root out these illegal and dangerous items from the government's supply chain. To me, strengthening the protection of American intellectual property must be a top priority. IPR plays a critical role in our economy, in employment, and in our global leadership. While every industry depends on IPR to some extent, a recent Commerce Department report identifies 75 industries that are "IPR intensive." These account for $5 trillion in annual U.S. output. That is like ⅓ of the entire U.S. economy. As the report indicates, companies in these sectors directly employ 27 million American workers, or about 1 in 5 of the entire U.S. workforce. In addition, suppliers to these companies employ another 13 million workers, thus, "IPR intensive" companies employ, directly or indirectly, 40 million Americans; 28 percent of the entire U.S. workforce.

In the Chamber's most recent report from 2010, in California, "IPR intensive" companies account for $923 billion of our annual economic output; fully 58 percent of our total economy. These companies and their suppliers employ 7.4 million Californians; 55 percent of our total workforce.

For America's future, it is essential that our Government ensure protection of our intellectual property abroad. Our trading partners must provide higher levels of protection for our intellectual property, including effective enforcement tools and more open markets. We have an opportunity now to further our efforts in this area. The U.S. is currently negotiating an ambitious agreement with countries in the Asia-Pacific region; the Trans-Pacific Partnership.

It is critical that this agreement reflect and prioritize the contribution of the U.S. IP industries to the U.S. economy by including strong protections for IP and robust enforcement provisions. This will benefit both the U.S. and our trading partners' creative and innovative industries and economies. Madam Chairman, thanks again for calling this important hearing and I look forward to the testimony of the witnesses.

Chairman ROS-LEHTINEN. Thank you so much Mr. Berman and thank you for your leadership in that important topic of intellectual property rights. Thank you. Mr. Smith, the chairman of the Subcommittee on Africa, Global Health, and Human Rights is recognized.

Mr. SMITH. Thank you very much, Madam Chair, for convening this timely and important hearing. Americans, as never before, are focused on jobs and competitiveness. All of us know that economic growth and vigorous exports are vital to our economic prosperity, sustainability, and now, in these difficult times, recovery. American companies and American workers can outcompete anyone in the world, providing that the playing field is level. The theft of intellectual property rights, however, robs Americans of a fair return on their innovation and their hard work.

The most egregious intellectual property rights thief in the world today is China. Chinese companies, protected by a ubiquitous dictatorship, steal, copy, and market American software, music, and films. Chinese policies pry technology and trade secrets from American firms that invest there and then abandon them. China is certainly in the big leagues, there are others, but they're the biggest perpetrator of industrial espionage where cyber crime is a new tool. China seems to believe that unfettered access to American markets is its natural right, while they give Americans the stiff arm in a myriad of ways, including, and especially, the stealing of American intellectual property rights.

This colossal infringement of IPR by China, and others, must end. I thank you and yield back.

Chairman ROS-LEHTINEN. Thank you very much, Mr. Smith, for you leadership. Mr. Gregory Meeks, the ranking member on the Subcommittee on Europe and Eurasia is recognized.

Mr. MEEKS. Thank you, Madam Chair, for holding this hearing today. And as an advocate for U.S. I am keenly aware of the risks associated with the U.S. companies venturing into intellectual markets less regulated and protected than our own. In fact, the producer of intellectual property need not formerly enter a particular market to put her products, whether those products are manufactured goods, IT content, books, movies, or sophisticated patented scientific devices at risk of theft.

Trade, travel, broadcasting, and the Internet make all types of intellectual property vulnerable to appropriation. We often hear about the impact of this type of theft in gross numbers, billions of dollars lost to producers of intellectual property. We hear about pirated movies and music, and everyone immediately thinks California. This problem, however, is pervasive; affecting every state in the nation. The impact of IP theft hits home wherever home might be. In New York, for example, the motion picture and television industry is responsible for 91,608 direct jobs and $8.2 billion in wages, including both production and distribution-related jobs.

Nearly 49,000 of the jobs are production-related. The IT industry generated over $19 billion in wagers throughout the state. Rampant software piracy, especially heavy in emerging markets, destroys innovation and harms New York's economy. Just 10 percent reduction in PC software piracy would result in nearly $3 billion in added New York GDP and would create nearly 1600 IT jobs. Just as we should look to expand U.S. exports to protect and create new jobs in the United States, we need to do better to protect the intellectual property that is the basis of this employment in this vast segment of our economy.

Let me just add quickly, I also add that I am deeply concerned about the risk to U.S. trade and investments in countries that won't play by the rules. In this regard, the issues facing Chevron in Ecuador are critical and I hope that this is explored here today at this hearing.

Chairman ROS-LEHTINEN. Thank you very much. And now I am pleased to recognize Mr. Rohrabacher, the chairman of the Subcommittee on Oversight and Investigations, who always has nice things to say about China.

Mr. ROHRABACHER. Thank you very much, Madam Chairman, and thank you for holding this hearing. It is a significant issue in that it dramatically impacts the people of the United States. The Communist dictatorship in Beijing has caused dramatic harm to the well-being of the people of the United States. It comes down to that. And they are relying on us to protect their interest, to protect their families, and we have not been doing that. One of the most unforgivable elements of the economic war China has been conducting against the people of the United States is the massive government-approved and government-organized theft of American intellectual property rights.

So thank you, Madam Chairman, for your leadership in trying to get something done where there has been hundreds of billions of dollars of intellectual property that has been stolen, hundreds of billions, and hundreds of billions of R&D that the Chinese have gotten for free in order to outcompete our people. We do the R&D, no wonder they have got a space program that now is trying to compete with the aerospace workers in my district, because they have stolen all of our R&D. And in California, I hate to disagree with my friend, it is worse in California. We have a lot of jobs that are tied directly to entertainment.

They have been stealing from the people of the entertainment industry, especially in California, stealing the product of their labor. No wonder our people don't have the money to pay for rent, don't have the money to raise their families, because we are providing free entertainment for the people of China, the most populous people of the world, and who is benefitting from that? The Chinese merchants who are tied in to their Communist Party dictatorship. We have got to take a stand. We have been cowardly up until now, Madam Chairman, in confronting this horrible attack on the wellbeing of the people of the United States.

Thank you for holding this hearing. I would like to put into the record a statement that I have——

Chairman ROS-LEHTINEN. Without objection.

Mr. ROHRABACHER. Thank you. Thank you, Madam Chairman.

[The prepared statement of Mr. Rohrabacher follows:]

REP. DANA ROHRABAHCER OPENING STATEMENT
FULL HFAC HEARING: UNFAIR TRADING PRACTICES AGAINST THE U.S. (7/19/12)

As the Foreign Affairs Committee we should be looking at more than the commercial theft or infringement of intellectual property. The strategic impact of the transfer of technology and knowhow is of greater importance from a national perspective. Communist China is the principle problem.

Beijing has been demanding that the United States remove export controls from high-tech "dual use" items that can be used for military as well as commercial purposes. They argue this is a barrier we have placed on our own exports.

After the State visit of President Hu Jintao last year, the Chinese media claimed that the Obama administration had promised to lift many of these restrictions. At the end of the May, 2011 Strategic and Economic Dialogue (S&ED), Vice Premier Wang said, "The United States commits to accord China fair treatment in a reform of its export control regime and relax high-tech exports control towards China."

This March, former Secretary of Commerce and now Ambassador to China Gary Locke said in Shanghai that the U.S. was working through a list of 141 high-tech items on which China wanted restrictions lifted. The official state news agency Xinhua reported May 7 following the most recent S&ED, "According to Chinese Minister of Commerce Chen Deming, U.S. Treasury Secretary Timothy Geithner said that there would soon be substantial progress in easing high-tech exports to China." And Treasury Undersecretary for International Affairs Lael Brainard recently told the Washington International Trade Association that the Obama administration's ongoing export-control reform effort would benefit China.

So what is going on here? Is the Obama administration so desperate to boost exports when the domestic American economy is stagnant that he is willing to risk the future security of the country? I hope our panel can address the issue of the strategic impact of the transfer of knowledge to a rival power, whether it is by theft or sale.

Chairman ROS-LEHTINEN. Thank you. My New Jersey colleague, Mr. Sires.

Mr. SIRES. Thank you, Madam Chairman, for holding today's hearing on a topic so vital to our economy and I might just add that I agree with a lot of what my colleague on the other side have said about China. Usually we are on the same wavelength on a lot of things, but it is critical when implementing trade policies that we ensure a level playing field. Unfortunately, as it stands today, the United States is at a disadvantage to countries like China that have weaker protections on intellectual property rights. Not only the weaker regulations and standards surrounding intellectual property rights in other countries put us at a disadvantage economically, it jeopardizes public health.

We have seen the health and safety risk of negligent intellectual property laws in the form of poisonous products, fake medicines, and medical devices, and counterfeit airplane parts. In determining the level of protection of intellectual property rights, we must strike a balance that protects innovation in our country and allows the United States to continue to be a leader, not an obstacle, in foreign development assistance. We must commit to engaging with foreign governments to truly protect industry and consumer rights, guarantee an even playing field, and global trade will boost our technological leadership and help grow our economy.

And I look forward to hearing our distinguished panel members and I yield back.

Chairman ROS-LEHTINEN. Thank you very much. Ms. Schmidt of Ohio is recognized.

Ms. SCHMIDT. Thank you, Madam Chairman. I would just like to add to the discussion that we are not alone in this thought. Thomas Friedman's book, The World is Flat, and Pat Choate's book, Hot Property, illustrates what international property theft has done to the integrity and the intelligence of our nation. Quite frankly, both authors have said it is quite difficult for us to stop it alone, that we need global support. The second thing I would like to bring up is that it is not just counter theft with the music and film industry alone. In my district, Proctor & Gamble was created. It is one of the largest companies in the world and international property is a big issue with them.

One of the sub-issues is their product of Tide, a great laundry detergent, the counterfeit product that is in China today not only loses their revenue, but quite frankly, the integrity of the product. So when a Chinese woman uses an inferior product that says the cloak of Tide, they don't see it doing what it says it does, and so it is a double loss for companies like Proctor & Gamble, and I look forward to hearing what our folks have to say.

Chairman ROS-LEHTINEN. Thank you so much, Ms. Schmidt. Mr. Chabot, the Subcommittee on Middle East and South Asia chairman is recognized.

Mr. CHABOT. Thank you, Madam Chair, for holding this very important hearing. The U.S. is the world's entrepreneurial leader, as evidenced by the overwhelming number of patents, and copyrights, and trademarks filed in the United States annually; however, U.S. industries are facing very real threats to their intellectual property abroad. Many foreign actors are actively engaged in eroding our intellectual property rights, often using a guise such as protection of the environment, to demand IP transfers. This is becoming a significant threat to the U.S. economy due to the dozens of industries that rely on the adequate enforcement of their patents, and trademarks, and copyrights in order to stay competitive in this global marketplace.

Many companies in the Southern Ohio region that I represent, and Ms. Schmidt represents, are significantly affected by lack of enforcement abroad. IP supports close to 2.7 million jobs in our state, in Ohio, which constitutes 57 percent of the private sector there. IP has always been critical to innovation and entrepreneurship in the United States, which is why it is imperative for our trade agreements to appropriately recognize and enforce these IP rights.

I hope our witnesses here today will shed light on how we can address this critical problem. And I yield back.

Chairman ROS-LEHTINEN. Thank you so much, Mr. Chabot. And now the chair is pleased to welcome our witnesses. First, we will start with Mr. Grant Aldonas, the founder and principle managing director of Split Rock International. Mr. Aldonas serves as the senior advisor with the Center for Strategic and International Studies and as an adjunct professor and fellow of the Institute for International Economic Law at Georgetown University Law Center. My youngest is a law student there, so if you see her in her classes, double the homework. She needs that.

Prior to forming Split Rock, Mr. Aldonas served as President Bush's Under Secretary of Commerce for International Trade and Executive Secretary for the President's Export Council from the years 2001 to 2005; welcome. Thank you.

Next, we will welcome Dr. Derek Scissors, a senior research fellow for economics at the Heritage Foundation's Asian Studies Center, where he focuses on the economies of China and India. Before joining Heritage, Dr. Scissors was the China economist at Intelligence Research, where he wrote its weekly China bulletin, China Watch and China Quarterly Forecast. Thank you, Dr. Scissors.

And finally, we would like to welcome David Hirschmann, the president and CEO of the U.S. Chamber of Commerce for Capital Market Competitiveness. He also serves as president and CEO of the Chamber's Global Intellectual Property Center, and is a senior vice president at the Chamber, where he serves on its management committee, but I know him as Susan's hubby, and he better make a lot of money because Susan has an extensive shoe collection that would make Sarah Jessica Parker envious.

So thank you to our witnesses. We kindly remind all of you to keep your testimony to no more than 5 minutes. Without objection, your written statements will be inserted into the hearing record, and, Mr. Aldonas, we will start with you, sir.

STATEMENT OF MR. GRANT ALDONAS, MANAGING DIRECTOR, SPLIT ROCK INTERNATIONAL (FORMER UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE)

Mr. ALDONAS. Thank you, Madam Chairwoman and Ranking Member Berman, members of the committee, I feel like I could short circuit the process by simply associating myself with the comments of the entire committee. The reality is, we are in an unacknowledged competition of economic models. And it is more than the individual aspects of unfair trade practices. The reality is, it is a battle between free minds, free markets on the one side and between state capitalism on the other. And the sooner we recognize that we are engaged in that competition and we understand the importance of vindicating our freedoms, not only because of the economic consequences, but because of the model that our country represents and the moral solvency of that model, the better off we will be. So I welcome the hearing.

It is an incredibly important topic, certainly at this time in the global economy and our own economy, but I think it is also important to recognize the reality of the challenges that we face. Let me start by underscoring the importance of trade, both exports and the imports, to the U.S. economy. It is not just that our trade is 25 percent of GDP, but that, every morning, every man and woman in the United States wakes up already wired into a global economy. That is true of General Electric's workforce making gas turbine engines in Greenville, Michigan, just as it is of my friend Bruce Hultgren who owns a paving business in my hometown in Minneapolis. His inputs, his trucks, all that depends on our trade policy. He understands he is in the global economy every time he gets up in the morning.

For that reason, the rules governing the global economy matter. The institutional incentives in the global trading system can either favor individual freedom, reward initiative, and encourage innovation, or they undermine the scope of individual effort, discourage investments in research and development, and ultimately slow both U.S. economic growth and the growth of the global economy. To ensure that we contribute to and benefit from a dynamic world economy capable of providing a foundation for lifting out of poverty and ensuring a more broadly shared prosperity, every nation, not just the United States, bears a responsibility to foster the world trading system rather than systematically undermining it.

The current fragile state of our own economy and the world economy underscores that fact. Expanding opportunities for trade essential and not only is a spur to short-term growth, but a basis for improving our productivity and competitiveness over the long term. Conversely, protectionism in its various forms, which we will discuss today, represents the worst possible policy response to an economic downturn. One of the great lessons of the inter-war years and the Great Depression is the extent to which protectionist trade policies can exacerbate an economic slump.

To a large extent, at least at the outset of the financial crisis and the recession, we thankfully avoided the mistakes of the 1920s and 1930s. We did not see a widespread resort to what I would describe as conventional protectionist measures as a response to the downturn caused by the financial crisis. Over the last several years, however, what we have witnesses is a very significant increase in foreign policies and unfair trade practices that are, not only inimical to our trade interests, but undercut the prospects for economic recovery growth of full employment here and abroad.

While seemingly expedient in the short run, those practices also undercut the growth potential of the countries that adopt them and they limit the prospects for success globally. That logic applies whether it is China or elsewhere, with still greater a force to practices that undermine intellectual property rights or compel U.S. companies to transfer their technology. Innovation drives productivity, which ultimately yields stronger economic growth. By diminishing the return on investments of U.S. companies that they made in research and development, such practices eventually lead to less investment innovation and less growth, both in the United States and globally.

In other words, confronting the unfair trade practices on which the hearing focuses is not simply a question of defending U.S. interests, it is critical to restoring global economic growth and delivering a more broadly-shared prosperity, particularly to those who live at the bottom of the economic pyramid. The importance of rolling back these practices is particularly acute for the world's poor. All prosperity ultimately flows from expanding individual freedom and improving the capacity of the individuals to exercise it. Government intervention in markets, expropriation, intellectual property theft, limits on consumer choice, diminished opportunity for private investment and entrepreneurship, erode the scope of individual freedom and undermine the rule of law.

In other words, wholly apart from their economic importance at a time of slow economic recovery and high unemployment in the United States, the policies and the practices governments use to distort markets in favor of their producers come at a price in terms of the values that are foreign policies should be designed to vindicate. There is also important strategic as well as economic consequences that flow from failing to confront these policies, as Ranking Member Berman alluded to in terms of our national security, our economic vitality, translates directly into an ability to project power, slow growth, and limited economic opportunity limits our ability to pay for America's global reach.

But allowing these things to fester is probably more important in one way. The more profound strategic reason for confronting these practices is that our failure to do so will result in a far less dynamic U.S. economy and will inevitably weaken the moral solvency of the example we set as a free society. Thank you, Madam Chairman.

[The prepared statement of Mr. Aldonas follows:]

Unfair Trading Practices Against the United States: Intellectual Property Rights Infringement, Property Expropriation, and Other Barriers

Testimony of the Honorable Grant D. Aldonas before the Committee on Foreign Affairs, U.S. House of Representatives July 19, 2012

Madame Chairman, Ranking Member Berman, and Members of the Committee, it is a privilege to be with you to discuss the foreign unfair trade practices and barriers to trade that U.S. firms and U.S. workers confront in the global economy. I applaud your interest in the topic and your commitment to confront the challenges we face in the trade arena and in our foreign economic policy generally.

My basic argument is straightforward. Over the past several years, we have witnessed an increase in foreign policies and practices that are inimical to our trade interests and undercut our prospects for economic recovery, growth, and full employment. While seemingly expedient in the short run, those practices also undercut the growth potential of the countries adopting them and limit the prospects for global economic growth in the process.

That logic applies with still greater force to those practices that undermine intellectual property rights or compel U.S. companies to transfer their technology as a condition of market access. Innovation drives productivity, which ultimately yields stronger economic growth. By diminishing the return on the investments that U.S. companies make in research and development, such practices eventually lead to less investment in innovation and less growth, both in the United States and globally.

In other words, confronting the unfair trade practices on which the Committee's hearing focuses is not simply a question of defending U.S. interests. It is critical to restoring global economic growth, fostering a more dynamic global economy, and delivering a more broadly shared prosperity, particularly to those who live at the bottom of the economic pyramid.

The importance of rolling back these practices is particularly acute for the world's poor. As Nobel Laureate Amartya Sen put it in his seminal work, *Development as Freedom*, all prosperity ultimately flows from expanding individual freedom and improving the capacity of individuals to exercise it.[1]

In many of our discussions of human rights, we tend to draw fine distinctions between political and economic freedom. But, the reality, as Sen points out, is that freedom is ultimately indivisible. In the absence of economic freedom and the wherewithal to exercise one's political rights, no person is, in fact, free.

[1] Amartya Sen, *Development as Freedom* (1999).

Government intervention in markets, limits on consumer choice, diminished opportunity for private investment and entrepreneurship erode the scope of individual freedom and undermine the rule of law. In other words, wholly apart from their economic importance at a time of slow economic recovery and high unemployment in the United States, the policies and practices governments use to distort markets in favor of their producers come at a price in terms of values our foreign policy should be designed to vindicate.

