

House Ways and Means Committee Hearing
October 25, 2011
Responses to Questions for Ambassador Demetrios Marantis, Deputy United States Trade Representative

Questions from Mr. Reichert

For Both Dr. Brainard and Ambassador Marantis:

Reichert Question 1: In 2009, the United States exported roughly \$15.7 billion in services to China, a surplus of \$7.5 billion. In my view, our sales should be higher, but access to the Chinese services market remains severely restricted. China imposes limitations in many key sectors, including banking, insurance, retail, express delivery, and telecom. Chinese investment restrictions have a significant effect on services companies, which often require a local presence in order to do business. Other Chinese regulatory barriers, including limitations on licenses, a lack of transparency, and discriminatory requirements also prevent services companies from gaining market share. What is the Administration doing to create new opportunities for U.S. services companies that wish to export to China and continue to expand the trade surplus in services?

A: The services sector is a major priority in the U.S. Administration's work with China. We will continue to use all avenues at our disposal to achieve additional market liberalization with China, including the Strategic and Economic Dialogue (S&ED), the Joint Commission on Commerce and Trade (JCCT), and other high-level bilateral opportunities, as well as multilateral negotiations. Although these issues are challenging, we have achieved some progress and will continue to push hard. We have a WTO dispute underway challenging a Chinese state-owned monopoly in electronic payment services that is blocking our world class debit and credit card processing companies from providing key services in China. In other areas, our efforts are yielding expanded access. Regarding financial services, China now has allowed foreign banks to compete to underwrite corporate bonds. In addition, at the 2011 S&ED, China committed to allow foreign banks to sell mutual funds and provide custody services, and pledged to advance towards allowing foreign-invested insurance companies to sell mandatory third party liability auto insurance. At the 2011 JCCT, regarding tourism services, China agreed to further expand the U.S.-China memorandum of understanding (MOU) on packaged leisure travel to the United States. Regarding telecommunications services, China agreed to publish in draft and allow public comment on the next revision of its value-added (VAS) telecommunications services catalogue, which will define the terms of access, including scope of licenses, for China's VAS sector. On transparency, to implement its S&ED commitments, China increasingly is providing a 30-day period for the public to comment on proposed trade and economic-related regulations and rules. We also do not hesitate to challenge China's restrictions on services at the WTO.

For Ambassador Marantis:

Reichert Question 1: I understand that USTR filed a new WTO case last September related to China's discrimination against U.S. electronic payment services (EPS) companies. USTR claims that China's creation of a state-owned monopoly service provider called China Union Pay violates China's obligations under the General Agreement on Trade in Services. It's my understanding that China is prohibiting our suppliers from processing payment card transactions in China so that only the state-run UnionPay can provide these services. This WTO case seems like exactly the type of strong enforcement action that we need more of. Could you provide an update on that case and explain what a victory would mean for the U.S. companies and workers that are affected?

A: Where dialogue with China does not lead to results, we will not hesitate to invoke WTO dispute settlement to address our concerns. That is what we did in the EPS case, where China's barriers appear inconsistent with its WTO commitments. This dispute is proceeding on schedule at the WTO. The second and final meeting of the dispute settlement panel was in December 2011. A confidential final decision on the merits is expected to be provided to the parties sometime in May, with a public panel report available sometime in June. A favorable decision adopted by the WTO would direct China to bring WTO-inconsistent limitations on access to its market by foreign suppliers of electronic payment services for payment card transactions into conformity with its WTO obligations. Several U.S. companies are world leaders in processing card-based electronic payment transactions. A decision against China's measures, which established the monopoly for China's national supplier, also would send a clear message that China cannot continue giving unfair advantages to favored national champions contrary to WTO rules.

Questions from Mr. Smith

Smith Question 1: I am committed to removing obstacles for U.S. exports. One of the greatest frustrations I hear from agriculture producers in my district comes from the unfounded and unscientific sanitary and phytosanitary (SPS) barriers imposed by some of our trading partners. As you know, China continues to maintain a series of regulations and restrictions on U.S. agriculture exports which are not supported by science. China must continue to work towards bringing its regulations into compliance with sound scientific principles and international standards. What is the Administration doing to remove these persistent barriers?

A: Achieving full market access for U.S. agriculture products in China remains a top priority for this Administration. The United States continues to urge China to eliminate barriers and open its market fully in a manner that is based on science, consistent with international guidelines, and is commercially viable. Intensive bilateral engagement has eliminated important SPS barriers to our pork and poultry exports and has facilitated soybean exports, but we continue to press to eliminate troubling obstacles to beef trade and other Chinese measures that harm our agriculture sector.

