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**China: Intellectual Property Infringement, Indigenous Innovation Policies, and  
Frameworks for Measuring the Effects on the US Economy**

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**Introduction**

Madame Chairman, members of the Commission, thank you for holding this hearing today and for accepting the U.S. Chamber of Commerce's request to testify.

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. Working with the Chamber's Global Regulatory Cooperation Project and Global Intellectual Property Center, the Chamber's China program has been a leader in the business community in addressing challenging intellectual property (IP) and indigenous innovation issues with China for many years.

The United States and China are important economic partners, and there is a mutual responsibility to work together constructively to combat protectionism

and eliminate discriminatory practices that create unfair market conditions. In the view of the U.S. Chamber, this shared responsibility must include ensuring that well-intended government practices, including industrial policy or the promotion of strategic sectors and industries, are not more trade-distorting or restrictive than necessary to achieve policy goals.

China could potentially become the largest foreign market for U.S. exports of goods and services in the coming years. Following the global financial crisis, U.S. exports to China have rebounded more rapidly than overall U.S. exports, and are now running 20% above their pre-crisis levels. U.S. exports to China are growing much more rapidly than exports to the rest of the world. China is already the third largest destination for U.S. merchandise exports, up from 11th place in 2000.

China is an important market not only for large U.S. firms, but also for small- and medium-sized enterprises (SMEs). The latest data show that small businesses directly account for roughly a third of the value of U.S. exports to China and they contribute a substantial part of the value of exports by our large companies as well.

However, the tremendous promise of the U.S.-China economic and commercial relationship, as embodied in these current trade and investment statistics, will be far more difficult to realize if China's growing web of indigenous innovation policies and lax IP rights protection and enforcement continue to chip away at the foundation of the relationship. The U.S. Chamber of Commerce is pleased that both governments are working to address these challenges at the highest political levels. Notwithstanding ongoing constructive efforts to address the challenges, American companies are troubled on two fronts by China's approach to IP and innovation.

First, continuing high levels of counterfeiting and piracy in China continue to erode the competitiveness of American firms and their workers. The concerns of American business associated with counterfeiting and piracy in China have a protracted history in U.S.-China relations, dating back more than twenty years. A significant part of the solution to this situation is for Chinese government authorities to exert the necessary political will and allocate sufficient resources to ensure effective and sustained enforcement of China's own laws prohibiting IPR

infringement. Regrettably, the exponential growth and development of the Chinese economy has not been matched to date by increases in the level of IP protection accorded to domestic or foreign companies.

The second concern is a more recent and strategic development, but no less serious. Although China has long had a series of policies, laws and guidance that have encouraged foreigners to transfer technology on non-market terms, China has more recently begun to implement a medium- and long-term indigenous innovation plan via a growing web of discriminatory industrial policies, including in the areas of government procurement, information security, standards setting, tax, antitrust, IP protection and enforcement, and industrial espionage.

This newer and emerging challenge to U.S. IPR is not a function of China's lack of political will to crackdown on infringers. Rather, it is a manifestation of a coherent, and government-directed, or at least government-motivated, strategy to lessen China's perceived reliance on foreign innovations and IP. China is actively working to create a legal environment that enables it to intervene in the market for IP, help its own companies to "re-innovate" competing IPR as a substitute to American and other foreign technologies, and potentially misappropriate U.S. and other foreign IP as components of its industrial policies and internal market regulation. This strategy, and the policies that underlie it, frequently circumvent and, in many instances, negate China's commitments in the World Trade Organization (WTO) and at such forums as the Joint Commission on Commerce and Trade and the Strategic & Economic Dialogue.

The common themes throughout these policies are: 1) undermine and displace foreign IP; 2) leverage China's large domestic market to develop national champions and promote its own IP, displacing foreign competitors in China; and 3) build on China's domestic successes by displacing competitors in foreign markets. The serious problems caused by China's innovation policies are compounded by the fact that these policies are being advanced in an overall environment of weak protection and enforcement of intellectual property rights (IPR).

Key components of China's broad effort are already undermining American exports and investment opportunities in China, and the IP of American firms that support both. We expect the negative impacts of certain policies that may be

prospective in nature to grow and cumulatively to have a major economic impact on the United States.

We commend the ITC for undertaking this critical project. The ability of the United States to respond to China's policies meaningfully and effectively requires that we have a clear understanding of their full impact, including in quantitative terms, on the U.S. economy. The Chamber recognizes fully that your success will depend upon strong support from the U.S. private sector as well as others in the U.S. government. In that regard, the Chamber and our members would be pleased to continue to work with you and the staff to identify sources of data, including those that provide analyses of trends in knowledge-based industries and on the environment in China that demonstrates a decline in enforcement actions and increased difficulties in bringing criminal actions.

Our strong hope is that your work will provide new metrics that will support more robust outcomes in the bilateral economic and commercial dialogue in the form of increased market access for American exporters and investors, increased procurement opportunities for American firms, and stronger protections for U.S.-held IP in China and around the world. It is such outcomes that must be used, at least in part, to measure the success and mutual benefit of our future commercial engagement with China.

### **Importance of IP to the U.S. Economy**

Before examining in greater detail the dual challenge to the U.S. economy posed by China's poor record related to IPR protection and enforcement and its approach to indigenous innovation, it is worthwhile to reflect briefly on the importance of intellectual property and innovation capacity to the American economy.

In a recently released report "*The Impact of Innovation and the Role of Intellectual Property Rights on U.S. Productivity, Competitiveness, Jobs, Wages and Exports*", the Chamber's Global Intellectual Property Center utilized government data to demonstrate that IP-intensive industries—such as life sciences, semiconductors, software, and aerospace—are succeeding globally, driving innovation, and investing heavily in research and development; that in turn grows the economy by

creating jobs and driving exports in a variety of different careers and trades, both “blue collar” and “white collar.”

More specifically, the report found the following:

- ***IP-intensive industries create jobs of all skill levels.*** The Census Bureau reports that the number of IP intensive production workers during 2000-07 averaged 9.5 million, equal to about 65% of total employment in all United States’ tradable industries. During this time, all but three U. S. tradable industries cut jobs. Pharmaceuticals, information software, and medical equipment—each an IP intensive industry—added them.
- ***IP-intensive industries pay their workers higher salaries.*** During 2000-07, the annual salary of all workers in IP-intensive industries averaged about 60% higher than the workers at similar levels in non-IP intensive industries. Meanwhile, annual salaries of low-skilled workers in IP-intensive industries averaged about 40% higher than in non-IP-based industries. IP jobs include all educational levels, skills levels, demographics, and industrial sectors.
- ***IP-intensive industries invest more in R&D to drive innovation.*** During 2000-07, IP-intensive industries spent almost 13 times more on R&D per employee than in non-IP-intensive industries. Industry spending on R&D in the United States accounts for approximately 72% of total R&D spending, totaling nearly \$1.2 trillion, an average of \$145 billion annually.
- ***Investment in IP creates new products and services that strengthen America’s competitiveness in global markets.*** From 2000-07, IP-intensive industries made up nearly half of output and sales of all 27 U.S. tradable industries and employed more than 30% of American workers in all 27 tradable industries.
- ***IP-intensive industries drive American exports.*** IP-intensive industries accounted for approximately 60% of total U.S. exports from 2000-07—rising from \$665 billion in 2000 to \$910 billion in 2007. In that time period, American firms exported an annual average \$405.5 billion of IP-intensive products versus \$278.1 billion of non-IP-intensive products.

- ***IP-intensive industry exports helped moderate U.S. trade deficits during 2000-07.*** Among the 27 tradable industries, only six industries reported trade surpluses—five of which were IP-intensive industries, generating an average \$14.6 billion in trade surplus each year.

Madame Chairman and members of the commission, these last two points are critical. If the United States and China are to successfully partner in an effort to remedy global macroeconomic imbalances, the United States will need to export more innovative products and services to China, and China will need to import and consume more. This was a major theme at last month's Strategic and Economic Dialogue at which both countries agreed that rebalancing was one of the most important steps China could take to help rekindle world economic growth. For the United States to be successful in exporting more, to protect current and future sales in China, and to safeguard the value of MNC investments in the country, America's comparative advantage in IP and innovation must be safeguarded.

Regrettably, at present, China's poor record of IP protection and enforcement continues to frustrate and prevent American companies and workers from realizing their full export potential in the U.S.-China relationship.

### **Long-Standing IP Protection and Enforcement Challenges**

The Office of the United States Trade Representatives' (USTR) 2010 "Special 301" Report underscores that IPR concerns with respect to China remain paramount. Supporting documents from industry for the annual Special 301 Report provide the most readily available data, but as noted above, there are other sources which we hope the Commission will seek out.

### ***Counterfeiting***

In the area of counterfeiting, the 2010 Special 301 report notes that "the share of IPR-infringing products seizures at the U.S. border that were of Chinese origin was 79% in 2009, a small decrease from 81% in 2008."

Counterfeiting was found by International AntiCounterfeiting Coalition (IACC) members to be particularly severe in 2009 across a broad range of products from

pharmaceuticals to mobile phones and from auto parts to apparel and footwear. Counterfeiting and gray market production of name brand products has been a long-standing problem in China. Over the past few years, there has been an explosion of so-called Shan Zhai counterfeit cell phones in China, which according to some estimates accounts for as much as 40% of all mobile phones in China's wireless market of more than 400 million subscribers. These counterfeit products are displacing the sale of legitimate products within China and are also being exported to and displacing legitimate sales in other countries.

According to the IACC, counterfeiters in China are continuing to increase their use of the Internet as a platform for the promotion and sale of infringing goods. The recent rise in seizures of postal shipments by China Customs supports this trend. During the first three quarters of 2009, China Customs seized 43,000 shipments of infringing goods as compared to 11,000 seized in all of 2008—an increase of almost 500%.