There are also important strategic, as well as economic, consequences that flow from failing to confront the policies and practices that are inimical to our trade interests and global economic growth. Most pointedly, in terms of our national security, our economic vitality translates directly into the ability to project power. Slow growth and limited economic opportunity limits our ability pay for America's global reach. In that sense, allowing trade policies and practices that limit our growth to fester could prove as critical to our national security as any technological advance in military platforms or investments in human capital or troop readiness.

But, the more profound strategic reason for confronting these practices is that our failure to do so will result in a far less dynamic U.S. economy, which will inevitably weaken the moral solvency of the example we set as a free society.

The following discussion is designed to provide some context for the Committee in terms of the growing use of unfair trade practices abroad before highlighting a number of the practices that present the greatest challenge to U.S. firms and U.S. workers. It then assesses whether we have the tools needed, either under U.S. international law, to address the policies and practices our companies and workers face. Finally, it discusses what our negotiating agenda should look like if we are to create an international system that rewards innovation and private investment, rather than proximity to political power.

Trade Policy and Economic Recovery

Expanding opportunities for trade forms a critical component of any sound strategy for restoring economic growth and creating employment, both at home and abroad. In the short term, for example, expanding trade pays dividends by stimulating production and hiring to fill export orders to growing markets when our economy slows.

But, the longer-term effects of liberalizing trade are far more profound. In the long run, economic growth depends entirely on our ability to raise our productivity. Trade allows for specialization, which permits us to focus on what we do best and trade for the rest. By allowing us to move toward our comparative advantage, liberalizing trade and the competition it encourages lifts our productivity and, ultimately, our standard of living.[2]

Conversely, protectionism, in its various forms, represents the worst possible policy response to an economic downturn. Analysis by the Organization for Economic Development and Cooperation ("OECD") emphasizes that, of all potentially policy responses it examined –

> dollar for dollar, direct trade restricting measures have the most strongly negative impacts on growth and employment: a one dollar increase in tariff revenues results in a USD 2.16 drop in world exports and a USD 0.73 drop in world income.[3]

One of the great lessons of the inter-war years and the Great Depression is the extent to which protectionist trade policies can exacerbate an economic slump. Many expected a sharp increase in protectionism when both U.S. and global trade fell sharply in 2009 – 12.5 percent off its previous peak – in response to the disruption and uncertainty created by the financial crisis, a collapse in demand, and the difficulty of securing trade finance. [4]

To a large extent, at least at the outset of the financial crisis and the recession, we thankfully avoided the mistakes of the 1920s and 1930s. We did not see a resort to conventional protectionist measures as a response to the downturn caused by the financial crisis of 2008. Some G-20 countries, notably Russia, did impose direct restraints on imports. Russia seized on the opportunity the financial crisis and recession offered to impose higher tariffs on automobiles, trucks, combine harvesters, soy meal, and selected dairy products, all products that represent significant export opportunities for U.S. producers.

But, the overall impact of those protectionist measures was muted, amounting to no more than 1 percent of world imports.[5] That is due, in part, to President Bush's efforts to rally the G-20 countries against as resort to protection at the onset of the global downturn. At President Bush's urging, G-20 leaders signed a pledge in November, 2008, to avoid protectionist measures in response to the global downturn, reflecting a shared commitment to "refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports." [6]

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[2] L. Alan Winters, *Trade Liberalization and Economic Performance: An Overview* (2004).
[3] OECD, Trade Policy and the Economic Crisis (May, 2010) 5.
[4] OECD, *Trade, Policy and the Economic Crisis* (May, 2010) 1.
[5] Ibid.
[6] G-20 Leaders Declaration (November, 2008) at para. 13.

A greater share of the credit, however, goes to the combined effect of commitments made within the framework of the World Trade Organization ("WTO") and under the network of bilateral free trade agreements ("FTA") with our largest trading partners. One measure of that effect is average tariff levels. Since the inception of the WTO's predecessor – the General Agreement on Tariffs and Trade or "GATT", average tariffs have fallen among most industrialized countries from 15 to 4 percent.[7] While tariffs in many major developing economies remained high until the late 1980s, they have fallen sharply since.[8] At the same time, by virtue of the North American Free Trade Agreement ("NAFTA"), tariffs imposed on U.S. exports by our two largest trading partners – Mexico and Canada – have fallen to zero.

Just as important as the decline in tariff levels, both the WTO and our bilateral FTAs contain rules that inhibit our trading partners from resorting to protectionist measures that flatly violate their commitments under those agreements. Even with respect to China, the Office of the United States Trade Representative ("USTR") has generally succeeded when it has brought actions against Chinese violations of the WTO, both in the litigation under WTO rules and in securing China's eventual compliance.[9]

The Incipient Rise of a "New Protectionism" and the Competition of Economic Models

What the discussion above highlights is that, at least at the outset of the financial crisis and global downturn, the basic framework of binding commitments against trade restrictive measures held. But, what we have seen, instead, as the global economy has lurched from one crisis to the next, is the steady growth of unfair trade practices that either fall short of full compliance with the existing global rules or are designed to evade those rules.

In my view, this "new protectionism" is not simply a trade policy response to the slow global recovery. It reflects a deeper challenge. We are, in fact, engaged globally in an unacknowledged competition of economic models – a competition between the market and the state.

Not so long ago, it was almost universally assumed that government should seize the commanding heights of the economy. That assumption was based on a misunderstanding of the causes of the Great Depression, the success of government planning industrial organization in support of the U.S. war effort in World War II, and, most importantly, the rise of the Soviet Union as an alternative model of economic organization.

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[7] International Monetary Fund ("IMF"), *Trade and the Crisis – Protect or Recover?* (April, 2010) 6.

[8] Brazil's average tariff, for example, fell from 51 percent in 1987 to a current 12 percent rate and India's average tariff has fallen from 71 percent in 1994 to 13 percent today. Ibid.

[9] See, e.g., USTR, *Dispute Settlement Update* (January, 2011) (detailing USTR's success in various WTO cases against China, including dispute settlement proceedings on intellectual property rights and trading rights for films and other audiovisual products.

Even while fighting the Cold War, many countries in the West, the United States included, adopted an economic model of far greater government involvement in the economy than was wise or warranted. French dirigiste policies and the platform of the British Labor Party both reflect that trend. That same model permeated the countries of the developing world that were emerging from colonialism to independence. Argentina's experience with Juan Peron's statism and India's reliance on Fabian socialism under Nehru offer prominent examples.

The United States did not escape the prevailing orthodoxy either. The federal government, for example, tightly controlled transportation, with the Civil Aeronautics Board making decisions even about the menus that U.S. airlines would serve on domestic flights. We also experimented with wage and price controls as recently as the late 1970s in an effort to control inflation. That, of course, failed. It left us with "stagflation" (both high unemployment and high inflation) by the end of that decade.

As you know, the state's position at the commanding heights of the economy faltered as an economic model in the late 1960s and 1970s precisely because government's control of the commanding heights of the economy failed to deliver the strong economic growth and full employment that its advocates promised. That led in the late 1970s and early 1980s to a reinvigorated defense of free markets, principally by Margaret Thatcher in the United Kingdom and President Reagan here at home. The success of their efforts in reinvigorating the U.K. and U.S. economies also put an end to the argument that Western notions of freedom, both economic and political, were in decline, while alternative models based on far heavier state control were in the ascendancy.

The 1980s debt crisis and the success of Chile as a counterpoint drove a similar rethinking of the model in Latin America. In Asia, China's pivot toward the market signaled a rethinking of the model even among socialist states. And, finally, the fall of the Soviet Union, which represented the apotheosis of state control of the economy, marked what many thought was a definitive end to the only alternative to free market capitalism.

Events, however, have a way of confounding expectations. The pendulum soon started to swing back toward greater state control. Over the course of the 1990s, the austerity imposed by the IMF and the inability of existing political elites in Latin America to cope with the adjustment required by financial markets led to the rise of populist figures like Chavez in Venezuela. The Asian financial crisis in the 1990s highlighted for many economic policymakers the risk of liberalization, particularly of their capital accounts, in the absence of stronger institutions underpinning the market.

Equally, for many critics of capitalism, the 2000 high tech bubble, the ensuing U.S. recession, coupled with the accounting scandals that followed, called into question the efficacy of the free market model. The 2008 financial crisis gave that process much greater momentum and tarnished the U.S. brand as the leading example and advocate in favor of free markets and free choice, as opposed to state control. Those who had resisted the trend toward free market capitalism, both here and abroad, felt the financial crisis confirmed their worst fears.

The resulting movement toward re-regulating markets and reinserting the state into the market was not confined to finance and, equally important, it has its own champions. What we have seen in the past four years has been the rise of China, not simply as an economic competitor for investment and employment, but as a model of reinvigorated state capitalism. Chinese policies like "indigenous innovation," that are intended to force Chinese state-owned companies up the global value chain, rather than obliging them to earn their way, are now in vogue elsewhere. Following China's lead, for example, Brazil has returned to its previous practices of imposing constraints on investment and capital flows, even while it maintained relatively high barriers to trade in high technology goods and services.

The point is that we are once again engaged in a competition of economic models, but without any strategic thought as to what that means for our national security and economic well-being or how we should approach that challenge from the perspective of our domestic and foreign policies. In my view, the Committee would be wise to think of the array of unfair trade practices that our firms and workers confront in that context, rather than thinking of them simply as "one off" measures affecting particular goods or services.

As I highlighted at the outset, those policies and practices – and the economic model that they represent – are not only inimical to American interests; they are fundamentally at odds with a vision of a global market economy in which individuals can shape their own economic future, just as they are inconsistent with the goal of restoring economic growth and a more broadly shared prosperity, both at home and abroad.

The New Protectionism in Action

Examples of the new protectionism are rife. Given the relatively clear WTO commitments barring increases in tariffs, many of the policies or practices that foreign countries have imposed involved so-called "non-tariff measures," such as tightening of licensing requirements, taking "safeguard measures" or imposing export restrictions. In addition, what American firms have faced is the growing popularity among developing countries of bringing antidumping actions against imports of U.S. goods, particularly China and India (developing countries accounted for almost 80 percent of all antidumping actions initiated in the year following the onset of the financial crisis).[10]

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[10] OECD, *Trade, Policy and the Economic Crisis* (May, 2010) 1.

The rise in antidumping actions in China and India is not new, but it has accelerated. Those actions often focus on U.S. firms like Corning, which outcompetes its Chinese competition on the basis of its technology. The Chinese dumping action was designed to offset that advantage. The implications for U.S. competitiveness more broadly are obvious – the policies and practices reflected in China's approach to antidumping undermine the investments that U.S. manufacturing companies make in their technology, which allows them to remain a step ahead of their competition in global markets.

Another measure on the rise involves "buy national" policies. As governments have expended significant sums on economic stimulus, they have often attached provisions, just as we did here in the United States, that would require the funds be used to buy local goods and services or to give local goods and services a preference in procurement bids. The major difference here is that the United States is a member of the WTO Agreement on Government Procurement ("GPA"), which limits the extent to which we can resort to such policies without legal repercussions in the WTO. Most developing countries, particularly large emerging competitors like Brazil, China and South Africa, are not GPA members, which leaves them free to discriminate against U.S. goods and services in public procurement as they see fit.

The new protectionism also embraces a number of policies that expressly designed to negate the competitive edge that American firms and workers have based on their technology. While it is not the only country to engage in such practices, China is the paradigmatic example due both to its economic success and the score of its intervention in the market on behalf of Chinese firms.

In a valuable recent report, Robert Atkinson of the Innovation and Information Technology Foundation ("ITIF") detailed the various practices that make up the Chinese model of intervention on behalf of Chinese firms. As a part of what Rob refers to as "innovation mercantilism," China pegs its currency to the dollar to avoid any appreciation that would allow greater imports from the U.S. or reduced Chinese exports to the U.S. market and provides distinct tax advantages to Chinese exporters.[11] It attempts to force U.S. companies to give up their technology as a condition of access to the Chinese market, whether through exports or investment.[12] The Chinese government heavily subsidizes its industry through preferential loans, tax breaks, and investment incentives, such as free land and energy.[13] China not only tolerates an extraordinarily high volume of intellectual property theft, it also maintains a discriminatory patent system designed to encourage or force the diffusion of technology developed by U.S. firms.[14] In

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[11] Robert Atkinson, Enough is Enough: Confronting Chinese Innovation Mercantilism (2012). In the interests of full disclosure to the Committee, I am a member of the ITIF's Board of Directors.
[12] Ibid.
[13] Ibid.
[14] Ibid.

addition, China has made a practice of limiting exports of critical materials like rare earth minerals, which have the effect of denying U.S. firms access to key inputs.[15]

Another pernicious feature of the Chinese system is the disturbing trend toward theft of intellectual property and trade secrets through cybercrime. Economic and industrial espionage and the theft of U.S. intellectual property represent serious threats to U.S. national security and our competitiveness in the global economy. In security terms, such actions erode the technological advantage that U.S. defense forces hold over potential adversaries and expose U.S. command and control systems to attack. In economic terms, American firms and American workers compete in a knowledge driven global economy, where commercial success depends on innovation.

Agencies from the International Trade Commission to the intelligence community universally agree that China is, by far, the most significant source of economic and industrial espionage targeting U.S. agencies, U.S. firms, U.S. academic institutions, and individual Americans. China is also the source of the vast majority of counterfeit and pirated goods entering the stream of global commerce.

The U.S. International Trade Commission estimated ("ITC") that, in 2009, U.S. firms lost $48.2 billion in sales, royalties, or license fees to Chinese IPR violations. In 2012, U.S. Customs and Border Protection seized $125 million worth of counterfeit and pirated goods originating in China, which accounted for 62 percent of all seizures, making China the leading exporter of fakes to the U.S. market. An industry group, the Business Software Alliance, estimated that, in 2010, the commercial value of pirated software in China exceeds $7.7 billion.

As significant as those numbers are, they understate the gravity of the threat. The ITC's estimate, based on reports by U.S. firms, relates only to their direct losses in 2009; it does not measure the broader impact that Chinese IPR violations have on the firm's profitability and capacity for future innovation.

Economic and industrial espionage can take a number of forms other than surveillance and outright theft. The range from unsolicited requests for information via personal contacts, telephone, and e-mail to the pursuit of business relationships for the purpose of acquiring sensitive or classified information or technology to proposals for joint research between academics.

That said, the growth of the threat today largely flows through cyberspace. According to a recent report by the U.S. National Counterintelligence Executive, foreign intelligence services, foreign companies and individuals ramped up their efforts in 2009-2011 to steal classified and/or proprietary technologies by tapping the computer networks of U.S. government agencies, private companies,

[15] Ibid.

universities, and other institutions.[16]

The National Counterintelligence 's report fingers China as the "world's most active and persistent" perpetrator of economic espionage. The record of Justice Department prosecutions under the Economic Espionage Act reinforce that conclusion – of the seven prosecutions in 2010, six involved a link to China.[17]

The threat will grow over the next several years due to the proliferation of portable devices that connect to the Internet and other networks, which create new opportunities for espionage. Cyber-espionage will also take advantage of the trend toward cloud computing, with its pooling of information processing and storage.

The Rise of State Owned Enterprises

Another feature of the Chinese system that bears emphasis is the prevalence of state-owned enterprises. State-owned enterprises ("SOEs") are fundamentally incompatible with free enterprise. There is no practical or meaningful way of differentiating the interests of the SOE from those of the state. I am deeply skeptical of the ability of the existing WTO rules on SOEs to encourage greater openness by SOEs precisely because neither the enterprise nor the state has any interest in operating under the competitive conditions the market otherwise imposes.

In that regard, China's SOEs reflect a broader phenomenon. All SOEs are insulated from the capital market pressures that force private enterprises to be profit maximizing and customer focused. They are also immune from the business and legal risks that private firms face every day, which not only impose costs, but shape investment and operational decisions. The SOEs are, furthermore, rarely subject to the same transaction costs as other firms (e.g., inside knowledge of government decisions that often shape commercial opportunities, to pick what may be the most benign example).

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[16] The collection efforts focused on information and communications technology (i.e., the backbone of many other technologies of interest to China); military technologies, particularly marine systems, unmanned aerial vehicles (UAVs), and other aerospace/ aeronautic technologies; civilian and dual-use technologies in sectors likely to experience fast growth, such as clean energy and health care/pharmaceuticals; and business information relating to supplies of scarce natural resources or that provides foreign actors an edge in negotiations with US businesses or the US Government.

[17] To get a flavor of the challenge Chinese practices represent, one of those prosecutions highlights the nature of the problem Dongfan Chung was an engineer with Rockwell and Boeing who worked on the B-1 bomber, space shuttle, and other projects. He was sentenced in early 2010 to 15 years in prison for economic espionage on behalf of the Chinese aviation industry. At the time of his arrest, he had 250,000 pages of sensitive documents in his house, which represents a fraction of what Chung passed to his handlers between 1979 and 2006. The information found at Chung's home filled four large filing cabinets – all of which would fit an inexpensive compact disc or thumb drive or, if Chung had tapped directly into his employer's computers, could have been sent via the Internet. Reports by U.S. agencies and firms of a recent onslaught of computer network attacks strong suggest that economic and industrial espionage have shifted in that direction.

In addition, SOEs, by definition, restrain competition. There is virtually no possibility for new market entrants, given the political advantages the SOEs hold and the economies of scale from which they benefit by virtue of what is often a state monopoly in their given industry. The net effect is to impede innovation and the creative destruction that is essential to the constant regeneration and advance that is the soul of the free enterprise system. Killing innovation, of course, limits economic growth, not just in the home country of the SOE, but in the United States and globally.

Finally, the SOEs' nexus to the state encourages unproductive rent-seeking, rather than entrepreneurship, innovation and customer focus, as a way of succeeding commercially. This differs from the restraints the SOEs' existence imposes on competition because the negative impact of their rent-seeking behavior extends beyond their own market.

The problem is that rewards of rent seeking by SOEs (i.e., lobbying for benefits from the government) are highly visible. Their success in culling benefits from consumers and taxpayers relatively quickly becomes the organizing principle and operating paradigm of the entire economy, if left unrestrained. Rent-seeking, whether here or there, tends to beget more rent-seeking precisely because it skews in the incentives in the system and what entrepreneurial talent exists is devoted to the activities that garner the highest return – i.e., finding new ways to gouge more from the public, rather than being forced to innovate for the benefit of consumers in the marketplace.

Nowhere is the growth of SOEs – Chinese and others – more evident than in the energy sector. While it is convenient to criticize American oil companies based on their size and assume they have substantial influence over energy prices, the reality is that ExxonMobil, which on any given day is the largest private firm in the world by market capitalization and a variety of other measures, no longer ranks in the top 20 energy firms in the world. Three separate Chinese SOEs do.

The three Chinese SOEs at the top of the global league tables in energy are not alone. Obviously, Saudi Aramco and Russian firms like Rosneft and Gazprom play an outsized role in energy markets as well. What that suggests is that, left unaddressed, the increasing rise of SOEs in countries like China is not simply a trade problem. It portends a time when our energy policy will be set in Beijing or Riyadh or Moscow, rather than in the United States.

The Spread of the New Protectionism

While China offers a paradigmatic example and serves as role model for other countries inclined to follow its example of "state capitalism," it is far from the only source of the new protectionism and the practices elsewhere are more varied. Here, Brazil's policies and practices are important. Brazil, for many years, adhered to the basic economic philosophy of Raul Prebisch, which leaned in the direction of economic autarky. The utter failure of that approach left Brazil with little alternative in the 1990s but to move in the direction of liberalizing its market in order to bring down inflation, halt the decay and erosion of Brazilian industry, and to repay the massive foreign debts its government had contracted over the previous two decades.

