

## **Submission on the The Australia - China Free Trade Agreement, by Alex Malik**<sup>1</sup>

### **(1) Introduction**

As an academic with a strong focus on intellectual property (“IP”) rights, the bulk of my comments will relate to the intellectual property rights impacts of the proposed Australia - China Free Trade Agreement (“FTA”). On the face of it, free trade agreements provide a great opportunity for Australian companies, businesses and investors. It is likely such an agreement with China would have substantial benefits for Australian companies and the Australian economy. This includes owners and developers of goods and services with an IP rights component.

However, as an academic with a strong interest in intellectual property (IP) rights I am concerned by an apparent lack of support by the Chinese Government for the protection of and enforcement of intellectual property rights in China. I believe, in order for the proposed Australia – China FTA to be the success it can be, some of the provisions of the FTA must reflect the interests of IP rights holders, because in many cases these interests reflect the interests of the Australian economy, overall.

### **(2) Protection from IP rights infringement**

Negotiations with China present a unique problem in the area of IP rights compared to prior negotiations with New Zealand, the United States and other jurisdictions. Not only are their substantial cultural, legal and political differences between China and Australia, but China also has a history of substantial IP rights infringement as the following analysis will indicate.

#### **(a) Record and music piracy in China**

While precise statistics are unavailable, it has been estimated that total music sales in China are estimated at \$600 million a year, yet only 10% of that total is from legitimate CDs and cassettes. In Taiwan, half of all albums sold are pirated, and in Hong Kong, about one third are pirates. In total, the music industry estimates it loses more than \$700 million a year to piracy in China, Taiwan and Hong Kong. These statistics are despite China’s admission to the World Trade Organization in 2001, which was expected to result in substantial reductions in CD and other forms of piracy.

According to the International Federation of Phonographic Industries (IFPI), “there was a sharp increase in the number of discs seized and pirate lines de-commissioned, mainly in South East Asia and Latin America ... South East Asia, and, to a lesser extent Eastern Europe, are the predominant centres of large-scale factory-pressed pirate music CDs ... Countries in the spotlight where piracy is at a rate of over 25% and notably worsening include ... China. The top five priority countries in terms of domestic piracy levels (include) China”.<sup>2</sup>

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<sup>2</sup> See:

Record companies are concerned that excess production capacity in optical disc plants may be used to produce unauthorised CDs. For the owners of CD production plants, allowing illegal CDs to be produced represents a low risk way to earn income during what would otherwise be “down time”.

IFPI has conducted a detailed analysis of worldwide production capacity and found that “the continuing spread of music piracy is global overcapacity in the manufacture of optical discs, i.e. discs carrying all media including music, film and computer software. IFPI estimates that there are approximately 1,000 optical disc plants worldwide. Such increases underline the lack of adequate regulation of optical disc manufacturing. This is a recipe for increasing illegal pirate sales, as supply of discs is far outstripping legitimate demand. For the combined ten territories shown, capacity outstrips local demand by over twenty times.”<sup>3</sup>

IFPI have produced the following table listing territories, their estimated capacity (all disc formats) and total legitimate demand (all disc formats):

<b>Territory/Estimated Capacity: mil. units</b>	<b>Total Legitimate Demand: mil. units</b>
<b>Taiwan</b>	<b>7600</b>
<b>Hong Kong</b>	<b>2700</b>
<b>China</b>	<b>2500</b>
Malaysia	1600
India	800
Singapore	720
Thailand	500
Poland	320
Russia	300
Indonesia	190
Czech Republic	170

The countries that comprise Greater China appear at #1, #2, and #3 on this list.

This fear regarding excess production capacity influencing piracy levels seems to have been warranted, based on what we have seen in the past eighteen months internationally. In South East Asia there is an “excess of supply over current legitimate demand for optical disc products in (these and) neighbouring countries. This makes piracy an attractive export business for many infringers. Increasingly, countries which surround Australia are becoming the base for both legal and illegal pressing plants which are capable of producing discs with software many times in excess of the legitimate demands of software owners and purchasers. Armed with the masters used to produce the optical discs, whether containing software, music or film or a combination of them, these plants are capable of vast production runs undetected by the copyright owners. There have been many raids on both legal and illegal plants in Asia in the last 5 years which have demonstrated this threat.”<sup>4</sup>

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- “Governments urged to step up enforcement to stop the damage to cultures, economies and world trade”, IFPI Report, June 11, 2002.
  - IFPI - Music Piracy, Organised Crime and Terrorism, 3rd edition.
  - IFPI Enforcement Bulletin - Issue 14 - March 2002.
  - IFPI Enforcement Bulletin - Issue 15 - June 2002.