The annual survey of the Quality Brands Protection Committee (QBPC)—a China-based industry association—indicated continued worsening of counterfeiting for multinational brand owners in 2008 as compared to 2007. According to that survey, 83% of respondents reported that the severity of counterfeiting in China was the same or worse as compared to 79% in the prior year, while only 6% indicated that situation had improved for their companies. In addition, 63% of respondents believe the economic impact of counterfeiting on their business was significant or worse compared to 56% in the prior year.

### ***Piracy***

Copyright infringement ranges from use of unlicensed software by businesses (known as end-user piracy), which is estimated at a staggering 79% of all software installed in 2009, to widespread infringement of films, music, books, and other copyrighted materials.

The piracy levels for video, audio, and entertainment software in optical disc format continue to range between 90-95% of the market according to The International Intellectual Property Alliance (IIPA).

While the physical market remains a significant challenge, China's newfound leadership in global internet, broadband and mobile phone use, has made China's

digital piracy the principal concern for many of our members in the television, film, music, entertainment software and publishing industries.

#### Audiovisual

China has become one of the biggest sources of illegal audio downloads in the world. According to the recording industry, 99% of music files downloaded or streamed in China are pirated.

The IIPA states that legitimate sales of recorded music in China was just \$75 million in 2009 compared to \$69 million in Thailand, which has less than 5% of China's population and a near equivalent per capita GDP. This is a direct result of piracy and discriminatory market access barriers in China.

The largest deeplinking site in China is Baidu and as IIPA states, it is responsible for 70% of illicit activity on deeplinking sites and over 40% of all unauthorized music downloads in China. Baidu is currently the most damaging to the recording industry's efforts to establish a legitimate online market in China.

In a case launched against Baidu, the Beijing No. 1 Intermediate People's Court in January 2010 found that Baidu is not liable for infringement on the grounds that it was not proven that they knew, or ought reasonably to have known, of the infringements taking place through their service, despite the fact that Baidu assembles and hosts deep-links on its own music service pages, and that it does not link to any available legitimate services. In addition, the Court ruled that Baidu neither knew, nor should have known, about the infringements when Baidu itself revealed such knowledge in its SEC disclosures as far back as 2005. This judgment is contrary to the reasoning in the earlier case where the Beijing Higher People's Court decided that a similar service, Yahoo! China, did have the requisite constructive knowledge. The judgment also illuminates the degree to which the Party-controlled court system will go to protect a national champion in a sector viewed as critical to innovation and control of the Internet. This case is now on appeal.

Chinese web sites are also a major source of Internet piracy of film, television, music, publications, and other copyrighted content. User-

generated content sites (“UGC sites”) based in China have become leading hosts of infringing, full-length copies of copyrighted content, which can be viewed on a streaming basis by users throughout the world. Peer-to-peer (P2P) streaming websites in China have also become major sources of infringing streaming video, particularly video of sports broadcasts. As this infringing content is often in English, these sites have a substantial impact on the ability of U.S. copyright owners to protect their intellectual property.

U.S. publishers are also facing significant piracy issues in China. For the past several years, domestic companies have been acquiring electronic copies of copyrighted U.S. scientific journal articles from government and university libraries and reselling them through online websites to legitimate producers’ primary customers. U.S. publishers and scientific societies are facing annual losses of \$80-100 million as a result of this growing problem.

The October 2009 directive to libraries to strengthen copyright protection was a step in the right direction. At the same time, infringing websites that were brought to the attention of the Chinese government in 2006 remain online, while a growing number of libraries at some of China’s most prestigious universities are partnering with these sites or copycats. Over 25 libraries are linking to one site in particular—Kangjian Shixun.

This piracy also includes Chinese journals and is harming efforts to advance its own innovation agenda and U.S. publisher efforts to facilitate the development of China’s domestic biomedical publishing and research enterprise.

### Software

For the PC software industry, end-user piracy remains the most significant piracy challenge. The commercial value of illegally used software in China has risen significantly from \$5.4 billion to \$7.6 billion, including a \$900 million increase during the past year. This was the largest increase of any country in 2009, and China had the largest increase of any country over the past four years (\$3.7 billion increase in commercial value of pirated software for 2005-09). Incremental progress on the piracy rate is not acceptable in a country that is the world’s 2<sup>nd</sup> biggest PC market and soon

to be the largest. And incremental progress is at best what the industry is seeing.

In addition, the manufacture of Shan Zhai counterfeit mobile phones necessarily requires, and thus results in, the piracy of software critical to the operation of a mobile phone. The direct impact of this is the loss of sales of new core chipsets and integrated software for the U.S. semiconductor industry. Based on average sales prices of relevant chipsets and estimates that Shan Zhai handsets account for about 40% of mobile phones in China, this could represent nearly \$500 million in lost sales.

Software piracy in China harms not only U.S. producers of software, but also the wide array of U.S. businesses that compete against the approximately 80% of companies in China—producing a wide range of products—are not paying for their software. China undertook important commitments in the Joint Commission on Commerce and Trade to ensure that its state-owned enterprises (SOEs) and ministries would use only legitimate software. It remains an important, yet unrealized commitment and should be a critical part of the Commission's analysis of the impact on U.S. employment.

These statistics and other anecdotal evidence indicate that high levels of counterfeiting and piracy restrict significantly job-creating U.S. exports to China. At the same time, Chinese exporters to the United States that use illegitimate software, for example, benefit from an unfair subsidy that allows those companies to compete on an unlevel playing field with their U.S. competitors. Moreover, high levels of counterfeiting and piracy result in lost sales by U.S. companies in China market and around the world. Consequently, U.S. companies have less money to invest in research and new product development at home, which serves to undermine U.S. competitiveness in the medium- and long-term.

### ***Judicial Enforcement of IP***

China's drive for "indigenous innovation" has infected every branch of government, as I will explain in more detail later. In any IP enforcement action, the issue remains whether a judge can overlook the political pressure to favor local companies and "indigenous innovation" that violates MNC IP rights—a task

that is rendered more difficult when the technology relates to one of the Chinese government's targeted industries.

For example, the recent guidelines of China's Supreme People's Court (SPC) regarding the implementation of China's national IP strategy contains much favorable language about the need to protect IP rights, but also includes several troublesome paragraphs indicating the judiciary's propensity to also advance China's national innovation agenda. For instance, they note:

*We should intensify the protection of core technologies which may become a breakthrough in boosting the economic growth and which have independent intellectual property rights so as to promote the development of the high and new technology industries and newly rising industries, improve the independent innovation capabilities of our country and enhance the national core competitiveness.*

Despite some improvements, IP enforcement is not yet predictable in China and the PRC court system is unreliable due to its close connections with the Party, and local, regional and national interests. Especially concerning to MNCs is (i) the increase in utility model patents being granted to Chinese companies as such patents require no substantive examination and are more difficult to invalidate due to a lower threshold of inventiveness than invention patents (which we call utility patents); and (ii) an associated increase in patent infringement suits filed in China by some of those same companies. There has not only been an increase in patent litigation, but also an increase in patent damage awards, as summarized in the chart below.

**High Chinese Patent Damage Awards:<sup>1</sup>**

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2004	\$50,000
2005	\$1,100,000
2006	\$210,226
2007	\$44,300,000 (Chinese Plaintiff / Foreign Defendant / Utility Model Patent)
2008	\$2,780,000

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<sup>1</sup> Sepetys, Kristina and Cox, Alan: NERA Economic Consultants, "Intellectual Property Rights Trends in Litigation in China: Trends in Litigation and Economic Damages" (2009). Available at [http://www.nera.com/image/PUB\\_IPR\\_Protection\\_China\\_0109\\_final.pdf](http://www.nera.com/image/PUB_IPR_Protection_China_0109_final.pdf). For real time data on damages awarded in selected jurisdictions, see <http://www.ciela.cn>.

Finally, China's SPC has rendered what appear to be advisory opinions in at least two known cases involving the incorporation of IPR into Chinese national standards that are cause for concern. In both cases, the SPC determined that the incorporation of patented technology into the technical specifications of Chinese national standards meant that the patent owner was entitled only to a less than customary royalty as compensation for infringement merely because the patent technology was essential to the standard. The statutory or other legal basis for this rationale is unclear. While these decisions do not formally have precedential value in China, the SPC's rationale that the patent holder is not entitled to full compensatory damages for proven infringement because the patent at issue is used in a Chinese standard parallels the thrust of provisions in China's Anti-Monopoly Law (AML), draft AML implementing regulations, and recent draft rules issued by the Standardization Administration of China (SAC), which are of significant concern to the Chamber and its members, as discussed elsewhere in this document.

### **Indigenous Innovation – The New Frontier**

Beyond the traditional challenges associated with counterfeiting and piracy, American companies are alarmed by the use of IP rules and regulations in China—along with a range of other policies in the areas of antitrust and foreign investment, standards setting, government procurement, subsidies and tax—as tools for strategically advancing the interests of SOEs and state-chosen companies. As Anne Stevenson-Yang and Ken DeWoskin noted in their seminal 2005 work, *China Destroys the IP Paradigm*, “coordinated with strong political and financial support for the domestic tech companies that are carrying “Chinese” technologies out into the world, [China's] leaders are hoping to engender a new and more sustainable form of mercantilism.”<sup>2</sup>

Before highlighting China's specific indigenous innovation policy tools and their ongoing and possible future impact on American intellectual property and innovation capacity, it is useful to reflect on the specific concerns that have driven and continue to drive China to re-assess its “market for technology” strategy and

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<sup>2</sup> Stevenson-Yang, Anne and DeWoskin, Ken, “China Destroys the IP Paradigm.” *Far Eastern Economic Review* (March 2005).

the development of policies to support that strategy, as reflected in official government documentation and speeches made by senior leadership.

