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Motivating China to Play Fair In Global Markets

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Motivating China to Play Fair In Global Markets

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Motivating China to Play Fair in Global Markets

William H. Lash, III

INTRODUCTION

This is my second trip here to Lindenwood. I can see the progress that has been made in providing even better facilities for the students in just the year and a half that have elapsed. I appreciate the opportunity to meet again with Lindenwood students and faculty and citizens of St. Charles and St. Louis Counties.

If you ask any nation's trade officials about trade policy and investment, China will be on the tip of their tongues right now. Everyone is focusing on China. China is the big dragon in the room that is absorbing tremendous amounts of resources: everything from steel and scrap metal to the second largest consumption of energy in the entire world. Prices are rising and shortages are appearing in many resource markets as a result of the rapid growth of the Chinese economy.

The other side of the coin is that most countries are making money by selling to the Chinese. Last year, U.S. sales to China were up twenty-three percent from the previous year. For the first quarter of the year, we are up by twenty-eight percent over the same quarter a year ago.

Missouri has had incredible success in China. In the past four years, sales from Missouri firms have risen by nearly 400 percent. That's a good clip, especially when the global economy has been slowing down.

China is one of the two big engines of economic growth. (The U.S. economy is the other.) But this does not mean that doing business in China is easy.

China Fever and Mo' Problems

An old rap song by Biggie Smalls called "Mo' Money, Mo' Problems" aptly describes the Chinese

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economy. First of all, people see a market of 1.4 billion people and they think: “This is going to be great. I will sell whatever I’m working on to China and I can retire after a few weeks.” People get “China Fever” which leads to “Mo’ Problems.” China Fever is my own term you appreciate. You will not find it in any business case studies or economics texts.

China Fever is suspending common sense and rational thought to chase sales that may never result in payment. Every month, someone will walk into one of our offices in China (we have many offices across the nation) and say, “I sold this guy a million dollars of equipment and I cannot find him and I cannot get paid.” We ask, “Where did you find this guy?” and he answers, “On the internet.”

Without being able to find out where the customer is located and what kind of people you are dealing with, why would you send a million dollars of equipment across the ocean, to a nation where enforcement of contracts is suspect? No credit check, no deposit. You cannot buy a car off the internet in the United States without money changing hands and there being a credit check.

But this is a *small dumb problem* compared to another real case. Executives of a U.S. company came into our office in 2001 and said that they had a problem with China. We said, “Welcome to the club; what is the problem?” And they said, “We built a power plant, Mr. Lash, but we’re not getting paid for it.” I said, “You mean no one is taking the power? The plant isn’t operating? What’s the problem?” And they said, “We didn’t get these – what’s the word – permits.” They built a \$300 million power plant without getting any permits!

I do not know what channel of TV they were watching, maybe the Cartoon Network, but on “Reality Planet”, saying you are a market economy and actually being one are two different things. In fact, China still has centralized planning; they are still producing five year plans. If something is not in that five year plan and blessed by Beijing, you are out of luck. Not to mention the fact that you cannot build a power plant in the United States without permits.

This company’s executives and its board of directors forsook good judgment, thinking they could make a killing over night. We managed to get them extricated

from the problem, but you have to admit that this was a *big dumb mistake* brought on by China Fever.

China attracts businesses from around the world. We believe that in the next five to eight years it will have the largest middle class in the world, with 500 million to 800 million potential consumers. However, the present reality is that most of the 1.4 billion people in China are living in poverty. They are not buying a lot of consumer goods so they are not particularly good marketing targets.

If you go to Shanghai or Beijing, you will see McDonald's, but further west you will not see the sparkling lights of Shanghai. Going to China and saying, "I've been to Shanghai and now I understand China," is like going to Washington D.C. and saying, "Now I understand America." The major Chinese cities and the rural areas have absolutely nothing in common. You have to go where the people are to get a more realistic picture of China.

When someone asks, "What do the Chinese think?" that is like saying "What do the Americans think?" There are 270 million Americans who all have different perspectives by geographic location, political affiliation, gender, and employment: China has similar issues and thoughts. The biggest challenge that we are facing (when I say "we", I mean the United States, the EU, Japan, and Korea) is to ensure China's compliance with World Trade Organization (WTO) rules.