Smith Question 2: More specifically, my home state of Nebraska ranks first in commercial red meat production, and as you know the USTR has been working for a number of years to gain full access to the Chinese market for U.S. beef producers under international standards established by the OIE. The most recent talks in January of this year resulted in an impasse, with the Chinese insisting on conditions which are either not consistent with the OIE standards or are not commercially viable. Does your office have a plan to address beef access at the Joint Commission on Commerce and Trade meetings in December and move this important discussion forward? Also, how will you proceed with the beef market access negotiations with Japan?

A: Achieving full market access for U.S. beef and beef products in China remains a top priority for this Administration. The United States continues to urge China to reopen its beef market fully in a manner that is based on science, consistent with international guidelines, and is commercially viable.

Ambassador Siddiqui and Under Secretary Scuse visited Beijing in late October 2011 to discuss beef market access with their counterparts, as well as other critical priorities like pork market access. At the Joint Commission on Commerce and Trade Plenary in late November 2011, both sides endorsed a commitment to increased technical engagement. Secretary Vilsack had good – and lengthy – discussions with his Chinese counterparts, and we discussed the issue at the official Plenary meeting with Vice Premier Wang Qishan. We have now reached out again to China to follow up and hope that these technical discussions will position us for more fruitful progress on the beef issue in early 2012.

The Administration is also deeply concerned about China's unwarranted ban on the use of ractopamine, a common feed additive. We are continuing to press China on this issue, including at the agricultural trade talks held in Beijing in late October 2011.

Further opening Japan's beef market in a manner that is based on science, is consistent with international standards, and is commercially viable remains a high priority for the U.S. Government. At the end of last year, Japan started the process to reassess the BSE issue, which we view as a vehicle for the United States to make progress with Japan on beef market access. As the first step of this process, Japan submitted questions to its Food Safety Commission to undertake a risk assessment that would support raising the age limit beyond the current threshold in a commercially-viable manner. We will continue to be in close touch with Japan as they move forward with the revisions of its BSE measures.

Questions from Mr. Kind

For Both Dr. Brainard and Ambassador Marantis:

Kind Question 1: The Committee is going to do some work on Customs Re-Authorization in the next several months. Every year Customs reports that the number one country for infringed products is China. What should we be doing to address this problem? Are there legislative changes that we can make to ensure that products made with stolen inputs are not allowed entry into the United States?

A: The levels of IPR theft that occur in China, as well as the volumes of IPR infringing goods exported from China, remain unacceptably high. That is why the President, in his State of the Union address, called for enhanced inspections to prevent counterfeit, pirated, or unsafe goods from crossing our borders, and we will provide more details on these efforts in the weeks and months ahead. The Administration is working to protect American IPR in China, and to reduce the export of infringing products made in China, through a variety of mechanisms – including results-oriented dialogue on IPR protection and enforcement, the annual Special 301 Report, and enforcing international rules to protect American intellectual property and market access through the WTO. The Administration pursues this strategy in close coordination with other relevant U.S. agencies, stakeholders, trading partners, and Congress. In addition, USTR works closely with the U.S. Intellectual Property Enforcement Coordinator’s Office, and the U.S. Department of Homeland Security –including U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement -- among many others agencies, to consider additional steps the United States can take to protect ourselves from these illegal and, in some cases, dangerous imports.

Kind Question 2: Given the current impasse in the Doha Round, however, what additional steps can the U.S. and other nations take to address the subsidies received by China's fishing fleet and the effect it has on fish stocks?

A: The United States will continue to pursue the prohibition of harmful fisheries subsidies that contribute to overfishing and overcapacity and in doing so will maintain pressure both directly and indirectly on China regarding such subsidies received by their fishing fleets. This will include continued work through the WTO, as well as in other relevant multilateral and regional fora such as the UN, FAO, APEC, and through the TPP negotiations. In the WTO Subsidies Committee, for example, we will be examining very closely China’s most recent subsidy notification to determine whether it is complete and if not, we will pursue the issue in the course of the Committee’s work in accordance with the provisions of the WTO Subsidies Agreement.

Kind Question 3: Will the Administration include Chinese fisheries subsidies as a priority issue in upcoming bilateral meetings, including the JCCT (Joint Commission on Commerce and Trade)?

A: The Administration has engaged China on the issue of fisheries subsidies through our multilateral discussions at the WTO. Together with the Commerce Department, USTR also is investigating the extent of China’s use of fisheries subsidies and will be considering whether the issue of fisheries subsidies should be placed as a priority issue on the agenda of upcoming bilateral meetings with China, including the JCCT.

Questions from Mr. Neal

For both Dr. Brainard and Ambassador Marantis:

Neal Question 1: Ambassador Marantis and Secretary Brainard, the medical technology industry is very concerned about the price controls proposed by the Chinese government, which could severely reduce market access, especially for small and medium size enterprises. What steps can you take to prevent these price controls from happening? Also, as you know, China requires the medical device industry to obtain approval from the US FDA before even beginning China's regulatory process. In my opinion, this is discriminatory since China's domestic producers have no such redundant requirements, and significantly delays American firms' market access. What can be done to address this problem?