### ***Drivers of Indigenous Innovation Policy***

The fundamental driver that forced China to re-consider its national scientific and technology development strategy is the current unsustainable model of economic development, and a latent realization that China must move rapidly up the value chain towards a knowledge- and services-based economy to remain viable and succeed in a globalized economy.

Second, China's indigenous innovation strategy stems at least in part from its national security concerns. Throughout a number of leading policy and government elites in China, there is a dominant view that China's national security challenges are both traditional and non-traditional in nature. It can be argued that China's non-traditional challenges such as population, social, and economic divide along with environmental degradation are a direct threat to the stability of the Communist Party's rule.

With this in mind, a dominant majority within the Party argue that China must have the ability to control its own destiny by innovating independent solutions that are free from foreign control. In a physical sense, this means that the atmospheric satellites to monitor pollution, network filtering technology to filter unwanted internet content, and vaccinations for highly infectious diseases must be developed, owned, and controlled by parties that are either under direct or indirect control of the State.

Hence, in 2006 the State Council issued a Technology Development Blueprint that makes it clear China's top leadership intends to reduce China's foreign technology reliance rate to below 30%. In the case of semiconductors, for example, the Chamber understands that China has set the goal of having only 15% foreign participation in the market by 2015. China, it appears, does not want foreign countries or enterprises to dictate the fate of China's development and growth as witnessed by, for example, the inability of China and other developing nations to decrease critical disease vaccination costs, perceived excessive royalties paid by China to western telecom firms to use foreign technology it does not control or

own, and reliance on imported technology to help China decrease reliance on coal and imported oil.

Third, China believes that a combination of unprecedented development challenges and 30 years of robust economic growth presents a unique opportunity to force innovation upon its local firms. In doing so, China has a desire to create national champions that will ultimately succeed abroad by first tackling complex social, economic, technological, scientific, and environmental problems in China. For example, if Chinese firms are able to respond to the government call to develop indigenous networking technology that allows the Chinese government to ensure confidence in the security of its own networks, then its home grown firms such as ZTE and Huawei should be able to export that expertise to most third markets abroad. Indeed, Huawei has received over \$30 billion in export credits to do just that—another example of granting preferential treatment to domestic manufacturers.<sup>3</sup>

Ultimately, China hopes the demand generated by domestic attempts to solve its unprecedented challenges will aid the development of national competitiveness of its firms and large economy on the world stage. China believes that the State is the best equipped to understand future trends in technology and scientific development, and more importantly, how its industrial development can be steered to take best advantage of these trends.

### ***Indigenous Innovation Policy Developments***

As early as 2002, China started to comprehensively assess its national priorities in relation to science and technology development. According to reports, Premier Wen Jiabao led a group that in 2003 prepared over 20 detailed reports and assessments of different policy options China could take to improve its level of innovation. Then, in 2004 the Politburo, China's highest political body, led a study session themed "China's S&T Development Plan for 2020" that reviewed the findings of these studies. This meeting was a defining event that solidified the Party's thinking on indigenous innovation; a concept that had long been touted by

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<sup>3</sup> Tao, Junjie, "China Development Bank and Huawei Sign Strategic Cooperation Agreement Worth \$30 Billion." *Xinhua* (September 22, 2009). Available at [http://news.xinhuanet.com/fortune/2009-09/22/content\\_12098823.htm](http://news.xinhuanet.com/fortune/2009-09/22/content_12098823.htm)

the Ministry of Science and Technology (MOST), but had not gained traction at higher levels within the Chinese government.

In 2005, Hu Jintao, General Secretary of the Communist Party and President of China, stressed: “We should . . . increase core competitiveness and strive to make S&T [science and technology] innovation with Chinese characteristics a reality. We must . . . speed up the building of a national innovation system, and strengthen original innovation capability.” Thus began a major shift in focus at the top of China’s leadership from “made in China” to “invented in China.”

Then, through late 2005, officials from a number of key ministries including the National Development and Reform Commission (NDRC), MOST, the Ministry of Finance (MOF), the Chinese Academy of Sciences and others worked hard to formulate an actual government strategy that would later be known as the The National Medium- and Long-Term Plan for the Development of Science and Technology (2006-2020) (MLP). The MLP was published in February 2006, which was followed in June by a State Council Document outlining specific and concrete supporting measures the government would formulate to promote the implementation of the indigenous innovation policy.

The MLP, which is viewed as the cornerstone of China’s indigenous innovation strategy, laid out for the first time the country’s new approach to fostering science and technology development in China. Furthermore, it solidified China’s grand designs on innovation, which was termed as “indigenous” or developed in a way that was independent of outside or foreign support.

Yet the plan did not try to hide the fact that China should “re-innovate” relevant foreign technology (i.e., by adopting and improving imported technologies). While the plan spoke of reforms to China’s scientific institutions, fostering the role of academia in innovation, and the advancement of exploratory and basic research, the real thrust of the MLP was to create a “mission oriented approach” to drive home-grown innovation at the expense of innovation from abroad.

The real substance of the MLP was therefore in the definition of what are described as *11 key areas, 8 frontier technologies, and 16 Megaprojects*.

The MLP portrays an extremely ambitious country in a great hurry. The breathtaking number of goals and projects laid out in the plan are on a tight timeline.

### ***Megaprojects and The Role of Import Substitution and Procurement***

It is clear is that the 16 megaprojects in the MLP are vehicles for an import substitution action plan to create Chinese indigenous innovation by “co-innovation” and “re-innovation” of foreign technologies brought into China by foreign companies seeking to profit from the massive financial government outlays on the megaprojects. These projects are the most ambitious component, yet most underreported and not widely known aspect of the indigenous innovation program.

According to the MLP, as the “major carriers of uplifting indigenous innovation capacity,” the megaprojects are aimed at “assimilating and absorbing” advanced technologies imported from outside China so the country can “develop a range of major equipment and key products that possess proprietary intellectual property rights.” Use of the procurement lever is assigned a critical role to generate demand for SOEs and to help them to create proprietary Chinese technologies from these projects. The MLP called for creating a buy-China policy for government procurement and expanding the creation of China’s own technology standards to alleviate the burden of paying license fees and royalties to foreign companies.

China’s aim for its SOEs to benefit from procurement under the MLP, whether “government” or “commercial”, and its aspiration that its SOEs develop into “global champions” were reinforced in 2008 by the State-Owned Assets Supervision and Administration Commission (SASAC) announcement that numerous sectors must remain entirely state-owned (aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping, and telecommunications) or largely in state hands (automobiles, chemicals, construction, electronic communications, equipment manufacturing, iron and steel, nonferrous metal, science and technology, and surveying and design).

While the MLP identified the goals and specific sectors in which the government deemed innovation was of strategic importance, the 11<sup>th</sup> Five-Year Plan for High-

Technology Industries (2006 -2010) formally detailed the 16 megaprojects areas. Though formulated by NDRC, MOST retains authority for the implementation of the 16 Special Projects.

Based on official MOST definitions, 13 of the 16 Special Projects are as follows (3 projects are currently deemed classified):

- Core electronic components, high-end general use chips and basic software products
- Large-scale integrated circuit manufacturing equipment and techniques
- New generation broadband wireless mobile communication networks
- Advanced numeric-controlled machinery and basic manufacturing technology
- Large-scale oil and gas exploration
- Large advanced nuclear reactors
- Water pollution control and treatment
- Genetically modified new-organism variety breeding
- Pharmaceutical innovation and development
- Control and treatment of AIDS, hepatitis, and other major diseases
- Large aircraft
- High-definition earth observation system
- Manned spaceflight and lunar probe programs

### ***The “Playbook” and Tools in the Government’s Toolbox***

By June 2006, the State Council issued its first group of implementing rules supporting the MLP. There were 99 supporting policies with a named person in the appropriate government entity designated as responsible for each policy and a deadline for carrying out the tasks. Most of those named were vice-minister level or higher. The NDRC was assigned the largest burden, with 29 policies to implement. The MOF and its tax administration together received 25 of the policies. MOST received 17, and the Ministry of Education received 9.

The NDRC’s main assignment was to strengthen the ability of small- and medium-sized enterprises to innovate, including such tasks as developing guidelines for increasing the recognition of Chinese brands and developing guidelines for building national engineering labs. MOF was assigned to produce the financial

policy push and pull: tax breaks and other incentives for enterprises to invest in innovation, and policies for driving innovation through government procurement incentives. MOST was awarded the responsibility for assigning funds for science parks, research labs and other support for science research and development such as the megaprojects. The China Development Bank (CDB) was directed to open the spigot on soft loans to enterprises that pursue indigenous innovation projects. The Export-Import Bank of China was assigned to create special accounts for innovative enterprises.

Within the MLP and in its “supporting measures” the Chinese government outlined the following tools as most useful at fostering indigenous innovation:

**Government Procurement:** The MLP clearly stipulated that China would create a catalogue to give preferential treatment to indigenous innovation products, and at the same time make it more difficult to procure foreign technology to encourage domestic government entities to buy local.

In late 2009, MOST released a policy that set out guidelines for the creation of a national “indigenous innovation product catalogue,” a list of products invented and produced domestically that would receive preferences in government procurement in China, according to MOF procurement regulations (similar policies were launched by other ministries and at the provincial- and city-level). To qualify for the catalogue, products had to contain Chinese-owned or developed intellectual property. If implemented, the policy would have excluded nearly all U.S. products.