World Trade Organization Compliance

I was the first official to welcome China to the WTO in 2001. In essence, we said: "Welcome to the club; we're watching you. Membership in the club comes with a thousand pages of rules and we expect you to memorize and honor each these rules. If an obligation is due on Tuesday, November 15th at 2 o'clock, we will be there at 2:01 to verify that you have complied."

In Beijing, they understand that they must fulfill all WTO requirements, but there are a couple of famous Chinese sayings that you need to be familiar with. One is, "The heavens are high and the emperor is far away." In English this means, "What Beijing doesn't know cannot hurt me out in the provinces." If a law is passed in Washington D.C. it is recognized across

the country. However, the further away you get from Beijing, the less law enforcement you have.

For example, a few years ago there was a series of worker insurrection cases where management of a U.S. company laid off some workers who then proceeded to riot for several days. As a result, management was barricaded in their office until the army came and rescued them. These events are not helpful when you are trying to build an attractive investment climate and to show how open the country is to new ventures.

Intellectual Property Rights and Piracy

Membership in the WTO is a major step for China, particularly when we are talking about the protection of American and international intellectual property rights: patents, copyrights, and trademarks. In China, piracy is at an epidemic level and realistically, no country, including the United States, is immune from it.

I am confident that no university student has violated a patent, copyright or trademark. No one here has ever downloaded a song illegally or bought an illegal CD or DVD. We know that this is wrong.

Of course, we also know that if you do copy these recordings, you will be tracked down like a dog and sued. When you get that twenty million dollar law suit, it really makes you wish you hadn't downloaded those 20,000 songs illegally.

If you go to New York City, Los Angeles or Chicago you are going to find people selling counterfeit purses and counterfeit DVDs. If a movie is still in the theatre and it is on DVD for ten dollars, hint, it is probably counterfeit. If that Louis Vuitton purse costs ten dollars, I can guarantee that it is a knock-off and more importantly, it's illegal to be selling it as authentic merchandise. While we deal with such incidents as a street crime or a nuisance crime, the bottom line is that in America people do get punished and they do go to prison for piracy. It is not the guy with the little stand that is the problem: it is the manufacturer, the importer, and the distributor.

I have seen that kind of piracy in Spain, in the jungles of Paraguay, and in the streets of Poland and Moscow. Recently, my assistant and I were in Jeru-

salem, the Old City, and we were walking in the steps where Christ walked. I stopped in the middle of our tour and said, "Wait, pirated material." I left the tour to see counterfeit CDs, DVDs and software. The fact is that no market or country is immune from piracy. What matters is how a country addresses intellectual property rights theft.

Rampant Rip Offs. Currently, China has a ninety percent rate of software piracy. So, nine out of every ten copies of software in that country are illegal. But China's piracy is truly an epidemic that goes far beyond software. There is nothing in this room right now, in the university, in your home, in your office, or in your factory that is not being copied by someone in China.

For example, I went into a store in Beijing and I bought a counterfeit Callaway Big Bertha Golf Club. In America, they are five hundred dollars each, but in China this club costs fifty dollars and the store owner even threw in two free hats. It was a good negotiation. I said, "Is this really a Big Bertha driver?" and he said, "Oh, yeah, it is real."

It was a decent golf club, but it was not a five hundred dollar Callaway Big Bertha. If they called it a Great Wall Driver, you might have thought it was legitimate. The name, the price and common sense tell you that it was a counterfeit.

We all joke about counterfeit goods, but I'm a compulsive pirate hunter. In the movie "The Sixth Sense," the kid said, "I see dead people." Well, "I see pirates" everywhere.

I walked up to a young man in one of our big cities and he asked, "Watch?" and I said, "Okay, you want to sell me a watch? What do you have?" He said, "Rolex" and I said, "Really, how much?" He said it was only thirty dollars for the Rolex. I negotiated this guy down to three Rolexes for ten dollars, but I do not think that they are real.