A: The Administration has engaged China on the importance of not implementing unfair price controls. This has been an ongoing effort, and so far, we are continuing to press for concrete progress. We understand that the latest Chinese proposal (August 2011) envisages the introduction of price controls in 2012. We have raised our concerns concertedly at senior levels and in the Joint Commission on Commerce and Trade (JCCT) and will continue to press China to hit the pause button and meet with industry to find a path forward so that Chinese consumers are not blocked from the benefits of our products.

The Administration also has raised concerns about China's redundant regulations for many years. We have achieved some success through raising the issue at WTO committee meetings and the JCCT, where the Chinese agreed not to impose duplicative regulations by separate agencies. We also have raised the problem of China requiring regulatory approval in the country of origin – such as FDA approval for U.S. medical devices – before China will consider approving the product. So far, the Chinese have maintained that this is a health and safety issue, indicating that prior approval provides them greater confidence in the safety of the medical device. Our view is that there are other, better, ways for China's FDA to ensure the safety of medical devices. We will continue to work to address this issue.

Neal Question 2: The medical technology industry also is concerned about protection of its intellectual property in China. Failure to adequately protect IP means not only a loss of revenues for the industry, but also potential liability and patient health concerns as well. What steps is the Administration taking to seek better IP enforcement from Chinese authorities?

A: Creativity and innovation are the engines of the American economy. According to industry estimates, IP-intensive industries employ about 18 million Americans. Countries that fail to respect U.S. intellectual property, either by failing to implement or enforce laws that adequately protect American intellectual property, or creating policies that disadvantage U.S. right holders, put American workers and businesses at a disadvantage. The Administration is committed to working with America's trading partners to secure adequate and effective intellectual property safeguards wherever American goods and services are sold.

With regard to China, the Administration is working to protect American IPR in China through a variety of mechanisms – including results-oriented bilateral and multilateral dialogue with China on IPR protection and enforcement, the annual Special 301 Report, and enforcing international rules to protect American intellectual property (IP) and market access through the WTO. USTR undertakes this strategy in close coordination with other relevant U.S. agencies, stakeholders, trading partners, and Congress. We have made progress on some IP challenges through both the WTO, and JCCT and S&ED processes, although much more remains to be done. For example, because of a U.S. trade enforcement win at the WTO, China has reformed its customs rules on destruction of counterfeit goods to comply with its WTO obligations. And through last year's JCCT and S&ED, we were able to push China to establish a State Council-level leadership structure to enhance IPR enforcement throughout China. We are open to all approaches, whether through robust engagement or through trade enforcement actions, to get substantive results from China on intellectual property challenges.

Neal Question 3: Ambassador Marantis and Secretary Brainard, in both of your written statements you highlight the fact that at the most recent Strategic and Economic Dialogue, China pledged to open its mandatory third party liability auto insurance market to foreign insurers. I welcome this news and am interested to know what steps the Chinese are taking towards fulfilling this commitment? Also, what are your plans for following up and ensuring that this commitment is met?

A: China has not yet taken visible steps to fulfill its 2011 S&ED commitment to open its mandatory third party liability auto insurance market to foreign-invested insurers. The U.S. Administration continues to press this issue actively as a top priority with all relevant Chinese policymakers, including the China Insurance Regulatory Commission and China's Ministry of Finance, in all appropriate high-level bilateral meetings, such as the S&ED and the U.S.-China Insurance Dialogue.

Neal Question 4: I'm hearing a great deal from U.S. manufacturers, including some in Massachusetts, about allegations that the Chinese government has orchestrated an artificial increase in the prices of Rare Earth Elements. For example, the price of neodymium, an element vital also to our defense industry, has increased by 1000 percent in the past 18 months. Ambassador Marantis and Secretary Brainard, can you tell me what steps the Administration is taking to address the effect of this price manipulation on our manufacturers?

A. We are very concerned about China's export restraint policy, which affects numerous raw materials, including rare earths. In close cooperation with like-minded trading partners, we have been making a concerted effort to move China away from these market distorting policies. In addition to the JCCT and other bilateral discussions, we also have been working multilaterally through the WTO and other international organizations to push for a closer examination of market-distorting policies – like China's export restraints – that run contrary to the reality of global interdependence when it comes to raw materials.

The recent major WTO victory in the U.S. challenge to China's export restraints on nine categories of key industrial raw materials also sends a strong signal to China that these kinds of policies must be eliminated. We are actively gathering facts on China's export restraint policies on rare earths and other raw materials that could assist us in determining our most effective next steps.