Six large categories of products were eligible to apply to be included in the catalogue, including computers and application equipment, telecom products, modern office equipment, software, new energy equipment and high-efficiency energy-saving products. Based on policies issues by other ministries, including the MIIT, it is possible, if not likely, that the scope of products within the catalogue will expand considerably in the future.

While the Chinese government subsequently offered some positive modifications to the draft policy, many concerns remain, including discriminatory practices by various national and local government authorities that are also involved in China’s indigenous innovation push. For instance, to become accredited for placement on the catalogue, products have to comply with undefined industrial policies. The

use of procurement lists and related indigenous innovation policies represent a structural issue with direct consequences for market access and the ability for foreign firms to compete on a level playing field in China.

China's policy approach underscores its intent to use the large scope of its government and SOE procurement markets to provide distinct advantages to domestic companies and products or to force technology transfer if foreign players choose to participate. China undertook a commitment in its WTO Accession Agreement that its SOEs engaged in commercial activity would make procurement decisions solely in accordance with commercial considerations. In practice, however, China frequently ignores this distinction, thereby creating increasingly serious challenges for American companies to compete. China has yet to join the WTO's Government Procurement Agreement, and it recently stated publicly that it would not cover any of its SOEs in an updated offer. China's position outside the agreement allows it to flaunt government procurement rules accepted by those nations that adhere to the GPA.

**Tax Incentives:** The MLP stated that it would develop a number of tax breaks and rebates for R&D activities and related equipment, training, and personal.

China has multiple tax incentives with varying conditions attached to them.<sup>8</sup> For example, in 2002, the central government decided to refund monies to local semiconductor manufacturers selling product in China to make their effective value added tax rate 3% compared with the 17% rate applicable to importers of semiconductors. USTR challenged the discriminatory tax on behalf of the U.S. Semiconductor Industry Association as favoring domestic over foreign goods in violation of WTO commitments. The Chinese government revoked the measure before a WTO panel was assembled.

Since that time China's tax incentives have become more sophisticated. China in 2008 adopted discriminatory Administrative Measures for Assessment of High New-Tech Enterprises (HNTE), which compel foreign enterprises to transfer IP rights associated with core technologies of the businesses they operate in China to a PRC-based entity in order to qualify for tax breaks as HTNEs. As a general rule, MNCs do not vest IP rights in their Chinese subsidiaries due to tax and other reasons.

**Financial Support:** The MLP's primary objective is to ensure that Chinese firms and State institutions meet the objectives within the megaprojects and adequately fund government programs. This includes incentives for listing firms on the stock exchange, providing access to venture capital funds, and other funding mechanisms.

By way of example, CDB signed a cooperation agreement worth \$30 billion with Huawei Technologies on September 22, 2009, according to a Chinese press report. The \$30 billion line of credit constituted a \$20 billion expansion of a \$10 billion line of credit that had been provided to Huawei by CDB in 2005. The same report noted that CDB had long been financing "strong Chinese companies internationalization in line with the national and local government policies," and had lent in excess of \$80 billion to such companies as of August 2009.

**Importing, Digesting, and Re-Innovating Foreign Technology:** Recognizing that foreign technology will still be critical to meeting some of China's needs, the government stated that where possible, import of technology should be avoided, but that if needed to be done, efforts should be made to "re-innovate" and commercialize that technology in China.

In December 2009, MOST, MOF, the Ministry of Industry and Information Technology (MIIT), and the State-owned Assets Supervision and Administration Commission (SASAC) jointly issued the Guiding Catalogue of Major Indigenous Innovative Technologies and Equipment 2009, a catalogue of industrial equipment products that they want domestic companies to develop in order to boost China's domestic equipment manufacturing industry. The catalogue covers 18 product categories including new-model agriculture equipment, high-end printing, heavy equipment, machine tools, civil aviation, mining and oil exploration and many others. In addition to offering tax and financing incentives to assist domestic producers, the catalogue gives manufacturers of the listed equipment types priority in receiving the national indigenous innovation product designation.

Many of the types of equipment listed in the catalogue are being imported or developed by FIEs in China. The catalogue specifies in its criteria an objective of import substitution, which is directed at replacing equipment imports from overseas suppliers. The other criteria that must be met include: urgently needed

for major projects and the construction of national economy; have large potential for export or the potential to create revenue in foreign exchange; to a large extent, potentially energy-conserving or material-saving, eco-friendly, with great economic and social benefits.

**Creation of Domestic Intellectual Property and Standards:** The core to China's innovation related IPR strategy is to create, re-innovate, and own more core IPR in the fields identified within the MLP. The MLP suggests regulators creating adequate protections for innovative projects will provide extra incentives to domestic firms to create IPR in areas designated as "strategic" by the State. Under the guise of IPR creation, the MLP and China's 2008 National IP Strategy state that China must develop a large set of standards that can compete head to head with existing international technology.

According to the Standardization Administration of China (SAC), China is revamping its standards system to (i) lessen the "control by foreign advanced countries over the PRC," especially "in the area of high and new technology"; and (ii) increase the effectiveness of Chinese technical standards as important protective measures or barriers to "relieve the adverse impact of foreign products on the China market." SAC has stressed that the development of discriminatory Chinese standards is critical because most other trade barriers such as tariffs, import quotas and licensing requirements have been removed as a result of WTO commitments.

National standards that favor domestic technologies are used in conjunction with other indigenous innovation policies to build up local champions. For example, China delayed the licensing of other broadband technologies such as WiMax for several years to give time for its homegrown TD-SCDMA technology to develop and gain traction in the Chinese market. Huawei, for example, benefitted from the licensing of TD-SCDMA at the expense of foreign technologies.

In short, the primary goal of MOST and other ministries is to use these measures to drive innovation in state designated sectors, and to ensure the success and proper commercialization of the megaprojects. Beyond the above-mentioned policy tools outlined in the MLP, the PRC government has promulgated new and updated existing policies to bolster the web of tools at its disposal to promote the

transfer of foreign-held intellectual property rights and innovation capacity to China as follows:

**Anti-Monopoly Law:** China's Anti-Monopoly Law (AML), which took effect in August 2008, has yet to be enforced outside of the merger context, but may serve to limit competition by foreign firms, including through legitimate exercise of IPRs owned by American and other foreign entities, while insulating Chinese SOEs and state-invested enterprises from similar scrutiny and action.

Using the AML to undermine IPR by, such as by capping prices, is no less serious a challenge to U.S. interests in IPR than China's tolerance for counterfeiting. It is obviously important to protect the investment of American companies in their brands. It is likewise important to protect their investments in and incentives to conduct R&D.

The text of the AML and proposed implementing regulations, unlike the antitrust laws and regulations of the United States and other jurisdictions, contain numerous references to IPR. Nearly all articles, statements or discussions of the AML by the Chinese government and by non-government authorities in China include references to "abuse" of IPR. China has launched an effort across international organizations, with a focus on the Asia Pacific Economic Cooperation forum, to recruit allies that would provide cover for the approach it may take in its domestic market.

Draft regulations issued by Chinese AML enforcement agencies under supervision of the State Council raise the likelihood that the PRC government intends to use the AML to fine owners of IPR that charge fees it considers "excessive," and to lower their fees going forward. As noted above, the SPC has opined that license fees for IPR included in industry standards should be substantially lower than normal or customarily received by the patent holder. Similarly, SAC has proposed to cap royalties at amounts that are "significantly/considerably lower than the customary royalty." This approach to price regulation may not be limited to IPR in standards, as representatives of the Chinese government and academic communities have opined that the public interest requires regulation of and low prices for any IPR that is a "de-facto" standard or even commercially useful to competing firms.

Because of the absence of any sound, objective methodology and the frequent uncertainty of facts that can be used to determine through regulation an appropriate price for IPR— challenges widely acknowledged by economists—it would be relatively easy for China to articulate justifications for different results in cases involving Chinese and non-Chinese IPR. Again, it is worth noting that AML provisions governing SOEs in strategic sectors, government agencies, and trade associations are relatively weak, and remedies for government abuse are inadequate compared to international practices.

**3<sup>rd</sup> Amendment to China's Patent Law:** At the end of December 2008, the National People's Congress passed the 3<sup>rd</sup> Amendment to China's Patent Law. The new Law expands the grounds for the issuance of compulsory licensing beyond that permitted by the WTO TRIPS Agreement and requires foreign companies in China to undergo opaque security examination by Chinese authorities before filing a patent abroad. While China's State Intellectual Property Office (SIPO) has never issued a compulsory license to date, new mechanisms in the Patent Law grant SIPO expansive authority over the issuance of compulsory licenses for reasons related inter alia, to competition law, which could potentially affect foreign as well as domestic companies rich in IP rights.

The amendment of China's Patent Law was also a lost opportunity to clarify the scope of patentable subject matter in a manner helpful to U.S. interests. Despite efforts by the U.S. Chamber, joined by counterpart organizations in other countries, to ensure that strong patent protection was afforded for inventions implemented in software, China's State Council, SIPO and relevant agencies failed to incorporate changes to the law that would provide such protection. While some foreign commentators believe that there is no statutory restriction against the patentability of software in China, as a matter of practice, SIPO's internal examination guidelines appear to exclude software as patentable subject matter. At a time when more and more functionality in ICT products are being implemented in software, this is unfortunate and denies U.S. software publishers additional protections and grounds for enforcement against infringers. Moreover, China's denial of patent protection for software is arguably inconsistent with China's obligations under the TRIPS Agreement to refrain from discriminating against different fields of technology.

**Information Security Policies:** China has also targeted information and cyber security technology as a priority area for fostering Chinese indigenous capabilities. Similar to other areas of strategic importance, a conscious decision has been made to force Chinese customers to buy domestic using a complex maze of policies.

