



“Ensuring Market Access Key to U.S. and Global Economic Strength”

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The Information Technology Industry Council (ITI) appreciates the opportunity to provide testimony on developments regarding China’s indigenous innovation and intellectual property (IP) policies at the latest Strategic & Economic Dialogue (S&ED), including the Third U.S.-China High-Level Innovation Dialogue, which was held earlier this month in Beijing. ITI represents global leaders in innovation, from all corners of the information, communications, and technology sector, including hardware, software, and services. China, along with other emerging markets, is a critical market for ITI member companies. Hundreds of thousands of American high-tech jobs are directly tied to robust trade and business with China. In fact, some of the largest beneficiaries of that trade are American workers and businesses, many of them small businesses which manufacture electrical machinery and equipment or develop software that feeds into the tech industry’s global supply chain.

The ability to freely access foreign markets such as China and compete on equal terms has been critical to the health of the tech sector, and has underpinned the United States as an innovative economy. As our economy recovers from a severe recession, it is critical our companies be able to access the 95 percent of the world’s consumers who live beyond our shores. More than 75 percent of the global growth in the tech market during the next five years is projected to take

place overseas. Maintaining free and open global markets will support our economic recovery and help achieve a shared goal of promoting U.S. exports. Indeed, U.S. exports to China are on the rise. Last year, our exports to China were nearly \$104 billion, up four-fold from a decade ago. Yet, U.S. tech companies operating in the China market continue to face increasingly challenging and complex market access barriers.

To be clear, our industry welcomes efforts of China and other nations to promote innovation. Where we have difficulties is when policies under the guise of innovation policy are developed and implemented in a manner that favors domestic companies at the expense of foreign players. Moreover, we are beginning to see some of this new, creeping protectionism being replicated in other parts of the world.

Today, I would like to highlight that, despite some rollbacks of China's problematic policies, many challenges remain that continue to create market access barriers for U.S. technology firms. I would also like to underscore our concerns over how these policies are being mirrored by developing countries in such markets as India, Brazil, Russia, and other major markets our companies rely on for growth. Finally, I will provide thoughts on how our industry can work with the U.S. government to address these challenges in both China and around the world.

China Continues to Champion Indigenous Innovation

China's indigenous innovation policies have been around for some time, dating back to the 2006 Medium- and Long-Term National Plan for Science and Technology (MLP). The chief aim of this plan was to foster the development, commercialization, and procurement of Chinese products

and technologies. More precisely, it was developed to give a leg up to domestic producers by compelling Chinese government agencies and State-Owned Enterprises (SOEs) to adopt rules and regulations favoring products and services that use Chinese-developed ideas and technologies. One of the most notable of China's policies to advance indigenous innovation was its effort to establish a national catalog of products to receive significant preferences for government procurement. Among the many problematic criteria for eligibility were stipulations that products contain intellectual property (IP) developed and owned in China and that associated trademarks be originally registered in China. This was an unprecedented use of domestic IP as a condition of market access that no other country in the world requires, and one that made it nearly impossible for American companies to qualify. IP is developed all over the world, not just in one country.

China has since backed away from this policy, and at the 2011 S&ED agreed to revise policies that link innovation and procurement. The rollback of this policy was due to the combined efforts of industry and like-minded governments around the world, including our own. But the indigenous innovation policy drive extends well beyond the catalogs and is morphing into other similar policies under different nomenclature.

Indeed, the Chinese government has transitioned to support indigenous innovation approaches within a new policy under the 12th Five Year-Plan called "the decision to develop Strategic Emerging Industries," (referred to as SEIs). In short, the SEI initiative can be seen as an important and sweeping program to develop indigenous technology at the expense of foreign industry. These developments come despite high-level commitments made by the Chinese government to treat foreign-invested enterprises equally under the indigenous innovation

program. Despite efforts to claim “indigenous innovation” is nondiscriminatory, China’s leadership, as recently as December 2011, has referred to this initiative as “*one of self-reliance.*” Some would say SEI is now the new code word for indigenous innovation.