Neal Question 5: Ambassador Marantis and Secretary Brainard, we just entered into three new Free Trade Agreements, but we have not spent enough time discussing the critical importance of adherence to the rules of global free trade - and one of my big concerns is the blatant and fraudulent evasion of our Antidumping and Countervailing Duty Orders. These agreements will do no good if they are used to facilitate circumvention and evasion of our trade laws. For example, unscrupulous exporters and importers of goods from China subject to antidumping and countervailing duty orders regularly commit Customs fraud to evade the duties imposed by the U.S. government. Trade cheats are no different than tax cheats. I am concerned that this rampant evasion makes U.S. trade remedies meaningless. This is an urgent issue that must be dealt with and our government needs to do a much better job of enforcing the laws that are on the books. I am told there are over \$400 million in uncollected duties annually in just eight industries. The total in uncollected duties in goods from China is likely far greater than that. What is the Administration doing to address this problem?

A: We agree that these are serious issues. The U.S. Department of Homeland Security – through U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement, the U.S. Department of Commerce, and the U.S. Department of Justice are the front line agencies deeply engaged in combating this problem, and we support the efforts being taken to address the problem of circumvention and duty evasion in a number of U.S. antidumping and countervailing duty orders involving Chinese firms.

Additionally, USTR, through its multilateral and bilateral interactions with its trade partners throughout the Asia Pacific region, is actively seeking strong commitments on cooperation in achieving compliance with all U.S. trade laws, including antidumping and countervailing duty law. We have such commitments in our three new FTAs.

Neal Question 6: The export-led strategy that produced such enormous growth for China is only as good as demand is. It seems to me that one approach to building demand in China and which seems to be in China's best interest, is to assist in boosting the Chinese social safety net through a robust retirement system. Yet, it is my understanding that the Chinese private pension system needs developing. It has been suggested that China should allow the most experienced, technically competent, and market-expert U.S. companies to enter the Chinese Enterprise Annuity market, which is Chinese equivalent to our 401 (k) system, as soon as possible under the current licensing framework to help free up more capital for domestic consumption. Secretary Brainard, what are your thoughts on that assertion and what more can the Administration do to ensure that this occurs?

A: Chinese citizens have to save substantial amounts of their income due to China's weak social safety net, which provides limited public pension and unemployment insurance coverage, and the limited availability of financial products that could help households save more efficiently to meet their financial goals and insure against risks. Chinese households' high saving rate is a major obstacle to China's efforts to shift towards consumption-led growth, and no doubt reduces Chinese demand for U.S. goods and services.

China needs to address the root causes of its high saving rate, including by welcoming increased foreign participation that would allow U.S. firms could help China achieve its goal of building a more modern retirement system by bringing their expertise and technical competence into their market. We have shared our own experiences with the Chinese in the hope that this will help them develop a modern enterprise annuity (401k) system. We continue to press China through the S&ED and other channels to re-open its enterprise annuities licensing system and grant licenses to qualified U.S. financial services companies to supply enterprise annuities services and financial products on the same basis as Chinese firms. This will remain a high priority for the U.S.-China Strategic and Economic Dialogue.

Neal Question 7: Once a trade secret is disclosed, it permanently loses all of its value. One recent estimate places the value of trade secrets owned by publicly traded U.S. companies at five trillion dollars. See Elizabeth A. Rowe, "Contributory Negligence, Technology, and Trade Secrets," 17 *George Mason Law Review* (2009), 1. I would like to know what the Administration is planning to do to help strengthen the legal infrastructure that applies to the protection and enforcement of U.S. trade secrets in China?

A: We share your deep concerns about cases of trade secret theft and about the problem of the theft of intellectual property more generally. China must ensure that its IPR enforcement system serves to both effectively deter IPR infringement and compensate rights holders who are victims of such infringement. To achieve these goals, China must provide fair, open, transparent, and predictable administrative, civil, and criminal enforcement mechanisms for all forms of IPR, including trade secrets.

The Administration has repeatedly raised the issue of violations of trade secrets with the Chinese government at the most senior levels where we will continue to press China to improve the legal infrastructure to strengthen the protection of trade secrets of both domestic and foreign corporations and to improve enforcement of IP rights. We also are engaged in candid dialogue with our stakeholders about the importance of careful, long-term strategic thinking about the protection and use of their core assets in every market where IPR protection and enforcement remains a challenge.

For Ambassador Marantis:

Neal Question 1: The United States International Trade Commission recently published an important report on the effects of China's IPR theft on the US economy. The numbers were staggering in terms of job losses, including to the IP-intensive manufacturing sector - high tech, transportation equipment, chemicals and consumer equipment - proving that IP is a big

contributor to the manufacturing sector. That study found that nearly a million jobs could be created in the IP-intensive sector of the U.S. economy if China's respect for IP was similar to how the U.S. respects IP. Ambassador Marantis, what options do you have to use this study to secure change from China? Are there cases that the Administration or the ITC can initiate to address these problems?