China over the last several years has also significantly increased its regulatory activity affecting the design, manufacture, import, use, and sale of information, communications and technology products, and the use of encryption in ICT products. Many of these initiatives include problematic practices out of step with international norms, including requiring product certification and testing in Chinese government labs, the use of Chinese domestic algorithms in encryption, and forced disclosure of source code and or IP.

For example, new certification and testing procedures (CCC) issued by the Certification and Accreditation Administration of China (CNCA) for information security products, which took effect on May 1, 2010, apply onerous mandatory rules to commercial products being sold in a public procurement context. While the scope of the certification is limited to government procurement, it is very possible for SOEs and other commercial entities to adopt the certification requirement on a commercial basis. No other country in the world mandates this kind of testing and certification for government procurements in the non-national security realm.

### **The Impact**

Because China is in the relatively early stages of implementing its indigenous innovation policies, there are a limited number of examples from which to assess the impact of its policies on American and foreign companies. History has shown that while China's strategic planning is excellent, its operational planning has been less effective, and it is possible that PRC policies will prove counterproductive in many sectors. The ITC will therefore be required to make numerous assumptions regarding the implementation of current and future PRC policies and their likely impact on American companies, workers and broader economic competitiveness.

Three examples, however, are instructive as to the potential future impact of China's indigenous innovation policies on sectors ranging from telecommunications to medical devices to pharmaceuticals to large commercial aircraft. Lost sales in some of these areas are not without implications for U.S. employment. As the Commission further develops its models, these examples may help to shed light on the complexities of the problems.

**Telecommunications:** Next generation networking and information technology is one of the areas flagged for strategic indigenous development under the Chinese MLP for Science and Technology Development. Not without surprise, this is a sector in which foreign industry is facing increasing challenges to compete with state sponsored competitors that are engaged in commercial activity, through the erection of a number of trade barriers in the form of mandatory standards, technology mandates, and directives to guide a certain percentage of government contracts to state firms.

While China relied heavily on imported telecommunications technology in the late 1990's and early 2000's during the development of its first mobile wireless 2G GSM networks, it soon began to realize that profits were being steered overseas as foreign firms dominated the market. Efforts were made by China's top leadership to foster competing domestic firms that would serve as a foundation to take on foreign companies down the road. This included the State making heavy investments into major companies such as ZTE, Huawei and Datang. The government then mandated that for China's 3G build out, China Mobile would have to use nothing but the proprietarily developed TDS-CDMA standard, which automatically gave a leg up to the dozens of Chinese firms that supported the standard. Furthermore, while not publically admitted by the Chinese government, the Chamber understands there may have been clear quotas given to the existing mobile carriers, now China Telecom and Unicom, to procure only a certain percentage of foreign equipment for each bid.

Finally, in another manipulation of the market, China continues to use its power over state firms to dictate the purchasing of mobile phones enabled with China's indigenously developed WAPI standard, an alternative to WIFI. This effort continues despite a commitment made to the U.S. government in 2004 that the PRC government would suspend indefinitely the implementation of WAPI as a mandatory wireless encryption standard. These several instances of government

intrusion into the telecommunications market signal that China is committed to fostering indigenous innovation outside the means and scope as specified within the MLP—which primarily pointed to the usage of government procurement to guide the purchasing of domestic technology.

**Renewable Energy – Wind:** Energy technology is a clear sector earmarked by the Chinese government for strategic indigenous development under the MLP. Since 2004, the Chinese government has implemented a series of measures that establish preferences for domestic equipment, domestic enterprises, and indigenous intellectual property that have significantly impacted foreign companies' competitiveness in the Chinese wind market. Even as foreign firms were able to meet the local content requirements, they continued to face ongoing market barriers in the form of product standards, bidding requirements, and other domestic preferences that favored locally-owned manufacturers over global suppliers. The *New York Times* reported that in March 2009, when the Chinese government accepted bids for NDRC wind power concession projects, "every contract was won by one of seven domestic companies. All six multinationals that submitted bids were disqualified on various technical grounds, like not providing sufficiently detailed data."<sup>4</sup> In 2008, the NDRC and eight government ministries and commissions issued a circular which stipulated that China's economic stimulus investments on new wind power concessions must provide preference to domestic products.

Foreign share of China's wind power equipment market has plummeted as a result of these measures, even as Chinese demand for them has experienced tremendous growth. According to the National Foreign Trade Council Report on China's Promotion of the Renewable Electric Power Equipment Industry, foreign share of annual Chinese new purchases of wind power equipment fell from 75% in 2004 to 24.4% in 2008. Moreover, in the same period, Chinese companies' share of cumulative installed wind power equipment capacity grew from 18% to 62%.<sup>5</sup>

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<sup>4</sup> Bradsher, Keith, "China Builds High Wall to Guard Energy Industry." *New York Times* (July 13, 2009). Available at <http://www.nytimes.com/2009/07/14/business/energy-environment/14energy.html>

<sup>5</sup> Howell, Thomas R.; Noellert, William A.; Hume, Gregory; and Wolff, Alan Wm.: National Foreign Trade Council "China's Promotion of the Renewable Electric Power Equipment Industry" (March 2010). Available at <http://www.nftc.org/default/Press%20Release/2010/China%20Renewable%20Energy.pdf>

**Rail Transportation:** A third area targeted by the indigenous innovation program is railroad infrastructure, particularly high-speed rail. China's railway development drive has garnered significant international attention due to the amount of funding it has received under China's stimulus program. China is now laying more new high-speed rail track than any other nation in the world, which China views as a vital move to enhance its infrastructure by making domestic connections that will hopefully further drive economic growth. Yet the technology used behind a core aspect of hi-speed rail, the locomotives and cars or rolling stock, is largely foreign and licensed for use within China.

China's railway system is under control of the Ministry of Railways, an extremely powerful organ that has resisted calls for it to be disbanded or merged into the Transport Ministry. It has over the last decade smartly guided entrance by foreign companies in the rolling stock manufacturing market into a limited number of specifically established joint-ventures with state owned firms. While 4 to 7 years ago foreign rail technology providers such as Siemens and Kawasaki Heavy Motors were not able to accurately forecast China's breakneck rail growth that would take place in 2008-2009, they understood well the potential of the China market, and thus entered into the JV's and licensed their technology so that their trains that run in Europe and in Japan could be made in China.

Today, varying versions of these Chinese built "foreign trains" dominate the hi-speed rail market in China, with some of the foreign firms making a hefty profit in the meantime. Yet, an important shift may be underway. According to reports by the Economist<sup>6</sup>, the Financial Times<sup>7</sup>, and New York Times<sup>8</sup>, the very same Chinese companies that are licensed to manufacture Siemens trains in China have been aggressively pursuing foreign rail contracts in places around the world such as Saudi Arabia and California in the United States. It thus appears that the technology transfer of foreign companies has helped Chinese companies to become global competitors in rail. There are questions as well to how China's

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<sup>6</sup> "A Railway Bonanza in China: Trouble Down the Track." *The Economist* (January 14, 2010). Available at [www.economist.com/businessfinance/displayStory.cfm?story\\_id=15276738](http://www.economist.com/businessfinance/displayStory.cfm?story_id=15276738)

<sup>7</sup> Anderlini, Jamil, "Siemens boards Chinese rail bid." *The Financial Times* (March 17, 2010). Available at <http://www.ft.com/cms/s/0/0bf13836-3164-11df-9741-00144feabdc0.html>

<sup>8</sup> Bradsher, Keith, "China Is Eager to Bring High-Speed Rail Expertise to the U.S." *The New York Times* (April 7, 2010). Available at [http://www.nytimes.com/2010/04/08/business/global/08rail.html?ref=high\\_speed\\_rail\\_projects](http://www.nytimes.com/2010/04/08/business/global/08rail.html?ref=high_speed_rail_projects)

state-owned rail companies will compete with foreign competitors going forward from a sheltered home market and with the potential backing of state-owned banks.

### **Recommendations for Quantitative Analysis**

For the ITC's quantitative analysis, the Chamber hopes it will begin by developing estimates of the market size of the sectors that China is targeting. One approach would be for the ITC to assess market opportunities in three parts: 1) the China market, 2) the U.S. market, and 3) the market in the rest of the world. The ITC may wish to attempt to estimate the current market share of U.S. and Chinese firms in each of these markets and monitor how those shares change over a 5 to 10 year period. U.S. companies are at risk not only in the China market, but in the United States and the rest of the world if China is successful in its long-term strategy to displace foreign competitors and their IP around the world.

The Chamber also recommends that the ITC monitor which countries capture leading market positions in emerging industries and technologies and attempt to quantify the impact on jobs in each area. It is particularly important for the ITC to focus on new and emerging industries, areas where the United States has excelled historically. It is possible that the United States may lose jobs in certain areas targeted by China. At the same time, the United States may create even more jobs in emerging industries and technologies. We hope the ITC can avoid the quandary of monitoring only existing industries, in which the U.S. may be expected to lose jobs over time. Such an approach could result in a distorted assessment of the impact of China's indigenous innovation policies on U.S. jobs and competitiveness.

The Chamber further recommends that the ITC be alert to efforts by China to target service sectors, in addition to technology sectors. The United States is the world's leading exporter of services, with a trade surplus in services of over \$130 billion in 2009, and services account for roughly 80% of U.S. private sector employment. Economic growth and a rising middle class in developing countries such as China create tremendous opportunities for U.S. service providers. The ITC should develop metrics to track these service sector opportunities and progress in China.