That liberalization, combined with the rise of new markets like China for Brazilian agricultural exports, worked. It put Brazil on the path toward far stronger economic growth and financial stability. But, much of Brazil's old trade regime remained in place, including relatively high tariff walls to encourage companies to invest in Brazil, rather than entering the market via exports, and domestic content requirements that, in the case of U.S. firms like our automakers Ford and General Motors, have the effect of forcing production to shift to Brazil from the United States.

While the WTO Agreement on the Trade Related Investment Measures ("TRIMs") limits Brazil's ability to return fully to the practices it once used, Brazilian officials have turned instead to the use of conditions on financing as a means of ensuring the same result – a significant preference for the use of Brazilian domestic content in any good produced for the Brazilian market.

Another example is the return in Argentina, Ecuador and Venezuela of expropriation as tool of government policy. The most recent instances have taken place in Argentina, where President Fernandez de Kirchner ordered the expropriation of all of the Spanish energy firm Repsol's investment in YPF, an Argentine energy producer.

The ostensible reason for the expropriation was Kirchner's claim that YPF had failed to invest sufficiently to develop Argentina's energy resources and that nationalization was in pursuit of Argentine "hydrocarbon self-sufficiency." In fact, the reason for the lack of investment was that the Kirchner government's imposition of price controls on energy as a means of avoiding the consequences of its broader economic policies had made it completely unprofitable to invest in further production, despite the discovery of a major shale gas formation in the Vaca Muerta basin that would potentially give Argentina the third largest recoverable natural gas reserves in the world.

The analogy to previous Argentine experience is obvious. The return of Peronist practices that had turned Argentina into an economic basket case in the 1980s suggests a dim future for Argentina. That dim future has important implications for U.S. firms and U.S. workers. American firms that are both heavy exporters to the Argentine market and significant investors (U.S. firms account for most of the country's investment in oilseed processing, a major source of Argentine exports) are concerned about the implications of the Kirchner government's moves against Repsol. More troubling is that all of U.S. trade could suffer further if the Argentine moves create an incentive for further retaliation by Spain or the European

Union, which are significant markets for American firms' exports from Argentina.

The new protectionism also has indirect effects for U.S. interests. For example, despite the ties that Ecuador shares with Colombia as a result of their membership in the Andean Community, Ecuador imposed direct restraints on imports of 1,346 Colombian products as a means of offsetting the depreciation of the Colombian peso. The products subject to Ecuadoran "safeguards" represent more than one-third of Ecuadoran imports from Colombia as recently as 2008.

Those restraints have serious implications for Colombian producers, who had previously had to contend with an overvalued peso in terms of their competitiveness. But, we are now in a free trade relationship with Colombia. Actions by Ecuador that damage the Colombian economy have significant implications for the success of the U.S.-Colombia FTA to the extent that they diminish the prospects of Colombian growth and U.S. export sales under the newly implemented trade agreement.

What the examples highlight is the folly of the new protectionism. As I noted at the outset, protectionist practices and policies that distort trade and investment incentives may seem expedient in the short run, particularly in the face of slowing economies caught up in the ongoing global economic crisis. But, they invariably lead to far more damaging consequences.

The most immediate consequences come from the likelihood that these policies and practices lead to retaliation. That potentially leads to the same sort of vicious circle we saw in the 1930s, when the instinct to raise tariffs to encourage production and save jobs, led to accelerating rounds of trade protection that ultimately exacerbated the Great Depression and led to less economic activity and less employment, rather than more.

The longer terms consequences, however, are far worse, as I indicated at the outset. What policymakers, particularly in countries like China, Brazil and Argentina tend to forget is that their recent success in the global economy has largely flowed from their adoption of institutions like private property and the enforceability of contracts that underpin a market based economy and offer confidence to local entrepreneurs to create local businesses that generate employment as well as meeting local consumer needs.

The new protectionism, by contrast, almost invariably involves some diminution of those rights and a weakening of those institutions. That means slower economic progress over the long term. In other words, while the protectionist policies and practices certainly harm U.S. interests, they also prove self-defeating for the countries adopting them.

A concerted effort by the United States to confront those policies and practices is manifestly in our own economic interest. But, I would submit that our effort to ensure that we challenge those policies and practices as part of the broader effort to vindicate the economic model of individual freedom and equality of opportunity that the American experiment should represent is just as important in terms of the global economy as our own.

Thank you. I welcome any questions you may have.

Chairman ROS-LEHTINEN. Thank you very much. Dr. Scissors.

STATEMENT OF DEREK SCISSORS, PH.D., SENIOR RESEARCH FELLOW, THE HERITAGE FOUNDATION

Mr. SCISSORS. Thank you to the chair and the committee for having me here. I am going to focus my remarks on China. The committee has already given many reasons for that, and actually, Grant has as well, talking about the battle among models. I will say that China is not the worst example of imposing trade barriers, but it is the biggest. It is not the only one, but it is the most important. We can learn a lot by assessing what China is doing and we can gain a tremendous amount by trying to get them to improve their practices to the extent that is possible.

I will start with IPR. IPR is a core issue in the China trade because the trade relationship between the U.S. and China, the American comparative advantage there is in innovation. Without IPR protection, you don't get as much innovation, which means that the U.S. comparative advantage is blunted, and that means we don't get the kinds of gains from trade that we want and we expect, and that we get in many of our other relationships. You see this in the composition of U.S.-China trade. China sends us more cell phones than we send them; that doesn't make as much sense as it should. The composition doesn't make as much sense as it should. You also see it in public attitudes.

The public likes trade, and yet, it has problems with trade with certain countries, and there is a good reason. The public is right. We are not having the kind of trade relationship with China that we should. And the main reason, if I had to pick one out, would be that, we don't get our comparative advantage in the China trade because they don't protect intellectual property. What is the problem with talking about intellectual property? Everybody here knows that there is no solution that is a magic bullet. Retaliation is very unlikely to help. It would have to be very carefully done; trying to give them the right incentives; managing their response.

If we sign a bilateral investment treaty with the China, very likely, they are just going to circumvent it. They are very good at that. The chairman actually hit the solution on the head. It is not direct and it is not perfect, but it will work better than others, which is, to sign agreements with like-minded countries that are very strong on IPR, that don't have Chinese involvement where they are trying to gain the agreement so they can step around it, and therefore, the Trade Promotion Authority is very important in this task. If we want to address Chinese IPR violation, we really need to be able to have the freedom to make agreement with like-minded countries and put indirect pressure on the Chinese that way.

The second topic I want to address, which I actually think is just as important, the committee hasn't really brought it up, but I know you are all aware of it, is subsidies. IPR is at that core of the U.S. economy; subsidies are at the core of the Chinese economy. It is, therefore, just as important to the relationship also, and unfortunately, in a negative way. We have been very focused here on subsidized Chinese goods coming into the American market. The latest example is solar panels, but our consumers gain from those subsidies. The subsidies that just hurt the United States are the subsidies that block off the Chinese market. We gain nothing from that, and in fact, the Chinese people lose as well.

Financial subsidies are a major part of this. I have a little joke I tell here that state-owned enterprises have effectively borrowed $3 trillion at no cost since 2009 and even the U.S. Government has to respect those kinds of amounts, but the subsidy I would like to focus on is not financial, it is not the $3 trillion in no-cost borrowing, it is protection from competition, because protection from competition is fundamental. If you can't compete you can't win, and the rest of it all is details. How does China prevent the U.S. from competing? They essentially do it by law.

State-owned enterprises don't go out of business ever, they are just merged with other state-owned enterprises and they never shrink, so there is no market space created when a state-owned enterprise fails. Vital sectors of the economy are to be dominated by state-owned enterprises by law; autos, banking, construction, insurance, I have a long list in my written testimony. If you can't get a majority share, if you are not fighting for most of a market, then the rest of the policies don't really matter. Those are just the ways of implementing China's goals to keep everyone out.

They discourage new businesses. They push out small competitors and businesses saying it is disorderly competition. There are a range of issues, but the bottom-line here is, if you don't allow competition, there is no way U.S. firms can win, and the other policies just don't make any difference in that framework. Solution; measure and pressure. The first thing we need to do is measure the subsidies. That is not very exciting, but when we go to China and we say we demand this and that, if we don't have a measurement, they will just say they improved it. We did want you wanted. We changed the policy. And they just invented a new policy.

We need to be able to measure what they are doing and come back to them and say you are not making any progress. How do we pressure them? The pressure is, we need to pick something. I would pick increasing competition, reducing their barriers to competition, but we can't have 15 things that we are asking them for in the SNED and the JZZT. It doesn't work. We have been doing that for years; it doesn't happen. So there has to be focus. Now, the positive side of all of this, it gets back to China being important.

The committee has mentioned Venezuela and Ecuador. Venezuela and Ecuador have very significant economic ties to China. We get the Chinese to change their policies it would be much harder for the Venezuelans, the Ecuadorians, and other countries, I don't mean to just pick on them, to practice the policies they are practicing. So China is the biggest problem, but it also offers us the opportunity for the most progress. And I am going to close on a personal note. I want to say thank you to my grandmother on the occasion of her 103rd birthday.

[The prepared statement of Mr. Scissors follows:]

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CONGRESSIONAL TESTIMONY

The Most Important Chinese Trade Barriers

Testimony before the

Committee on Foreign Affairs,
United States House of Representatives

July 19, 2012

Derek Scissors

The Heritage Foundation

My name is Derek Scissors. I am Senior Research Fellow for Asia Economics at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Every nation has its trade barriers, and every nation struggles with how best to protect intellectual property. Still, there are better and worse trade partners. There are also bigger offenders—countries whose pure economic size means their policies matter more.

According to the United State Trade Representative, the People's Republic of China (PRC) is consistently among the worst countries with respect to infringing intellectual property. Beijing also has perhaps the world's most extensive system of subsidies, which block foreign access to the Chinese market. Add the fact that the PRC is now the world's-second largest economy and the combination is pernicious.

Weak intellectual property protection strikes at the heart of Sino–American trade. Unfortunately, it is not at all clear how best to improve that protection. Simple retaliation might be justified, but it would not be helpful.

It will thus be more productive to focus on Chinese subsidies, which are just as important to bilateral trade but more tractable. Concerning subsidies, the focus has been on artificially cheap Chinese exports flooding the U.S. In this case, however, American consumers benefit. Where subsidies are entirely harmful to U.S. interests is exports to the PRC. There, American goods and services are effectively blocked by subsidies, benefiting no one but certain Chinese firms. American efforts should focus on reducing barriers to the Chinese market created by subsidies.

In confronting Chinese trade barriers, Congress should:

1) Seek to create indirect incentives for progress in Chinese protection of intellectual property. One method is strong intellectual property provisions in the Trans-Pacific Partnership.

2) Make reducing Chinese subsidies the top economic priority in bilateral talks. In particular, basic anti-competitive regulations in a range of industries must be eased.

3) De-emphasize the exchange rate, as it is a minor factor compared to IPR and subsidies.

The problem of trade barriers extends well beyond the PRC, but it is toughest nut to crack and lower Chinese barriers will have positive ramifications around the globe.

IPR: Undermining the Trade Relationship

The Committee's focus on intellectual property is entirely justified. Incentives come from secure property rights, and the incentive to innovate comes from secure intellectual property rights (IPR). When IPR is weak, the incentive to innovate weakens.

This is crucial because America's comparative advantage is in innovation. Our comparative advantage is expressed in export of technology goods, focused on computing but also including medical and other advanced equipment. Innovation makes competitive a wide range of American services, from education to entertainment. This is true for U.S. trade with all countries.

The China angle: It is universally accepted that Chinese IPR protection in China is inadequate.[1] This reduces incentives for American individuals and firms to innovate in goods and services trade with the PRC. Beijing expects the U.S. to respect China's comparative advantage in assembly of consumer goods. In contrast, the American comparative advantage in IPR will be respected at some point in the future.

A standing Chinese complaint is that the U.S. restricts technology exports to the PRC.[2] Some restrictions are driven by national security, but most stem from a refusal by American firms: Who wants to export, only to see innovations stolen and reverse-engineered in short order?

Top U.S. Exports to China, 2011

Category	**Value ($ billions)**
Waste and scrap	11.5
Soybeans	10.5
Aircraft	6.4
Autos	5.3
Semiconductors	5.2
Organic chemicals	3.6
Plastics materials	3.1
Cotton	2.6
Meat and poultry	2.2
Computer equipment	2.0
Sub-total	52.4
All U.S. exports	103.9

Source: United States Department of Commerce, Census Bureau, *U.S. International Trade Statistics*, http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

With innovation thus blunted, American comparative advantage is distorted. Scrap metal is the leading export. Other top goods exports make sense but volumes are painfully small, such as for computer equipment. This is stark in comparison to Chinese exports to the U.S in 2011, where the top three categories are computers, communication equipment, and computer equipment, and just these were slightly larger than all American exports to the PRC. With IPR at risk, the U.S. does not export at volumes consistent with combined Sino–American GDP of over $22 trillion.

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[1] "China Reaffirms Its Consistent Position on IPR Protection," China Central Television, June 20, 2012, http://english.cntv.cn/20120620/111409.shtml.

[2] Xinhua, "Relax High-tech Restrictions," May 8, 2012, http://news.xinhuanet.com/english/indepth/2012-05/08/c_131573738.htm.

Comparative advantage is fundamental. A secondary but ugly problem is economic espionage. Espionage is only one way to violate IPR and erode American comparative advantage, but it is egregious. Even if the U.S. suspended trade, economic espionage would continue. Many countries practice economic espionage, but the PRC may be the most aggressive. Worse, Chinese economic espionage seems to be intensifying, rather than easing as the country develops its own technological capabilities.[3]

The effects of weak IPR are unpleasant. Americans want more trade but not necessarily free trade.[4] For some time, the single biggest concern has been China. The public is perceptive: The extremely powerful mutual gains argument for trade is partly undermined in the Chinese case because American comparative advantage is thwarted. Sino–American trade relations seem "wrong" because in a sense they are: The U.S. is not receiving the gains from trade that it should.

China is making progress in IPR, but it is slow and skewed to areas where Chinese firms have intellectual property. Unfortunately, there is no magic solution. Retaliation is risky, both because it could rebound against the U.S. and because it might have little effect on Chinese treatment of IPR. But there is a fact for American and Chinese policymakers to contemplate: While China's IPR protection is weak, the U.S. commitment to the trade relationship will remain in question.

Subsidies: Blocking American Goods and Services

It almost seems fortunate that there is another major trade problem, because this one is easier to solve—not easy, but easier.

The subsidies problem starts with the World Trade Organization (WTO). The WTO definition of what constitutes a harmful subsidy is too narrow. It focuses on financial contributions yet is difficult to apply when dubious financial practices are widespread but not universal, as with preferential bank lending. WTO violations are much easier to establish when trade is directly involved than when trade is inhibited indirectly, but losses in the latter case can be massive.[5]

Many countries take advantage of this flawed definition, including the U.S. The U.S. has also had clashes with many partners over foreign subsidies that are difficult to pin down under WTO rules. The PRC is far from alone as a subsidy abuser, but it stands out in the size and nature of subsidization. Subsidies are both huge and directed almost entirely to state-owned enterprises (SOEs). The status of SOEs (in any country) is itself at issue under the WTO, making it that much harder to come to grips with the subsidies these enterprises receive.[6]

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[3] Derek Scissors, "Chinese Commercial Espionage: U.S. Policy Recommendations," Heritage Foundation *Issue Brief* No. 3564, April 9, 2012, http://thf_media.s3.amazonaws.com/2012/pdf/ib3564.pdf.
[4] "Americans Are of Two Minds on Trade: More Trade, Mostly Good; Free Trade pacts, Not So," Pew Research Center for the People and the Press, November 9, 2010, http://pewresearch.org/pubs/1795/poll-free-trade-agreements-jobs-wages-economic-growth-china-japan-canada.
[5] "WTO Subsidies Agreement," Trade Compliance Center, http://tcc.export.gov/Trade_Agreements/Exporters_Guides/List_All_Guides/WTO_subsidies_AG_guide.asp.
[6] Duane W. Layton and Paulette Vander Schueren, "WTO Appellate Body Issues Ruling on US Definitive Anti-Dumping and Countervailing Duties on Certain Products from China," The Mayer Brown Practices, March 21, 2011,

China has multiple sources of genuine competitive advantage, but these are often suppressed to ensure the dominance of SOEs, whose advantages are not market-based. Subsidies take the form of below-cost land, energy, and other inputs, implicit financial transfers, and regulatory protection. Because it is not financial in nature, regulatory protection is barely touched by WTO rules. It is also hard to measure. Yet it is the most important subsidy that Chinese SOEs receive because it suppresses competition, including competition from imports.

Most SOEs, from large and centrally controlled to the many smaller provincial firms, can never be outcompeted because they cannot go bankrupt. They have effectively no obligation to creditors or any non-state shareholders. When failing, they are typically merged with other SOEs, with no downsizing and therefore no market share made available to non-state entities.[7]

When market concentration is high, Beijing acts to preserve it. The PRC is 151st of 183 countries on the World Bank measure of the ease of starting a business. In industries with a higher number of competitors, there is a broad program to shrink that number while retaining large state entrants.[8] This is occurring most famously in rare earths, but also in autos, cement, steel, and many other industries. The desired result is a few large state-owned firms, just a small step short of a state monopoly. These national champions are also intended to expand for the purpose of winning overseas markets.[9]

But the best protection from competition is by direct order of the central government. The state must own all participating firms in oil and gas, petrochemicals, electric power, and telecommunications. In aviation, coal, and shipping, the state must control the sector as a whole. In autos, construction, machinery, metals, information technology, and environmental technology, the state is to expand until it controls the sector. SOEs also comprise nearly all of insurance, the media, railways, and the huge tobacco industry. Most important, nearly all banks are state-owned, a lever to control the rest of the economy.[10]

State control/dominance is undefined, but it plainly blocks a market-leader role for foreign firms either based in or exporting goods and services to the PRC. For instance, the foreign share in

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http://www.mayerbrown.com/publications/wto-appellate-body-issues-ruling-on-us-definitive-anti-dumping-and-countervailing-duties-on-certain-products-from-china-03-21-2011/.

[7] Interview with Yan Qiong, "Mergers, Acquisitions, and Restructuring of State-Owned Enterprises," King & Wood's Publication Group, October 2010, http://www.kingandwood.com/article.aspx?id=Mergers-Acquisitions-and-Restructuring-of-State-Owned-Enterprises&language=en (accessed July 16, 2012), and Nie Peng, "Steel Merger Will Become China's Biggest," *China Daily*, April 19, 2010, http://www.chinadaily.com.cn/bizchina/2010-04/19/content_9747309.htm (accessed July 16, 2012).

[8] The World Bank, "Doing Business: Economy Rankings," 2011, at http://www.doingbusiness.org/rankings (accessed July 16, 2012), and Katie Cantle, "Global Competition," *Air Transport World*, November 1, 2011, http://atwonline.com/airline-finance-data/article/global-competition-1109 (accessed July 16, 2012).

