

# TOWARD A NEW U.S.-CHINA INTELLECTUAL PROPERTY ENFORCEMENT STRATEGY

*Peter K. Yu*\*

## Introduction

Massive piracy and counterfeiting has been the subject of a perennial dispute between China and the United States. Although China's accession to the World Trade Organization ("WTO") has provided the United States with a new weapon in its arsenal—the mandatory dispute settlement process—the recent panel decision on *China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights* reveals significant limitations to using this process to strengthen the protection and enforcement of U.S. intellectual property rights in China. One therefore cannot help but wonder what other enforcement strategies the United States and its rights holders should adopt.

Although there has yet to be any quick and easy solution to providing dramatic improvements on intellectual property protection and enforcement in China, and commentators have repeatedly noted the lack of a "magic bullet," this Essay outlines five principles that policymakers can use to revamp their intellectual property enforcement strategy. These principles take into account not only the unique and rapidly-changing local conditions in China, but also the past challenges to U.S. efforts in strengthening intellectual property protection and enforcement on the ground.

## 1. Understand Provincial and Local Differences

The first principle was developed as a direct response to the significant regional differences within China. As I pointed out in the past, China is "a country of countries." The country is large, complex, diverse, and "sometimes internally contradictory." The Chinese speak different languages, enjoy different cuisines, grow up with different cultures, and subscribe to different historical and philosophical traditions. Conditions in Beijing are often very different from those in Guangzhou, intellectual property strategies that are effective in Shanghai are likely

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to fail in a village in Guizhou, and the trade patterns found near the coasts are very different from those found inland.

To some extent, the need for a regional approach in China reminds one of the approach Charles Dickens' publisher, Ticknor and Fields, used more than a century ago. At that time, the United States was still at the stage of formative development—not that different from China a decade ago. As Zorina Khan recounted, “in 1856, the [publisher] sold over \$10,000 worth of books in Cincinnati, an amount that was equal to its sales in the entire South. The company spent more on advertising in the city of New York in 1856 than it did for all the states in the South.” If Ticknor and Fields planned its marketing strategy without treating the developing American market as homogenous, one has to wonder why the U.S. government and many of its rights holders continue to ignore the many significant regional differences within China.

Of all the strategies the USTR employed to evaluate the regional impediments to obtaining dramatic improvements in intellectual property protection and enforcement in China, the most promising is the push for a special provincial review. In June 2006, the USTR steered its focus away from country-level assessment, which it has used for more than a decade. For the first time, it requested information concerning provincial developments in China. As stated in the announcement in the *Federal Register*, “the goal of this review is to spotlight strengths, weaknesses, and inconsistencies in and among specific jurisdictions.”

The use of a provincial approach is important, for several reasons. First, such an approach will help enhance the understanding of the divergent protections offered in different parts of the country. Given the sometimes drastically different socio-economic conditions within China, a nationwide assessment of intellectual property enforcement tends to be misleading, if not meaningless. As a representative of the U.S. Chamber of Commerce noted in his testimony before the U.S.-China Economic and Security Review Commission: “The root of China's IP problem resides in the provinces. It is . . . absolutely critical that we cultivate the support of the provincial/local officials, as well as local industry, if IP enforcement is to be addressed in a truly meaningful way.”

Second, by identifying the “hot spots” of piracy and counterfeiting, a provincial approach will help give credit where credit is due. It will also help reduce the frustration of many Chinese—policymakers and otherwise—especially those in regions that have undertaken successful intellectual property reforms or that have made considerable sacrifices in making a transition to a regime that is more respectful of intellectual property rights. While intellectual property protection continues to be a problem for foreign rights holders throughout China, one cannot deny the many important developments in the major cities and coastal areas in the past two decades.