In October 2010, shortly before the Chinese government began to walk back from its indigenous product catalogs, it began to promote the concept of SEI’s. In a high-level State Council decision, the government selected seven strategic sectors including “next-generation IT” for renewed government support. China also announced it will spend \$1.5 trillion on the development of these seven sectors, through 2015. Should Beijing distribute the funds evenly among the seven industries over five years, this would mean China’s tech industry would receive annual government funding of roughly \$42 billion each year through 2015. To put a point to it, this support would all go to Chinese companies.

More than Just Government Procurement Policy

Our concern is that despite U.S. “success” in rolling back some of China’s IP requirements and procurement catalogs, the Chinese government continues on its path of discriminatory innovation policies in an increasingly sophisticated way. This includes a new web of indigenous innovation policies under the SEI banner, continuing lack of IP protection and enforcement, mandating local standards, and an alarming trend of using vague national security concerns related to information security to discriminate against foreign tech companies.

In particular, the trend to promote and favor indigenous IP is a core aspect of the 12th Five Year Plan and Strategic Emerging Industries policies. The policies below are a sampling of those and other kinds of specific troubling policies China is now promoting under the SEI program:

- A new SEI “core products and services catalogues” being drafted by the Chinese Government that will likely end up guiding government and SOE procurement decisions;
- A stated policy goal to satisfy 30 percent of domestic semiconductor market demand with indigenously designed semiconductors by 2015;
- Reaching an 80 percent self-sufficiency rate for flat panel displays by 2015;
- Creating a “Chinese Domestic Cloud” based on indigenous technologies and IP;
- Providing preferential public procurement incentives for domestic information security technology manufactured in China; and
- Providing \$1.2 billion in subsidies in 2012 alone to develop indigenous networking technology IP.

Ironically, while China seeks to foster the development of its own IP, it also remains a persistent outlier when it comes to IPR infringement. Some progress was made in 2011 with the launch of a State Council Special Campaign and a related State Council level office to increase IP rights protection efforts, specifically targeting the usage of pirated software by government agencies. There were also positive statements made at this month’s S&ED that indicate China will extend this campaign to commercial enterprises. Despite these commitments, the trend lines still appear markedly negative. In addition, the United States Trade Representative (USTR) in its recent 2011 Special 301 Report alluded to an “alarming increase” in trade-secrets theft of U.S. IP-intensive industries originating from China.

Of equal concern to the global tech industry is China's drive to develop its own unique national standards outside the norms to which the industry has adhered during the last few decades. This includes not only mandating standards for the commercial market, but also doing so in ways that make it difficult to address problems through trade remedies. For example, while the Chinese government agreed to "suspend indefinitely" at the 2005 U.S.-China Joint Committee on Commerce and Trade (JCCT) China's homegrown WIFI standard WAPI, it is now a de-facto mandatory standard. China has managed to do this despite previous commitments by compelling its state-owned telecommunication carriers to include WAPI in commercial bidding documents for WIFI equipment.

Since WAPI, our industry has seen China issue a plethora of problematic tech standards. UHT/EUHT is a good example, which is yet again another Chinese attempt at developing unique standards to compete with WIFI. Despite widespread opposition from both foreign governments and industry, and compatibility issues with existing WIFI standards, the Chinese government earlier this year approved the standard. UHT/EUHT advanced as "voluntary," but we have concerns that, like WAPI, it will become a de-facto mandatory standard once the government communicates its "guidance" to state-owned industry. Other examples include China's new standards for wireless 4G encryption, or various competing national standards for cable TV video-encoding, both of which we fear will likely end up as de-facto mandates.

We face myriad discriminatory opaque market access barriers for global companies looking to do business in China from these technical unique national standards. This is in stark contrast to

the voluntary, industry-led and global standards which have helped to drive innovation and growth for our industry.

Beyond standards, China continues to increase burdensome testing and certification regulations on tech products sold in both government procurement and commercial markets that are inconsistent with global norms. We often see overlapping, unnecessary or onerous testing requirements related to safety and other product testing, most of which is conducted in government-affiliated laboratories. The far-reaching Multi-Level Protection Scheme (MLPS), for example, places huge barriers on many high-tech products going into critical infrastructure systems in China. This includes unworkable testing mandates and domestic IP requirements. China's encryption rules are perhaps the most onerous. They bar foreign companies from selling key security technology that is now the bedrock to ensuring consumer and business trust in the Internet.