[9] Xinhua, "China to Drive Consolidation of 8 Industries Over Next 5 Years," July 7, 2011, http://news.xinhuanet.com/english2010/china/2011-07/07/c_13971925.htm (accessed July 16, 2012), and Bruce J. Dickson, "Updating the China Model," *The Washington Quarterly*, Vol. 34, No. 4 (Fall 2011), pp. 39–58, http://csis.org/files/publication/twq11autumndickson.pdf (accessed July 16, 2012).

[10] Zhao Huanxin, "China Names Key Industries for Absolute State Control," *China Daily*, December 19, 2006, http://www.chinadaily.com.cn/china/2006-12/19/content_762056.htm (accessed July 16, 2012).

telecom and oil is trivial. Foreign banks and insurers have less than 2 percent of sector assets.[11] The mandate that SOEs must come to control the domestic market kept auto imports below 5 percent of total sales even when Chinese automakers were backward. The current target for import displacement in favor of domestic production is environmental technology.

The Stateen: 18 Sectors the State Must Lead

Autos	Information technology	Petrochemicals
Aviation	Insurance	Power
Banking	Machinery	Railways
Coal	Media	Shipping
Construction	Metals	Telecommunications
Environmental technology	Oil and gas	Tobacco

There can be no better subsidy than an assured share—in this case, an assured share of a very large market. When the market share for American goods and services is tightly limited from the outset, other policies make little difference. Yet the WTO cannot address this.

The WTO definition of subsidies indicates it should be easier to break down barriers that result from financial subsidies, but that is not true in the Chinese case. The European Union recently inched forward on addressing Chinese financial subsidies in telecom, provoking threats from Beijing, which does not want light shone on its practices.[12]

The chief financial subsidy is bank lending by state banks to state firms at below-market interest rates. Banking dominates Chinese financing: From 2009 to 2011, bank lending totaled $3.7 trillion. State banks control over 90 percent of banking assets.[13] Unsurprisingly, they make as much as 80 percent of loans to SOEs, with even the central government concerned about the amount and cost of credit going to private firms.[14] For SOEs, the People's Bank has kept real (adjusted for inflation) interest rates near or below zero for years. And since SOEs do not truly go bankrupt, even trivial interest payments can be ignored.

This is not an export subsidy; it is an *existence* subsidy. Chinese SOEs do not borrow in order to dump on foreign markets, though that happens; they borrow in order to maintain or expand their position at home. The WTO has not been able to address this, but it obviously leaves less space for foreign goods and services in the Chinese market.

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[11] Wang Xiaotian, "Foreign Banks Remain Optimistic over Expansion in China," Xinhuanet, October 20, 2011, http://news.xinhuanet.com/english2010/china/2011-10/20/c_131202001.htm (accessed July 16, 2012), and PricewaterhouseCoopers, "Foreign Insurance Companies in China," September 2010, http://www.pwc.be/en/china-desk-newsletter/Assets/Foreign-insurance-companies-in-China.pdf (accessed July 16, 2012)

[12] Paul Mozur, "China Hits EU over Trade Spat," *The Wall Street Journal*, July 12, 2012, http://online.wsj.com/article/SB10001424052702303740704577521963892808818.html.

[13] Michael F. Martin, "China's Banking System: Issues for Congress," Congressional Research Service *Report for Congress*, February 20, 2012, http://www.fas.org/sgp/crs/row/R42380.pdf. Outside of banking, SOE-dominated sectors accounted for nearly 85 percent of stock exchange capitalization at the end of 2011. The biggest participant in the "corporate" bond market has been the Ministry of Railways.

[14] Jialin Zhang, "China Backpedals," *Hoover Digest*, 2011 No. 1, January 12, 2011, http://www.hoover.org/publications/hoover-digest/article/62771 (accessed July 16, 2012), and Xinhua, "Chinese Premier Urges Financial Support for Cash-Strapped Small Businesses," October 5, 2011, http://news.xinhuanet.com/english2010/china/2011-10/05/c_131175191.htm.

There are other subsidies. The state owns all land, and SOEs often receive it for free. In contrast, acquiring land is difficult and expensive for non-state companies. Non-state firms also suffer from insecure ownership: Local governments can evict them for reasons that include reducing competition for SOEs. The size of this subsidy has grown because land costs have soared in the past decade. Other inputs to production, such as power, are also subsidized.

General policy support of SOEs is essentially guaranteed. At the orders of the Communist Party, SOE officers move back and forth from policymaking positions. Further, many are closely related to high-level Party cadres.[15]

The results are stunning. The International Monetary Fund (IMF) puts China's 2011 *per capita* income lower than Namibia's. Nonetheless, with the lion's share of the domestic market guaranteed, Chinese state-dominated steel and coal production is approaching half the world total.[16] State banks and telecoms are, on some measures, the world's largest.[17] The PRC has the second-most companies in the global *Fortune* 500 at 73, now ahead of Japan despite being far poorer. Almost all of the entrants are SOEs, and three SOEs are in the world's top 10.[18] American companies face artificially inflated giants.

A firm contemplating the Chinese market should find it daunting. If labeled strategic, an entire sector can be closed. Foreign interest bears on whether a sector is so labeled - machinery became suddenly more valuable when an American company tried to become a major player.[19] The newest strategic sector, environmental technology, did not exist in China until just a few years ago and was identified largely due to foreign activity.

Any downturn is a further threat to multinationals. Low- or no-cost borrowing means that SOEs can defy the pressure of a shrinking market, overproducing even as demand fades.[20] Subsidies ensure there is no market of 1.3 billion for American exports, American firms based in China, other foreign firms, and even domestic private firms. There is only what SOEs leave behind.

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[15] Chen Jialu, "CEO Reshuffles Signal New View of Watchdog," *China Daily*, August 24, 2010, http://www.chinadaily.com.cn/bizchina/2010-08/24/content_11194717.htm (accessed July 16, 2012), and "China's Power Families," *Financial Times*, July 10, 2012, http://www.ft.com/intl/cms/s/2/6b983f7a-ca9c-11e1-8872-00144feabdc0.html#axzz20RpPdY6G.

[16] Press release, "World Crude Steel Output Increases by 6.8% in 2011," World Steel Association, January 23, 2012, http://www.worldsteel.org/media-centre/press-releases/2012/2011-world-crude-steel-production.html (accessed July 16, 2012), and World Coal Association, "Coal Statistics," August 2011, at http://www.worldcoal.org/resources/coal-statistics/ (accessed July 16 2012).

[17] Philip Lagerkranser, "China Banks Surge to World's Largest May Be Too Good to Be True," Bloomberg, April 29, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aueh06DOY37A (accessed July 16, 2012), and Janet Ong, "China Tells Telecom Companies to Merge in Overhaul (Update 1)," Bloomberg, May 25, 2008, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aYQg0d5NANkM (accessed July 16, 2012).

[18] "Global 500: Our Annual Ranking of the World's Largest Corporations," *CNN Money*, July 2012, at http://money.cnn.com/magazines/fortune/global500/2012/countries/China.html.

[19] Xinhua, "Carlyle Abandons Xugong Dream," July 24, 2008, http://news.xinhuanet.com/english/2008-07/24/content_8760203.htm.

[20] Embassy of the People's Republic of China in Negara Brunei Darussalam, Economic and Commercial Counsellor's Office, "70% of China's Products to Be in Oversupply," August 1, 2005, http://bn2.mofcom.gov.cn/aarticle/chinanews/200508/20050800219859.html.

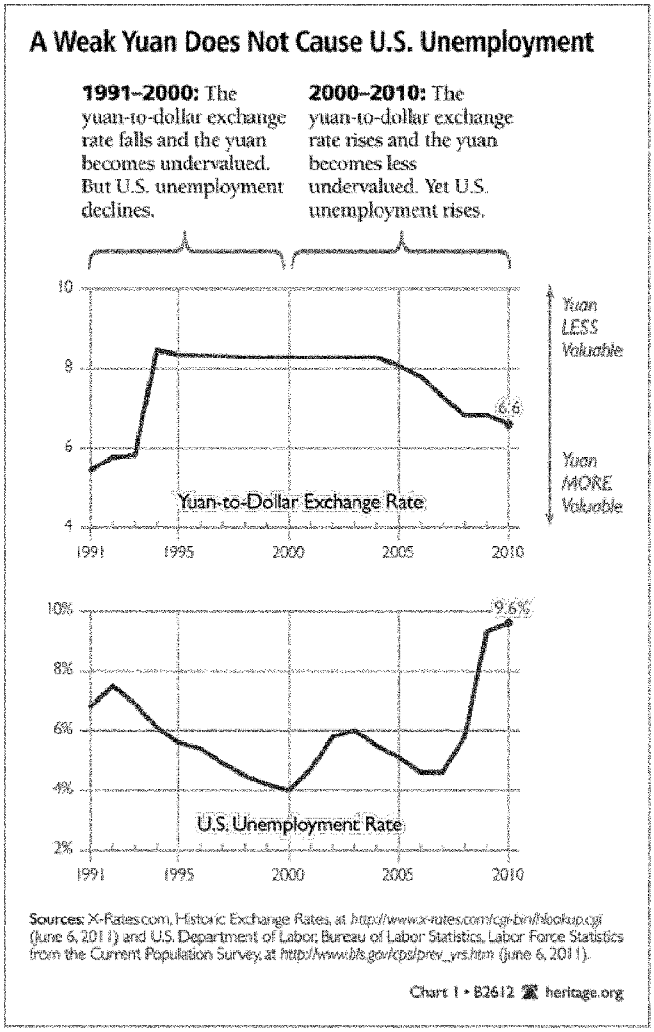
The WTO has been utterly unable to come to grips with this. It is therefore up to the U.S. to act, but American action will be ill-considered and likely harmful until a proper understanding and measurement of subsidies is in place.

The Exchange Rate: Overrated

The IPR and subsidies discussions should make it clear that the dollar-to-yuan exchange rate is a trivial factor. IPR violations rob the U.S. of comparative advantage, subsidies effectively seal off most of the Chinese market—the exchange rate cannot compare.

Even the extent of the RMB's undervaluation against the dollar cannot be determined. The IMF in mid-2011 offered an unhelpful range of 3 percent to 23 percent.[21] Beijing intervenes so much it is impossible to determine the market-driven exchange rate. Further, the PRC's exchange rate policies are aimed, not at the U.S., but at peer producers such as Mexico. The effect of the yuan's peg a weak dollar does not fall against the yuan. Instead, they fall in tandem. The disadvantage is inflicted on countries which see both the dollar and yuan weaken against their currency. Breaking the peg would shift Chinese jobs to these countries, not the U.S.

[21] Reuters, "IMF Says Property Bubble in China a Concern; Yuan Still Undervalued," July 20, 2011, http://www.reuters.com/article/2011/07/21/imf-china-idUSS7E7FQ01820110721.



Unsurprisingly, there is no evidence that a weaker yuan causes U.S. unemployment and a stronger yuan means more American jobs. The evidence actually seems to say the opposite. This is because it is our policies that drive our unemployment; the yuan simply does not matter.

The Best American Response

It follows immediately that the American emphasis on the exchange rate has been wasteful. Along these lines, making eight demands of China at each high-level meeting has accomplished little. The exchange rate should be dropped from the list of U.S. priorities, and Congress should not impede that change.

Intellectual property is far more difficult, a core issue but one with no apparent solution in the Chinese case. Retaliation can be justified but offers little hope for progress. For some countries, bilateral investment treaties or free trade agreements can include IPR provisions that induce progress. With the PRC, that would be a high-risk strategy. It is likely that Beijing would adhere to an agreement but also use its many policy tools to find other ways to continue to limit IPR. This has happened with a number of the terms of China's WTO accession.

An indirect approach, not targeting China or any country, may be more helpful. The WTO has considerably improved the global climate for IPR as compared to a generation ago. Much more work must be done, but the WTO has shown it can improve upon bilateral pressure. The catch, of course, is that the WTO itself is moribund, and there is even a possibility the entire process has run its course. More options are needed in case the WTO remains stuck.

The U.S. has sought multilateral arrangements with a smaller number of like-minded countries. Examples are talks with the EU and attempts at a Western Hemisphere free trade area. The lead initiative at present is the Trans-Pacific Partnership (TPP). One goal of the TPP is to create incentives for countries such as China to change behavior in order to join. Since IPR is central to U.S. comparative advantage, Congress should ensure the TPP includes provisions that, if Beijing did join, would considerably strengthen Chinese protection of IPR.

On the more tractable matter of subsidies, the U.S. has taken the first step, if belatedly. The United States Trade Representative in fall 2011 finally notified the WTO of nearly 200 subsidies that China should have reported but did not.[22] Little progress has been made since, in part due to obvious Chinese recalcitrance but also in part due to the narrow WTO subsidies definition.

The U.S. should therefore move beyond both the PRC and the WTO by measuring Chinese subsidies independently. Regulatory protection against competition must be included, which will be difficult, inexact, and controversial at the outset. But if it is not included, subsidies will be seriously underestimated and considerable harm will continue to be inflicted on American firms. Estimates will improve over time, and the process could force either the PRC to provide its own information on subsidies or a change in WTO practice.

Bilateral pressure must be brought through presidential summits, the Strategic and Economic Dialogue, and all other tools, including appropriate legislation. This pressure should be focused on the regulatory protection SOEs receive. America currently approaches China with numerous,

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[22] Press release, "United States Details China and India Subsidy Programs in Submission to WTO," Office of the United States Trade Representative, October 2011, http://www.ustr.gov/about-us/press-office/press-releases/2011/october/united-states-details-china-and-india-subsidy-prog.

vague demands which are never met. A measurement of subsidies would allow the U.S. to make concrete proposals and, more important, assess progress over time. Also, a sound subsidies measurement is needed to ensure that American action is corrective, not protectionist.

Land ownership is the heart of Communist ideology and will not change. Interest rate reform is critical but will accomplish nothing if SOEs can ignore repayment. Nor will it be possible simply to eliminate regulatory protection. However, the number of "strategic" sectors can shrink, and the extent of state dominance in these sectors rolled back. For instance, machinery should never have been included. Beijing can also limit the required market share. In petrochemicals, 51 percent should be enough. In admittedly sensitive industries such as oil, 75 percent state control is far better than 95 percent. Just clarifying the target state share would be a useful first step.

Sustained American demands for the smallest possible role for Chinese SOEs translate into the largest possible share for American goods and services. The U.S. so far has failed to act along these lines. Congressional legislation aimed at Chinese trade barriers should focus on curbing the regulation that enables SOEs to avoid competition. The first step is to document the effects of this regulation.

It should be said that the principle of reducing regulation to encourage competition plainly does not apply only to China. It can apply to a wide range of American partners that create regulations with one eye on disadvantaging foreign products.

It also applies to the U.S. itself. The U.S. should be ready to reduce our own regulatory barriers to competition. This will not only establish our credentials in negotiation with foreign partners, but also make American companies more competitive against Chinese SOEs and everyone else. Congress obviously has a key role to play here.

Chairman ROS-LEHTINEN. All right. A 103rd, you are going to live forever, Dr. Scissors. All right. I feel like Al Roker here. Mr. Hirschmann, you are next, sir.

STATEMENT OF MR. DAVID HIRSCHMANN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GLOBAL INTELLECTUAL PROPERTY CENTER, U.S. CHAMBER OF COMMERCE

Mr. HIRSCHMANN. Madam Chairman, Ranking Member Berman, and distinguished members of the committee, thank you for allowing me to testify on behalf of the Chamber's Global Intellectual Property Center, and the chairwoman was kind enough to mention my wife, Susan, all I can say is, I assure you her shoes are not counterfeits. This is a very timely hearing and just the latest example, frankly, of the bipartisan leadership in this committee on these issues. I think that is fitting because protecting the millions of jobs tied to inventing, creating, discovering, and bringing to market new products and services is a goal that unites all of us and impacts every business in this country.

Study after study has shown that innovation and creativity, incentivized by a strong intellectual property rights system, are the driving forces behind the U.S. economy. In fact, our most recent study that was cited here shows that more than 55 million American jobs are tied directly and indirectly to intellectual property. These are jobs that pay 30 percent higher wages than on average and account for $5.8 trillion in national output. IP is also one of the most valuable trading assets and a key to our global competitiveness. In 2011, our innovative and creative industries comprised close to ¾ of all U.S. exports, and this is true in all 50 states, to the tune of $1 trillion.

Today, I would briefly like to make five points before taking any questions. First, while counterfeiting and piracy are not new crimes, the scale, scope, sophistication, and devastating impact of intellectual property theft has grown dramatically. The criminal networks engaged in the systematic theft of everything we invent may not spend money on research and discovery, as has been mentioned, but they are very sophisticated marketers and distributors. Cross-border theft of IP-protected products has mushroomed from a cottage industry into a global network of illicit crimes, including counterfeit and piracy both in the physical world and in online environments.

Second, counterfeiting and digital theft impact every industry across the nation. In February 2011, Frontier Economics found that the global value of counterfeited and pirated goods is up to $650 billion every single year. And they further estimated that that would triple to $1.77 trillion in just 3 years. Counterfeiters and digital thieves are increasingly sophisticated and deceive us into purchasing counterfeit automobile parts, food, medical devices, medical supplies, electrical supplies, pharmaceuticals, that do not even meet the most minimal safety standards, or in the space of pirated movies and music, consumers are falling prey to malicious computer viruses and identity theft.

The entities behind these illicit goods aren't haphazard infringers. They are operators of sophisticated, organized criminal networks. For example, recent news reports have found that the sale of pirated movies and music now provides a major source of income for the Zetas, the drug cartel in Mexico.

Third, business is doing and must do everything it can to protect its own IP. This includes both embracing and investing in new and innovative ways to distribute their products and developing new technologies and partnerships to protect both consumers and their supply chains. Every government must also redouble its efforts to protect intellectual properties, and we need to set the example right here at home. The recent extraordinary efforts of the IPR Center, led by Immigration and Customs Enforcement, are evidence of what can be accomplished, and it has been done thanks to the great support on a bipartisan basis from this Congress.

Lastly, we need to achieve meaningful advances in protecting our greatest trading assets overseas. Foreign governments increasingly allow, and even encourage has been said, unwarranted exceptions to IP that weaken company's ability to innovate. Examples include India's recent issuance of its first compulsory license to allow generic manufacturing of patent anti-cancer drug and Australia's recent passage of legislation that stripped trademark owners of their ability to use brand on tobacco products.

Meanwhile, a number of countries have inadequate IP laws or fail to effectively enforce their own IP laws. China is the best example and remains, as everybody has said, the leading source of counterfeit and pirated goods worldwide. While China has taken some steps to advance certain IP reforms, we believe the real change will only occur when intellectual property environment has changed in China. One of the most immediate opportunities to assert U.S. leadership in promoting our innovative and creative economy is the negotiation of a Trans-Pacific Partnership, as Ranking Member Berman has indicated.

This is a template for future agreements, so it is essential that TPP include comprehensive high standards for intellectual property protection, looking at the U.S.-Korea Free Trade Agreement as a benchmark. We urge governments to continue to ensure that TPP provides such strong protections. We can't exclude any sector of our economy and we must secure meaningful, important opportunities for biotech pharmaceutical companies, including the 12 years of data protection for biologics that is currently in U.S. law.

In concluding, let me simply reiterate that it is essential for the administration and this Congress to continue to identify ways to combat foreign theft of our creative and innovative products, to protect the 55 million jobs that these products support, and we look forward to working with this committee to continue to advance that agenda.