Moreover, a blind insistence on greater enforcement throughout the country without acknowledging the important success some provincial and local governments have achieved would create resentment among a large portion of the Chinese population, which continue to regard the USTR's repeated threats and demands as “American excesses.” Such insistence would also foster a misimpression among local Chinese leaders that the U.S. government and foreign businesses will never be satisfied no matter what they do. This misimpression would not

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only erect further barriers to future cooperation, but also make it difficult for the administration and rights holders to cultivate useful local allies.

Third, a continued insistence on significant overall improvement in the country is simply unrealistic, ineffective, and counterproductive. An intellectual property enforcement strategy that insists on the complete eradication of piracy and counterfeiting in China would be as futile as the hope to achieve zero leakage in the digital environment. Although some commentators have predicted, in the run-up to China's accession to the WTO, that "pirates and counterfeiters [in China] will . . . gradually move into legitimate businesses[,] and the focus of counterfeiting and piracy will shift away from [the country] to lesser developing countries, such as Vietnam," close observers of regional developments in China will quickly point out that piracy and counterfeiting problems are likely to stay in China in the near future.

To be certain, the intellectual property protection and enforcement in Beijing, Shanghai, Guangzhou, and other major cities and coastal areas have greatly improved, in part due to the emergence of local intellectual property-based industries. Piracy and counterfeiting, however, have not migrated out of the country. Instead, they have now spread to other parts of the country, whose conditions are no different from those of the big cities a decade ago when intellectual property protection began to strengthen.

Finally, a better and deeper understanding of China's regional differences could provide useful information to help U.S. industries make better investment decisions. As Harold Chee, a noted Chinese business expert, reminded us, "if anyone tells you grandly, 'I'm going into the China market!', your immediate reply should be, 'Where, exactly?'" Today, many rights holders are likely to be satisfied if they obtain secured markets in the metropolitan areas. Thus, improving intellectual property protection and enforcement in the major cities and the coastal areas is still important, even if piracy and counterfeiting continue in the poorer parts of the country.

In fact, as regional and local governments fight hard to attract foreign direct investment, the picture in China will become more complicated in the near future. Because gains in one region may result in losses in another, many local authorities have been particularly concerned about the unemployment and labor displacement problems created by the closure of pirate and counterfeit factories. After all, greater intellectual property enforcement will lead some regions to suffer more job losses and unemployment than others, due in large part to a lack of skilled labor, education, technological infrastructure, and training facilities in the suffering regions. The closures induced by intellectual property reforms will also shift production out of a region or a locality. Thus, if problems are likely to linger for a significant period of time, rights holders may encounter severe local resistance and lax enforcement. The divergent protection may even lead to "interregional disputes over intellectual property infringement and enforcement."

Unfortunately, for all its many benefits, the USTR's provincial approach has been discontinued. While some policymakers and commentators blamed the discontinuation on the initiation of the present WTO dispute, others noted the high costs of and challenges in collecting data outside the major Chinese cities. As experts familiar with raids and enforcement have repeatedly pointed out, fighting piracy and counterfeiting in some areas can be as dangerous as

fighting drugs. Some of the strongholds of piracy and counterfeiting also benefit from local protectionism and corruption.

## 2. Take the Long View

The second principle draws on the Chinese emphasis on taking the long view. Such emphasis is understandable given China's more than four millennia of history. The Chinese perspective is well-captured by the reported response of Zhou Enlai, the former premier of China, when he was asked what he thought of the French Revolution: it was too soon to tell!

In June 2008, the Chinese State Council promulgated the *Outline of the National Intellectual Property Strategy*. Since then, China has undertaken many initiatives to promote domestic innovation, which quickly attracted criticisms from the U.S. administration and rights holders. As the USTR noted in the *2010 National Trade Estimate Report on Foreign Trade Barriers*:

A troubling trend that has emerged . . . is China's willingness to encourage domestic or "indigenous" innovation at the cost of foreign innovation and technologies. For example, . . . in November 2009, China issued the Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work with the aim of improving "indigenous" innovation in computer and other technology equipment. In order to qualify as "indigenous" innovation under the accreditation system, and therefore be entitled to procurement preferences, a product's intellectual property must originally be registered in China.