In sum, while we have now have more official government-to-government dialogues that cover these issues with China than with any other country, our success in rolling back problematic policies remains limited. China continues to mandate problematic standards, force the disclosure of sensitive IP, and enact preferences for local products in an increasingly sophisticated way. It is incredibly important to address this now, especially since such protectionist models are being replicated in other markets.

Mirroring China

In recent years, the Chinese economic model of growth has become increasingly attractive to developing countries around the world. More troubling, a significant number of governments have begun implementing new trade-restrictive policies similar to those of China. These policies continue to undermine the ability of American tech companies to compete fairly in critical markets. The spread of these policies has become particularly acute over the past couple of years as governments wrestle with economic and political challenges at home.

Specifically, these governments, which now include the likes of India, Brazil, Argentina, and Russia, have begun implementing a number of policies designed to boost their domestic manufacturing, high-technology and R&D capabilities, and services – often at the expense of foreign companies. We have seen India follow in the footsteps of Beijing through a recent national policy that mandates onerous local content requirements for electronic procurements. Or, take for example Argentina, which has put in place an import-licensing scheme that discriminates against foreign technology goods. Then there is Brazil, which has mandated the local sourcing of telecom equipment to be used to build out infrastructure to support new spectrum.

These types of policies will reverse decades of global growth and innovation. The U.S. Government has been successful in reversing some discriminatory policies in several important markets. But these reversals appear more tactical than permanent, and discriminatory policies are continuing to proliferate. If left unchecked, these policies will lead to a crippling loss of

competitiveness and global market share for our companies, undermining economic growth and job creation here in the United States.

The Solution: Let's Get China Right

The first step in setting things on the right course is to ensure we get China right. China is obviously too big to ignore, and as we have seen, has created a new model for development which some call the “Beijing Consensus.” The U.S. Government should continue concerted efforts to address specific trade barriers, as well as strategically address the broader, underlying trends of protectionism and promotion of Chinese national champions. We commend past efforts by our government to address China’s indigenous innovation policies, and we urge continued support of bilateral dialogues such as the S&ED, JCCT, and Innovation Dialogue. The Administration’s role in pushing back numerous policies, including the indigenous innovation catalogs, has been instrumental. The United States should continue working closely with the private sector and with other governments to develop a clear, coordinated strategy for encouraging China to adopt global norms. When we have been most successful in dealing with China, it has been the result of close cooperation among governments and between our government and the private sector. And this needs to be an on-going, results-based effort.

At the same time, we need to recognize that China does not speak with a single voice, and there are a growing number of actors that have begun to see the world as we view it. This includes increasingly global Chinese enterprises that are embracing global standards to help lower their costs to sell their products in overseas markets. Or sophisticated consumers that want the same products sold in developed markets, not the out-of-date and bland technology mandated by a

government bureaucrats. While it is not always easy to find these actors, and even challenging to get them to speak out, it must be done. Real change in China will only come when its own citizens realize the negative effects of its industrial policies.

Towards a Global Solution

The time has finally come to develop a more comprehensive strategy to defeat these policies at a global level, promote the global benefits of effective policies that support open markets and nondiscriminatory innovation, and defend growth, innovation, and job creation. This strategy should focus on those countries where retrograde policies are most acute and serious, and are increasingly being recognized by developing governments such as India and Brazil. While this effort needs to include a high-level, comprehensive tier of work, it must also be tailored for individual markets. Recent successful efforts by a broad array of private-sector coalitions to roll back discriminatory industrial policies in China and India can serve as effective models for these efforts.

This means the U.S. government, in collaboration with the private sector, must communicate to these governments a clear vision for viable alternatives to which they can turn to achieve the results they want in fostering innovation and development. This includes understanding that governments can and will continue an important role in fostering innovation, such as through promoting STEM education or creating tax incentive for R&D. At the same time, governments must clearly recognize that most innovation comes from the private sector. In the short term, we suggest that the U.S. government begin to address these concerns at the G20 to be held next month in Mexico City.

Our industry is already working with the U.S. government to identify and analyze the most pertinent challenges, and to provide other governments possible solutions. More is needed, however, to raise the level of attention – both within the United States and with our trading partners – regarding the existence of these challenging problems and how to combat them creatively. These steps are necessary to ensure that American technological competitiveness remains strong.

Thank you.

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