<sup>3</sup> <http://www.ifpi.org/site-content/antipiracy/piracy2003-piacy-statistics.html>.

<sup>4</sup> “Effective IP enforcement strategic approaches to countering software piracy”, by Michael Williams, 2001.

The recording industry has been involved in various legal proceedings concerning China or involving Chinese companies.

For example, in 1999 IFPI filed a lawsuit in the Second Intermediary People's Court of Beijing which alleged that My Web<sup>5</sup> set up pages on its China-based portal that enabled internet surfers to download IFPI members' sound recordings in MP3 format through hyperlinks and search engines. Under a Court sponsored mediation agreement, My Web paid the court costs, apologised to the plaintiffs and took down its hyperlinks to the unauthorised MP3 files.<sup>6</sup>

In 2001 a 14 year old was arrested in Hong Kong for distributing copyright protected songs on the Internet for free. The boy had allegedly set up a Web site and illegally created his own server.<sup>7</sup>

In 2002, the Recording Industry Association of America (RIAA) asked a court Friday to order four Internet Service Providers (ISPs) who maintain the Internet "backbone" to prevent access to a Chinese website that provides unauthorized copies of copyrighted music. The website, Listen4Ever.com allowed individuals to undertake unauthorised downloads of IFPI controlled music, until it was closed down. It was alleged to have been based in China.<sup>8</sup>

### **(b) Software piracy in China**

The problem of software piracy seemed to take hold in the mid-1990s.

In the mid 1990s the piracy rate was estimated at 98%, with losses exceeding US\$500,000,000. In 1994 about 750,000 personal computers were sold in China, yet only about \$1 million US dollars worth of business application software was legally purchased during the same period.<sup>9</sup>

The problem has continued in the new millennium.

"Losses to the worldwide software industry caused by the use of unlicensed software amounted to \$10.97 billion in 2001 ... according to a (BSA) report ... (the) study of software piracy estimates the use of unlicensed software in 85 countries by comparing the amount of legal software supplied to a country with the anticipated demand for software in that country. The difference between the two figures represents the number of unlicensed applications, and multiplying that figure by the average price of business applications gives the estimated dollar loss ... the use of unlicensed software worldwide grew from a rate of 37% in 2000 to 40% in 2001, meaning that four out of every 10 programs used worldwide are unlicensed, BSA says in the study." The "Asia-Pacific accounted for the largest share of the losses at \$4.7 billion, representing an unlicensed use rate of 54%. Asia contains countries with very high unlicensed use rates such as Vietnam (94%), China (92%), and Indonesia

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<sup>5</sup> MyWeb describes itself as a leading TV portal in Asia Pacific's emerging Internet markets. According to its website, its business model facilitates Internet usage through television set-top boxes, an affordable alternative to personal computers.

<sup>6</sup> "Internet settlement in China leads to joint IFPI/My Web copyright campaign", IFPI press release, March 23, 2000.

<sup>7</sup> "Schoolboy nabbed for Internet music piracy", Reuters, May 16, 2001.

<sup>8</sup> "Recording Industry Attacks Internet to Stop Chinese Pirates Lawsuit Would Extend Great Internet Firewall of China to US", Electronic Frontier Foundation Media Release, New York, NY, August 19, 2002.

<sup>9</sup> "A Study into the Problem of Software Piracy in Hong Kong and China" by Kenneth Ho, 11 July 2002.

(88%). But New Zealand has one of the lowest rates in the world at 26%, and Australia's rate fell from 33% to 27% during the year.<sup>10</sup>

In 2001, in the case of Microsoft v Shanghai Huahui Computer Company, the Shanghai Huahui Computer Company was convicted of illegally installing Microsoft's Windows and Office software on its computers. Shanghai's No.1 Intermediate Peoples Court ordered the Company to publicly apologise to Microsoft and pay RMB280,000 (approximately \$A70,000) in damages and costs.