[The prepared statement of Mr. Hirschmann follows:]

100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: Unfair Trading Practices Against the U.S.: Intellectual Property Rights Infringement, Property Expropriation, and other Barriers

TO: U.S. House of Representatives Committee on Foreign Affairs

BY: Mr. David Hirschmann, President and Chief Executive Officer, Global Intellectual Property Center, U.S. Chamber of Commerce

DATE: July 19, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

About the U.S. Chamber of Commerce

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Testimony of David Hirschmann
President and Chief Executive Officer
Global Intellectual Property Center
U.S. Chamber of Commerce

Introduction

Thank you Chairwoman Ros-Lehtinen, Ranking Member Berman, and distinguished members of the Committee on Foreign Affairs. My name is David Hirschmann, and I am the President and Chief Executive Officer of the U.S. Chamber of Commerce's Global Intellectual Property Center (GIPC).

The GIPC was established in 2007 as an affiliate of the U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

The GIPC champions intellectual property rights as vital to creating jobs, saving lives, advancing economic growth and development around the world, and generating breakthrough solutions to global challenges.

I appreciate the opportunity to speak with you today about the importance of protecting and enforcing the intellectual property rights of America's creators and innovators around the globe.

Economic Contributions of IP

Intellectual property (IP) is a key engine of growth and economic development in the global economy. IP-intensive industries create real jobs for Americans. These jobs can be found in every corner of the U.S., as evidenced by the U.S. Chamber's recently-released *IP Creates Jobs for America* study. According to this study, IP-intensive industries directly and indirectly support more than 55 million American jobs – jobs that pay 30% higher wages than those in other industries – and account for $5.8 trillion in national output.

IP is also one of our most valuable trading assets and a key to our global competitiveness. In 2011, our innovative and creative industries comprised close to three quarters of all U.S. exports. In both Florida and California, for example, IP accounts for over 75 percent of each state's exports. With 95 percent of consumers living outside the United States, transparent, high standard and commercially meaningful IP rules in the global marketplace are essential to the growth of our IP-intensive industries in all states.

For the U.S. to remain the most innovative economy on Earth, we must ensure that our IP-intensive industries remain confident that copyrights, patents, and trademarks will be enforced. Sound IP policies and enforcement of IP rights abroad are essential to advancing U.S. economic recovery, driving America's competitiveness and export growth, and creating high-quality, high-paying American jobs.

Challenges and Opportunities to Protecting IP Overseas

Today's global intellectual property rights (IPR) system is designed to incentivize individuals and businesses small and large to invest in innovation and creativity. This time-proven system also helps provide assurances to consumers that the products they use are authentic, safe and effective.

America's IP-intensive industries, however, are facing increasing challenges to bringing their creations and innovations to the global marketplace due to unpredictable and insufficient intellectual property systems in a number of foreign markets. Our innovative economy also faces growing threats from counterfeiting and piracy networks operating online and in the traditional marketplace. Moreover, some foreign governments are actively seeking to weaken IPR in their own countries and in multilateral institutions, undermining the ability of businesses to innovate, bring the newest and most effective technologies to market, and differentiate brands.

IP theft is a particular problem worldwide as counterfeiting and piracy have a significant influence on the global economy. The Organization for Economic Co-operation and Development (OECD) estimated in 2009 that for the G20 economies the value of counterfeited and pirated goods in international trade totaled $250 billion per year.[1] However, that analysis did not include both domestically produced and consumed counterfeit and pirated products and pirated digital products being distributed via the Internet. If those metrics were included, the estimates would be "several hundred billion dollars more."[2]

In February 2011, Frontier Economics updated OECD's method of analysis to include those metrics, and concluded that the value of counterfeited and pirated goods

[1] OECD, Magnitude of Counterfeiting and Piracy of tangible products: An Update (Nov. 2009).

[2] OECD, The Economic Impact of Counterfeiting and Piracy, p.4 (2008).

would be up to $650 billion every year.[3] That same study estimates that the value of counterfeited and pirated goods could reach $1.77 trillion by 2015.

The effect of counterfeiting and piracy are serious. In the G20 economies, 2.5 million jobs have been lost to counterfeiting and piracy.[4] That number will continue to rise if the tide is not stemmed. In some cases, it is hard to quantify the loss to the global economy, but it is clear that online counterfeiting and piracy cut into the sale of genuine products, force manufacturers to raise the prices of authentic products to cover costs, lower employment, deter investment in R&D as well as capital investment, reduce tax receipts, and raise law enforcement costs.

Fighting intellectual property theft on the Internet is imperative. A study of websites dedicated to trading in infringing copyrighted or trademarked goods found that these websites generated over 53 billion visits annually.[5] Approximately a quarter of all Internet bandwidth is used for digital theft.[6] These websites undercut an intellectual property system that helps provide assurance to consumers that the products they use are authentic, safe, and effective and put consumers at risk.

A global patchwork of laws and enforcement invites the criminal enterprises behind online counterfeiting and piracy to shop for a forum in which they can elude justice. The Office of the United States Trade Representative (USTR) has recognized the significance of this problem in the context of its two Special 301 Out-of-Cycle Reviews of Notorious Markets. We urge the U.S. government to make action by foreign governments to address and fix Notorious Markets in their jurisdiction a top priority.

Country Analysis

Earlier this year, the GIPC submitted its first ever Special 301 Review comments to the Office of the U.S. Trade Representative. The Special 301 Report is a critical mechanism to shine a spotlight on countries that are threatening American jobs and economic growth by undermining the intellectual property rights of our creative and innovative industries.

[3] Frontier Economics, Estimating the Global Economic and Social Impacts of Counterfeiting and Piracy (Feb.2011).

[4] Frontier Economics, Estimating the Global Economic and Social Impacts of Counterfeiting and Piracy (Feb.2011).

[5] MarkMonitor, Traffic Report: Online Piracy and Counterfeiting (Jan. 2011).

[6] Envisional Report, "An Estimate of Infringing Use of the Internet" (Jan. 2011).

Our submission provided an overall assessment of eight countries that significantly deny adequate and effective IP protection and enforcement. These countries are Brazil, Canada, China, India, Mexico, Russia, Turkey and Ukraine. I would like to highlight a few of the greatest challenges and opportunities that we face in promoting IP improvements in a select number of these countries.

There is no better example of the challenges and opportunities our businesses face in protecting IPR than China.

China remains the leading source of counterfeit and pirated goods worldwide. According to the U.S. Customs and Border Protection, China accounts for 62 percent or $124.7 million of the total domestic value of seizures. In a recent study by the Business Software Alliance (BSA), the piracy rate in China was 77 percent and almost $9 billion of pirated software was illegally obtained in China in 2011—the highest in Asia.

China has taken some steps to advance certain IPR reforms. We appreciate the transparency of the Supreme People's Court in its drafting of a Judicial Interpretation regarding Internet liability, and the Chinese government's drafting of amendments to the Copyright law. In addition, China has made important commitments to expand its software legalization programs to local government departments. We continue to monitor these priority areas to ensure that domestic and U.S. rights holder concerns are addressed fully and effectively and also urge the government to ensure effective regulatory data protection for innovative pharmaceuticals.

We commend China for taking steps toward better IP enforcement by making permanent their 2010 Special IPR Campaign. In particular, the GIPC welcomes Premier Wen Jiabao's announcement of the creation of an IPR "Leading Group" within the State Council and looks forward to seeing the Leading Group advancing more robust intellectual property reforms that benefit domestic and U.S. rights holders.

The ultimate judgment of this campaign's success will be determined by whether it reduces levels of intellectual property violations, and correspondingly, increases legitimate sales. We believe that these outcomes will occur only when the intellectual property environment in China has changed.

Russia will join the World Trade Organization (WTO) in August. This is a welcome development for American workers, farmers, and companies because accession to the WTO requires Russia to further open its market to imports, safeguard investments, and strengthen the rule of law. Russia will also accede to the WTO

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and be subject to the organization's dispute settlement process. However, if Congress fails to approve Permanent Normal Trade Relations (PNTR) with Russia before the August district work period, Moscow will be free to deny U.S. workers, farmers, and companies the full benefits of its reforms. America risks being left behind as European and Asian companies build on their head start in the world's ninth largest market.

While the Chamber strongly urges Congress to approve PNTR before the August district work period, we also note that Russia continues to present significant challenges to U.S. innovators and creative artists. We urge the U.S. government and Congress to remain vigilant in ensuring that Russia implements its intellectual property commitments in full, including by making greater progress combating online piracy.

We also want to highlight significant concerns regarding recent actions in India that threaten innovation and overall health policy. In March, the Government of India issued its first compulsory license to allow for the generic manufacturing of a patented anti-cancer drug. In a public statement, we expressed our disappointment with this action. While we share the Government of India's desire to improve access to medicines, we believe the issuance of compulsory licenses for anything other than exceptional circumstances does irreparable harm not only to the biopharmaceutical industry but also to all innovative industries. Weakening patent protection for innovative pharmaceutical products will impede the development of new life-saving solutions without improving access to quality, affordable health care.

There have also been unwarranted efforts to weaken trademark protections in the name of public health. The GIPC is particularly concerned by government policies that reduce or eliminate the ability of manufacturers to distinguish their brands, especially when consumers are often reliant upon those brands to identify products they know and trust. An unfortunate precedent was set, for example, by Australia, in November 2011 when the government passed legislation that stripped trademark owners of their ability to use their brand on tobacco products.

While the challenges faced by our IP industries overseas are numerous, there are also important opportunities to seek greater improvements in IP systems around the globe. One of the most immediate opportunities is the negotiation of the Trans-Pacific Partnership (TPP) Agreement. If the TPP Agreement is to be "a model for ambition for other free trade agreements in the future," as declared by the TPP leaders in November 2011, it is essential that the Agreement include comprehensive, high-standard IP protections, looking to the U.S.-Korea Free Trade Agreement and U.S. law as a benchmark.

We urge the U.S. government to show heightened leadership to ensure that the final text of the TPP provide robust protections for creators and innovators and the 55 million American jobs supported by IP-intensive industries. This includes pushing back on any efforts to weaken IP rights or to exclude any sector from protection in the Agreement. It is also essential that this Administration put forward any remaining text that secures commercially meaningful opportunities for all biotech and pharmaceutical companies to enter the TPP country markets, as well as provides 12 years of data protection for biologic products.

These efforts are essential as new entrants are poised to join the negotiations. Recently, the Chamber welcomed the invitations to Canada and Mexico to join the TPP.

Both Canada and Mexico have taken some steps to improve their IP systems in recent months. Earlier this month, Canada enacted copyright reforms that represent a positive step forward in ensuring IP rights for creators are protected. More recently, Mexico signed the Anti-Counterfeiting Trade Agreement.

There are still a number of outstanding IP issues that both the Canadian and the Mexican governments must deal with to ensure that IP is properly protected and enforced, including further copyright reforms, the provision of *ex officio* authority to customs officials and further improvements to provide greater certainty for pharmaceutical innovators. The Chamber looks forward to continued progress on IP matters in Canada and Mexico, including in the context of the TPP.

Conclusion

Adequate and effective protection and enforcement of intellectual property abroad is vital to our economy. It is essential that the Administration and this Congress continue to identify ways to combat foreign theft of our creative and innovative products and the 55 million jobs that these products support. The U.S. Chamber looks forward to working with members of the Committee to secure improvements in IP systems around the globe.

Thank you.

Chairman ROS-LEHTINEN. Thank you very much. Excellent testimony, gentlemen. I will ask questions on two issues. Although we have not talked about the Arab boycott on Israel, I wanted to ask you what thoughts you have about the impact that the Arab League boycott on Israel has had on U.S. companies. How effective have been the steps taken by our Government to reduce its impact? What measures can we take in Congress to ensure that neither U.S. businesses nor Israel are negatively impacted by this boycott?

And secondly, on the issue we have been discussing, Beijing claims that it cannot control the illegal copying and downloading by its citizens of music, and movies, and other types of U.S. intellectual property, yet, the Chinese regime invests massive resources and efforts in blocking the free exchange of information by its citizens, including simple messages in support of democracy, or prisoners of conscience, of course, that cannot be allowed, they say. What are your comments on the Chinese regime's control of political expression at all costs, yet saying that it cannot prevent illegal downloading from open sites?

So anyone who wishes to comment on the Arab League and the Chinese line.

Mr. ALDONAS. Sorry. Let me start with the Arab boycott. My own experience in private practice for many years as an international lawyer was that it had a very significant impact. And that the choices that firms were required to make wasn't just dealing or coping with our regulations, which they were happy to comply with, it really was the impact and the power of what you had in terms of purchasing power in the Middle East as a result of oil. So ironically, I think the two things that we could do that are most important don't relate to our regulatory regime, they actually relate to developing our own energy resources, so that, in some respects, we reduce the power of the boycott.

The second thing is, we have a free trade agreement with Israel which is not as broad as it should be. When we negotiated in 1984, it was our first step toward free trade. It was our first bilateral agreement and on both sides we did not go as far as we could. At this point, Israel has found its own energy resources. We don't have an energy chapter in the FTA. In terms of the linkages between our economies, so much of what Israel contributes to our economy is high-tech. We actually don't have a chapter that expands on that trade or thinks in terms of, how would you create an electronic market?

And what I would think about doing is then building from that to a regional initiative. We do have free trade agreements with Morocco. We do have free trade agreements with Jordan. We do have a QIZ program in the Palestinian Territory. Trying to build off of the U.S.-Israeli model and build, frankly, a model that is in opposition to the boycott, I think, is the most profitable way to do it and also the most positive way to do it.

Chairman ROS-LEHTINEN. Thank you very much. Dr. Scissors.

Mr. SCISSORS. I think I will stick to the China question after Grant's excellent answer on the Israel question, the Chinese could obviously do better. They don't devote the resources to IPR that they devote to lots of other things that are apparently more in their interest, but we know that. We know the resources that are available to the Chinese state. We see it in evidence all the time in negative, and sometimes positive, ways, and they are important in IPR. We have to change their incentives. And I think my colleague, Mr. Hirschmann, and members of the committee, have indicated the way to do that, it is not to try to bludgeon them into doing it. They just won't listen.

The way to do that is to say, okay. You want to play that way. We are going to get a group of people, including trade partners you really value, we are going to play a different way, and if you want to trade with Australia, maybe Indonesia comes into this, countries that have resources, you are going to have to change the way you behave. So bilaterally, I don't know what we can do to get them to use more resources that they have, the chairman is exactly right, but indirectly, I think we can change their incentives where they realize, all right, well, if we don't go along with this we are going to lose more than we are gaining by stealing.

Chairman ROS-LEHTINEN. Thank you very much. Mr. Hirschmann.

Mr. HIRSCHMANN. China's laws are stronger than its practices and you are right that when China recognizes that it is in its self-interest in an area, it has demonstrated that it is also able to enforce its laws. And it has not done so consistently on intellectual property. But China is also not monolithic and we have found that there are certainly businesses within China, government leaders within China, who understand that China's future is in innovation. And one of the things we have tried to do is strengthen their hand, work with them, because ultimately, while China's enforcement of intellectual property is inconsistent, to the point that the problem continues to grow, to agree that businesses in China begin to demand from their government that their own intellectual property be protected, and the rest of the world joins forces in holding China accountable, I think we will make real progress.

Chairman LEHTINEN. Well, thank you, and I will end with a question that I don't have time to answer, but a number of countries in the Middle East, including Saudi Arabia, are notorious for widespread commercial abuses, such as their refusal to pay foreign companies and individuals for services rendered. And these individuals and businesses have few, if any, effective means for redress, and Congress has enacted legislation to require the administration to seek resolution of these disputes, including the establishment of a special claims process, but the problem remains. It has not been eased up at all and I had wanted to ask what we can do in Congress to ensure that there is a fair and speedy resolution on these cases. So we will leave that for another day. Mr. Berman is recognized for his questioning period. Thank you, gentlemen.

Mr. BERMAN. Yes, I mean, you have touched on some of these issues, but I would like to just push a little harder on China specifically. Dr. Scissors creates a model of Chinese Government intentions. They don't want competition. State-owned enterprises don't fold for failure, they merge in other entities. They don't allow market space. Other than the obvious importance of measuring in the area of intellectual property violations—the costs and scope of the theft, the activity, and the conduct—tell me a little more what you mean by pressure because, hoping that the Chinese private innovative sector creates enough pressure on its own government that, for their interest, they decide to force this, sounds like a very long-range plan.

What is the short-range plan? Because it does occur to one that dealing with what we are dealing with here, should there be a huge escalation? Should we be talking about threatening China with the issue that it probably takes most seriously, which is its market access to us? And with all the costs that has for American consumers, for trade wars, for all of this, what is the argument against a rapid escalation of our tactics and weapons to challenge China's notorious market? What are the arguments against doing that and finding more moderate, more incremental, kinds of strategies?

Mr. SCISSORS. There are two arguments, and I think the whole committee is aware of one of them, it would cost the United States. China is very much in favor of competition overseas. Other people should compete and that competition is good for everyone. Competition is what drives economic progress and if we take away Chinese competition we hurt ourselves. They don't like competition at home. Competition is good for others, so there are costs to the United States. I think we are aware of those. I would add to that, we haven't——

Mr. BERMAN. But in and of itself, is the cost to the United States in the short term greater than the price of what is occurring continuing?

Mr. SCISSORS. Sir, I don't think those are the only options because I don't think we have done a good job in confronting the Chinese without going to the big retaliation phase. We don't confront them on a bilateral basis with, look, this is exactly what the harm that is being done, we are measuring it, and the harm is not dropping. We don't do that. We do lots of things. We ask them for lots of things. They tend to be very vague and policy-drive, not outcome-drive. The WTO is stalled. I think that is very unfortunate. I think an American effort in the WTO on IPR and subsidies would be much preferable as a first step to taking action against China, and as the committee, including yourself, has recognized, grouping of like-minded countries have a way of influencing China without causing a confrontation.

So if you are asking me if we have tried everything else, is it worth it? I might say no, because, you know, we haven't measured the situation yet, so I don't know exactly, but I understand the question. I don't think we have tried everything else. I don't think we have been very effective in what we are trying to do. TPP is a great possibility for changing that, but I think we need to try other things before we go to massive retaliation.

Mr. BERMAN. Okay. Let me just try one last quick response from Mr. Hirschmann on the Russia issue. You advocate granting PNTR status and I think there is a lot of logic to that. Are the current Russian commitments on intellectual property protection adequate? Are they meaningful? Are we better off with Russia in WTO and them having normal trade relation status in terms of making progress here?

Mr. HIRSCHMANN. Well, thank you for raising Russia. At this point, Russia is going to get into the WTO, so the question is, will we have, you know, the benefits of PNTR will accrue largely to the

United States by having access to that market. But the reason this has taken a number of years is because the United States and this Congress were right to insist that Russia not just make promises in exchange for getting into the WTO, but that it make actual commitments.

Mr. BERMAN. You mean, not replicate the China model.

Mr. HIRSCHMANN. They actually practice what they say they are going to do. There have been some improvement in some areas, but overall I think Russia still has a lot to do and this Congress should continue to hold Russia accountable to live up to its commitments.

Mr. ALDONAS. Madam Chairman, could I just take 10 seconds to respond to Congressman Berman's first question? The first thing, and I am going to go back to the analogy of where our conversation started this morning, which is export controls. The problem with sanctions, which you have said eloquently over so many years, is, they are frequently not sufficiently targeted to have the impact we want. And the broader cost, both to our economy and to a lot of people in the Chinese economy of the simple escalation is, it is not targeted to actually affect the actors that would make a difference.