While it is understandable that the U.S. administration and rights holders are concerned about the adoption of policies that discriminate against foreign companies, it is also important to appreciate the long-term benefits of a policy that calls for greater domestic innovation in China.

For more than a decade, commentators, myself included, have argued for the need to develop a critical mass of local stakeholders in China to help push for stronger intellectual property protection from the inside. It is therefore highly encouraging that many Chinese leaders and nationals now finally understand the importance of domestic innovation. The more innovation there is, the more likely the Chinese will support greater intellectual property reforms in the future.

Indeed, the presence of a critical mass of local stakeholders is the key to successful intellectual property law reforms. By locating support from the inside, these reforms often result in more sustainable protection that is well-tailored to local needs, interests, conditions, and priorities. It is therefore no surprise that the American Chamber of Commerce–China recommended in its 2006 White Paper that "successful realization of [China's] innovation priorities is the upside inducement for the Chinese to implement the fundamental reforms necessary to guarantee protection of IPR."

Nevertheless, as I recently testified before the United States International Trade Commission, there are good domestic innovation policies and bad domestic innovation policies—just like any other type of policies. The good ones will help develop a critical mass of local stakeholders to support the intellectual property system. The bad ones, by contrast, discriminate against foreign companies. They may also violate China's international obligations

under the WTO or other international agreements. There is an important distinction between the two, and it is important that U.S. policymakers and rights holder do not throw away the good domestic innovation baby with the discriminatory policy bathwater.

While we certainly hope that Chinese policymakers will be able to develop a right mix of policies that promote good domestic innovation policies, as compared to discriminatory ones, it is very rare for policymakers to get their policies right from the get-go without trial and error. This is particularly true when the Chinese policymakers are only beginning to understand the importance of domestic innovation; they are actually learning what it means to have more domestic innovation and how to do so. From the standpoint of greater intellectual property protection and enforcement, the most important and urgent thing is that the Chinese leaders and people understand the importance and benefits of innovation. Such an understanding is likely to provide long-term benefits for both the United States and its rights holders.

Moreover, many of the indigenous innovation policies, including those criticized by the USTR in the *National Trade Estimate Report*, are still at the drafting stage. Given the fact that many policies in the gray areas are likely to undergo further adjustment, and that the Chinese regulatory system is highly flexible and at times incomplete, it is rather shortsighted to quickly criticize China's eagerness to push for discriminatory measures to promote domestic innovation. Such criticisms are likely to be counterproductive; they will fuel avoidable nationalist claims that the United States prefers China to stay weak.

Thus, instead of making such criticisms, more energy and resources should be devoted to help Chinese policymakers separate good domestic innovation policies from bad domestic innovation policies. Such separation will help policymakers acquire a better understanding of the policy constraints that emerged as a result of China's commitments at the WTO or under other international agreements.

### **3. Appreciate Local Solutions on Their Own Terms**

The third principle calls for a greater appreciation of local Chinese rules and customs. Put differently, it can be beneficial to think like the Chinese when assessing the strengths and weaknesses of these rules and customs. As shown in the TRIPS enforcement dispute, there is a tendency for the U.S. administration and rights holders to push for greater criminal enforcement, as compared to what they call "toothless administrative enforcement." However, as I have discussed elsewhere, the effectiveness of administrative enforcement, when compared with criminal enforcement, varies according to local conditions. While judicial and criminal enforcement may be better in major cities and for rights holders that focus primarily on exports, administrative enforcement may work well in other areas (where local knowledge and linguistic skills are more important). It may also work better for those who are on the ground and have a long-term relationship with the region.

The lack of discretion in customs authorities—the second claim in the TRIPS enforcement dispute—provides another good example. Although discretion has many benefits, it could have unintended consequences in places that are confronted with problems of local protectionism and corruption. Before one makes a hasty judgment toward a certain policy or regulatory approach, one needs to embrace a holistic perspective and inquire about the reasons

behind such a policy or approach, including those that arguably fall outside the intellectual property area.