First of all, ten dollars is a really good deal and one of the watches even says "Superlative," but it is spelled wrong. That is a warning signal. The bottom line is, I popped off the back of the watch and it is self-winding. This is a watch that took some workmanship.

If this guy could sell me three self-winding watches

for ten dollars and still make a profit, he's on to something. Whoever makes these watches could compete with other brands by advertising "Great Wall Watches, Self-Winding" and sell them for twenty-five dollars – imagine the profit. Pirates do not have to sell counterfeits because people will buy legitimate products. We do not mind the competition, but we hate cheating. Slapping someone else's name on a product is the ultimate insult.

Chinese piracy has become so extensive that they even counterfeit chewing gum. A pack of gum is fifty cents, maybe a dollar tops. Wrigley's gum had a forty-five percent market share in China and they were doing pretty well until the pirates began getting involved.

Chinese pirates went even further than just copying the gum and its packaging. They copied the Wrigley's driver uniforms, the little caps, and the trucks. Then they followed the Wrigley's drivers on their routes. So, they would follow the Wrigley's delivery man, come a few days later and say, "Here's your order, my colleague will be back next week with the rest of it." That is sophisticated piracy; that is "playing well above the rim."

We have to find a way of constantly engaging trade officials because this type of piracy is so intelligent. China has to be very vigilant, have real penalties and have real enforcement.

NASCAR is recognized internationally and trademarked in China. "NASCA" has no meaning, but NASCA materials that look a lot like NASCAR goods are sold throughout the country.

Two years ago we had a problem with Bee playing cards. A deck of playing cards is hardly a high profit margin product. The company is located in Ohio, so we went there to show them the rip-off Chinese cards. Back in China, we located the pirates, did a raid, and shut the guy down. During my last trip to China, however, as I was leaving, I had a few Yuan left. I went into the duty free shop and looked around and saw Bee playing cards. I thought, "It can't be, they're all gone." So, I picked up a pack, and saw that it was not "Bee" playing cards. The package had the same markings, but it was a deck of "Bem" playing cards. Now, I do not know what a "Bem" is, but I told my officer, "Okay, new case. Find these guys, we have

got to shut them down.”

Serious Consequences of Piracy. Not all forms of piracy are that innocuous, however. How about pirating auto parts? Imagine that you are driving to your favorite lake resort on a rainy day and all of a sudden the brakes do not work because they are counterfeits. There are \$800 million of counterfeit car parts being sold.

Counterfeit airplane parts are another serious problem. We were at the Boeing factory last week, and if a bolt or screw gets dropped on the floor, they do not use it. They cannot take the chance of using a part that was not made precisely for the section of the aircraft being worked on. When you are building that plane, you want to make sure that it is being held together with parts that are designed to withstand the forces that the airplane will encounter.

The scariest part of piracy is that we are finding counterfeit pharmaceuticals. When you go to a drug-store in the United States you know that they are not making their profits through piracy. If you go to the medicine shops in Beijing, you do not know what you are going to get. You are not going to hold each pill up to a magnifying glass. When we are taking pills, we want to trust that the pharmaceutical is the genuine article. Half the pharmaceuticals in Beijing are counterfeit.

Some of the counterfeiters are stealing the brand name but they still make knock-offs that have the same active ingredient. It is theft, but this drug will actually produce the desired results.

Sometimes the counterfeits have no active ingredients at all so you are taking something for your diabetes, your heart problem, your cold, or your flu and you are rolling the dice. Your chances are 50/50 that it is a real pill. If you use a fake watch, you may not make a meeting, but with a fake pharmaceutical, you may have an early meeting with your maker.

FIGHTING CORRUPTION, GAINING POLITICAL STABILITY

One of the reasons that piracy fully developed in China is that even ten years ago there was no sense of intellectual property in that nation. The government

owned everything and the people owned nothing. If you were a song writer, it was not your song, it was the government's song. Everyone had the right to hear it, to record it, to sing it, and to play it.

As part of the WTO process (China spent fifteen years trying to join the WTO) China began to recognize some intellectual property rights. Initially they began to focus on securing brands. However, they were not recognizing names like Nike, Procter and Gamble or GM; instead, they focused on protecting famous Chinese brands. This was not helpful, and we are trying to get them to start recognizing famous Western brands. Nonetheless, making the step from Communism to recognizing market principles like private property is not an easy one.