## **Conclusion and Next Steps**

China's continuing lax enforcement and protection of American intellectual property rights is having an adverse impact on American companies, jobs and competitiveness now. When coupled with more recent indigenous innovation policies that restrict the ability of American companies to access the market and compete in China and around the world by creating advantages for China's SOEs and state-influenced champions, both sets of policies have the potential to undermine significantly the innovative capacity of the American economy in key sectors, and, consequently, harm the competitiveness and livelihood of American business and the workers that they employ. It is essential, therefore, that American policymakers have not only a qualitative understanding of China's approach, but a robust and regularly updated quantitative assessment of the impact of China's approach. As you proceed with your work, we urge you to develop economic models that are dynamic and comprehensive enough to measure the challenges before us and accommodate China's ever-changing use of discriminatory policies that are being deployed in the name of helping the country to become more innovative.

Madame Chairman, and members of the Commission, the U.S. Chamber of Commerce and our members view the project that you are undertaking as of critical importance. Your work can help to ensure the continued leadership of American economy in advancing global innovation, creating high-paying jobs in this country, and helping to realize President Obama's goal of doubling U.S. exports over five years. Achieving each of these goals will support our country's long-term competitiveness and economic development.

We again thank you for this opportunity to provide our views on a topic of great importance to our members. The U.S. Chamber stands ready to support your efforts.

December 10, 2009

The Honorable Wan Gang  
Minister of Science and Technology

The Honorable Xie Xuren  
Minister of Finance

The Honorable Zhang Ping  
Chairman of the National Development and Reform Commission

Dear Minister Wan, Minister Xie and Chairman Zhang:

As heads of associations representing a wide array of companies and industries around the world, we are committed to fostering strong ties with China as it continues its more than 30-year path of economic reform. We are, therefore, deeply troubled by the joint circular (Notice No. 618) posted November 15, 2009 that would implement an Indigenous Innovation Product Accreditation system. Implementation of this system will restrict China's capacity for innovation, impose onerous and discriminatory requirements on companies seeking to sell into the Chinese government procurement market, and contravene multiple commitments of China's leadership to resist trade and investment protectionism and promote open government procurement policies.

We strongly believe that implementation of this program will undermine the more positive relationship that our countries have been working so hard to achieve with China.

The Indigenous Innovation Product Accreditation Program will hinder, rather than promote, China's own goals of advancing its science and technology capabilities. Access to the best products and services from around the world is critical to spurring technological progress in all sectors of the economy, overall economic growth and higher living standards. Not only is the compressed application deadline of December 10, 2009 unworkable, but the very restrictive and discriminatory program criteria would make it virtually impossible for any non-Chinese supplier to participate—even those non-Chinese companies that have made a substantial and long-term investments in China, employ Chinese citizens, and pay taxes to the Chinese government. The result will be less efficient and more costly purchases of innovative products and services by the Chinese government and a slowing of the very technological development that China is pursuing.

Further, the criteria of Notice 618 diverge markedly from global practices and include unique requirements that the product's intellectual property be developed and owned in China, and that any trademarks be originally registered in China. By contrast, quality, performance and value are given only a minimal role. China and the international community have a common interest in ensuring robust protection of intellectual property rights as we forge a closer economic agenda. China's new criteria fail to recognize the truly collaborative, cross-border and global nature of R&D that produces innovation and that few if any products are developed in a single national territory. Establishing local intellectual property ownership as a market access condition would run counter to free and open trade and to fostering collaborative innovation.

The Accreditation Program also runs directly counter to the commitment of President Hu and other world leaders to pursue open trade and investment policies and avoid protectionism. Additionally, it would dilute, if not effectively nullify China's commitment at the July 2009 U.S.-China Strategic and

Economic Dialogue in which China clarified that its procurement policies were open to foreign-invested enterprises (FIEs) and recognized the importance of non-discriminatory procurement policies.

For all of these reasons, we strongly urge the Chinese government not to proceed with the requirements of the joint circular. We would very much appreciate the opportunity to exchange views and share our experiences with your government on how best to advance your science and technology goals and to promote innovation through a fair and transparent selection process.

Respectfully,

Michael Barbalas  
President  
American Chamber of Commerce in China  
(AmCham-China)

Brenda Foster  
President  
American Chamber of Commerce in Shanghai  
(AmCham Shanghai)

Dennis Slater  
President  
Association of Equipment Manufacturers (AEM)

Robert W. Holleyman, II  
President and CEO  
Business Software Alliance (BSA)

Bob Vastine  
President  
Coalition of Service Industries (CSI)

Yoshiyuki Sukemune  
President  
Communications and Information Network  
Association of Japan (CIAJ)

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Director General  
DIGITALEUROPE

Michael C. Maibach  
EABC President & CEO  
European-American Business Council (EABC)

Richard Vuylsteke  
President  
American Chamber of Commerce in Hong Kong  
(AmCham Hong Kong)

Harley Seyedin  
President  
American Chamber of Commerce in South  
China (AmCham South China)

John J. Castellani  
President  
Business Roundtable (BR)

Perrin Beatty  
President and CEO  
Canadian Chamber of Commerce

Todd Thibodeaux  
President and CEO  
Computing Technology Industry Association  
(CompTIA)

Gary Shapiro  
CEO  
Consumer Electronics Association (CEA)

Calman J. Cohen  
President  
Emergency Committee for American Trade  
(ECAT)

Pascal Kerneis  
Managing Director  
European Services Forum (ESF)

Loic Riviere  
Director General  
European Software Association (ESA)

Seungcheol Lee  
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Japan Electronics and Information Technology  
Industries Association (JEITA)

Toshimi Hayano  
President  
The Japan Electrical Manufacturers' Association  
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Naoki Aoyama  
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John Engler  
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Som Mittal  
President  
NASSCOM

William Reinsch  
President  
National Foreign Trade Council (NFTC)

George Scalise  
President  
Semiconductor Industry Association (SIA)

Ken Wasch  
President  
Software & Information Industry Association  
(SIIA)

Christopher W. Hansen  
CEO  
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Jim Hawley  
General Counsel and Acting CEO  
TechNet

Grant Seiffert  
President  
Telecommunications Industry Association (TIA)

Peter M. Robinson  
President and CEO  
United States Council for International Business  
(USCIB)

Thomas J. Donohue  
President and CEO  
U.S. Chamber of Commerce (USCC)

John Frisbie  
President  
US-China Business Council (USCBC)

Cc: The Honorable Chen Deming, Minister of Commerce

January 26, 2010

The Honorable Hillary Rodham Clinton  
Secretary of State

The Honorable Timothy Geithner  
Secretary of the Treasury

The Honorable Eric H. Holder, Jr.  
Attorney General

The Honorable Gary F. Locke  
Secretary of Commerce

The Honorable Ron Kirk  
United States Trade Representative

Dear Secretary Clinton, Secretary Geithner, Attorney General Holder, Secretary Locke and  
Ambassador Kirk:

We seek your urgent attention to policy developments in China that pose an immediate danger to U.S. companies. The Chinese government has promulgated a series of “indigenous innovation” programs as part of a long-term plan that threaten to exclude a wide array of U.S. firms from a market that is vital to their future growth and ability to create jobs here at home. Given the far-reaching impact of these policies on the American economy, we urge you to make this a strategic priority in our bilateral economic engagement with China.

For several years, the Chinese government has been implementing indigenous innovation policies aimed at carving out markets for national champions and increasing the locally owned and developed intellectual property of innovative products. We are increasingly alarmed by the means China is using to achieve these goals.

Of most immediate concern are new rules issued by the Chinese government in November to establish a national catalogue of products to receive significant preferences for government procurement. Among the criteria for eligibility for the catalogue is that the products contain intellectual property that is developed and owned in China and that any associated trademarks are originally registered in China. This represents an unprecedented use of domestic intellectual property as a market-access condition and makes it nearly impossible for the products of American companies to qualify unless they are prepared to establish Chinese brands and transfer their research and development of new products to China.

This directive targets some of our most innovative and competitive manufacturing and service industries, including computers, software, telecommunications and green technology. Once this system is in place, it is expected to be expanded to other industries. The November directive

was followed in late December by the announcement that the government would develop a broader catalogue of indigenous innovation products and sectors to be afforded preferences beyond government procurement (i.e., including subsidies and other preferential treatment). The December announcement, which was issued by four Chinese agencies including the State Owned Assets Supervision and Administration Commission (SASAC), also raises the specter of China subtly encouraging its many state-owned enterprises to discriminate against foreign companies in the context of procurement, including for commercial purposes.

These particular programs are part of a broader set of government policy initiatives covering, for example, patents and standards, competition policy, encryption and tax, the effect of which is creating barriers to competition in the Chinese market for our most innovative companies.

They also run counter to repeated pledges by the Chinese government to avoid protectionism, including the joint commitment of President Hu and President Obama at their recent summit in November to pursue open trade and investment. Moreover, they do not provide a constructive framework for a positive, cooperative and mutually beneficial relationship.

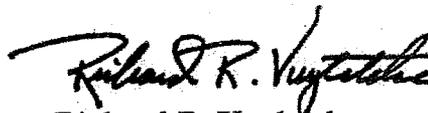
U.S. economic growth relies in significant measure on access to key international markets. China is the world's third largest economy and represents a major potential growth market for the United States. A healthy U.S.-China bilateral relationship requires an expanding economic relationship based on mutual openness. Systematic efforts by China to develop policies that build their domestic enterprises at the expense of U.S. firms and U.S. intellectual property is not a framework for a positive and cooperative relationship. Additionally, we are further concerned that such policies, if left unchallenged, will be pursued by other important trading partners, compounding the impact on the U.S. economy.

We respectfully request that your agencies make this issue in particular a strategic priority in your bilateral economic engagement with China; develop, in consultation with the business community and like-minded foreign governments, a strong, fully coordinated response to the Chinese government; and raise this issue with your Chinese counterparts in all appropriate multilateral and bilateral meetings and forums.

