

THE
IP COMMISSION

THE COMMISSION ON THE THEFT OF
AMERICAN INTELLECTUAL PROPERTY

REF: Section 301 Investigation: China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation

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WRITTEN COMMENTS ON BEHALF OF THE COMMISSION ON THE THEFT OF AMERICAN INTELLECTUAL PROPERTY TO THE UNITED STATES TRADE REPRESENTATIVE

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Robert Lighthizer
United States Trade Representative
Office of the United States Trade Representative
600 17th Street, NW
Washington, DC 20508

**Written Comments on behalf of the Commission on the Theft of American Intellectual Property
to the United States Trade Representative**

I. Introduction

The Commission on the Theft of American Intellectual Property (IP Commission) thanks the Office of the U.S. Trade Representative (USTR) for the opportunity to provide comments regarding appropriate actions in response to Chinese predatory IP practices. The Commission appreciates the Office of the USTR's dedication to safeguarding American workers, entrepreneurs, consumers, and investors and the nation's security through strengthening rule of law.

The IP Commission is an independent and bipartisan initiative of American leaders from the private sector, public service in national security and foreign affairs, academe, and politics. The IP Commission was formed in 2012 to document and assess the causes, scale, and other major dimensions of international intellectual property theft and its effect on the United States, and to assess China's role and purposes in that theft.

The IP Commission is a program of the nonprofit, nonpartisan National Bureau of Asian Research (NBR). It is co-chaired by former Director of National Intelligence, Admiral Dennis Blair, and former Chairman and CEO of Intel, Craig Barrett. For the last five years, the Commission has been a leader outside of government in examining the mass theft and forced transfer of America's intellectual property and in offering policy solutions.

In March 2018, the IP Commission published a set of updated recommendations, which build on the Commission's foundational report issued in May 2013 and the updated report released in February 2017. We appreciate the extraordinary interest in this and our prior work shown by Congress, this administration, concerned allies, and a quarter million people who have downloaded the reports. The most recent recommendations are attached as an appendix to these comments.

These written comments raise three main points: the small scale of the proposed U.S. tariffs versus the enormity of the problem; the inability of tariffs alone to succeed as a long-term solution; and recommendations for other strategic actions that could have more reliable long-term effects.

II. Current Tariff Levels in Relation to the Problem

The Commission assesses that China is the worst IP infringer of American IP today and believes this is due primarily to China's predatory economic policies and lack of rule of law. In fact, the Commission estimates that the scale of the annual theft of American IP likely surpasses the U.S. trade deficit with China; in 2017 the goods trade deficit was \$375 billion, while in comparison, the loss of American IP likely reaches \$600 billion annually.

Chinese tariffs on U.S. exports and restrictions on U.S. investment significantly exceed U.S. tariffs on Chinese imports and restrictions on Chinese investments, even considering USTR's proposed \$50 billion in new tariffs. For instance, China's tariffs on motorcycles are 45 percent, while the U.S. charges no tariffs on motorcycles. China's tariffs on motor boats are 10 percent, and U.S. tariffs are 1.5 percent. See the chart below for a sampling of tariff comparisons on more products. Investment restrictions tell a similar story. While the United States is generally open to foreign investment, including by Chinese companies, China restricts U.S. investment in a number of industries, often requires U.S. companies invest as minority stakeholders in joint ventures, or requires that the U.S. investor transfer its technology or manufacture within China.

When comparing American versus Chinese tariff levels and investment restrictions, it becomes clear that the current list of tariffs pale in comparison to the problem. While the Commission thanks the administration for acknowledging the urgent problem of Chinese predatory economic policies and recognizes that the proposed tariffs are a step in confronting the problem, the Commission recommends other, more strategic courses of action.

Sampling of tariff comparisons

| Product | Chinese Tariff Rate | U.S. Tariff Rate |
|---|---------------------|------------------|
| Aircraft | 5% | 0 |
| Alarm clocks | 19.3% | 3.9% |
| Circuit breakers | 10 to 14% | 2 to 2.7% |
| Glassware (household) | 24.5% | 6.9% |
| Mattresses | 20% | 3% |
| Medical devices (ultrasonic scanning, electrocardiograph, MRI apparatus, etc) | 4 to 8% | 0 |
| Mineral or chemical fertilizer | 15.5% | 0 |
| Motorcycles | 45% | 0 |
| Motor vehicles (cars) | 25% | 2.5% |
| Photographic cameras | 14.6% | 0 |
| Radio broadcast receivers | 11.2% | 0 |
| Sewing machines | 21% | 0 |
| Spectacle lenses | 20% | 2% |
| Table knives | 18% | 10% |
| Tower cranes | 10% | 0 |