In fact, as foreigners quickly found out in China, what works at home does not always work well in China. Although some of the adjustments these foreigners made sounded counterintuitive in the beginning, they made sense and paid off in the end. Today, many of the highly popular seminars on doing business in China are filled with tips on how to deploy these seemingly counterintuitive strategies to increase profit margin.

#### **4. Don't Hide the Ball**

The fourth principle induces people to reveal the concern as it is, rather than mask it as something else (in part to earn sympathy in the public debate at home). In many intellectual property discussions that the United States initiated in the past two decades, the main concern was not primarily about intellectual property protection and enforcement. Rather, it was about the need for greater market access of intellectual property-based content. It is therefore no surprise that many policymakers, commentators, and the mass media have frequently misclassified the market access dispute as the second intellectual property dispute.

Consider the movie industry, for example. The industry has repeatedly complained about the quota China employed to limit the distribution of foreign movies, including those from the United States, Europe, and other parts of the world. Following its accession to the WTO, China allowed the importation of slightly more than twenty movies. Thus far, the failure of the U.S. rights holders in exporting movies has led to their inability to meet the growing demand for Western movies in China. As a result, local consumers have no choice but to turn to other channels, which range from purchasing pirated optical disks from street vendors to downloading movies from illegal internet websites.

The frustration of the U.S. movie industry is understandable. It is indeed hard to defend many of the content regulations that China has retained despite its many WTO commitments. Nevertheless, when market access disputes are framed as intellectual property violations, the claims in the disputes are significantly weakened. For the Chinese, it becomes just another round of foreign bullying in an area that is of limited domestic priority. For others, it is a stretch that borders on a reinterpretation of commitments China made in the TRIPS Agreement.

To some extent, the eagerness to mask a market access dispute as a TRIPS enforcement dispute may explain why the United States did well in the market access dispute, *China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, but not so well in the TRIPS enforcement dispute. While the United States lost its major claim on criminal enforcement and had only limited success on the customs claim in the TRIPS enforcement dispute, it largely prevailed on the market access dispute—before both the WTO panel and the Appellate Body.

Moreover, the fact that policymakers—and for that matter, commentators—find it ill-advised for the United States to launch a WTO challenge against China on intellectual property enforcement grounds does not mean that these same people will always find objectionable a challenge on market access grounds. Indeed, it is not unusual to find Chinese policymakers and

commentators bitterly divided over these two issues. Their disagreements are further exacerbated by bureaucratic rivalries, institutional fragmentation, raging turf wars, ideological disagreements, and differences in policy preferences. Thus, even though both intellectual property and market access issues go hand in hand and may be equally important to intellectual property rights holders, it is a bad strategy to lump the two issues together—or worse, mask market access issues as TRIPS violations.

When the TRIPS enforcement dispute was compared with the market access dispute, there is no denying that the highly politically sensitive issues in the latter have created considerable tension between the U.S. and Chinese governments. However, the panel report on that dispute may ultimately be more important than the panel report on the TRIPS enforcement dispute. In fact, the report on the market access dispute may become an important driving force in opening up the Chinese market for publications, sound recordings, and audiovisual entertainment products.

## 5. Beware of Difference Engineers

The final principle highlights the danger precipitated by those whom I will call “difference engineers.” In *When Cooperation Fails*, Mark Pollack and Gregory Shaffer recounted how some interest groups have successfully captured the debate on genetically modified foods and crops by enlarging the differences between the United States and the European Union over their treatment of these products for regulatory approval and marketing purposes. As they noted:

The best explanation for the differences lies neither in innate or “essentialist” forms of culture (such as US and European attitudes toward food, risk or technology) nor in institutions alone (such as US specialized agencies compared to European political processes), but in the ability of interest groups to capitalize on preexisting cultural and institutional differences, with an important role played by contingent events such as the European food-safety scandals of the 1990s.