A: This study underscores the serious challenges we face in China regarding rampant IPR theft. It also sends a clear message to China, and we will continue to be relentless in pressing to achieve sustained improvements in China's IP enforcement. USTR works to protect American IP rights holders in China through a variety of mechanisms – including results oriented dialogue on IPR protection and enforcement, the annual Special 301 Report, and enforcing WTO rules to protect American innovators' IP and market access rights. USTR undertakes this strategy in close coordination with other relevant U.S. agencies, stakeholders, trading partners, and Congress.

- In the case of China, intensive bilateral dialogue has achieved tangible results. For instance, the Administration secured wide-ranging commitments from China in the S&ED and JCCT to eliminate discriminatory “indigenous innovation” criteria used in government procurement and to select industrial equipment for preferential treatment, thus ensuring access to China's market for American machinery manufacturers.
- On software, the United States' pressure has led China to create unprecedented audit and inspection mechanisms to drive the use of legitimate software in the government sector and at state-owned enterprises (SOEs).
- China also has taken steps to address piracy of electronic journals, create more effective judicial rules for addressing Internet piracy, and crack down on landlords who rent space to counterfeiters in China.
- USTR's Notorious Markets out-of-cycle review under Special 301 provisions of the Trade Act of 1974 encouraged significant results such as:
 - A commercial deal between major Western music labels and China's most popular website to provide access to legal content, rather than linking to pirated music.
 - A major Chinese sales website announcing a new trademark enforcement program with major brand owners.
- More systemically, through last year's JCCT and S&ED, we were able to successfully push China to institutionalize its high-level government coordination and leadership mechanisms to enhance long-term IPR protection and enforcement.

But, IPR theft in China remains and we will continue to prioritize this issue in our engagement with China.

Neal Question 2: Ambassador Marantis, what are your expectations for the upcoming JCCT as far as IP is concerned, particularly with respect to software legalization by the SOEs? Isn't this another way for China to subsidize its manufacturing sector by allowing its largest and most profitable SOEs to not pay for the IT they use in the manufacture of products destined for the United States and other markets? China's 12th five-year plan envisions a strengthening of the

SOEs in strategic sectors. What are you doing to ensure that China actually moves on the SOE commitments? Is Treasury helping you with this effort given its work with the Chinese in this area?

A: We continue to engage China at all levels to address software piracy, since this is a major problem, and we have made some progress. In fact, the President himself pressed the issue during last year's State visit by President Hu Jintao.

In response to our efforts, China has taken unprecedented steps to set up mechanisms that can curb this problem, and we are pressing to see concrete change on the ground.

- China agreed at the 2010 JCCT to establish software asset management systems at government agencies, to allocate budgets for legitimate software purchases, and to promote the use of licensed software at SOEs.
- At the 2011 State Visit of President Hu, China further bolstered its commitment to software legalization by agreeing to conduct financial audits focused on the use of legal software in government agencies and to publish these audit results.
- At the 2011 S&ED, China agreed to improve its high-level, long-term IPR protection and enforcement mechanism and strengthen its government inspection mechanism to make sure that software being used by government agencies at all levels is legitimate.
- In the 2011 JCCT, China committed to increase resources devoted to conducting audits and inspections, and to further improve management of government software assets, including by the use of technical means. China also agreed to further promote the use of licensed software in enterprises and conduct additional enterprise software management pilot projects beyond the pilot project for 30 SOEs it has underway.

Securing these commitments required significant coordination across relevant agencies, including with Treasury. While we must see how these steps work out in practice, and much more work remains to be done, China's recent commitments mark a significant opportunity for genuine progress on this difficult issue. We will be following up aggressively through both the S&ED and JCCT processes that are underway for 2012.

Neal Question 3: Ambassador Marantis, China made commitments at the JCCT with respect to continuing to provide the necessary budgeting for software legalization. There are some concerns that China is treating this as a one-off process and the budgets aren't there for continued legalization. How is that proceeding? What are you going to do to ensure that China is treating this as a continuous and on-going process, like all other governments do?

A: As mentioned above, we continue to engage China at all levels to address software piracy, and China has taken a series of unprecedented steps to set up mechanisms that can curb this problem. We share your concern that if such mechanisms and Chinese commitments are not backed up with a continuing focus by China, including by assuring adequate budgets and other resources, progress will cease. We have specifically pressed China in our engagements to allocate continuing, not one-time, budget resources to software legalization. As we engage

China in 2012 to both monitor and implement its prior commitments, as well as to build on prior commitments, we will continue to press China to back up its commitments with real action.