Shortcomings of Tariffs

The current 1,300 products that USTR includes on its proposed tariff list includes a mix of high tech and low-tech products. The Commission notes that tariff increases often hurt U.S. businesses and consumers by raising prices of manufacturing inputs, raw materials, and consumer goods, and invite retaliatory tariffs that harm U.S. exporters. If tariffs are used as a tool to change predatory Chinese behavior, the Commission recommends targeting only those products that have benefitted from stolen IP or are receiving Chinese state assistance as part of China's aggressive Made in China 2025 policy. The Chinese response – to use tariffs in a superficial way against politically sensitive targets in the U.S that are not derived from national security interests or unfair trade practices – demonstrates that the PRC misjudges the fundamental economic nature of the problem, and calls into question whether tariffs are the best tool. Finally, the U.S. use of tariffs is not the kind of stealthy, strategic campaign needed to hurt Chinese IP thieves over the long term. As opposed to tariffs, the Commission recommends that following actions.

III. Proposed Alternative Responses to Curtail IP Theft and Influence Chinese Actions

The following recommendations include both coercive policies (actions that can influence Chinese actors and encourage better behavior, while testing Chinese intentions to implement real reforms) and structural policies (actions that mitigate risk and protect U.S. economic interests). In addition to the new recommendations below, the Commission released a list of recommendations in March that are included in the appendix.

Identify bad actors

The United States must identify which Chinese companies, state-owned enterprises, and individuals are conducting IP theft, and keep public records of these bad actors and all their subsidiaries. Publicly naming and shaming these entities could prevent U.S. companies from unknowingly doing business with them. The U.S. government should also ban Chinese individuals associated with these companies from conducting business in the United States, accessing the banking system or stock exchange, researching at U.S. universities, or buying property. Building a public registry of Chinese actors could create a system to discourage IP theft and incentivize abiding by the law.

Work with partners

The United States must coordinate with partner countries that also believe in the rules-based trading system and are concerned about Chinese IP theft, such as Japan, the European Union – particularly Germany and France, and Australia. These partners should develop a multinational registry to thoroughly share information on bad actors and deny them access to the market if they have a record of stealing IP from any of the partner countries. If bad actors no longer have access to these important markets, they would realize it is too costly to cheat and steal IP.

Address supply chain vulnerabilities

As the United States takes steps to address IP theft and threats to American innovation, it is imperative to address supply chain vulnerabilities. American companies have significant exposure to risk of supply chain disruption given the extent of integration into the Chinese economy. American policy should take these vulnerabilities into account. Just as in warfare, supply lines matter, and in economic competition or confrontation, supply chains matter. To maximize supply chain flexibility, the United

States must execute a trade agenda that promotes key trade agreements as a necessary component of its foreign economic policy. Integrity and flexibility of supply chains for American companies is vital for national security.

Stop import of goods produced with stolen IP

Whenever a U.S. producer has alerted authorities to products entering the country that have been made with stolen IP, the sale of those products must be immediately stopped. Ideally, these goods should be identified and stopped at the port of origin rather than the port of entry, as prescribed in the Trade Enforcement and Facilitation Act of 2015. No Chinese entity should be able to profit from the sale of counterfeit goods or products produced with stolen IP.

Increase speed of action

Whenever a bad actor is identified, or an American company alerts authorities to the theft of IP or sale of products made with stolen IP, authorities must act with haste – within hours or days, not weeks or months.

IV. Conclusion

The administration has taken a step in the right direction by recognizing the enormous and critical problem of Chinese intellectual property theft, but tariffs alone are not the best solution. The more targeted actions recommended by the Commission might take longer, but would have long-term and far-reaching impacts that can wipe out bad actors' incentives to cheat and crush their success. For additional recommendations, including recommendations for CFIUS expansion and new export controls, see the Appendix.

APPENDIX

Recommendations Regarding the Trump Administration's Section 301 Investigation

March 2018

The Commission on the Theft of American Intellectual Property (IP Commission), co-chaired by Admiral (ret) Dennis Blair and Dr. Craig Barrett (former Chairman and CEO of Intel Corporation), provides the following policy recommendations for consideration by the Trump administration in response to the Section 301 investigation of Chinese theft of intellectual property (IP) and forced technology transfer.

Given the continued assault on American technology, products, science, copyrights, and trade secrets, the IP Commission notes that changing the cost-benefit calculus of foreign entities determined to steal the IP of American firms is essential to the nation's full economic recovery and future economic success. Too many brilliant start-ups have seen the value of their work stolen and never had the chance to prosper; too many established manufacturers have had their products reverse-engineered and their markets inundated with cheaply priced copies; too many multinational companies have been compelled to transfer technology as a condition of market access. The administration must act, and act decisively with unilateral and multilateral initiatives.

