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## EDITORIAL

### CHINA

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*“Third-class companies make products; second-class companies develop technology; first-class companies set standards.”*

Popular saying among Chinese business and government leaders

*“China’s mobile telecom market will no longer be a playground for overseas companies in the coming 3G age”*

Zhang Guobao, Deputy Minister, PRC State Development Planning Commission

**China:** The concept of China defies modification in a mere editorial title. With a fifth of the world’s people and an exploding global share of both finished goods exports as well as raw material imports, the potential commercial influence of this behemoth can scarcely be underestimated.

But while China is emerging as a dominant commercial player on the world stage, it is more than mindful of the 150 years of political and trade exploitation it suffered at the hands of foreign powers. Those abuses of national sovereignty included the forcing of an odious drug trade on its people by the British and the French; its ultimate defeat at the hands of those same powers in the Opium Wars in 1839, after it tried to protect its citizen from exploitation; the loss of control of scores of so-called Treaty Ports such as Shanghai and Hong Kong; and the carving up of the entire country into multiple “Spheres of Influence,” within which the powers that claimed them asserted further indignities, including foreign legal jurisdiction and tariff control.

It is against this backdrop that China’s emergence as a great commercial power must be understood, as China’s attitude towards perceived inequalities of today is informed and sensitized by the abuses of the past.

Today, of course, there are no formal spheres of influence. But there are many international trade networks, conventions, treaties and practices that have evolved in the West in modern times, largely without Chinese involvement, due to the turmoil that it experienced throughout the last century. China must deal with these realities, many of which are less susceptible to its influence than the raw markets that it can otherwise control through its substantial cost of manufacturing advantages.

These realities include the dominant position of patent portfolios owned by global corporations based in the West, as well as a global standard setting infrastructure that is already entrenched. While China’s rearmament plans garner more coverage in the popular press, it is worth examining each of these more pedestrian issues in greater detail, as they are more closely linked than one might expect (on this, more below).

Turning first to standards: there are virtually no manufactured goods today that are not effectively regulated by standards compliance requirements. Those standards are set by the hundreds of accredited standards development organizations (SDOs), particularly in traditional manufacturing sectors, and the newer consortia that have sprung up in their hundreds in the information and communications technology (ICT) space. The standards output of these organizations is approved by global standards bodies such

as ISO, IEC and the ITU, and global treaties such as the World Trade Organization's Technical Barriers to Trade Act related to this output as well.

The implementation of tens of thousands of these same standards necessarily infringes on patents. The vast majority of these patents are owned outside of China, and here is where current and historical frictions begin to converge.

This is because competitors based in the West and in Japan often cross license their patents, lowering the effective costs of manufacturing (for example) consumer electronics. Since few Chinese companies today have patents that would be infringed by building products to international standards, these companies are forced to pay the full royalty load on such devices – a cost that may exceed the available profit margin many times over. In a sense, foreign powers still enjoy spheres of influence over Chinese exports and internal consumption based upon intellectual property rights (IPR).

Not surprisingly, this modern economic advantage is not appreciated in China, especially as it harks back to the more overt abuses that it suffered in earlier times. So what is China to do?

Several strategies are available to it. They include ramping up China's internal patent office, setting its own standards for goods sold domestically, and increasing its participation in the existing global standards setting infrastructure – and China is pursuing all of these strategies, as examined in greater detail in this month's **Feature Article**. And unlike the United States, the government of which has traditionally offered no economic support for domestic standard setting, China is investing heavily in the creation of domestic standard setting capabilities.

Consequently, while the U.S. government is associating little strategic importance to its own standard setting infrastructure at a time of net domestic manufacturing job losses, Beijing has elevated the same topic to a high priority in its efforts to accelerate the further transfer of manufacturing jobs from America to China. With the notable example of last year's high-level agency involvement in the wireless Wi-Fi/WAPI standoff between the United States and China at the prodding of Intel, Texas Instruments and others, U.S. companies are largely on their own. (see: **Breaking Down Trade Barriers: Avoiding the China Syndrome**.)

Can the United States government continue to ignore China's determined standards strategy? We think not. The reasons are not only defensive, but also opportunistic. Defensively, because U.S. industry can hardly afford to be at a further disadvantage in selling its wares to millions of increasingly affluent Chinese middle class consumers. But also opportunistically, because the more China becomes assimilated into cooperative global commerce, the less attractive to Beijing will military adventures across the Taiwan Strait and elsewhere appear to be.

What can be gained from such encouragement? In a classic scene in the brilliant but mordant 1976 cinema satire **Network**, global conglomerate CEO Arthur Jensen famously intones to the increasingly unstable Howard Beale:

There is no America. There is no democracy. There is only IBM, and ITT, and AT&T, and DuPont, Dow, Union Carbide, and Exxon - those are the nations of the world today.... The world is a business, Mr. Beale. It has been since man crawled out of the slime, and our children will live, Mr. Beale, to see that perfect world in which there's no war or famine, oppression or brutality. One vast and ecumenical holding company, for whom all men will work to serve a common profit.

One would hardly wish to live in a world as cold and sterile as this. But if we are, after all, to live increasingly in a commercial world dominated not only by IBM and Dupont, but also by Wal-Mart and China's Lenovo Group (which bought IBM's ThinkPad laptop line), we should harness at least that part of Arthur Jensen's vision that could lead to greater world stability.

In this sense, the decisions that China makes regarding its standards policy will be a bellwether for its broader commercial strategies. Will China turn to the West and become a full participant in the global standards setting infrastructure? Or will it conclude that its best interests lie in wrapping itself in the

enormous power of its domestic manufacturing and consumption potential, presenting ultimata to the world instead?

China's eventual settled policies remain to be seen, but certainly they will be influenced by whether the West demonstrates understanding to issues such as China's IPR disadvantages, or is seen in Beijing to be seeking once again to establish commercial, patent-based spheres of influence at its expense.

The lessons, then, are two-fold. First, the United States needs to incorporate a more pervasive awareness of standards into its international strategies. But its goal should not be to become more influential than China in setting future product standards. Rather, it should seek a leveling of the global standards playing field that will encourage China to become more assimilated into global commerce and less protectionist in its own standards strategy. The long-term result will be not only the opening of an increasingly affluent Chinese marketplace to western goods, but reduced tensions with the most credible contender to become the world's next superpower as well.

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