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Madam Chair, Members and staff of the Commission, thank you for the invitation to present testimony at this hearing.

At the outset I would like to explain my background and interest in this issue. From August 1993 through December 1998 I served as Assistant Secretary of Commerce and Commissioner of Patents and Trademarks.¹ In this capacity I was the Clinton Administration official primarily responsible for intellectual property policy.

This was a period of intense activity in trade and intellectual property diplomacy. The WTO treaty and its TRIPS annex were negotiated and signed by the United States and the implementing legislation was enacted by Congress. Also, the WIPO Copyright and Phonograms Treaties were negotiated and implemented in U.S. law in the form of the Digital Millennium Copyright Act (DMCA.) These treaties updated international copyright law to encompass the Internet and digital environments and the DMCA amended U.S. copyright law accordingly. Further, during this period bi-lateral negotiations between the United States and China enabled China to become a member of the WTO.

After my departure from government service I founded and continue to direct the activities of the International Intellectual Property Institute, a non partisan, nonprofit think tank and development organization dedicated to helping developing countries more effectively use intellectual property rights as a tool of economic growth and wealth creation.

It is my understanding that this hearing is being held for the purpose of examining the impact of Chinese IP policy on the bi-lateral trade relationship of the two countries and the effect that policy is having on the U.S. economy.

I believe that the current U.S. China relationship does not meet the expectations we had at the time the Clinton Administration fashioned the ground rules for that relationship.

¹ As a result of a statutory change this position is now known as Undersecretary of Commerce and Director of the United States Patent & Trademark Office. However, its responsibilities and placement in the Presidential chain of command remain the same.

The underlying assumption was that the United States would permit China and other developing countries to benefit from their comparative advantage in labor costs while we would benefit from our comparative advantage in technology. Ideally, this would work to the benefit of all parties.

However, for this trade-off to work it is necessary for our trading partners to give full recognition to the intangible value of U.S. exports. And, intangible value cannot be fully realized unless the patents, trademarks and copyrights that protect that value are recognized and enforced.

I expect that other witnesses will present statistical data on copyright piracy, product counterfeiting and other forms of IPR infringement. In general, this data will show that infringing products constitute a large share of the Chinese market.

In some industries – such as PC software or sound recordings – infringement of copyright virtually equals theft of the product itself. However, for many more products and services the intellectual property component does not encompass the full value of the offering, but is the component that guarantees the seller full value and a fair share of the market. This is particularly true of products embodying inventions where the patentable elements of the product may not encompass the entire product, but make it more attractive to purchasers and able to command a premium price.

Between 1998 and 2008 the U.S. trade deficit with China grew from \$81.8 billion to more than \$268 billion.²

While there are explanations for this unacceptably large imbalance, such as currency valuation, that have nothing to do with intellectual property rights, the failure of China to give full value to U.S. intangible exports – as envisioned in the original architecture of our bi-lateral relationship – is clearly responsible to a significant degree for the failure of U.S. exports to China to narrow this gap.

I have visited China a number of times since our 1999 bi-lateral agreement and have followed closely the development of the Chinese IP system during that period. And, I acknowledge that China has made progress in developing a modern intellectual property law regime, an increasingly credible system of judicial dispute resolution and administrative IPR enforcement mechanisms. Certainly, its IPR statutes for the most part meet TRIPS standards. And, the State Intellectual Property Office (SIPO) which is the equivalent of our USPTO has evolved into one of the largest patent offices in the world, with a corps of examiners operating at a level of sophistication approaching the patent offices of historically developed countries. However, for

² U.S. Census Bureau, Foreign Trade Statistics: <http://www.census.gov/foreign-trade/balance/c5700.html>

all of these advancements the reality remains that the Chinese market is not providing the export opportunities for intangible exports of U.S. products and services that we expected when the bilateral relationship was designed.

Copyright piracy and product counterfeiting continue at levels that are totally unacceptable. And, Chinese policy makers seem intent on fashioning a domestic market that does not give U.S. high tech and information exports a level playing field. This is reflected not simply in weak IPR enforcement, but also in attempts to fashion idiosyncratic technology standards and/or government procurement requirements that prejudice globally established U.S. exports. Further, censorship of the Internet denies America's most innovative companies the opportunity to establish a significant market share. One has to look no further than the withdrawal of Google from mainland China to Hong Kong to see the impact of these non tariff barriers to effective participation of globally competitive U.S. companies in the Chinese market.

With regard to its patent system, the number of domestic applicants for patents in China exceeds that of domestic applications in any national patent office except the United States and Japan. However, the vast majority of these applications are for a form of patent protection not found in U.S. law – utility models. This form of patent protection does not require the examination of prior art that is the basis for obtaining internationally recognized patents. And, while other countries have long provided for utility models, it is my understanding that U.S. applicants are increasingly finding that SIPO has previously issued utility model patents to inventions where the U.S. applicant is seeking full patent protection.

Taken all together the various aspects of the emerging Chinese intellectual property system combine to disadvantage IPR based imports, sheltering domestic technology and information-based industries from effective foreign competition, while the Chinese create their own export-competitive industries.

China is emerging as a technological power, graduating significantly more scientists and engineers than the United States. Its population of Internet users has become the largest in the world. I expect that in coming decades China will have a robust system of intellectual property rights protection and enforcement appropriate to a tech-based economy. Unfortunately, that may come too late for U.S. industry. Having sheltered its own market while developing competitive IP based products and services, China will then be in a position to assert a comparative advantage, based not only on cheap labor and currency manipulation, but in the very areas of comparative market advantage that we in the U.S. had envisioned in the 1990s when we negotiated what we thought would be a fair and balanced trading relationship.