Taking strong positions can be accomplished without forsaking America's values and fundamental commitment to the rule of law. As with challenges faced in the past, the IP Commission urges transparent, law-based approaches to ensure fairness, equal treatment, and justice as well as effectiveness.

The IP Commission acknowledges that the measures recommended below are part of a broader effort. The commission encourages the administration to make plans and policies that seek to develop a comprehensive U.S. economic strategy, one that revitalizes and protects the United States' own national innovation system. Doing so will help create a U.S. innovation ecosystem that unleashes the creative genius of America's entrepreneurs, providing for the lawful protection of their nascent ideas, research and development, production, and marketing.

The IP Commission recommends the following specific measures to respond to predatory practices by Chinese and other actors.

U.S. Policy Actions

1. Use the emergency economic powers already granted to the president to deny access to the U.S. market and banking system to Chinese entities found to be directly benefiting from the theft of American IP.

- Under the International Emergency Economic Powers Act of 1977, the president is allowed to sanction individuals and organizations and to "prohibit any transaction in foreign exchange." Section 1637 of the 2015 National Defense Authorization Act expands this authority to cover "all transactions in property" of any person who the president determines "knowingly engages in economic or industrial espionage in cyberspace."

2. Designate the national security advisor as the principal policy coordinator on the protection of American IP to reflect the president's priority and to ensure interagency coordination.

- The administration should create an assistant to the president and deputy national security adviser for economic security to coordinate the policy dimensions of IP protection, export controls, and investment controls, including the Committee on Foreign Investment in the United States (CFIUS). This position would coordinate with the special assistant to the president for trade policy, or the two positions might be merged.
- The national security adviser would review all new measures to protect IP, new export controls, and new CFIUS legislation to ensure that measures to stop technology and trade-secret leakage are coordinated and encourage American innovation and production.

3. Provide statutory responsibility and authority to the secretary of commerce to serve as the principal official responsible for effectively administering the president's policies on IP protection.

4. Expand authority to the secretary of the treasury (in consultation with the secretary of commerce and national security adviser) to deny the use of the U.S. banking system to Chinese and other foreign companies that use or benefit from the theft of American IP.

- This builds on the existing statutory authority of the president as outlined above and was proposed but not adopted during the prior administration. The IP Commission strongly encourages the adoption of this recommendation to ensure that the United States is well-placed to address new and emerging threats on an ongoing basis.

5. Strengthen and modernize the CFIUS process managed by the Treasury Department to include an evaluation of IP protection as a condition for investment in the United States.

- Congress should adopt the Foreign Investment Risk Review Modernization Act (HR 4311), which appropriately widens the categories of covered transactions, expands the specific factors that can be considered by CFIUS to deal with new threats to U.S. military technology, and provides for improved congressional notification.

- The CFIUS process should evaluate major new foreign investments on the basis of the demonstrated level of protection afforded to U.S. companies' IP, including assessments of a foreign entity's historical record of IP theft.
- It should assess whether acquiring companies have damaged or threatened U.S. national security or the national security of U.S. treaty allies through the illegal acquisition of American IP, or other activities against U.S. security policies and interests.
- CFIUS should review acquisitions that have been previously approved when new evidence comes to light of damaging actions by the foreign companies.
- It should develop a monitoring mechanism for ongoing evaluation of approved investments in sensitive industries.
- The administration should add financial resources and manpower to the CFIUS interagency team.

6. Establish a National Counter IP Theft Center, on the model of the National Counterterrorism Center in the intelligence community, to develop a deep understanding of the corporate structure, funding, and activities of foreign companies that pose the greatest threat to American IP.

- This action would establish close coordination with the National Intellectual Property Rights Coordination Center (<https://www.iprcenter.gov>) to inform U.S. government decisions by the Securities and Exchange Commission, the Department of Commerce, and the Department of the Treasury under their authorities.

7. Create a new Investment and Export Control Center, under the secretary of commerce, to develop and implement integrated policy regarding the protection of U.S. technology.

- Such a center would integrate export control procedures with CFIUS efforts to deliver a coherent and integrated set of outcomes to protect U.S. technology from the various methods sought to acquire it for foreign entities—from dual-use violations to forced tech transfer as a condition of market access.

8. In keeping with the IP Commission's earlier recommendation to strengthen the International Trade Commission (ITC) Section 337 process, establish a quick-response capability within the ITC for sequestering goods that incorporate stolen, pirated, or otherwise illegally procured materials or forms of IP.