The US Government's Special 301 Report identifies countries where piracy is rampant and whose copyright protection and enforcement regimes are inadequate, and singles out barriers that prevent or restrict entry of legitimate U.S. intellectual property exports. Placement on either the "Watch List" or "Priority Watch List" indicates that a country does not provide market access for persons relying on intellectual property and/or an adequate level of protection for, or enforcement of, intellectual property rights. According to the most recent report, large-scale production of pirated entertainment software products occurs in China. The prevalence of piracy in these areas hampers the ability of entertainment software publishers to develop a viable legitimate market in those territories and hinders legitimate market development in neighbouring, and target export nations.<sup>11</sup>

### **(c) DVD, Film, television and video piracy in China**

"Video piracy has exploded into a billion dollar business in Asia ... (it is) controlled by organized gangs and fast-evolving technology that makes copying easier than ever ... in Asia, counterfeit CDs, VCDs and DVDs are openly sold on the street for a fraction of their retail price. A panel of industry experts warned that high profile crackdowns in the region have failed to stop the trade because offenders typically face token penalties."<sup>12</sup>

On April 19, 2000, in cooperation with the Motion Picture Association (MPA), the Chinese authorities seized the largest number of pirated DVDs, VCDs and CDs ever in a single raid in China. The raid conducted on an illegal optical disc distribution center in Guangzhou also resulted in an arrest of four persons, including the figurehead of the syndicate. Of the record number of 200,000 DVDs seized by officials, the MPA estimated that over 150,000 of the DVDs had infringed more than 100 titles owned by MPA member companies. Some of those movies included Stuart Little, Toy Story 2, The Thomas Crown Affair, Anna and the King, Sleepy Hollow, Eyes Wide Shut, and The Mummy. Officials also noted that the majority of the pirated copies were individually packed and ready for delivery to the local optical disc market.<sup>13</sup>

Piracy is not just a problem in China. It is also a problem in Australia involving Chinese nationals.

"Australian Federal Police general manager (southern region) Graham Ashton says organised crime syndicates in Asia have targeted Australia, particularly Victoria, as an important market. Ashton said: "We have found the level of sophistication is such

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<sup>10</sup> "Losses to the worldwide software industry", David Legard, IDG News Service, June 10, 2002.

<sup>11</sup> <http://www.videogame.net/vgn/newsstory.cfm?newsid=1403&system=Multi> and <http://biz.yahoo.com/bw/050429/295572.html?.v=1>.

<sup>12</sup> "Panel Says Video Piracy Thriving in Asia", Associated Press/ Yahoo News, December 3, 2002.

<sup>13</sup> "Record number of DVDs seized in single raid in China" Motion Picture Association of America (MPAA) press release, April 27, 2000.

where they operate almost in a franchise structure. Operators in this country are given fairly strong written instructions on how to conduct their business in Australia. They are required to keep very detailed records to report back to their syndicate bosses overseas as to how they are travelling in terms of sales and marketing." Police, in co-operation with the Australasian Film and Video Security Office, seized 5650 pirated products for sale in 2000. By 2002, raids had netted 87,911 films. "Ashton says most of the gangs are based in Malaysia, but Chinese syndicates are also involved. And with very light penalties in Australia, there is no shortage of locals willing to become distributors. Between January 2002 and April 2003, none of the 26 Australians found guilty of illegal sales went to jail, although two received suspended sentences. The average fine applied was \$4200, remarkably light considering that one Melbourne market operator was recently observed selling \$20,000 of product in just four hours. The fines are levied on a per title basis, so that \$4200 might relate to 20 pirated titles, reducing the fine to just \$210 per offence. "There is no deterrent value in these fines whatsoever," AFVSO's Steve Howes says. "A seller who had recently been fined was seen back at the market selling more films a week later. When asked why, he told police that he was making money to pay his fines."<sup>14</sup>

In late 2002 Chinese authorities seized 5.2 million pirated movie discs from two boats. A police boat was dispatched after a tip that two vessels loaded with pirated pornographic discs were unloading at a port in the city of Huizhou, Guangdong Province. According to the official Xinhua News Agency, police seized 2.2 million pornographic discs in 2,200 boxes. The other vessel was carrying over 3 million porn discs. The smugglers escaped.<sup>15</sup>