As a result of the efforts by these interest groups, or what I will call “difference engineers,” the trans-Atlantic divide between the U.S. and EU regulatory approaches has become more significant than it actually was on close inspection. As Professors Pollack and Shaffer observed, “it was *not* inevitable that US regulators would adopt a product-based approach to GMO [genetic modified organism] regulation, nor was it obvious from the outset that the EU would adopt the strict, politicized, and highly precautionary system that emerged over the course of the 1990s.”

Like the differences between the European Union and the United States over GMO regulation, the differences between China and the United States in the intellectual property area may not be as significant as the U.S. media or trade groups have reported. In fact, there are a lot of similarities between the two countries, especially when one compares the two countries cross-temporally based on their respective stage of development. For example, both China and the United States are large and diverse, and their nationals can be easily isolated from other countries. Despite continuous globalization, a large number of both Americans and Chinese have not traveled abroad. To many of them, it would already have been an eye-opening experience to visit New York from Montana or to travel from Guilin to Shanghai. Likewise, the two countries

harbor significant differences at the regional and local levels. The policies that New Yorkers support may be unpopular in South Carolina or Texas. What works perfectly for Beijing may also not work well in the Sichuan province.

Nevertheless, there exist a large and growing number of players that will benefit from an environment where China and the United States harbor significant differences. The more differences there are, the more valuable their expertise will become, and the more they can influence the policy and business debates. Given the immense benefits differences may bring about, some of these players unavoidably will seek to exploit the differences to their advantage. When these differences are enlarged and sharpened, and at times even fabricated, important areas of potential cooperation—including those in the area of intellectual property protection and enforcement—may be ignored.

Even worse, the enlarged differences may help escalate tension into conflicts that would require a considerable amount of resources and political capital to resolve. The two countries will be worse off as a result. Even if conflicts do not arise, an undue focus on the differences will distract policymakers from finding the much-needed solutions to target the crux of the enforcement problems.

The existence of these differences may even create an illusion about a country's enforcement priorities. As Justin Hughes, the current senior advisor to the director of the U.S. Patent and Trademark Office, rightly pointed out in his written testimony before the U.S.-China Economic and Security Review Commission, "the profligacy of the American trade deficit with China means that even if every iota of IP infringement in China stopped, [the United States] would still have a long-term, intolerable trade imbalance." Likewise, two World Bank economists noted that "the U.S. current account deficit . . . largely is due to the lack of domestic savings and not to China's barriers to imports (which, in fact, have come down dramatically in recent years) or to an undervalued Chinese exchange rate (which is a real but fairly recent problem)." Given these expert opinions, one has to wonder why the discussion of piracy and counterfeiting problems in China remain tied to that of the U.S. trade deficit. After all, most policymakers and commentators know full well that greater improvements in intellectual property protection and enforcement in China would only have a limited effect on the U.S. trade deficit.

## **Conclusion**

The five principles outlined in this Article seek to provide guidance on how the U.S. intellectual property enforcement strategy can be revamped to ensure stronger intellectual property protection and enforcement in China. Whether a more effective strategy will emerge ultimately depends on whether U.S. policymakers and industries have the needed political will to understand intellectual property developments in China on their own terms. It also depends on whether the United States interacts with China based on what it is, as opposed to what policymakers assume the country to be or hope it will become.

While the Chinese leaders were repeatedly criticized for their lack of political will in dramatically improving intellectual property protection in China, it is high time we pay attention to the equal lack of political will on the part of the U.S. administration and transnational

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businesses to push for greater intellectual property enforcement in China. The limited political will to move intellectual property protection and enforcement to the top of the U.S.-China bilateral agenda is understandable, given the large variety of issues on the agenda and the fact that intellectual property does not compare favorably with other important issues, such as nuclear nonproliferation or currency exchange. Nevertheless, until there is a political will to revamp the existing U.S.-China intellectual property enforcement strategy, it is unrealistic to expect significant improvements in intellectual property protection and enforcement in China.