What I would suggest is that, many of the tools we have domestically are not well-adapted to the global economy in which we operate. So, for example, we do have provisions that allow you to enforce, at the border, your intellectual property rights. The reality is, it is only on the finished product; whereas, many of the intellectual property violations are deep in the value chain. But there is a series of things we could do with our own laws that would be much better at targeting the individual companies, and particularly the state-owned enterprises that engage in this kind of behavior.

Chairman ROS-LEHTINEN. Thank you very much. Thank you, Mr. Berman. Mr. Rohrabacher, the chairman of Subcommittee on Oversight, is recognized.

Mr. ROHRABACHER. Thank you very much, again, Madam Chairman for holding this very significant discussion. I know people think that I am not for free trade because I am rather passionate about some of my beliefs in dealing with China, but I am a free trader. I believe in free trade between free people and I do not believe that it is possible for free people to have free trade with their fellow citizens of the world if the other people they are dealing with live under a Communist-style dictatorship as they do in China. I believe that the rules will always be manipulated so that there is a flow of power and wealth, not only from one country to the other, but from one people to the ruling dictatorship. That is why they are a dictatorship in the world's most populous country because they know how to wield power for their own benefit.

We have been played for suckers over the years. We have been played for fools. And we should because we have been permitting ourselves to act like fools. Oh, we are so afraid. We are so afraid of this dramatic confrontation that will happen. We are cowardly. They are not cowardly. They are brazen in their theft of wealth that should be going for our people to help our way of life, to help people pay for their family's education, or their family's home, and instead, the wealth is going, because we are permitting a one-way free trade. We are permitting massive theft of value that we have invested to go to another country that is dominated by a click of people that ensure that the wealth and power that goes there is under their control.

It is not bizarre. It is cowardly. And let me ask about WTO. Well, first of all, let me know about Russia. When Russia sees the way we are acting about China, why would they think that they have to change any problem that they have got? They, in fact, think that they are being discriminated against if we are letting China off the hook. They don't even have any political reform in China as compared to Russia. Russia has dramatic political reform over these last 30 years, yet, they have all these massive restrictions still on them from the Cold War, and yet, we let China, which is the world's worst human rights abuser, literally, get away with murder.

If we do rely on the WTO, which I voted against permitting China into the WTO, do we have a situation where we can enforce our own findings against China if we see that there is an organized effort by the Chinese Government to steal intellectual property from us, which we know exists? If we prove that, can we then unilaterally move forward or then do we have to rely on some panel from the WTO, perhaps with really significant countries like Cambodia or Nigeria, making the decision for us?

Mr. ALDONAS. If I could, first of all, thank you for your comments because I largely agree with the idea; if it is not a free people, free trade is hard to have. Having said that, with the WTO, the answer is yes or no. You know, if we are in a situation where the rules, as they currently are, cover the practice, we have actually had a considerable success in litigating against the Chinese. The real problem is that, the WTO rules, such as they are, are largely confined to trade in industrial goods. They don't reach many of the things that are a competitive advantage. They don't go far enough. So the bindings on China are insufficient to go after the kind of broad panoply that you have described, Congressman, in terms of their affairs.

That is why I think what Derek has said is, we need to be working with other countries to be developing the disciplines that go further, and it goes to the point you made about Russia. The reality is, we got into the trading system, the GATT and the WTO, with a bunch of countries that had similar underlying assumptions about free-market economies. We never bothered to state those assumptions and the principles on which the entire system has to be based, and until we get there, we won't actually have global free trade.

Mr. SCISSORS. Just really quickly, I mostly agree with what Grant said. There are some things you can make progress on in the WTO; there are some things you can't The WTO is a partial answer. It is not a complete answer. We can do better with the WTO if we go to them with a measurement of what the Chinese are doing. We don't do that on some issues, like subsidies, now, but that isn't going to finish the process. The process also has to be finished, as you mentioned in the outset, by making agreements with countries that agree with us, and making a stark choice between, you can play it this way and this is who you get to deal with, or you can play it this way and you get to deal with a much bigger, more prosperous, set of countries.

Mr. HIRSCHMANN. I would just add that, in addition to the very excellent points here, we do need to have an all-of-the-above strategy. The U.S. is not only a big market for Chinese legitimate products, it is also a big market for counterfeit Chinese products and we don't do enough to enforce our own laws here and to address the counterfeits that come into our own economy. Second, what we have seen that when, as Dr. Scissors and Grant Aldonas have pointed out, China's leading trading partners unite behind an issue, you don't make perfect progress, but you make better progress. And we need to put every effort we can to working with Europe and other trading partners with China to put this issue higher on the agenda for all of us.

Chairman ROS-LEHTINEN. Thank you very much, Mr. Rohrabacher. Thank you. Mr. Meeks, the ranking member on the Subcommittee on Europe.

Mr. MEEKS. Thank you, Madam Chair. Let me ask Mr. Aldonas first. I just want you to elaborate a little bit more on the Russia situation, that Russia is getting into the WTO, and whether or not, by Russia being in the WTO, and by us granting PNTR, will that have any effect at all with reference to reducing IP theft? I just want a little more elaboration on that.

Mr. ALDONAS. They will be subject to the disciplines of the TRIPS agreement and as I am comfortable as I am as a free trader of saying that you want a society, going to Mr. Rohrabacher's point, where everything isn't free as a participant in the system, we are better off with them under those rules. There is absolutely no doubt in my mind.

Mr. MEEKS. So to anybody then, what do we do? You know, the realities of the global marketplace, we made certain trade commitments that we are not going to undo, but what can we do when a trading partner is acting in a manner that is unfavorable to American interests? What should we do? I mean, you heard my comments earlier about what is taking place in Ecuador and Chevron, and, you know, you just have some people that they are not going to—what should we do in those instances?

Mr. ALDONAS. I think Ecuador is an interesting example because we do have leverage in the fact that they are a part of the ATPA process, whether or not, given what they have done with expropriation, and given the violations they have committed of the Bilateral Investment Treaty, particularly with respect to Chevron, whether they should be entitled to those tariff preferences, is a serious question. My own instinct, that is an opportunity where you do retaliate because they are flatly flouting the rules of the Bilateral Investment Treaty and investment is one measure that we are supposed to be taking into account when we think about the preferences we offer.

More broadly, you have to be thinking about whether you can help Peru with an FTA, as you have done, outcompete Ecuador because the answer at the end of the day, even with China, is, can you build a better model that starts to outcompete them for capital and for investment? And so my instinct, even in the Western hemisphere is, as Derek was saying more broadly, let us find a way to get back in touch with the people that are committed to free trade. Let us build that.

It may not include Brazil or Argentina right off the bat, it certainly won't include Venezuela and Ecuador, but if we get started in terms of that and connecting into Asia, we are in a far better position to say that Correa and the other politicians in Ecuador are going to have to listen and start to move in the direction we want. So in the medium and short run, use the enforcement tools, longer run, we create a better mousetrap.

Mr. SCISSORS. I just have a quick thing to add, because we all seem to be agreeing with each other on this, but documentation is really important here. We have this kind of knee-jerk reaction, they are doing something wrong, but you can't fix every trade problem. We are not going to fix every trade problem in China. We are not going to fix every trade problem in the United States. So what are the big ones? And we really need to be able to document that in comparison, where do we put our eggs? I think Ecuador is a good candidate, but I really want to see, what are they costing U.S. businesses, U.S. workers, with their action, as compared to other actions we have to go after?

There has to be a set of priorities here; otherwise, we just degenerate down into a knee-jerk reaction to everything, and I don't mean to imply that is the case in Ecuador, I am just saying, when you want to know what can we do with trade partners, the first thing I want to know is, how bad is it really? Because I am not going to solve all the problems. Is this a problem I really need to solve? Do I have to bring out sticks and carrots for this one or can I really just say, I got to move on to something else?

Mr. MEEKS. Mr. Hirschmann?

Mr. HIRSCHMANN. I just want to add one point on Ecuador, and Venezuela for that matter, you know, expropriations are exceedingly negative in that they impact more clearer than anything else in the investment climate in a country, even worse, if that is possible, is when expropriations are carried out without any process whatsoever. And Ecuador and Venezuela have gone even one step further by not even recognizing the international agreements they have reached or binding international arbitration. So I think, you know, there is almost a three-part test there. The other thing I would add is, when all those things are happening, it is also symptomatic of larger violations of rule of law across the board that severely impact the citizens of those countries, so those would argue for a tougher approach.

Mr. MEEKS. So, I mean, we are sitting here today and we are doing this hearing, and I think part of the purpose of the hearing is, Congress is frustrated. We don't want, as you heard in my opening statements, the loss of revenue that takes place in my little state called New York, but we are trying to get, and I am trying to find out, what affirmative action should we take? Some say end the preferences agreement. Is that the right thing to do or is it not the right thing? What is the line when you cross that line that you are talking about, when it is more serious than others, you know, or something that we can remedy?

You know, that is what we are trying to determine. I think we have to determine it as legislators, and I don't have any more time, but just saying that those are the kinds of questions that we have, or I have, and I would love to know what you think in that regards because I don't want to cut off our nose despite our face.

Mr. ALDONAS. I love the direction of the question, Congressman Meeks, because the reality is, there is a lot of things that we have, whether it is Section 337 on intellectual property, whether it is customs enforcement, which could be better. They don't do anything on their own motion. They have to wait for somebody to petition, even though they got a ruling from the ITC that should ban the intellectual property violations. There is all sorts of things we should be cleaning up that are specific to the tools we could use ourselves on enforcement of things like IP.

With expropriation, since the investment is there, the question is, how are you going to try and discipline that process more broadly? And frankly, that really depends on what kind of incentives we create for investment elsewhere.

Chairman ROS-LEHTINEN. Thank you so much. Thank you, Mr. Meeks. Thank you to the panelists. Mr. Turner of that little state of New York is recognized.

Mr. TURNER. Thank you, Madam Chair. I want to relate a personal experience I have had. About 20 years ago I worked for a Hollywood studio and I traveled to Moscow to secure an agreement for the home video rights for a new movie that we expected to do very well there called Red Heat. I don't know if you remember it, Arnold Schwarzenegger, it was a good movie. I was there about a day and walked into the subway station by Lubyanka, the famous prison, and there were boxes of Red Heat, the Cyrillic alphabet around our graphics and artwork. I bought one, copy was absolutely terrific.

This would bespeak that, they had ties, this was pre-release, into Hollywood to get the artwork and all the other things they needed. This would be a vast criminal network. The income on this had to be tremendous. That was a long time ago. And if anything, I am sure they have gotten a lot better. There have been a number of regime changes in Russia, but these guys are still working and working well. Also, I think there is evidence that they are taking American properties, copying it, and then sending it back to us in the black market.

Are we aware of this as a criminal enterprise and what steps are we taking that you know of or should we be taking? And I direct this, you mentioned this, Mr. Hirschmann, so if you would like to lead on that and I would like all your opinion's if you would. Thank you.

Mr. HIRSCHMANN. I recently met with a young woman who is a film editor out in Hollywood and I asked her why she wasn't working. She said, well, I have been working for a film that was filmed in China by a Chinese filmmaking company and employed thousands of Chinese to make it, and I was helping edit it here in Hollywood, and by the time we got done editing it, it had been distributed so many times counterfeit in China that there was no longer a market in China for their own movie. And so there are countless examples of that across the world.

You know, one thing to remember is that, increasingly, people who distribute counterfeit products, whether it is physical products or movies and videos, are using the Internet to do that. The Internet is a vibrant distribution network for all kinds of products and we need to be very careful to preserve the innovative properties of the Internet and continue to encourage innovation there. But at the same time we have to recognize that it is also being used by a few to distribute products in that way. So I think one thing we can do is to begin to work with the world to find reasonable pro-Internet freedom, but still rule-of-law approaches to address the distribution on the Internet of counterfeit goods and stolen digital properties.

Mr. TURNER. Do we know if these criminal enterprises are ad hoc or is there a continuing thread in this?

Mr. HIRSCHMANN. In most case they are not ad hoc. They are very sophisticated networks operating, usually not in one country, but in multiple countries. You might find the servers in one country and the business, the place where they take the credit card orders, in another country, so it really requires a global approach to addressing that problem. And this are every bit the sophisticated, organized criminal networks that their predecessors were that we dealt with effectively here in the United States.

Mr. SCISSORS. Just something that is indirectly, but I think important in its relevance, there is a bill in front of, well, I am not sure of its status, there is a bill in the House on economic espionage, which is a criminal activity and goes at IPR the same way as you are talking about. It involves large criminal enterprises, and the bill has to do with penalties, and there are possibilities. There are lines of attack that work. As David just said, these are global enterprises, which means it is not the case that if we pass a penalty in the U.S. we will never see these guys because they are safe in some country that we can't get access to. They are not in one country. They are in lots of countries.

They like to travel. They like to portray themselves as legitimate multi-nationals. Globalization gives us ways to put pressure on them just like it gives them more access to us. So I do think, in thinking about economic espionage, which is more my area of expertise in this matter, that there are ways that the U.S. can change its laws, not to solve the problem, but to exert more pressure on these companies and make it more difficult for them to be very organized, and very large, and very profitable.

Mr. ALDONAS. If I could, I think you are absolutely right to treat it as a criminal enterprise and what that implies is that there are tools available. The individual theft becomes a predicate offense for a RICO charge and that becomes a criminal enforcement matter and we can turn to INTERPOL to help us enforce it, but we don't do that now, all right? I mean, the sad fact is, is that, even with the way we have thought about access to our securities markets, the U.K. securities market, they are a large enterprise that benefit from making profits of these illegal activities, and we don't do an awful lot to enforce disclosure under those circumstances. Specific conditions that said we are going to force disclosure of this, the sunshine would help. It really would.

Chairman ROS-LEHTINEN. Thank you so much. Thank you, Mr. Turner.

Mr. ALDONAS. Thank you.

Chairman ROS-LEHTINEN. Mr. Sires of New Jersey is recognized.

Mr. SIRES. Thank you, Chairperson. You know, I would like to share a story with you that happened to me and really opened up my eyes. I was having lunch here at the Members' restaurant and they happen to have catfish that day. I don't eat a lot of catfish, but I ate the catfish. You know, I took some catfish, I went to the table, and the ranking member of the Agriculture Committee, as I am eating the catfish, says to me, "You know, we had to put some language in the Agriculture Committee bill because most of the catfish is imported in this country now, that is consumed here, and actually, in Vietnam, they grow the catfish right next to the sewage outflow."

So needless to say, I haven't eaten any catfish since, but, you know, that goes to the question that the American people don't know what is coming in. I mean, I was like, oh, my God. Then we have the other issue—and then, of course, obviously that industry is being destroyed in Alabama, where we have a legitimate catfish industry, because, obviously, it is a lot cheaper to raise the catfish in Vietnam than it is in Alabama. But, you know, the other question that I have also is, you know, with the development of the solar panels.

You know, we develop the solar panels, you know, I guess we help China, whatever, they stole it, you know, the way of making it, then they come here and they dump all these solar panels in this country and it basically destroys our industry. I mean, we have got to find a way of dealing with these things because they are costing us a great deal of jobs in this country. And when I say that I agree with some of the comments by Dana Rohrabacher, we have to get a little tougher, you know, with some of these things. And I don't think the American people really know, sometimes, what comes in and what we consume. We are just not that well informed.

I mean, I watch it and I am here listening to everything that goes on here in this country all day long. So I was just wondering if you have a comment about that.

Mr. ALDONAS. Yes, I do. So I think Congressman Meeks would testify, I am a free trader, and what I would tell you is that——

Mr. SIRES. Don't eat the catfish.

Mr. ALDONAS. Yes, I would. There is no consumer benefit, which is what free trade is about, to allowing unsafe products into our country, and it does mean doing what governments should do. That is not a debate about whether this, as a government function, should do, which is to protect our consumers. And that is not in opposition to the idea of free trade. So if that catfish is a health problem, of course we should be focusing on it. We want to participate and get the benefits of the global economy, but only to the extent it is serving our consumers. So you instincts are right and I just want to reassure you, it is not a protectionist measure when you are doing that, that is free trade.

Mr. SCISSORS. On Chinese solar, I think the opening topic of the committee is IPR. That is the key issue here. If the Chinese, on their own, develop better and cheaper solar panels, we should be able to buy them. I don't want to tell people they can't buy them. I don't want to tell people they can't expand solar power because it is too expensive. There is a cheaper solar panel over here, but you can't have it. I don't want to do that. If the Chinese stole the solar panel technology, now, that is a totally different story, and that is why information is crucial here.

I mean, I don't mean to say anything about our solar panel companies, because we do some great work in this country in solar panels, I don't want a solar panel company to be able to come to Congress and say, they stole it. Just trust me. They steal lots of stuff. They stole that. I want evidence and I want a process by which we can take that evidence and say, here is the problem; here is what it costs us; here is our retaliation. So free trade says, if they are making better solar panels on their own, we want to be able to buy them. IPR protection, what we are talking about here, says, if they are stealing it, we need to document that and we need to take the action that is appropriate to what they have done.

Mr. SIRES. But what happens when they dump in the market, you know, to purposely hurt another industry in another country?

Mr. SCISSORS. Well, I mean, dumping is a separate issue from IPR. That is a perfectly legitimate issue. The Chinese are very likely to be dumping because they originally grew up selling to Europe and Europe doesn't have the money anymore, so they are very likely dumping solar panels, or have been at certain times, then the Congress has a choice to make. Cheaper products have a benefit for the clean energy industry in this country; they do, but there is a tradeoff. And we have means to decide, we don't like the dumping, we are going to measure the dumping, and take retaliation appropriately, but there is a cost and a benefit there when they are doing it legitimately.

The great thing about this hearing is, if they steal the IPR, that is just theft. It is a clear-cut case. When we get into dumping you have to decide, do I want the cheap product or do I want to punish them for dumping?

Mr. SIRES. Mr. Hirschmann, do you have a——

Mr. ALDONAS. Just to add further on the dumping side. I used to have to administer that part of the Commerce Department and it is another one of those areas where the tools that we have are not adequate to the global economy in which we operate. The reality is, you know, going to Derek's good point, I don't want to prevent cheaper products where somebody is competing on the basis of their own innovation from coming to the country, but I do think it is time to reconsider what we do with the dumping laws and it may be time to consider whether or not a private right of action makes more sense than asking the Commerce Department to investigate it.

In other words, put a tool in the hand of the company that is most affected, put them in a position where they have to provide the evidence that Derek suggests, but also allow them to be able to go after the company that is penalizing their potential and find a way so they have direct recourse rather than a tariff, which sort of damages our economy. It doesn't actually have that much of an impact on the dumping company. But I think it might be time to rethink how we approach that issue.

Chairman ROS-LEHTINEN. Thank you. Thank you so much, Mr. Sires.

Mr. SIRES. Thank you.

Chairman ROS-LEHTINEN. Have you seen that show, Hillbilly Catfishing? I don't think you want to eat it from the United States either. Mr. Marino of Pennsylvania is recognized.

Mr. MARINO. Thank you. Thank you, Madam Chair. That is why I am a meat-and-potatoes guy. My professor in undergraduate work told me a long time ago to watch the sleeping bear; China. And he predicted with a great deal of accuracy where we are at today concerning China. And if we believe that private industry in China, which is an oxymoron in and of itself, will have any effect on IP theft, I think we are truly kidding ourselves. China is a dictatorship. It is a brutal regime that will not change its basic ideology. Nevertheless, China wraps its arms around capitalism, which I think, to a certain extent, we are responsible for because they are getting rich, in part, because of capitalism.