Political Priorities

Every government has its policy priorities. In America, our top priorities are security and the economy. In China, the top item on their policy agenda is political stability. Anything that keeps people out of Beijing, not protesting, and not rioting is a good thing.

I went to China recently and when I came out of my meeting there were Chinese protestors who had been forced off their land. The Chinese government was very nervous about how to handle this and they were embarrassed that Americans were seeing these disgruntled citizens. The government wants stability and a person with a job, regardless of what they are doing or who they are hurting, will not be in the streets protesting.

In many smaller towns, the only jobs are those working for a factory that is run by a pirate. If you shut that illegal business down, you increase the ranks of the jobless.

At the beginning of my talk, I mentioned that two famous Chinese sayings apply to the problems faced with doing business in China, the second of these is, "The mightiest dragon cannot crush the local snake." Well, the pirate in that area is the local snake and Beijing is the mighty dragon that does not have the law enforcement ability or the will to prosecute those cases.

Corruption

Wherever you have a political system that is not democratic, you are going to have corruption. Every country has some corruption, but there are currently 20,000 cases of corruption being investigated in China. And, these are only the visible crimes. The real number is easily seven to ten times this amount.

Right now, we have a case that we are working on with Zippo lighters, a very all-American product. Every Zippo lighter is made in the USA whether it is the new modern one with Elvis etched on the cover or an old fashioned one with a flag. Zippo reported a major case of counterfeiting and we were working with them to find the manufacturer and to try to get the Chinese government to shut them down. We raided the pirate factory, caught some of them and found 200,000 lighters.

So it was a good raid and the federal prosecutors from Beijing were coming out to Guangzhou to prosecute the case. It is like the U.S. Attorney's office coming in to handle a case. They arrived and lo and behold the local law enforcement office had destroyed the evidence. No evidence, no case. No case, no crime. Everyone goes home.

How did that happen? We know how it happened. Money changed hands and everyone was powerless to do anything.

Weak Laws

If I walked into a manufacturing plant right now in China and there were counterfeit anti-aging medications, golf clubs, or CDs piled from the floor to the ceiling, this may not be piracy under current Chinese law. Their law requires proof of \$50,000 dollars of actual sales. Now, assuming that the pirates do not have open books, it is difficult to prove what their sales are.

In most cases you need one or two confidential informants. You have to bribe a worker, and have him say, "Yes, these are the records." Plus, it is dangerous to get these informants. We have to spend time with the prosecutors and the other officials of the People's Republic to get new laws on the books so that illegal manufacturing, distribution and, most importantly, exports will be criminalized.

Weak Enforcement of Laws

Law enforcement is also a real problem. If you have great laws, but your enforcement is bad, then the laws are meaningless.

Before the police do a raid in China, they all have to turn in their cell phones so they do not call ahead and tell Uncle Joe to hide the stuff. In addition, the police do not want to do a raid at night. If you have watched NYPD Blue or any good police show, you know that most raids are done at night. Criminals are sleeping during the day or playing on their Sony Play Station. The Chinese police do not want to do these raids at night because the criminals turn off the lights and beat them up. The cop is thinking, “I’m not getting paid much money, it is dark, and I’m getting my head beaten in.”

Under these circumstances, it is rather difficult to encourage good law enforcement. Fundamentally, however, it is a question of political will.

STEPS TO FIGHTING PIRACY

So, what are we doing as a government to fight piracy? First and foremost, we are working to educate the Chinese. You have to train customs officers and intellectual property officers to understand what they are supposed to do and how to recognize counterfeits. While Bee playing cards or Proctor and Gamble products might be easy for you and me to recognize, it is not necessarily second nature for a Chinese government bureaucrat.

The second thrust to our efforts is to get China to change their laws. We are also working with them on joint raids and changing customs – our customs and their customs.