In 2003 three US film studios filed suit against three Chinese companies alleging copyright violations through the sale of pirated video discs. Fox Entertainment's Twentieth Century Fox Film Corp sued Shanghai Hezhong Enterprise Development Co for allegedly selling pirated copies of the fourth series of the television series "X Files". It sought 220,000 yuan (26,800 dollars) in compensation. The company also sued Shanghai Yatu Film Culture for allegedly selling pirated copies of the same title and of "Speed 2", and demanded 415,000 yuan (50,600 dollars) in compensation. Shanghai Husheng Audio-Visual Co was sued for allegedly selling fake copies of the fourth series of "X-Files", and the films "Courage Under Fire" and "Moulin Rouge". Fox claimed 615,000 yuan (75,000 dollars) compensation. Walt Disney Co sued Yatu over the alleged pirating of copies of "A Bug's Life" and "Dinosaur". Vivendi Universal's Universal Studios sued Husheng for allegedly selling pirated copies of "The Lost World: Jurassic Park" and "Jurassic Park III". It also sued Hezhong over "The Bone Collector" and "Jurassic Park III".<sup>16</sup>

In 2003 a record 42 million smuggled and pirated DVDs and video and audio CDs were destroyed across China. All of the discs destroyed had been confiscated during crackdowns on smuggling cases, starting in 2001. "It is the biggest of its kind in terms of the quantity destroyed in one place and the overall quantity destroyed across China," Gui Xiaofeng, deputy director of the General Administration of Press and Publication, was reported as saying Wednesday by the China Daily.<sup>17</sup> Some critics viewed this demonstration as being nothing more than a token or a demonstration for international media.

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<sup>14</sup> "Filmmakers reeling as pirates take cut", Australian Financial Review, June 1 2003.

<sup>15</sup> "Movie Discs Seized In China", Associated Press/Yahoo, June 28, 2002.

<sup>16</sup> "Fox Disney Universal sue China firms over pirated films", AFP, July 14, 2003.

<sup>17</sup> "Record haul as China raids pirates: China makes occasional demonstrations of its fight against copyright piracy", CNN, August 13, 2003.

In the first half of 2004, the MPA investigated over 10,660 cases of piracy - up 42 per cent compared with a year earlier - and assisted law enforcement officials in conducting nearly 4,000 raids in the Asia-Pacific region. These activities resulted in the seizure of around 11.8m illegal optical discs and the initiation of over 2,000 criminal legal actions. The top three Asia-Pacific markets for seizures of pirated VCD and DVD product were mainland China, Hong Kong and Malaysia.<sup>18</sup>

#### **(d) Gaming piracy in China**

According to a 2005 report by the Entertainment Software Association, Malaysia and China are among the countries pirating the most software, including video games. The ESA provides a filing each year to the US Trade Representative, which uses it to produce an annual "Special 301" report. This year's Special 301 said Malaysian operations remain the top producers of pirated discs. China was a close second, as its pirated materials there constituted 90 percent of its total software and games market. Many Chinese Internet cafés even offer patrons the use of pirated games and unauthorized servers. That's bad news for Chinese companies attempting to legitimately develop and sell online games, the ESA's report says. "Freeing these markets from the pirates' stranglehold will help empower a local video game economy," said ESA president Doug Lowenstein. Chinese piracy factories also continue to churn out massive numbers of cartridge games. "Despite efforts by the US government over the years, it's déjà vu all over again as these countries ... skirt their global obligations to protect intellectual property," Lowenstein said. "We hope that this year's report will prompt the US to crack down even further."<sup>19</sup>

#### **(e) Counterfeiting in China**

Counterfeiting from China costs Western businesses an estimated \$16 billion in sales each year, according to trade groups. Hong Kong newspapers recently reported that counterfeiters were turning out fake T-shirts for Beijing's 2008 Olympics just a week after the supposedly fake-proof logo was first unveiled.<sup>20</sup>

Much of the available evidence indicates that in recent years the trend of intellectual property rights infringing acts "has shifted from random, low-quality and one-off infringements to more systematic and "professional" production of high-quality counterfeits. These counterfeiters have large scale production and resources, secure and regular customers, efficient production and distribution. They are experienced in avoiding detection and reducing the damage if they are caught, either through very dispersed or secretive production, or through disguising their production under the guise of producing their own brands. The counterfeits, while being of inferior quality and materials, are nevertheless often indistinguishable from the genuine to an untrained eye."<sup>21</sup>

#### **(f) Trade mark infringement in China**

In 2000 a judgement on the Ikea trade mark was handed down by a Chinese court. In *Inter Ikea Systems (China) Limited v China International Network Corporation Limited (CI Net)* the Beijing Second Intermediate Court ordered the defendant, CI Net, to terminate its registration of *ikea.com.cn* because it infringed the Ikea's trademark.