With best regards,



Stephen J. Ubl  
President and CEO  
AdvaMed



Richard R. Vuylsteke  
President  
The American Chamber of Commerce in  
Hong Kong



**Brenda Lei Foster**  
President  
The American Chamber of Commerce in  
Shanghai



**Harley Seyedin**  
President  
The American Chamber of Commerce in  
South China



**John Castellani**  
President  
Business Roundtable (BRT)



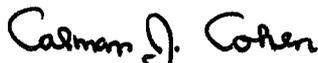
**Robert W. Holleyman, II**  
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**Bob Vastine**  
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**Gary Shapiro**  
President and CEO  
Consumer Electronics Association (CEA)



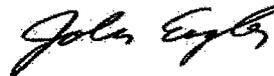
**Calman J. Cohen**  
President  
Emergency Committee for American Trade  
(ECAT)



**Dean C. Garfield**  
President  
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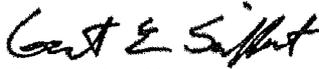
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Industry Comments on the Draft Notice Launching the National Indigenous Innovation  
Product Accreditation Work for 2010

May 10, 2010

Summary

The signatory organizations listed below welcome the opportunity to comment on China's Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010 ("the Draft Notice"). As organizations representing thousands of companies, many with deep and longstanding engagement in the Chinese market, we welcome China's efforts to strengthen its innovative capacity, to which our companies have already made great contributions through their R&D and other investments in China.

We appreciate the Chinese Government's efforts to address some of the most troubling aspects of the national indigenous innovation product accreditation system detailed in the November 2009 Circular No. 618 and accompanying Instructions ("the 2009 Notice"). However, the business community still has many remaining concerns with these measures.

While we support and encourage innovation in China, and look forward to working with the Chinese Government to promote an environment that enhances opportunities for innovation in China, we believe that the Draft Notice and the many related policies would actually decrease, not increase, innovation in China. These related policies, broadly linked to indigenous innovation, limit the types of products that are developed and used in China and exclude some of the most innovative suppliers, the associated R&D, and resulting innovation benefits to the Chinese market.

We look forward to working with the Chinese government to encourage an environment that enhances opportunities for innovation in China.

To do so effectively, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not to carry forward this program.

We also urge China to proceed with an ongoing dialogue with stakeholders on best policies and practices that promote innovation and do not discriminate against foreign firms' investments in and exports to the Chinese market. In that regard, as an essential first step, the Chinese government should undertake an immediate review of all innovation policies to ensure they do not discriminate between foreign and domestic suppliers and achieve the goal of the opening China's market wider to foreign investment and exports promised by President Hu and Premier Wen.

We strongly believe that the best ways for China to further enhance its innovative capacity are to:

- (1) further open its markets to foreign investment, to enable China to obtain the full benefits of foreign technology and know-how;
- (2) provide incentives to innovate by: ensuring full respect for intellectual property rights including patents, copyrights and trademarks; avoiding policies which establish preferences based on nationality of the owners of the intellectual property rights; and acting forcefully and promptly to prevent misappropriation of such rights;
- (3) promote full and open competition, so that Chinese consumers and companies have access to the best technologies, resources, and products at competitive prices; and
- (4) adopt non-discriminatory, merit-based and transparent procurement policies and practices that allow all innovators to compete on an equal footing.

In addition to adopting the above basic policy framework to promote innovation, China should actively consider added positive, non-discriminatory steps to build its innovative capacity, such as increasing government funding for research, expanding university research programs, providing incentives for private sector research and development, improving science and engineering education, promoting entrepreneurship and fostering innovation clusters.

We would welcome the opportunity to engage in such a dialogue and share best practices. China, along with other G5 and G8 countries, "acknowledge[d] the need to conduct a constructive dialogue in order to address contentious issues in a manner which would assist in the promotion and protection of innovation and intellectual property rights (IPRs) to the benefit of all economies."<sup>1</sup> In this regard, it is important for China to consider changes to its broader set of policies related to innovation that affect the ability of non-Chinese companies to compete in China.

Finally, given China's commitments in its WTO accession document as well as recent Strategic and Economic Dialogue commitments, we urge China to ensure that any new laws or regulations it implements are consistent with the policies and spirit of the WTO's Government Procurement Agreement, and to move its policies in a direction consistent with eventual accession to that Code.

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<sup>1</sup> Concluding Report of the Heiligendamm Process (G8 Summit 2009), Par. 23.

## Comments

### A. Overarching Issues

The signatory organizations listed below welcome the opportunity to comment on China's Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010 and appreciate the Chinese Government's revisions of the national indigenous innovation product accreditation system detailed in the November 2009 Circular No. 618 and accompanying Instructions (2009 Measures).

Our organizations bring together thousands of companies, many of which have deep and longstanding engagement in the Chinese market and many more that will likely participate in an open innovation regime in China. We welcome China's efforts to strengthen its innovative capacity, which already has been greatly advanced through the R&D and other investments our companies have made in China.

Innovation is occurring at ever-increasing rates, is increasingly interdisciplinary, technologically complex, collaborative and global.<sup>2</sup> Our own experience in many countries around the world is that an open, collaborative and non-discriminatory approach that respects intellectual property rights is the fastest and most effective way to promote innovation. Indeed, "[b]oth experience and research have shown that the best way to encourage competition, promote efficiency, and spur innovation is through adherence to principles that allow market forces to determine the availability, commercialization, deployment, and use of technologies."<sup>3</sup>

The real benefit of innovation to a society comes from the application of innovative technologies throughout all industry sectors. This creates far greater economic growth than the initial development of the technology in a particular company or industry. Government policies should thus promote the rapid adoption and diffusion of innovative technologies throughout the economy, regardless of the source of the innovation.

We strongly believe that the best ways for China to further enhance its innovative capacity are to:

- (1) further open its markets to foreign investment, to enable China to obtain the full benefits of foreign technology and know-how;

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<sup>2</sup> *Innovate America*, Council on Competitiveness. 2004. As the G5 and G8 countries have noted: "the flow of ideas around the world has changed the way innovation is generated," which is "manifested in the digitalisation of the economy, the internationalisation of research and development networks, industrial design, and the development of open innovation. . . ." Concluding Report of the Heiligendamm Process (G8 Summit 2009), Par. 24 & 26.

<sup>3</sup> APEC Digital Prosperity Checklist, Section IV Innovation: Creative Industries/Individuals Principle No. 1 (November 2008).

(2) provide incentives to innovate by: ensuring full respect for intellectual property rights including patents, copyrights and trademarks; avoiding policies which establish preferences based on nationality of the owners of the intellectual property rights; and acting forcefully and promptly to prevent misappropriation of such rights;

(3) promote full and open competition, so that Chinese consumers and companies have access to the best technologies, resources, and products at competitive prices; and

(4) adopt non-discriminatory, merit-based and transparent procurement policies and practices that allow all innovators to compete on an equal footing.

Although the 2010 Draft Measures address some of the concerns previously expressed regarding the eligibility of products for accreditation, we continue to have serious concerns about the approach of the Draft Measures.

Preference policies that favor one technology or product over another, including specific lists or catalogues of designated products, are counterproductive to promoting long-term successful innovation. Such lists create a significant potential for uneven treatment and cumbersome management, and risk being easily outdated as soon as issued, particularly given the innovative nature of the products the catalogues are designed to spur.

China should also remove indigenous innovation procurement preferences from China's draft Government Procurement Law Implementing Regulations and elsewhere, as these same problems will occur in any instance that such a list is used. For similar reasons, China should eliminate the use of product catalogues at the local and provincial level, where explicit references to import substitution and domestic intellectual property ownership remain. Without clarification from the central government that the use of product lists is unacceptable at any level of government, discrimination against foreign companies will continue, and innovation will be hindered.

Many concerns remain about the Draft Measures themselves and the challenges posed by the many policies issued by various national and local government authorities that encompass China's indigenous innovation drive. These policies represent a structural issue with direct consequences for market access and the ability for foreign firms to compete on a level playing field in China.

Procurement practices should be non-discriminatory, merit-based, and transparent, allowing all innovators to compete on equal footing with full protection of their intellectual property.

Our concerns with the 2010 Draft Measures are heightened given other policies related to innovation and procurement adopted by the Chinese Government. These other policies are identified more specifically below.

For all of these reasons, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

B. Concerns with Specific Elements of the Draft Notice

Although the Draft Notice address some of the concerns previously expressed regarding the eligibility of products for accreditation for government procurement, several key questions remain on the specific requirements for accreditation and how this program would be implemented. There are several elements of the Draft Notice that are unclear and which continue to generate significant concern among our members. Among them:

- The link between procurement preferences and products and services included in the NIIP Catalogue. The Draft Notice provides that accredited products will be included in the NIIP Catalogue and “receive support in accordance with the PRC Law on Science and Technology Progress and other relevant state regulations.” The Draft Notice does not, however, specify what this “support” entails – and most importantly, whether and what procurement preferences will be awarded to innovation products. We urge the Chinese Government to sever the link between the Catalogue and government procurement, and instead to endorse a policy of merit-based procurement with decisions made on the basis of whether a product is best suited to the needs of the procuring authority, regardless of whether that product is or is not included in the Catalogue. We note that a number of Chinese policy makers have suggested that the NIIP is not about government procurement. This action would reinforce the statements already made.
- The requirement that products comply with “national industrial and technology policies” (Accreditation Condition (1)). With the exception of Accreditation Condition (5) – which requires that products that are subject to compulsory certification regimes must be certified in order to be eligible for accreditation – the Draft Notice do not specify the “national industrial and technology policies” with which products must comply. To the extent that these policies include IPR requirements or other restrictions on market access, we encourage the Government to modify and clarify these policies and to eliminate all market access barriers to foreign companies. The Draft Notice should specify the nature and scope of such policies so that it avoids enabling the creation of additional market barriers.
- The requirement that a product be locally researched and developed (Accreditation Condition (2)). Accreditation Condition (2) requires that the applicant “owns the intellectual property (IP) rights in China or licensed IP usage rights in China of products it has researched and developed . . . .” The Draft Notice also requires that applicants have Chinese legal status. Taken together—and reinforced by requirements in the application itself—these requirements could be read to mean that in order for a product to be eligible for inclusion in the NIIP Catalogue, the R&D must have been led by a Chinese entity in China. Most foreign firms, some joint ventures between foreign and PRC companies which don’t have Chinese legal status

under China's Company Law and Civil Law, and even some Chinese firms (particularly those with foreign research or development centers) will be unable to satisfy this requirement. As noted in the Summary, in today's global economy, product design and development may be performed in many different countries, including but not limited to China. Conditioning market access on the place of development or locus of IP ownership distorts competition and distorts the market-based incentives that should drive innovation. We encourage the Chinese Government to delete this language from Accreditation Condition (2). (We note that we have not yet seen the 2010 application form, which may help to clarify this point.)