Often, Americans get caught during our raids. I believe that a few years in a Chinese jail would teach Americans to stop trafficking in counterfeit DVDs. That’s what I call a good deterrent. My view is if you are involved in committing a crime, you go to jail. It is not fair that Americans get to go to “Club Fed.” If you commit the crime in China, you can do your time in China. You can make some counterfeit license plates: you’ll learn a lot that way.

On top of that, we are working to get the Chinese more focused on enforcement. There are two aspects

to this. First of all, it will not work unless the Chinese make it their own priority and they are doing that. China's Vice Premier has been spending a lot of time focusing on enforcement.

They are not doing this just to keep our team or the President happy. They are making this a priority because China wants to double its GDP by 2010 and they cannot do so without direct investment. They cannot get there without technology and right now we are telling companies, "Do not bring your best technology to China because it will not be safe, your trademark won't be safe and your trade secrets will never be safe." The Chinese perceive that this is happening and they see that they have to do a better job of making investors comfortable as well as to develop their own brands.

When I hold press conferences I like to do something rather dramatic – every year I go a little further. I have been in Italy and taken fake Gucci bags and ripped them in half. I have taken fake DVDs and smashed them on the table – Americans are loud and violent people, you know.

Last year I was on TV in China and I identified individual pirates. I said this guy is a pirate and here is his address. I told the police where they were and said, "Go do the work." Never before had that happened on Chinese TV. Fortunately, we had the western media there so the Chinese had to keep the cameras rolling.

I planned to add a dramatic touch by taking the fake Callaway Big Bertha golf club that I had bought, and smash it over my knee and say, "I'm an American and I'm mad." But, I also remember from the OJ trial that "if the glove doesn't fit, you must acquit." In this case, "if the club doesn't shatter, it does not matter." Before the press conference, I had the club in my room and I thought, "I had better rehearse this." That club was not going to break easily. It had a good graphite shaft.

The point is that this was not a Callaway Big Bertha, but it could have been a significant export. China has to convert its economy from piracy to one of competition in these areas.

When I was a young person, the big insult was, "You are so poor that your stuff comes from Japan." The idea of high quality material coming from post-

occupation Japan was laughable. There was no Sony. There was no Lexus. Japan was known for low quality. When Japan began to innovate on their own, they began to produce materials and goods that are now sold around the world.

China can do that. They can manufacture their own golf clubs: just do not steal them from us. With regard to more sophisticated industries like pharmaceuticals, a controlled economy that works through Communism does not produce a lot of innovation. The Soviet Union, produced only one innovative pharmaceutical. That's not a very good track record for contributing to the quality of health for your people. The same thing is true for China, they have to be forced to innovate.

We are still optimistic that we can reach the Chinese on these plains. We believe that engaging them is a good option but we find that, around the world, our trading partners are severely suffering and looking for action.

CONCLUSION

The day the bombing began in Afghanistan, I was in a meeting with an economic sub-cabinet minister from Japan and everyone's pagers and beepers started to go off. We were all ready to leave when the head of the embassy said, "Wait,, I know you guys want to leave and that's no problem, but Secretary Lash has a few points about China's WTO compliance." Immediately, the Japanese came back to the table because this topic has their attention.

Right now Japan is losing \$34 billion a year to piracy in China. The European Union and the United States are each loosing \$20-24 billion a year. It is not just the economic damages that we are worried about, it is also the health and safety risks.

Everyone is looking at this situation. We are not ruling out any option to make sure that the Chinese come to the table.

China worked hard and long to become a member of the World Trade Organization. Trade promotes interaction and interaction leads to increased trust on political, as well as, economic levels. It is imperative that China follow WTO rules in order to continue to develop its economy and to improve its relationships with its trading partners.

William H. Lash, III is the Assistant Secretary of Commerce for Market Access and Compliance. His office works to ensure that foreign governments fully comply with the more than 250 trade agreements the United States has signed. Assistant Secretary Lash also chairs the Department's Iraq and Afghanistan Reconstruction Task Forces, which provide information and resources to businesses interested in participating in reconstruction efforts and commerce in these two countries.



Previously, Mr. Lash was a Professor of Law at George Mason University School of Law, and prior to that, Associate Dean and Director of the Law and Economics Center at GMU.

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