Neal Question 4: Ambassador Marantis, US industry had hoped that there would be substantial increases in sales of software as a result of the government legalization campaign, but the sales increases are still incremental. This obviously needs to be encouraged and it would be useful to understand the USG's strategy. In addition, industry is starting to have some progress with respect to civil and criminal cases. Can you share some information on this and how we can encourage more enforcement activities?

A: USTR works closely with industry to both monitor the progress of China's software legalization efforts, and to develop the best possible ideas for attacking the problem of software piracy in China. We also press at expert and senior levels to remove barriers to fair and speedy legal proceedings, so that our stakeholders can receive the relief they need. We believe that sustained pressure on China from all quarters to ensure that it protects the IP rights of software companies and other holders of intellectual property is critical, and such civil and criminal cases against infringers are certainly an important tool.

Neal Question 5: Ambassador Marantis, with respect to government procurement, USG agencies are required to purchase and use legal software. There are provisions in the FTAs that you have managed to negotiate that extend this obligation to other governments. What are you doing to have China undertake this same kind of obligation, even before it completes its FTA negotiations for its agencies and its vendors? Is there more that we can do to lead by example?

A: Although we are not engaged in FTA-type negotiations with China, we believe that maintaining high-level political pressure on China on the issue of software legalization through negotiating fora like the JCCT and the S&ED, as well as other high-level bilateral meetings, can yield positive results in the area of government procurement of legal software. We agree with you that the United States should lead by example, and the U.S. Intellectual Property Enforcement Coordinator, housed in the White House, has been working with Federal agencies to review the U.S. Government's practices and policies regarding the use of software by Federal contractors and to promote the use of only legal software. Additionally, in January 2011, White House officials issued a joint statement to federal executives reminding them that all technology used in the Federal government must be properly licensed in accordance with applicable law. The Administration will continue to lead by example in this area, as we engage other countries like China on the issue.

Neal Question 6: Ambassador Marantis, the Committee is going to do some work on Customs Re-Authorization in the next several months. Every year Customs reports that the number one country for infringed products is China. What should we be doing to address this problem? Are there legislative changes that we can make to ensure that products made with stolen inputs are not allowed entry into the United States?

A: USTR works closely with other offices and agencies, including the U.S. Intellectual Property Enforcement Coordinator, and the agencies within the U.S. Department of Homeland Security with the authority to enforce U.S. IP laws – including U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement -- among many others, to consider additional steps the United States can take to protect ourselves from these illegal, and in some cases, dangerous imports. One area includes enhanced inspections to prevent counterfeit, pirated, or unsafe goods from crossing our borders, as President Obama announced during the State of the Union.

Neal Question 7: Ambassador Marantis, during the hearing, various members of the Committee raised concerns with the protection of U.S. intellectual property in China. Despite some progress, continuing problems with the piracy of software were discussed. I also have significant concerns with China's weak legal infrastructure as applied to both the protection and the enforcement of trade secrets. There are multiple obstacles to trade secret enforcement in China, including an evidentiary burden that is too high, a minimal ability to conduct discovery, low damages that lack any effective deterrent value, and local protectionism. Yet the protection of this valuable IP in China is critical to maintaining the competitiveness of U.S. companies, especially given that U.S. industry is seeing an increase in (i) both state-sponsored and private party misappropriation of trade secrets through cross-border cybercrime, and (ii) government mandated disclosure of trade secrets as a condition of market access or doing business in China. According to iDefense, in 2009, "Chinese state authorities continued their efforts to extend control over their population's use of cyber space ... [and] cyber espionage and cyber warfare planning activities grew incrementally in scope and sophistication." *2010 Cyber Threats and Trends*, iDefense-VeriSign, December 15, 2009. A former White House advisor noted in 2010 that, "every major company in the U.S. and Europe has been penetrated ... China and Russia are stealing peta-bytes worth of information." *Dealing with Sophisticated Threats in Cyberspace without Creating Big Brother*. Richard Clarke; RSA Conference 2010, March 3, 2010, available at <http://www.rsaconference.com/2010/usa/index.htm>. In addition, iDefense reported an increase in Chinese businesses' use of corporate infiltration and disruption attacks against competitors over the course of 2009. For example, the head of the internet monitoring department within Beijing's Municipal Public Security Bureau was arrested for allegedly accepting more than \$5.5 million in bribes to assist a local anti-virus company to defeat its competitor. As an example of the increasing erosion of trade secret protection through government mandated disclosure, a Chinese competition authority would consider the refusal by a successful company to license its trade secrets to a competitor to be an "abuse of dominance" and the company forced to disclose the confidential information if access to it was "essential to innovate and compete." *Guidelines/or Anti-Monopoly Law Enforcement in the Area of Intellectual Property Rights*, Art. 15 (Fourth Draft Revision). Moreover, various multi-national companies have had to disclose trade secrets as part of Chinese foreign investment requirements.