- Such a capability should draw on and reflect the United States' global leadership as a champion of the rule of law. It should be established using a probable-cause standard of proof for any initial sequestering of goods; provide for a consistent, transparent process for rapid review and judgement; and promote best practices in ensuring access to evidence while also protecting confidential business information.

9. Require the Securities and Exchange Commission to judge whether companies' use of stolen IP is a material condition that ought to be publicly reported.

10. Establish in the private, nonprofit sector a dynamic and regularly maintained database of known foreign entities that have illegally or illicitly obtained American IP to collate and publicize information about their theft alongside key investment and trade data.

- The creation and regular maintenance of such a nonpartisan database would further empower a broad base of American stakeholders—particularly state and local governments and small and medium-sized enterprises—to make informed decisions about the risks of particular investments and economic partnerships.

11. Enhance the work of the National Intellectual Property Rights Coordination Center, which currently focuses on information-sharing and law enforcement, to make the center the real locus of policy on IP rights protection.

- The administration should increase manpower and resources, especially in the Department of Justice and FBI, to investigate and prosecute cases of trade-secret theft.

12. Continue to encourage and welcome investment and economic partnerships with Chinese entities that have demonstrated a commitment to promoting high standards of IP protection and that do not engage in unfair trade practices.

- As aptly noted in the administration’s recent National Security Strategy, the United States “welcome[s] all economic relationships rooted in fairness, reciprocity, and faithful adherence to the rules,” including the pursuit of ongoing closer U.S.-China trading ties. On this basis—and without “turning a blind eye to violations”—the United States should continue to engage with China on pursuing genuine opportunities to strengthen the bilateral relationship. This includes continued efforts on the U.S.-China 100-Day Action Plan and the establishment of a high-standards bilateral investment treaty in ways that “benefit all with equal levels of market access and opportunities for economic growth.”

13. Make it a national goal to delegitimize Chinese indigenous innovation efforts dependent on the theft of foreign IP and ensure that all U.S. agencies speak with one voice to move China to become a self-innovating economy.

Multilateral Policy Actions

14. Initiate a multilateral policy dialogue among like-minded countries, starting with the European Union and Japan, as well as Australia, the Republic of Korea, and Singapore, to strengthen national policies on Chinese foreign investment (Multilateral CFIUS).

15. Establish a dialogue with Europeans, Japanese, and others who share interests in protecting IP and reforming international trade rules and institutions to harmonize national legal and regulatory frameworks and share information on bad actors.

- The IP Commission applauds the December 12, 2017, joint statement by the United States, the European Union, and Japan expressing a commitment to work together to ensure a “global level playing field.” Such partnerships should be encouraged and expanded, including to potentially bring in other champions of free trade and high standards for IP protection.

- The World Trade Organization has proved largely ineffective in providing for the protection of IP from an infringer like China. As a consequence, the United States must work with its allies and friends to chart a path forward that serves the interests of nations committed to the rule of law and fair markets and that incentivizes others to adopt the requisite norms and practices.

16. Encourage the development of evaluative tools that assess the levels of national IP protection and formulate work plans in response (similar to the Trade Secret Protection Index (TSPI), which is an existing tool that assesses national IP-protection performance).

17. Develop a program that encourages technological innovation on a multilateral basis to improve the ability to detect counterfeit goods.

18. Establish IP “centers of excellence” with priority countries with strong rule of law to promote best practices for protecting IP rights.

About the IP Commission

The IP Commission is an independent and bipartisan initiative of leading Americans from the private sector, public service in national security and foreign affairs, academia, and politics. The IP Commission published reports in 2013 and 2017 documenting and assessing the causes, scale, and other major dimensions of international intellectual property theft as they affect the United States; the reports also proposed appropriate U.S. policy responses that would mitigate ongoing and future damage of intellectual property rights by China and other infringers.

About the Commissioners

Co-chairs:

- Admiral Dennis C. Blair, Co-chair of the IP Commission; Chairman of the board and Distinguished Senior Fellow at the Sasakawa Peace Foundation USA; former commander of the U.S. Pacific Command; and former U.S. director of national intelligence
- Craig Barrett, former Chairman and CEO of Intel Corporation

Other Commissioners:

- Dr. Charles W. Boustany Jr., Chair of the Center for Innovation, Trade, and Strategy at the National Bureau of Asian Research; former six-term U.S. Representative from Louisiana
- Slade Gorton, former U.S. Senator from Washington State; member of the 9/11 Commission
- William J. Lynn III, CEO of Leonardo North America and DRS Technologies
- Deborah Wince-Smith, President and CEO of the Council on Competitiveness
- Michael K. Young, President of Texas A&M University