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<sup>18</sup> [http://www.theregister.co.uk/2004/12/07/asia\\_pacific\\_piracy\\_rampant/](http://www.theregister.co.uk/2004/12/07/asia_pacific_piracy_rampant/).

<sup>19</sup> [http://www.gamespot.com/news/2005/02/11/news\\_6118497.html](http://www.gamespot.com/news/2005/02/11/news_6118497.html).

<sup>20</sup> "Record haul as China raids pirates: China makes occasional demonstrations of its fight against copyright piracy", CNN, August 13, 2003.

<sup>21</sup> "Intellectual property enforcement in China – a practical perspective" by Stuart Adams, July 1, 2000.

Since the IKEA case, Beijing courts have protected other trade marks such as Elle, KFC, and Subway.

### **(3) Enforcement of IP rights – a caveat**

While the natural response to the problem of intellectual property rights infringement in China is to call for greater enforcement measures, there are risks associated with this approach. For example, Dr Assafa Endeshaw suggests that the recent lobbying by the United States for greater enforcement measures in China may not have been very effective because of the relative underdevelopment of Chinese economy.<sup>22</sup>

It is clear that China has a developing judicial system, with its own problems, such as a lack of transparency and consistency across its judicial decisions. Many Chinese judges do not have legal qualifications at a tertiary level, and it has been claimed that law enforcement authorities in China have little understanding of intellectual property issues.

The US government has not been alone in attacking China on its IP rights protection record. Japanese government has urged China to crack down on piracy of video games, CDs and movies. The Ministry of Economy, Trade and Industry said in a report that China has failed to live up to its obligations as a member of the World Trade Organization, although it was admitted to the body in December 2001. The "2003 Report on the WTO Consistency of Trade Policies by Major Trade Partners" features a number of criticisms of China over what Japan describes as inappropriate trade practices under WTO rules. It calls on China to carry out fundamental improvements in the field of enforcement of laws and regulations to clamp down on piracy of products that involve intellectual property rights.<sup>23</sup>

In the meantime, the US government has accused the Chinese government of lacking the political will to push through greater IP rights protection.

In reality the lack of political will may not be the problem, in which case there is little reason for the Australian government to join the chorus demanding greater IP rights protection. It has been argued that such an approach will do no more than "annoy" the Chinese government. Perhaps a more conciliatory approach by the Australian government would be more effective, rather than attempts to publicly cajole the Chinese government.

Despite these problems, there are steps the Australian government can take.

The Australian government must consider whether current Chinese legislation adequately protected the rights of intellectual property rights holders, and if not, it should take steps to ensure that Chinese legislation adequately protects these rights holders. The first step is to analyse existing laws, and identify weaknesses in these laws. It is also important to identify weaknesses in the enforcement regimes in China.

In recent years there has been substantial legislative activity in China. For example, we have seen a new trade mark law come into effect on December 1, 2001. The changes included improved protection for well known but unregistered trade marks. Prior to this legislative change, unregistered rights of well known trade marks were

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<sup>22</sup> "Intellectual Property in China: The Roots of the Problem of Enforcement", Assafa Endeshaw, Acumen Publishing Company, Singapore, 1996.

<sup>23</sup> "China urged to deal with piracy: Beijing not meeting WTO rules on CDs, videos, movies", The Japan Times, March 29, 2003.

only protected under the pre-existing Anti-Unfair Competition Law. The Chinese government is to be congratulated for these types of legislative changes.

These changes also demonstrate that the Chinese government is not reluctant to undertake legislative change, if the merits of such change can be demonstrated. It is up to the Australian government to convince the Chinese government of the merits of increased intellectual property rights protection and the harmonisation of Australian and Chinese intellectual property laws.