A: We share your deep concerns about cases of trade secret theft and the problem of the theft of intellectual property more generally. China must ensure that its IPR enforcement system serves to both effectively deter IPR infringement and compensate rights holders who are victims of such infringement. To achieve these goals, China must provide fair, open, transparent, and

predictable administrative, civil, and criminal enforcement mechanisms for all forms of IPR, including trade secrets.

The Administration has repeatedly raised the issue of violations of trade secrets with the Chinese government at the most senior levels. I have done so myself in recent exchanges with my Chinese counterpart at the Ministry of Commerce, as has Vice President Biden and Secretary Geithner in his high-level meetings in Beijing last month. We also have been working with China through expert dialogue and other engagement to improve the legal infrastructure for enforcement of IP rights, including trade secrets.

Finally, we are engaged in candid dialogue with our stakeholders about the importance of careful, long term strategic thinking about the protection and use of their core assets in every market where IPR protection and enforcement remains a challenge.

Questions from Mr. Pascrell

For both Dr. Brainard and Ambassador Marantis

Pascrell Question 1: I am deeply concerned about the problem of competition from Chinese State-Owned Enterprises (SOEs). China's meteoric rise since it gained full access to the WTO a decade ago has been extraordinary. It has become the largest global manufacturer. But that was not the result of free market forces alone. Rather, it is the result of deliberate government policies to develop and dominate manufacturing and accomplished by massive intervention in the marketplace. About half of all of the productive assets in China (like steel plants and solar panel plants) are owned or controlled by the Chinese government through state-owned or controlled enterprises. The Chinese government provides, for example, financing at below market rates and raw materials at less than market prices. This gives SOEs a tremendous competitive advantage -- and has shutdown thousands of U.S. plants and cost thousands upon thousands of jobs here when they have had to compete against dumped and subsidized imports from such Chinese state-owned or supported enterprises.

Now the Chinese are intending to have their SOEs invest directly in the U.S. to buy or build commercial facilities. I am concerned about Chinese state actors who want to buy and set up commercial operations in the United States which are going to act at the direction of that government--not based on commercial considerations--to gain market share in the U.S. or get access to finite energy resources.

1.) What is USTR and the Administration doing to ensure that Chinese SOEs and state supported enterprises act based on commercial considerations when they acquire an on-going facility or build a green field facility in the U.S.? As you know, CFIUS only deals with investments affecting national security, but investments and operations by SOEs here that are subsidized by the Chinese government can be just as damaging to our economic security.

A: Together with other agencies and our Embassy in Beijing, we are actively investigating new potential problems relating to China’s state-owned and state-invested enterprises (SOEs), in particular following China’s implementation of the Twelfth Five-Year Plan, which calls for large amounts of financial and other support for SOEs, particularly those in “strategic emerging sectors” like green technologies.

The Administration has been clear that China must ensure that its SOEs do not receive unfair advantages, such as with respect to access to credit, tax treatment, regulatory applicability, and access to the factors of production, and have pressed for interest rate liberalization. We also have stressed the importance of SOE operations being guided exclusively by commercial considerations, and press for greater transparency in SOE corporate governance.

We are pressing China to address our concerns on SOEs at the highest levels and in a number of bilateral dialogues and high-level engagements, including the Strategic and Economic Dialogues (S&ED) and the Joint Commission on Commerce and Trade (JCCT), as well as in multilateral fora such as the WTO and G20.

In these dialogues, and in multilateral fora like the G-20, we also underscore the need for Chinese SOEs to pay greater dividends into the government’s general budget, and to pursue commercial rates of return in their commercial activities. Progress in this area cannot only help ensure that Chinese SOEs compete fairly with other enterprises, including foreign enterprises, but also will enable China to strengthen its social safety net, which is an important element in rebalancing China’s economy. With regard to Chinese SOE investment in the United States, to the extent that any acquisition of a U.S. business raises national security concerns, CFIUS has the authority to review the transaction and address such concerns. In addition, Chinese SOEs are of course subject to U.S. competition laws designed to combat anti-competitive behavior.

More broadly, in both the Trans-Pacific Partnership Agreement and Doha Round negotiations, the United States has proposed tough new disciplines on government subsidies and non-commercial financing to SOEs.

2.) What are you doing to ensure U.S. workers and companies can compete in the U.S. market against Chinese SOEs on a level playing field?

A: As we have noted in the answer above, ensuring that U.S. businesses and workers can compete on a level playing field with our trading partners is fundamental to the Administration's trade policy, and we are focused on ensuring that SOE preferences in China or elsewhere do not harm our workers and businesses.

3.) What is the status of the Model BIT and are you addressing this issue within it? Any BIT with China must have strong disciplines for SOEs that invest in the U.S. market.