- The requirement that the IP in the product “does not have any disputes or controversies with other products’ IP” (Accreditation Condition (2)). This language is vague and could result in a product being excluded from eligibility simply because a third party, including a competitor, asserts an IP infringement claim against the applicant, or seeks invalidity of the IP rights for abusive or anticompetitive purposes – even if that claim is meritless. The impact could be especially severe for Chinese holders of utility model and design patents (who hold over 90% of such patents), which are not examined for substance over prior art. There are numerous other reasons the language is flawed. The language also fails to distinguish an IP “right” from an IP “claim” that may read on a particular product. Moreover, patentees from time to time may seek to bring re-examination proceedings against patents in order to further strengthen their claims. In certain areas, such as information technology- which are patent-intensive, it will be difficult to find a product that is completely free of patent claims of one kind or another, in China or overseas. If such a provision is deemed necessary, the sentence should be revised to state that products may be excluded from the NIIP Catalogue only where the applicant is found by the State Intellectual Property Office not to own the relevant IP claims or have legal authorisation to use it and a court has made a determination that the claims relevant to the product are invalid or do not read on the product.
- The requirement that a product's technology be “advanced” (Accreditation Condition (4)). The Draft Notice indicates that a product can be considered “advanced” where it has “substantively improved upon the original product in terms of its structure, quality, material and craftsmanship, and demonstrates a clear improvement in product performance.” We are concerned that these terms are highly subjective and susceptible to divergent and inconsistent interpretations by those applying them (presumably the experts designated by the various central, regional, provincial and municipal Science and Technology Units). We also know from experience that such subjective criteria can sometimes be used to mask biases in favor of certain suppliers based on factors other than merit. We encourage the Chinese Government to delete these requirements and focus on whether the product meets or exceeds the needs of the procuring authority.
- The requirement that a product have “potential economic benefits and bright market prospects” (Accreditation Condition (6)). These terms are nowhere defined,

and again are vague and susceptible to subjective and diverging interpretations by those applying them. We encourage the Chinese Government to delete these requirements. Again, the focus should be on merit-based procurement that meets the needs of the procuring authority rather than anticipated commercial demand. Government and commercial needs often differ significantly.

- The apparent requirement that in the case of joint ventures, the percentage of Chinese investment in the applicant must exceed 50%. The Draft Notice states that “any product manufacturing unit in China that has acquired Chinese legal status” can apply to be accredited. While we have not seen the 2010 application for accreditation, the 2009 application required applicants to disclose their equity structure (including the proportion of Chinese and foreign investment, the name of the largest shareholder, and the proportion of that shareholder’s equity). We understood that to qualify for accreditation, the percentage of Chinese investment in the applicant had to exceed 50%. While we have not seen the 2010 application for accreditation, to the extent that it includes the same requirement, we encourage the Chinese Government to refrain from using equity ownership requirements as a tool to restrict eligibility for benefits under government policies.
- The content of the application itself – and more specifically whether it would impose any further requirements for eligibility on top of those set forth in the Draft Notice itself. The Draft Notice does not include examples of the application form. Instead, the Draft Notice simply states those applicants will be required to complete a product declaration form and submit it “along with other supporting documents.” We encourage the Ministry of Science and Technology (MOST) to publish the application form for comment, as well as a list of required supporting documents required and, to the extent those documents include confidential company information, a description of what measures will be taken by the Government to protect that information from disclosure or misuse. It is imperative that the application forms mirror the criteria in the Draft Notice and not introduce new conditions for eligibility.
- The composition of the expert panels that will conduct product accreditation reviews and the rules that govern their work. The Draft Notice indicate that the central, regional, provincial and municipal Science and Technology Units will appoint “experts” to assess products and recommend which products satisfy the accreditation conditions; MOST, in conjunction with the National Development and Reform Commission (NDRC) and Ministry of Finance (MOF), will also appoint experts to assist in compiling the final NIIP Catalogue. The Draft Notice do not specify how these experts are to be selected, what qualifications the experts will be expected to hold, or how the expert groups will make their decisions. We encourage the Chinese Government to develop transparent procedures for the selection and supervision of these groups if the decision is made to continue the catalogues.

Given broad concerns about the absence of clarity around so many provisions in the Draft Notice, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

### C. Further Concerns on Related Policies

There exists general concern of Chinese policies with overlapping and unclear application aimed at promoting innovation that we believe would deny market access or other commercial benefits to non-Chinese firms, impair the flow of technology and potentially hinder China's efforts to develop its innovative capacity. Our organizations would like to work with your government to address these concerns as well.

In addition to the Draft Notice, our organizations remain concerned about other Chinese innovation-related policies that hinder foreign-invested enterprises from participating fully in China's marketplace for goods and services or otherwise impede market access. As detailed below, many of these measures either

- (1) encourage or mandate procurement from domestic Chinese suppliers;
- (2) extend monetary or other benefits only to Chinese suppliers; or
- (3) provide preferences to products including "Chinese" IP, or compel the transfer of or otherwise fail to adequately protect IP in non-Chinese products.

Each of these policies also raises potential questions about China's compliance with its obligations under existing international trade disciplines and its pledges to reject protectionism and not to discriminate against foreign invested enterprises for procurement purposes.

We believe that greater clarity is needed as to how the Draft Notice fits into the broader set of measures that comprise China's innovation policy, and whether a product or service that is eligible for inclusion in the Accreditation Catalogue must nonetheless satisfy the requirements established in these other measures. To better understand the impact of the accreditation process laid out in the Draft Notice, we would respectfully request more detailed information on how the policies detailed below apply to accredited products.

Further, we believe that to the extent any of these measures extend to the purchasing decisions of state-owned enterprises (SOEs), they are inconsistent with China's clear commitments in its WTO Accession Agreement that SOEs engaged in commercial activity would make procurement decisions solely in accordance with commercial considerations.<sup>4</sup>

Examples of such policies include:

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<sup>4</sup> See Report of the Working Party on the Accession of China, WT/MIN(01)/3<sup>4</sup> 10 November 2001, Par. 45-47.

- Import substitution policies, such as the Guiding Catalogue of Major Indigenous Innovative Technologies and Equipment 2009, which specify import substitution in its criteria.
- Government procurement policies such as the Government Procurement Law (GPL), which states that the government “shall procure domestic goods, construction and services,” and the proposed GPL Implementation Rules, which establish narrow standards for determining when a good or service qualifies as “domestic” and discourage the procurement of imported products.
- Central and provincial government measures extending discriminatory preferences to “indigenous innovation,” such as the December 2009 MIIT/SASAC/MOST/MOF Guiding Catalogue for Indigenous Innovation of Major Technical Equipment (which establishes preferences for “indigenous innovation” certified products in 18 sectors and sets forth as an objective substituting domestic products for imported ones).
- Standards mandates, such as the 2009 MIIT requirements that Chinese WLAN Authentication and Privacy Infrastructure (WAPI) standard be included with any Wi-Fi enabled mobile device and several 2008-09 Requests for Proposal (RFPs) from China’s state-owned telecommunications carriers requiring WAPI in wireless access points..
- National laws that effectively weaken intellectual property rights, such as the 2008 amendments to China’s Patent Law which expand the grounds for the issuance of compulsory licenses and require foreign companies in China to undergo security examinations by Chinese authorities before filing patents abroad.
- Efforts by the Standardization Administration of China (SAC) to develop Standardization Rules that could lead to below market licensing or the use of compulsory licensing of foreign technologies used in “mandatory national standards.”

This universe of policies run counter to China’s commitment at the time of its WTO accession to join the Government Procurement Agreement. These policies are also inconsistent with the commitments by World Leaders in the G-20, including Chinese President Hu Jintao, to reject protectionism. We believe innovation is best served by practices that are non-discriminatory, merit-based, and transparent, allowing all innovators to compete on equal footing.

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We appreciate MOST’s willingness to release the Draft Notice and solicit comment. We note that the deadline for filing comments on the Draft Notice and the first date to file an application for accreditation coincide (on 10 May 2010). We nonetheless hope that the

Government will take our input, and that of other stakeholders, into account before finalizing the Draft Notice.

We look forward to working with the Chinese government to encourage an environment that enhances opportunities for innovation in China.

To do so effectively, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

We also urge China to proceed with an ongoing dialogue with industry stakeholders on best policies and practices that promote innovation and do not discriminate against foreign firms participation in the Chinese market. In that regard, as an essential first step, the Chinese government should undertake an immediate review of all innovation policies to ensure they do not discriminate between foreign and domestic suppliers.

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