Other questions need to be asked by the Australian government of the Chinese government. How are IP enforcement systems organised in China? Is the structure of these systems efficient? Can it be improved? Can communication levels and information dissemination be improved? Can skills levels be improved? What can be done to improve the training of local police and customs officials? Can private bodies and IP rights holders become more proactive? How would this be achieved? Does the legislative framework exist for IFPI (to use an example) to be more effective in China? Can a criminal and civil based IP rights protections system work side by side in China?

#### **(4) Education**

According to a study from earlier this decade “China, as a nation, is addicted to counterfeit products. The production of these goods, in everything ranging from chocolates, beanie babies and watches, to heavy industry items such as automobiles and aircraft parts, is a vital part of the nation’s economy. To attempt to enforce trademarks, copyrights and patents could have a disastrous effect on the nation’s economy and growth. Yet a Catch-22 exists because no country has ever developed a healthy economy without somehow enforcing intellectual property rights.”<sup>24</sup>

Since then, there appears to have been little change in public attitudes towards counterfeiting in China. As a result the Australian and Chinese governments should invest in educational programs for China which make the public aware of the costs associated with counterfeiting.

These educational programs could take a number of forms including the following:

- Community wide educational activities in the form of TV, radio and newspaper advertising extolling the virtue of non counterfeited products,
- University courses targeting tertiary students and other future decision makers in China, which focus on the costs and impacts of counterfeiting, and
- Strategic courses targeted at customs and law enforcement officers, which focus on enforcement activities including the means of identifying counterfeited products. Similar courses have been conducted in Australia. I can provide details of these courses including content, structure and format, should these details be required.

The court system in China and its treatment of intellectual property related issues is improving. For example, recently specialist IP courts have been instituted in China. The Australian Government must continue to encourage this type of development by providing expertise including legal and judicial training where it is needed.

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<sup>24</sup> “Can China Enforce International IP Laws?”, by Toby True - Cleveland Bureau, Internet Law Journal, March 8, 2001.

## **(5) Censorship and internet access**

Historically, it has been claimed that China has not valued free speech to the same extent as some Western countries. This may or may not be true – I do not purport to compare or contrast vastly different cultures. Some critics have even suggested that China attempts to control their cultural environment through the implementation of strict policies of censorship.

In recent times, internet users in China have suffering sharp slowdowns in access because of the Government's increased efforts to police online content. According to one report, "China appears to be trying to reap the internet's benefits while also controlling what its people read and hear. Authorities have invested both in spreading internet access and in installing technology to scan websites and email for content deemed subversive or obscene. Beijing has essentially built an online barrier around China, requiring traffic in and out to pass through just eight gateways — a step that heightens official control. Banned topics include human rights and the outlawed Falun Gong spiritual group. Problems emerged in October after the installation of "packet-sniffer" software that briefly holds chunks of data for screening."<sup>25</sup>

In June 2003 the Chinese government announced that it had issued licenses to 10 local firms to open Internet cafe chains. According to analysts, this move was designed to "to squeeze out smaller players and tighten control of sensitive political information."<sup>26</sup>

Censorship stifles creativity and the development of films, music and other goods and services with an intellectual property component. The Chinese government should be encouraged where possible to reduce censorship and encourage freedom of personal expression, including the production of new films, music and other creative products by Chinese nationals. Such an environment of freedom would also encourage the importation of creative goods from Australia, thereby creating economic and cultural benefits for the Australian economy.

## **(6) Conclusion**

The Federal Government is to be commended for attempting to create a free trade agreement between Australia and China. Such an agreement will create opportunities for Australian creative and technological based industries. However in order for these opportunities to be maximised the Australian Government much ensure that intellectual property rights legislation adequately protects Australian rights holders in China. This may involve a program of amended legislation, increased enforcement activity and increased educational activities. However, such a process must be accomplished with great delicacy, so as not to offend the Chinese Government or impinge on their autonomy. Such a process must also consider the rights of Australian consumers. While it is desirable for the Australian economy to be further opened to Chinese imports, such a process must not prejudice Australian consumers by opening up the Australian market to dangerous counterfeits.

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<sup>25</sup> "China censorship slows net", Correspondents in Beijing, The Australian, March 7, 2003.

<sup>26</sup> "China Seen Tightening Control Over Internet Cafes", by Juliana Liu, Reuters, June 10, 2003.