



COMMENTARY

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The U.S. Escalates its WTO Complaint against China

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After two years of threats and four months of consultations, U.S. Trade Representative Susan C. Schwab has requested that the WTO establish a dispute resolution panel for its case against China over intellectual property rights. Specifically, the US charges China with violation of its obligations under TRIPS, the international intellectual property agreement negotiated in the Uruguay Round in 1994.

For years the U.S. has voiced its complaints about piracy in China, and placed China on the USTR's catalog of IP-offenders, the Priority Watch List. However, despite rampant piracy in China, other trade priorities of the U.S.-China relationship forestalled any WTO complaint. This USTR action represents the first time a complaint against China for breaching IP rights has reached this stage.

Paradoxically, the Chinese government seems to acknowledge the role of intellectual property protection in its strategy to strengthen its international competitiveness. As evidence of this, this week WIPO, the UN's intellectual property arm, released a study revealing an eight-fold increase in patent filings by residents in China between 1995 and 2005. Internationally, the Chinese patent office has the highest growth rate for resident (+42.1 percent) and non-resident (+23.6 percent) filings. China is eager to evolve from its role as the world's manufacturing hub into a center of knowledge creation. Building an innovation economy, one in which ideas are the value-drivers, requires rigorous intellectual property law enforcement.

While China may be striving to create and patent inventions, the general reputation of its IP rights is extremely poor. China is a world leader in the production of counterfeit goods—software, DVDs, prescription drugs. The Chinese central government has failed to enforce IPR down at the provincial level and effectively curtail the widespread theft of intellectual property. There are numerous explanations, not least of which is the government's fear of social unrest.

Although many U.S. firms have complained of IP violations in China through trade groups, many were unwilling to provide the necessary evidence for a WTO case. If the Chinese government retaliated against the cooperating firm, that firm could lose access to the world's largest and fastest-growing market.

The other hurdle for the U.S. government's WTO case against China is the TRIPS agreement itself. TRIPS lays down minimum standards for IP laws. In order to comply, most countries passed new patent acts or amended regulations. The central issue in China, as in many other developing countries, is the enforcement of these laws. On this topic, TRIPS is maddeningly vague. The agreement demands good faith efforts at enforcement. For this reason, Chinese bulldozers crushing mountains of pirated CDs have become photo-opportunity-style evidence of TRIPS compliance. Compliance with the enforcement language in TRIPS is not tied to piracy level or any other outcome.

For the past several years, the U.S. has negotiated at length with China over its IP concerns. China pledged improvements repeatedly. U.S. firms reported some slow, small measures of progress. Despite the many areas of concern to the U.S., the current case is fairly limited in scope and relates to several laws on copyright.¹ For example, by setting vague threshold volumes for copyright prosecution, China allows counterfeiters to engage in business while avoiding criminal charges, according to the U.S. filing. Under ambiguous Chinese law, determining whether or not to prosecute a counterfeiter is based on the price of *counterfeit* material not the price of the *original* goods, the value of which has been stolen. The U.S. government also charged that counterfeit goods are released for sale into the market by the government after merely removing the fake labels. The U.S. argues TRIPS requires such good to be permanently seized and destroyed.

¹ The U.S. filed two separate IP cases in April, but has not yet decided whether to request a panel for the other case, which deals with access of copyrighted goods to the Chinese market.

China sees the current U.S. move as a roundabout means of pursuing TRIPS-plus in China. Frustrated by holes in the TRIPS agreement, particularly respecting pharmaceuticals, the U.S. government has forged a series of free trade agreements with smaller nations, which commit them to higher and more concrete standards of IP protection than contained in TRIPS. Other developing countries have held fast, arguing that they will implement TRIPS but nothing more. China responded to the U.S. case by stating that it is fully TRIPS-compliant and that U.S. charges overreach TRIPS obligations. China also expressed disappointment that the U.S. pressed forward with this case despite the substantial “progress” that China has made in protecting IPR.

The U.S. has pursued two other WTO cases, unrelated to IPR, against China in the past year. Both are pending but neither has escalated as rapidly as this one. The political timing of these cases, with a Democratic Congress pressing for greater trade protectionism against China, is significant. Moreover, China as a growing export power has only recently been realizing the importance of addressing its trading partners concerns, witness the recent spate of product recalls with the U.S. as an example. Although Chinese officials accused the U.S. of protectionism, they were still eager to show no tolerance of bad practice.

The WTO Dispute Settlement Body will meet this Friday to consider the USTR’s request for a panel for the case. Unless the US and China have reached a settlement, China will likely request a delay in the establishment of a panel for additional time for consultation. Three possible outcomes of the WTO case—win, lose, settle—merit evaluation. The significance of winning at the WTO is clouded by the possibility that China would refuse to alter its domestic laws. Under such circumstances, it is difficult to see what retaliation the U.S. could effectively leverage to punish China. Before reaching such a point, of course, there would be lengthy appeals.

Losing the case would be a diplomatic blunder and set back efforts to lower piracy levels for U.S. companies in China. The U.S. government showed caution both in its delay in bringing this case and in the scope of the charges. However, such caution does not guarantee that the U.S. will prevail at the WTO.

The third and most likely outcome is that the U.S. and China will negotiate a settlement outside of the WTO process. Indeed, this latest move by the U.S. may be intended to increase pressure for such negotiations. One Chinese academic has already suggested that WTO itself will be unable to force China to change its domestic laws. The most common practice for the U.S. in WTO complaints is to reach a settlement while the WTO proceedings are in motion, as in the value-added tax case in 2005. USTR’s move provoked China; now the U.S. needs a strategy for negotiation to ensure that this escalation of the complaint leads to a constructive result.

Chinese membership of the WTO has long been a controversial issue. Many nations felt China did not qualify for membership per se but was allowed entry, in no small part due to hopes of addressing many international trade concerns, including IP protection and currency floatation. IP theft is a central issue in the US-China trade relationship and while China may be moving in the right direction, the U.S. feels not enough is being done. Increasing IP enforcement has been one of Beijing’s major challenges, yet it is in China’s long-term interests to solve these problems. Ultimately, the U.S. has raised legitimate complaints over China’s TRIPS compliance with this case. Amending a few laws, however, represents only one small step in the difficult process not only to satisfy TRIPS obligations but to develop a strong IP rights system that attracts investment and engenders domestic innovation in China.