And the Chinese Government has absolute control over everything. I have spent my life in college, and graduate work in law school, and up until this point of studying China pretty significantly, and it reacts on a day-to-day basis. I don't think China is concerned with long-term future. And as far as Russia, Russia already is very much aware of our lack, the U.S.'s lack, of a response to China's IP theft. Russia is just waiting. I just visited Russia a short period ago. They are very concerned and want to get into WTO. It is the ultimate for them. But watch what happens when Russia does get into the WTO, it will step up its intellectual property theft to the levels of China.

So with that little dissertation, and we will start with Mr. Hirschmann, and then anyone else who has a comment, please chime in, because I have a couple of questions, what is the reality? What are the facts, the bare-bone facts, if the U.S. simply says to China, within 6 months, if you do not change your policies of flooding the market, stealing our intellectual property, products coming in this country will substantially curtail, if not stop?

Mr. HIRSCHMANN. I don't think we, you know, as Grant Aldonas pointed out, you have to balance our desire to make progress in China with also making sure that, where we benefit from the relationship from China, we don't shoot ourselves in the foot, and simply denying consumers products from China, or starting a trade war with China, while, you know, it would certain escalate the confrontation with China, but I don't think it would be a swifter path to solving the problem. I wish there was a simple solution and I can see why that is tempting, and I don't think that simply waiting for indigenous businesses in China to rise up is the answer, but it is part of the answer, because China is not monolithic.

It is also true that we can do a better job of closing off markets to counterfeit Chinese products. We can also join with the rest of the world. The one thing I do know is, they are not likely to listen just to us. And too often, to be candid, other issues in the U.S.-Chinese, or in the European-Chinese, relationship end up trumping these issues. If we are going to make progress on these issues we have to be united and put them at the high up top of the list.

Mr. MARINO. Doctor?

Mr. SCISSORS. If you were to do that in the short term it would be much more harmful than it needs to be. There are a lot of corporate supply chains that run through our allies, our companies, their companies, and then also China. And a short-term adjustment like that is going to be very difficult. I am, you know, going to caution, there are a lot of gains from—we just had a Chinese State entity today buying GM pension assets. It helps GM, but might save the U.S. Government some money. There are a lot of gains in this relationship. If you were going to go the route of saying enough is enough, we have a new Chinese Government coming in this fall, you tell them, look, the last government was a disaster, we are not putting up with 10 more years of this.

Give them a time period. Don't say 6 months, it is not fast enough for them, it is not fast enough for us. Give them a time period, give everybody warning, if you are going to go the retaliation route and say, new government, you get to change gears, we are not accepting another 10 years of statism, that would be a more responsible retaliation route because it is us, it is our allies, it is our companies, we are all involved in this process.

Mr. MARINO. Thank you. Sir.

Mr. ALDONAS. You know, I guess what I would say is that, we have this disturbing tendency, I know I do, to assume that China is monolithic and that there is no politics going on over there, but China has gone through a generational shift. The folks who have been in charge for 10 years are the people who kept their heads down and made their way through the Cultural Revolution. The people who are coming now brought you the Cultural Revolution and there are two different factions that draw very different conclusions from that experience.

One part of that generation desperately doesn't want to go back, another part wants to embrace that reality and reinforce it. And I think our job is to be sophisticated enough to bring pressure to bear on them where we can influence their decisions, but actually to create the political space for that reform movement to move in the direction they know they have to. They know they are living with a 4000-year-old system of Guanxi rather than a rule of law. They have to make a transition. They know they have to make that transition and employ that 650 million people that are west of Shiyan with nothing but a handheld hoe.

Mr. MARINO. Okay.

Mr. ALDONAS. But I think we have to provide the incentive for them at the same time we are providing a stick to the other side to say, that is not going to work and it makes me start thinking about, what is the biggest ticket item you could use to send a signal that the relationship has to change? It doesn't necessarily have to be across-the-board tariffs on imports, but we do have to send a signal that enough is enough.

Mr. MARINO. Thank you.

Chairman ROS-LEHTINEN. Thank you, Mr. Marino. And we will conclude with Ms. Bass, the ranking member on the Subcommittee on Africa, Global Health, and Human Rights. You are recognized.

Ms. BASS. Thank you, Madam Chair, and I want to thank the gentlemen who have given us testimony for you expertise today and congratulations to your grandmother. You are very blessed to still have her in your life. You know, this is a very important issue for my district. We have spoken a lot about Hollywood. I actually represent Hollywood, Culver City, a lot of the entertainment industry, a number of studios, and also the music industry, and I just, in listening to you, wanted to know if any one of you could provide me some specific examples so I can understand a little better. For example, I think I have heard several things. I think I have heard that there is a need for—well, that we could do better.

For example, we don't necessarily have the tools, then I believe I have heard we actually have the tools, but they are not necessarily enforced. I was wondering, is it a question of resources? Is it political will? What is missing? Because it seems as though you have described that the parts are there, but for whatever reason, we have not put it all together and have actually enforced, or used the tools, when we could, and maybe you could give me some examples.

Mr. SCISSORS. I will go first because I am short. What is missing is focus. We need to decide what our priority is. I said this in my opening statement, you can't go to the Chinese with eight vague demands. It is not going to work. They don't want to cooperate and you are giving them an opportunity not to. So the hardest thing for Congress to do is to not pressure the administration that at the next meeting, at the next Presidential Summit, I want you to bring up my issue, and I want you to bring up mine, and mine, and mine, and mine, and mine.

Ms. BASS. Right.

Mr. SCISSORS. There has to be some sort of decision about, this is the big thing. IPR would be a very tough one, but it would be a justified one. So the number one thing I would suggest is, there has to be some sort of consensus on, this is where we draw the line and, you know, the relationship isn't going to be perfect, but this needs to improve.

Ms. BASS. Do you have opinions about what that priority should be?

Mr. SCISSORS. Yes, and my opinion is that, until you get the Chinese to accept more competition within China, we can't make progress. Everything else is at a level below that. And right now, they were moving toward more competition, for about 20 years, 25 years, this government, they have moved away and they need to move back. And everything else gets better if they do that and it gets worse if they don't. So that is where I would put it. I have a lot of specifics, but I don't want to take up all the time.

Ms. BASS. Okay.

Mr. ALDONAS. We have a lot of debate about currency. The Chinese are actually getting worse on currency right now. They are actually driving the Renminbi down relative to the dollar because they are concerned about European markets at this point, but we shouldn't overlook the fact that the more powerful reason is actually the lack of competition in capital markets and the fact that you have, essentially, a system of indentured capital for Chinese savers. That is the real problem, right? And one of the answers is expanded market access.

And when I think about Hollywood, my daughter is trying to be a comic out there, and when I talk with Kiki about, you know, these sorts of issues, and she asks me very similar questions, I say, look, you know, the irony is, is that, ensuring that there is broader market access for Hollywood studios in China so that the product gets there, that the cost is low, that the Chinese people have access to a legitimate product, which they now have the income to buy, is our best answer, and that is a very specific demand, and it is a positive one.

It is not saying we are going to bash you. What I am saying is, let us go to the table and say, sorry, part of the answer on IP, particularly as it affects Hollywood, is you deny our studios the ability to market their product the way they can do it cost effectively and serve the consumer. So there are specific and, I think, positive ways to try and address the problem at the end of the day, but it starts, not only with focus, it actually starts with what the concept of the challenge is. And I think the real challenge we face is, we have a set of tools that, frankly, aren't geared toward the world we live in, and until we get there and we rethink all of the tools with that perspective in mind, China is the paradigmatic example, we probably won't make the progress we have to.

Ms. BASS. Well, the example that Mr. Hirschmann mentioned about how the film was being counterfeited before it was even in the editing stages, I have heard that many, many times.

Mr. ALDONAS. Absolutely.

Ms. BASS. And, I guess, if you do, and, you know, not right this minute, have legislative proposals, I would certainly be interested in knowing what they are.

Mr. HIRSCHMANN. Let me raise one to build on what Dr. Scissors and Grant Aldonas have said, which is, we recommend in our testimony that we strengthen the 301 process, which is the process at the United States Trade Representative's Office. You know, it has been a useful tool to do that report every year. USTR uses it to guide, but really, we need a process that has much clearer metrics, much clearer benchmarks, and that we can use to rally and focus the world's attention on specific problems and make real progress. So that is one area. And the second is, Congress can play a useful role in ensuring that the administration negotiates the strongest possible provisions on intellectual property in the Trans-Pacific Partnership Agreement.

You know, China will be watching to see what we do there and if we don't continue to raise the bar when we do negotiate trade agreements, we will pay a price for that.

Ms. BASS. Thank you very much.

Chairman ROS-LEHTINEN. Thank you, Ms. Bass. Mr. Royce, the chairman of the Subcommittee on Terrorism, Nonproliferation, and Trade. Thank you, Mr. Royce.

Mr. ROYCE. Thank you, Madam Chair. The Chinese Government estimated its public procurement market at, I think, $110 billion in 2009, but we have figures from our Department of Commerce report, Doing Business in China, that puts that actual figure in excess of $200 billion. We saw some figures from the European Chamber of Commerce, they report that their estimate, because of the way these companies work there, or are publicly owned, of the Chinese Government contracts, they put their estimate at over $1 trillion.

So that is a lot of money. A lot of potential contracts out there for U.S. business, but only in theory, because in fact, that market is closed, largely, to us in the United States. But at the same time, Chinese entities continue to be awarded U.S. Government contracts despite not being a party to the WTO's general procurement agreement. That agreement among 40 major WTO member countries is intended to open up contracts to foreign competition, so they just won't sign it. To address this problem, I have introduced a bill with Mr. Connolly which prohibits Chinese-based companies from receiving U.S. Government contracts until China joins the GPA, which will then force them to open their market.

And I was going to ask each of you, would this approach be a helpful incentive for China to join the GPA and would its joining help eliminate Chinese unfair trade practices against U.S. companies in the public contract market? The other aspect of this that is so troubling is just how much of China is, in fact, you know, big government in China as opposed to an evolution toward more market economy, but if I could have your views.

Mr. SCISSORS. Unfortunately, I am going to have to say no. We have plenty of examples of the Chinese signing agreements and finding ways around them because of the extent of state intervention. They have a lot of options for how to do things.

Mr. ROYCE. So your presumption is that they will just violate that rule and that we won't use the enforcement mechanisms under the WTO to compel them to?

Mr. SCISSORS. My presumption is that, if you are talking about really opening the GPA market——

Mr. ROYCE. Right.

Mr. SCISSORS [continuing]. Government procurement market in China, not making improvements, because you can make improvements, I am not arguing that, but the big one, where we count all the SOEs and those very large numbers you are talking about, that is much more fundamental than signing another WTO.

Mr. ROYCE. Yes, but how do you do that? I mean, I have given you one suggestion of a way in which we cut off their contracts here.

Mr. SCISSORS. Their contracts here are minor, Congressman. That is not going to have an effect. You have set the stage perfectly.

Mr. ROYCE. Right.

Mr. SCISSORS. You can count this up to a $1 trillion.

Mr. ROYCE. Right.

Mr. SCISSORS. They are not making anything like a $1 trillion here, so I mean, they are just going to weigh those two things and say, no, I don't think so. You know, you have to go at, if you want access to big things, which is pushing the state back, opening the market, which I completely agree with you, is the proper goal, you have to involve big things. And big things are, look, this is the nature of our relationship. We are not getting our comparative advantage and you are. We are going to start trading with other people more through the Trans-Pacific Partnership, through other kinds of deals like that, because the whole nature of the relationship needs to change.

Mr. ROYCE. But I understand we have this dialog with them, but I have suggested a concrete act where we cutoff contracts, you are saying, that alone won't—then can you suggest something decisive? Because I am not certain dialog, as much dialog as we have had, is going to lead us to where we need to go. Is there decisive action we can take in terms of access to the U.S. market which would cause them to reconsider?

Mr. SCISSORS. I know I am taking up all the time, I wouldn't use access to the U.S. market. A big, expanding, well-done, TPP is the best lever on the Chinese.

Mr. ROYCE. Let us go to——

Mr. ALDONAS. Yes, I don't disagree with Derek's point about a TPP and outcompeting them for investment capital is ultimately the answer in terms of what will sway people, it is creating the political space for a new generation that does want to move in the direction of reform, but I differ in the sense that I like your idea. We reach an agreement with certain countries to provide certain preferences under that, and the fact that countries like China benefit from that agreement and from an open procurement market while they don't open their procurement market, I feel perfectly comfortable as a matter of political economy as opposed to economics to say that we definitely should adopt that approach. I would go one step further.

I would say that you also need rules within the GPA that reinforce things under TRIPS, so there ought to be a linkage between intellectual property violations and GPA that says, even if you are a member of the GPA, if your computers are running pirated Microsoft software, sorry, you don't get the benefits of the procurement code. And then what I would also say is that, I would be looking hard at the rules on state-owned enterprises in the WTO, and any other agreement we reach, to make sure that similar sets of disciplines apply to the SOEs, because I think Derek's point is that, you know, GPA, government procurement, you have those definitional problems, but if you really accept the Chinese economy as it is, it is the state-owned enterprises that——

Mr. ROYCE. Mr. Aldonas, we worked together some years ago when you were on the Senate Finance staff on AGOA. I would like to just ask if afterwards I could talk to you about your ideas on how to add that to the legislation.

Mr. ALDONAS. Sure. More than happy to do it.

Mr. ROYCE. All right, very good.

If I have time I will ask Mr. Hirschmannn for a response, if not, I yield back.

Chairman ROS-LEHTINEN. Go right ahead.

Mr. ROYCE. Thank you.

Mr. HIRSCHMANNN. I think we would agree that China is very focused on what might emerge as competing markets for itself. So if we can surround China, while that may not be as swift an action, we have certainly—they are watching very carefully what happens in Vietnam and other countries in Southeast Asia, and they are losing market share in some areas to the—if we can raise the bar in the rest of Southeast Asia through strong TPP, I think we will make progress far faster than any other approach.

Mr. ROYCE. Thank you, Mr. Hirschmannn. Thank you, Madam Chair.

Chairman ROS-LEHTINEN. Thank you, Mr. Royce. Pleased to yield for his questioning time to Mr. Sherman, the ranking member on the Royce committee, the Subcommittee on Terrorism, Nonproliferation, and Trade.

Mr. SHERMAN. The Royce committee, the best.

Washington and Wall Street have backed the trade policies over the last 20 years. We see the results. And we are told that if we just rearrange the deck chairs on the Titanic, we won't need to use the lifeboats. Well, this is simply absurd to have you gentlemen come to us and say, we gave MFN for China, we saw the result, so now we need more free trade agreements without fair trade, without balanced trade. But we are told we have got to get tough with China. How do we do that? More imports to the United States from more places that may or may not accept our exports. We are told that yes, we were in a $700-billion trade deficit, but that is because American workers are lazy or overpaid, not because Washington and Wall Street have adopted terrible policies in their own best interests and not in the interests of American working families.

I will start with Mr. Aldonas. I know we are focused on movies and intellectual property. China limits the number of screens where American movies can appear. Have we had the guts to say there will only be 20 stores in America that sell Chinese apparel? I think that is a one word answer.

Mr. ALDONAS. No.

Mr. SHERMAN. And this is because Wall Street makes money by selling that apparel here. Nothing prevents a man from understanding something so much that his livelihood depends upon him not understanding it, and nothing is clearer than that MFN for China and the host of so-called free trade agreements have destroyed the American dream.

What would happen to the Chinese economy if we ended MFN for China?

Doctor?

Mr. SCISSORS. They would have a period of rather difficult adjustment so they would probably have about a 2-year slump, an outright slump. They would either make the adjustment to move toward more market economy, or they would subsidize goods to send then to other countries which would then ship to the U.S.

Mr. SHERMAN. When I say MFN, I don't mean transshipment would be allowed. You are positing a world where we end MFN for China and so the Chinese goods come to the United States by way of Mexican ports? You are changing my hypothetical.

Mr. SCISSORS. I know, but I am trying to indicate, sir, that your hypothetical doesn't involve just stopping MFN for China. It involves unraveling a large part of the world trading system.

Mr. SHERMAN. No. It means that when goods come into our country we have to know their origin, we do that already. I assume that when something says made in China it is not made in North Korea. If you tell me that that is not the case then——

Mr. SCISSORS. Well, sir, think about the supply chain. Think about the supply chain. Is a computer that was assembled in China, made in China?

Mr. SHERMAN. A computer with over 51 percent value-added in China is majority value-added in China. A computer that is 21 percent value-added in China is 21 percent. And if you impose a tariff on a good and you say it is 21 percent value-added in China, therefore it is subject to 21 percent of its value is subject to a tariff, then you have an endless sliding scale. You simply have to determine what percentage of the good was made in that country.

Now you bring up sourcing rules, of course we now have sourcing rules that allow that we have a China free trade agreement already. We call it the South Korea Free Trade Agreement. Goods that are 60, 70 percent made in China get to come into our country duty free, no reverse access.

Five minutes is simply not enough time to discuss how Washington and Wall Street have acted in their own interests and have been responsible for what we have seen over the last 20 years, which is the destruction of the American dream. I yield back.

Chairman ROS-LEHTINEN. Thank you very much, Mr. Sherman. Thank you.

Mr. Manzullo, the chairman of the Subcommittee on Asia and the Pacific, the Manzullo subcommittee.

Mr. MANZULLO. Thank you. Good to be here. Grant, good to see you, and I appreciate all the efforts that you have made to help out with the steel embargo. Steel tariffs were placed by the Bush administration and I fought those, and you were the portal in commerce that allowed us to get the specialty steel that kept thousands of American jobs. I just want to thank you publicly for that.

Our committee held a hearing several months ago dealing with the piracy of intellectual property rights in China and one of the witnesses was a fellow by the name of Fellowes, F–E–L–L–O–W–E–S, world renowned in the making of paper shredders. Their American facility is located in the suburbs of Chicago. Mr. Fellowes testified that he had a partnership with a Chinese entity and an investment of about $180 million. One day the American partners were locked out. The shop was closed. A lawsuit was filed by the so-called disgruntled customers who had ordered these shredders and could not get them, and then the Chinese courts entered judgment levied on the property, smoking Fellowes. This is another example of what happens with the piracy and the complicity of the Chinese courts.

My question to the three of you is, in these cases where the Chinese courts are getting involved, do you see any indication at all with the exception of a few cases, of them doing anything to protect American property rights?

Mr. ALDONAS. No. I mean the problem, Congressman Manzullo, is that oftentimes in their legal process, the judge is looking over their shoulder at what the provincial governor wants. And if the provincial governor is someone like my former counterpart who just took the fall, they are trying to find a way to shift those assets that Mr. Fellowes had invested in into the hands of one of their colleagues in China. So no great surprise the judge is looking over their shoulder at the provincial governor and decides to disenfranchise the U.S. investor.

Mr. SCISSORS. Unfortunately that is true. The judiciary is controlled by the Party, and the interesting thing, I guess, from an academic perspective is the local Party versus the central Party. The best option U.S. firms have, and this is not a good option, is to be able to go to the central Party leadership and say, the local judiciary is making a decision which will hurt China as a whole. That means the same government we have been rightly criticizing as not respecting IPR as a whole is the better option in the court cases. It is not a very appealing situation. But local judiciary as Grant said is responsible, but it is responsible to local officials. So they don't care about precedent. They just care about what is benefitting the local economy at that time. And when your better outcome is to go to Beijing, you are not in a very good situation.