A: In the context of our BIT negotiations with China and other key partners, we agree that issues raised by SOEs and other state-influenced entities are important. The 2004 model BIT contains a number of provisions that discipline discriminatory or unfair practices by, or in favor

of, SOEs. The Administration is carefully considering whether additional provisions are needed to address the problems posed by SOEs in China's economy and in the economies of other future BIT partners.

For Ambassador Marantis:

Pascrell Question 1: What are your expectations for the upcoming JCCT as far as IP is concerned, particularly with respect to software legalization by the SOEs? Isn't this another way for China to subsidize its manufacturing sector by allowing its largest and most profitable SOEs to not pay for the IT they use in the manufacturing of products destined for the United States and other markets? China's 12th five-year plan envisions a strengthening of the SOEs in strategic sectors. What are you doing to ensure that China actually moves on the SOE commitments? Is Treasury helping you with this effort given its work with the Chinese in this area?

A: We continue to engage China at all levels to address software piracy, since this is a major problem, and we have made some progress. In fact, the President himself pressed the issue during last year's State visit by President Hu Jintao.

In response to our efforts, China has taken unprecedented steps to set up mechanisms that can curb this problem, and we are pressing to see concrete change on the ground.

- China agreed at the 2010 JCCT to establish software asset management systems at government agencies, to allocate budgets for legitimate software purchases, and to promote the use of licensed software at SOEs.
- At the 2011 State Visit of President Hu, China further bolstered its commitment to software legalization by agreeing to conduct financial audits focused on the use of legal software in government agencies and to publish these audit results.
- At the 2011 S&ED, China agreed to improve its high-level, long-term IPR protection and enforcement mechanism and strengthen its government inspection mechanism to make sure that software being used by government agencies at all levels is legitimate.
- In the 2011 JCCT, China committed to increase resources devoted to conducting audits and inspections, and to further improve management of government software assets, including by the use of technical means. China also agreed to further promote the use of licensed software in enterprises and conduct additional enterprise software management pilot projects beyond the 30 SOE pilot projects it has underway.

Securing these commitments required significant coordination across relevant agencies, including with Treasury. While we must see how these steps work out in practice, and much more work remains to be done, China's recent commitments mark a significant opportunity for genuine progress on this difficult issue. We will be following up aggressively through both the S&ED and JCCT processes that are underway for 2012.

Pascrell Question 2: China made commitments at the JCCT with respect to continuing to provide the necessary budgeting for software legalization. There are some concerns that China is treating this as a one-off process and the budgets aren't there for continued legalization. How is that proceeding? What are you going to do to ensure that China is treating this as a continuous and on-going process, like all other governments do?

A: As mentioned above, we continue to engage China at all levels to address software piracy, and China has taken a series of unprecedented steps to set up mechanisms that can curb this problem. We share your concern that if such mechanisms and Chinese commitments are not backed up with a continuing focus by China, including by assuring adequate budgets and other resources, progress will cease. Because we share that concern, we have specifically pressed China in our engagements to allocate continuing, not one-time, budget resources to software legalization. As we engage China in 2012 to both monitor and implement its prior commitments, as well as to build on prior commitments, we will continue to press China to back up its commitments with real budgets.

Pascrell Question 3: US industry had hoped that there would be substantial increases in sales of software as a result of the government legalization campaign, but the sales increases are still incremental. This obviously needs to be encouraged and it would be useful to understand the US's strategy. In addition, industry is starting to have some progress with respect to civil and criminal cases. Can you share some information on this and how we can encourage more enforcement activities?

A: USTR works closely with industry to both monitor the progress of China's software legalization efforts, and to develop the best possible ideas for attacking the problem of software piracy in China. We also press at expert and senior levels to remove barriers to fair and speedy court proceedings, so that our stakeholders can receive the relief they need. We believe that sustained pressure on China from all quarters to ensure that it protects the IP rights of software companies and other holders of intellectual property is critical, and such civil and criminal cases against infringers are certainly an important tool.

Pascrell Question 4: In its WTO accession agreement, China made commitments to protect against unfair commercial use and disclosure of undisclosed test and other data submitted to authorities in China to obtain marketing approval for pharmaceuticals. Protection under the agreement is supposed to be at least 6 years, although none is afforded in practice. What will you do to ensure that China protects regulatory data in a way that lives up to their agreements and supports the innovative economy we have built?

A: USTR has, in coordination with U.S. stakeholders and the U.S. Department of Commerce, among others, pressed China to afford meaningful protection (against unfair commercial use, as well as against disclosure) to confidential test and other data required to support an application for regulatory marketing approval for pharmaceutical products. While there has been some progress, including under the JCCT, we all agree that the time is now for China to implement

necessary revisions to its laws, rules, and regulations, so that all pharmaceutical products utilizing new chemical entities would receive the full 6 years of protection. We will continue to work with stakeholders and the Chinese government to ensure China's implementation of its WTO commitments in this area.