Mr. HIRSCHMANNN. I think that is exactly right, and it is another example of why, both how complex it is to deal with China and why we need to understand that China is not monolithic. Even at the provincial level we have occasionally found people who understand the need to move forward. And so the only way I would amend what Dr. Scissors says, I think you have to push at both levels at the same time, and you have to also use the competition among the provinces to your advantage within China.

Mr. MANZULLO. One of the things that I have noticed is several years ago a local firm had made a bid on a waterworks improvement facility and the Chinese stole everything, the intellectual property, they even downloaded and stole their Web site. I asked the Chinese Ambassador to come into the office and he did, along with the DCM. We explained to them the situation, and the word got back that you don't do stuff like this, and there was a favorable ruling in the Chinese courts. If you asked the Chinese Ambassador to do that today, no one comes in. The relationship that Members of Congress now have with the Chinese is nothing as it was a few years ago. Does that indicate anything to any of you?

Mr. SCISSORS. Yes, this government, the government that has been in charge since 2002 that is about to leave, thankfully, is a statist, aggressive government. And it is not the same government that presided over Chinese true reform period which ended about the time this government took over. So what it indicates is that you have the possibility of a better government in China and a worse government in China. As David has repeated, it is not a monolithic entity. We have a worse government now. We also have a new government coming in for 10 years. It is coming in in the fall. I am not going to promise you they are better. That is a very difficult question. But that is an important question for Congress to get a handle on. You guys have front-line experience. Are the new people who are coming in more responsive? If they are not that is a piece of information because they are going to be in charge for 10 more years.

Mr. ALDONAS. And I can, actually, Congressman, is my most recent trip to China was to Hong Kong, and the surprising thing there was how many Chinese entrepreneurs were leaving. In other words, they are betting against their own country and sort of the strengthening in some respects of the position of the state-owned enterprises, the strengthening of this model of having the right political connection to get the right result in the Chinese court. And the next generation of Chinese leaders, there certainly are leaders in that next generation that understand that that is a much deeper threat to, what, even to the Party maintaining its position in Chinese society than the idea that you shouldn't engage in free trade. So ultimately things are changing. I am not sure they are changing in a positive way in the short term, but China is going to come very quickly to the point where it confronts the fact that the very things like private property, contract enforcement that allowed them to move from 1979 to the present day with that growth are going to come to a short stop. Because every step they are taking is eroding that set of underlying institutions that actually allow their economy to grow.

Mr. MANZULLO. Thank you.

Chairman ROS-LEHTINEN. Thank you very much, Mr. Manzullo. Mr. Connolly is recognized of Virginia. Thank you, sir.

Mr. CONNOLLY. I thank my friend the chairman, and I want to welcome our panel on being here.

Last year I was on the congressional trip to the Silicon Valley and to Seattle where we visited Microsoft, and we actually had sort of a big seminar for the business community and it was talking about this very topic, intellectual property protection and infringement. And what stunned me was, we had a string of business representatives, every single one of them had his or her own story about blatant intellectual theft in China. There was a candy manufacturer where right down to the color picture packaging of the package of their products was outright stolen. Starbucks, whole and entire replications of Starbucks' coffee shops plunked down in Chinese markets, right down to the logo, the product looks exactly the same, entirely unrelated to Starbucks, stolen. Microsoft software, stolen. It was really an astounding presentation and what struck me was—and I am going to elicit your reactions—what is the United States Government doing about this? I mean it is across the board. It is blatant. We are not talking about knock-offs in a certain part of town that we have got to kind of crack down on. This is not Itaewon in Seoul years ago.

What is your honest assessment of the United States Government's enforcement, vigorous enforcement, what should it be, and what leverage do we have to try to make sure the Chinese come into the family of nations in terms of respectable, honest, predictable, reliable protection of intellectual property when the violations are so sweepingly blatant and across the board in terms of products?

Mr. ALDONAS. So I am tempted to use an analogy to the environment. There is this thing called a Kuznets curve where things get a lot dirtier before they get better, and it all depends on rising income. And so the irony in all this is that we are actually better off with the China that has the incentive to move in the right direction, because as incomes rise those consumers want to buy the right thing.

I am charmed a little bit by your example because I had some negotiations at one point with the vice chairman, Madam Wu Yi. We literally walked out of those; I walked into a Starbucks, bought a Starbucks cup that said Beijing on it, walked outside and saw the replica on the street. And she was standing next to me and all I had to do was point out the obvious that we are now outside the street, here is the—so it is that deep, just as you suggest.

But I think the answer honestly is to say, how do we appeal and create the political space for the folks who still do very much want to perform? They don't want their entrepreneurs to leave. They do want a China that can employ the 650 million people west of Shiyan. That really is the struggle. Because you have got to find things that target the people, the state-owned enterprises that are the negative element, and you also at the same time be sophisticated enough to say, let's provide an incentive for that other part of China from which we can both benefit from a mature relationship. That is not what we have now.

Mr. SCISSORS. I am going to not disagree with Grant. I am going to compliment him in the sense of providing another angle. I was a business consultant for more than a decade on China, and one of my clients would ask me, how do I keep the Chinese from stealing my intellectual property? I said, don't deal with the Chinese. That is the only answer. Well, I have to; they are such a huge, wonderful market. Okay, well, then you are making the decision.

And I want American companies to be able to make that decision. I mean Qualcomm is a great American company that has been able to protect its intellectual property through very hard work in China, so it can be done. But the real response from the government is to create relationships that are better than the relationship that we have with China. And we keep bringing that up again and again and again, but if American companies look at other American trade partners and say, wow, we can really do good work in Indonesia, say, or in Brazil, then the Chinese are going to have to change and we don't have to fight over the details because they will just lose all this business.

The reason people get their stuff stolen in China is because they are in China and someone says, oh, I want to copy that and take their market share. The best way, the unanswerable way, the thing the Chinese can't do anything about is if companies say, I like my business opportunities better elsewhere, and the U.S. Government can help with that.

Mr. HIRSCHMANNN. There is an even more recent news story about an Apple store in China where the employees didn't realize they actually weren't Apple employees because they wore the t-shirts and thought they were going to work for Apple every day.

These are highly sophisticated thefts. It is not fly-by-night. It is not your grandfather's counterfeiting and piracy, and I wish there was a simple answer but there simply isn't. It is an all of the above approach to dealing with the problem. We have to deny them markets for those products. We need to organize a global response. And we need to realize that what many companies do is not just stay out of the Chinese market but they withhold from the Chinese market their most innovative products. And ultimately China will want to attract that as well.

Mr. ALDONAS. Just one final comment really, to pick up on what Derek was saying. We have an opportunity with the Transpacific Partnership, and it is going to be a challenge for Members of Congress because we are going to be negotiating with Vietnam. But I will say, the single most important reaction that I have seen out of the Chinese Government is when Intel decided to put a plant in Vietnam rather than in China. And to the extent we can use the TPP process to encourage Vietnam with its historic relationship with China to make choices that China has yet to make, and they do start to outcompete the Chinese for capital because the reality is Vietnam has become the new south coast of China. The go-West policy of the Chinese Government hasn't worked. The more you see of that the more responsive they have to become because they have to deal with the economic reality of trying to continue to attract that investment flow. And that will come to an end if there is a better option.

Chairman ROS-LEHTINEN. Thank you very much, Mr. Connolly.

Mr. CONNOLLY. Thank you.

Chairman ROS-LEHTINEN. Excellent answers. Thank you, gentlemen.

Mr. Kelly, my friend, vice chair of the Subcommittee on Asia and the Pacific, is recognized.

Mr. KELLY. Thank you, Madam Chairman.

Mr. Scissors, in your testimony you suggest about a grab bag approach that the administration has as opposed to being very specific to make sure that we get more production out of it. What can we do to push that initiative?

Mr. SCISSORS. Well, the first thing, I hate to put it this way because I am going to make myself really unpopular, is Members of Congress have to not start pushing their own agendas, right. I mean one of the things that people in the administration complain about is that they feel like there are 10 members with 10 different things they want to accomplish. So whatever Congress decides. If Congress decides it is IPR, then IPR. If Congress decides as I would it is subsidies, Congress can decide whatever it wants. But there has to be more of a unified voice. The administration ends up, different departments respond to different members and then we go with this long laundry list. IPR is a great choice. And what you get is some sort of sense of the Congress, either legislatively or resolution or even just private communication from the leadership saying, look, you have 2 years. We want you to focus on IPR for the next couple years. That would really put the administration, whichever administration, Republican or Democrat, on the hook that the Congress is united. When the Congress isn't united you get the tendencies within adninistrations for Treasury to want one thing and Commerce wants another thing and State wants another thing, and it is a lost cause. So I would pick subsidies, Chinese subsidies. Somebody else might pick IPR. Congress passing legislation just encouraging the administration. All they need to do is signal. That is the first step.

Mr. KELLY. All right. And I understand what you are saying. And I would say that it is probably not, there is 435 agendas, and certainly during a year of reelection that it becomes even more intense. So the idea for me has never been who is the most popular, who is the most productive, so we have got to start looking at that because, I think, as we become more productive as a body our popularity will rise with it. The opportunities though, when we look at the TPP, tell me, how can KORUS serve as a good model for TPP, especially when it comes to IPRs? Any of you can answer. In fact, all of you can answer. We struggled with that agreement for so long, and we waited too long, in my opinion, to get there, and it caused a great deal of problem internally with the republic. It caused a shift actually in some of the government there.

Mr. ALDONAS. I agree with you completely about both the delay. It serves as sort of the baseline. But I am troubled by this idea that we are bragging in the TPP about negotiating a 21st century agreement. It is literally true, we are in the 21st century, right, it is not wrong to say it is a 21st century agreement. But think about what we are saying. You can either take an incremental approach based on KORUS, or you could say our entire economy has shifted onto a different basis, industrial organization has been changed fundamentally by globalization. We need to reenvision what our goals have to be in that context.

What I would say is, it is time that we actually articulated in TPP the notion of free trade and ideas. What are the institutional settings that would allow not only to develop technology, make use of it, make a profit at it, but encourage diffusion, particularly in the poorest countries in the world? That ought to be our goal. In other words, it is reimagining what we should be doing. It is not content with just saying, well, we have TRIPS, let us make an incremental change there because we have seen a particular problem in this country or that country. Of course that is part of the way the negotiation works, but the much more fundamental shift we have to say is where is the global economy going, where our economy is going. If growth depends on innovation what do we have to negotiate, and it is free trade and ideas ultimately.

Mr. KELLY. Any other witnesses?

Mr. HIRSCHMANNN. The reason we keep pointing to the Korea Free Trade Agreement is because it is the highest level protection that we have achieved internationally. I keep remembering that when the NAFTA was negotiated, the word "Internet" was not part of the agreement. The world does evolve. And the purpose of the next agreement is to build upon that. So what Congress can do is make sure that it is united in asking the administration to build upon the model in Korea and to seek stronger protections that aren't just in our interests but really are in all the TPP partners' interest to protect intellectual property.

Mr. SCISSORS. And just to add to that. If Korea, that is a great issue for Congress to coalesce around. We passed the KORUS. It has good IPR standards. Congress can build upon that and encourage the TPP process that way. In response to your first question, What can Congress do?, that is a great avenue for Congress to follow.

Mr. KELLY. I thank you all for being here today. And I think the opportunity is so great that for us now to be debating things that really don't add to the ability to create jobs and take advantage of a market that is out there for us, I don't want to participate in it from this country. I want to make sure we dominate in it. So I think that should be our goal always, and as we go forward that would be my goal and I think all the goals of the members I serve with here. I don't know of anybody that doesn't want to see our country retain its status and go forward.

And so with that I yield back. Thank you, Madam Chairman.

Chairman ROS-LEHTINEN. Amen. Thank you so much, Mr. Kelly. Thank you to all of the members for excellent questions, but most especially, thank you, our panelists, for good solid recommendations and suggestions about what we can do working together with private businesses to level the playing field and do away with these unfair trade practices. So thank you very much for being here, and the committee is now adjourned.

[Whereupon, at 12:04 p.m., the committee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

FULL COMMITTEE HEARING NOTICE
COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515-0128

Ileana Ros-Lehtinen (R-FL), Chairman

July 17, 2012

You are respectfully requested to attend an OPEN hearing of the Committee on Foreign Affairs, to be held in Room 2172 of the Rayburn House Office Building **(and available live via the Committee website at http://www.hcfa.house.gov)**:

DATE:	July 19, 2012
TIME:	10:00 a.m.
SUBJECT:	Unfair Trading Practices Against the U.S.: Intellectual Property Rights Infringement, Property Expropriation, and other Barriers
WITNESSES:	Mr. Grant Aldonas Managing Director Split Rock International *(Former Under Secretary of Commerce for International Trade)* Derek Scissors, Ph.D. Senior Research Fellow The Heritage Foundation Mr. David Hirschmann President and Chief Executive Officer Global Intellectual Property Center U.S. Chamber of Commerce

By Direction of the Chairman

The Committee on Foreign Affairs seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202/225-5021 at least four business days in advance of the event, whenever practicable. Questions with regard to special accommodations in general (including availability of Committee materials in alternative formats and assistive listening devices) may be directed to the Committee.

COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF FULL COMMITTEE HEARING

Day *Thursday* **Date** *July 19, 2012* **Room** *2172 RHOB*

Starting Time *10:00 a.m.* **Ending Time** *12:04 p.m.*

Recesses ___ (___ to ___) (___ to ___) (___ to ___) (___ to ___) (___ to ___) (___ to ___)

Presiding Member(s)

Rep. Ileana Ros-Lehtinen

Check all of the following that apply:

Open Session ☑
Executive (closed) Session ☐
Televised ☑
Electronically Recorded (taped) ☑
Stenographic Record ☑

TITLE OF HEARING:

Unfair Trading Practices Against the U.S.: Intellectual Property Rights Infringement, Property Expropriation, and other Barriers

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COMMITTEE MEMBERS PRESENT:

See attendance sheet.

NON-COMMITTEE MEMBERS PRESENT:

HEARING WITNESSES: Same as meeting notice attached? Yes ☑ **No** ☐
(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: *(List any statements submitted for the record.)*

Rep. Rohrabacher (SFR)
Rep. Connolly (SFR)

TIME SCHEDULED TO RECONVENE ________
or
TIME ADJOURNED *12:04 p.m.*

Jean Carroll, Director of Committee Operations

Hearing/Briefing Title: Unfair Trading Practices Against the U.S.: Intellectual Property Rights Infringement, Property Expropriation, and other Barriers

Date: 07/19/12

Present	Member
X	Ileana Ros-Lehtinen, FL
X	Christopher Smith, NJ
	Dan Burton, IN
	Elton Gallegly, CA
X	Dana Rohrabacher, CA
X	Donald Manzullo, IL
X	Edward R. Royce, CA
X	Steve Chabot, OH
	Ron Paul, TX
	Mike Pence, IN
	Joe Wilson, SC
	Connie Mack, FL
	Jeff Fortenberry, NE
	Michael McCaul, TX
	Ted Poe, TX
X	Gus M. Bilirakis, FL
X	Jean Schmidt, OH
	Bill Johnson, OH
	David Rivera, FL
X	Mike Kelly, PA
	Tim Griffin, AK
X	Tom Marino, PA
	Jeff Duncan, SC
	Ann Marie Buerkle, NY
	Renee Ellmers, NC
X	Robert Turner, NY

Present	Member
X	Howard L. Berman, CA
	Gary L. Ackerman, NY
	Eni F.H. Faleomavaega, AS
X	Brad Sherman, CA
	Eliot Engel, NY
X	Gregory Meeks, NY
	Russ Carnahan, MO
X	Albio Sires, NJ
X	Gerry Connolly, VA
	Ted Deutch, FL
	Ben Chandler, KY
	Brian Higgins, NY
	Allyson Schwartz, PA
X	Chris Murphy, CT
	Frederica Wilson, FL
X	Karen Bass, CA
	William Keating, MA
X	David Cicilline, RI

The Honorable Gerald E. Connolly (VA-11)

HCFA Full Committee Hearing: Unfair Trading Practices Against the U.S.: Intellectual Property Rights Infringement, Property Expropriation, and other Barriers
Thursday, July 19, 2012
10am

Two years ago, this Committee heard testimony on the Administration's Joint Strategic Plan on Intellectual Property (IP) Enforcement. That plan laid out several positive strategies to protect the copyrighted property of American companies. These strategies included: increasing transparency in enforcement policy, ensuring coordination among all levels of law enforcement, asserting our rights internationally, and securing our supply chain. These were all welcome steps in preventing a crime which costs U.S. businesses billions of dollars per year. Intellectual property theft stifles innovation, places rule breakers on unfair footing, and exposes consumers to faulty products.

Since then, the Office of the Intellectual Property coordinator has released updated materials. According to the 2012 joint strategic plan, "the U.S Government has made significant progress in improving protection of American technology, creative works, and brands."[1] The 2012 fact sheet cites an increase of 67% of seizures by various Department of Homeland Security entities from FY 2009 to FY2011. In the same period, "seizures of fake consumer safety and critical technology merchandise rose by 183%."[2] With regard to intellectual property rights enforcement overseas, the paper states that the highest levels of the U.S. Government, including the President himself, have approached officials in countries such as China.

China's transgressions when it comes to IP theft are well-known, though that country has taken some steps to address the issue. This year's Special 301 Report from the U.S. Trade Representative (USTR) cites China's Special IPR Enforcement Campaign which began in 2010 and became permanent in 2011. Nevertheless, the USTR report concedes that, "Despite these signs of progress, IPR protection and enforcement in China remain a significant challenge."[3] The report goes on to cite the concerns that many industries have about China's indigenous innovation policy being a front for "coerce[ing] the transfer of IPR from foreign rights holders to domestic entities."[4] Piracy in China is harmful to U.S. business in multiple ways. Not only does the original U.S. company lose profit, but when it comes to goods like software, there is an additional concern. Non-Chinese companies, which rightfully pay for goods like software, must compete with Chinese companies, which do not pay for these goods. Two years ago, Robert Holleyman of the Business Software Alliance told this Committee that, "China's 80 percent software piracy rate means that 4 out of 5 enterprises in China can compete unfairly with enterprises in the US that are paying for the software they use to run their businesses and improve productivity."

American businesses are not the only entities harmed by copyright violations and IP theft. A 2010 report from the Government Accountability Office listed several counterfeit products which U.S. consumers have encountered. The counterfeit goods include "pharmaceuticals, automotive parts,

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[1] 2012 *U.S. Intellectual Property Enforcement Coordinator Joint Strategic Plan*, Two Year Anniversary, June 2012, ii.
[2] Ibid., ii.
[3] U.S. Trade Representative, *2012 301 Special Report*, 27.
[4] Ibid., 27.

electrical components, toys, and household goods."[5] The most troubling characteristic of these goods "is that U.S. consumers are likely to have been deceived about the origin of the product."[6] This means that counterfeiters can take faulty products that have not passed inspection by U.S. consumer authorities and place the logos of reputable brands on those faulty products, endangering our citizens' health and safety.

Fortunately, the United States has recognized the importance of addressing unfair practices due to IP theft by continuing to update the Joint Strategic Plan—a thorough and ambitious document. I want to give credit to the Intellectual Property Enforcement Coordinator (IPEC)—Victoria Espinel—and her staff for their work on IP enforcement. I look forward to listening to the testimony of all our witnesses today to see how we can move forward in protecting the intellectual property of American companies.

[5] *Intellectual Property; Observations on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods* (Government Accountability Office), p. 10.
[6] Ibid., 10.