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ENSURING PROTECTION OF AMERICAN INTELLECTUAL PROPERTY RIGHTS FOR AMERICAN INDUSTRIES IN CHINA

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

NOVEMBER 21, 2005

FIELD HEARING IN BEVERLY HILLS, CALIFORNIA

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ENSURING PROTECTION OF AMERICAN INTELLECTUAL PROPERTY RIGHTS FOR AMERICAN INDUSTRIES IN CHINA

MONDAY, NOVEMBER 21, 2005

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:04 a.m., at the John H. Mitchell Theater, The Museum of Television and Radio, 465 North Beverly Drive, Beverly Hills, California, Hon. Tom Coburn, Chairman of the Subcommittee, presiding.

Present: Senator Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. The Subcommittee on Federal Financial Management, Government Information, and International Security will come to order.

Thank you, each and every one of you, for being here.

Today's Subcommittee field hearing will focus on the massive piracy of American intellectual property that persists in China.

This is an official act of the Subcommittee on Homeland Security, and as such, your testimony, both will be made a part of the record, as well as it being recorded.

The important thing is the information—what you have to say is gathered and made available to Congress. And so the purpose of having this hearing at this time is because how large this issue is in terms of how it confronts us both in terms of intellectual property, but also in terms of security, also in terms of the future of our country, also in terms of job loss versus job creation that has come about because of it.

This is a field hearing as a follow-up to a previous hearing held by this Subcommittee this past June where the Subcommittee took a snapshot of the direction of the World Trade Organization (WTO) where we asked the question about how U.S. economic interests were being served and sovereignty protected.

One of the key findings at our hearing was the severity of the intellectual property vandalism occurring in China against American entrepreneurs, innovators, artists, and consumers.

That is why we wanted to take the next logical step and zoom in on the issues specifically, and what better location than here in

the great State of California where major industries affected by intellectual piracy are located.

Today we will hear firsthand accounts of companies and representatives of various sectors who are experiencing intellectual property theft in China.

One of the reasons why I like to hold hearings outside of Washington is that sometimes the hearings are filled with a lot of dry government language. When something is as close to the pocketbooks of every American as today's topic is, it is important that we do not obfuscate that with inside-the-beltway jargon, and real language is used.

Robbery from employers and industries, as represented here today, should resonate in the ears of American people because ultimately it is their money. Money spent on high prices for goods and services, jobs lost to foreign competitors, and lower profit margins for employers and everyday investors in these companies whose nest eggs do not grow as they should.

The point cannot be emphasized enough that American jobs are at risk once China steals our American intellectual properties by copied American goods. The U.S. Congress estimates that counterfeit trade in China is worth from $19 billion to $80 billion a year in terms of loss for us.

When you apply the general rule of thumb that $1 billion in economic activity equals 12,000 to 14,000 jobs, that means we are talking anywhere from 240,000 to a million jobs a year that are being impacted, opportunities for Americans to earn, opportunities for the income and taxes off of that earnings, opportunities to create a future.

The dictionary defines intellectual property as product of the intellect that has commercial value, including copyrighted product and property such as literary or artistic works, ideation of property such as patents, applications, origins, business methods, and industrial processes.

Taking the intellectual property of every American citizen is the cornerstone of America's innovation and the success of our Nation's economy.

American citizens must know that when they invest and dedicate their energy, resources, and creativity providing the product that has the potential to better and benefit our quality of life, their intellectual property rights (IPR) will be protected by our Nation's laws.

And as our Nation engages with other nations in trade relations, it is the job of those of us in Washington to assure that our international commercial partners abide by and protect America's wallet on intellectual and property rights.

The founding fathers rightly identified property rights as one of the fundamental rights upon which economic and cultural life of a Nation must be based.

As Madison stated, the rights of persons and the rights of properties are the objects for the protection of which the government was instituted.

For some time now the U.S. Government and its citizens have engaged with the struggle to stop China from stealing the intellectual property of American citizens.

As the U.S. Chamber of Commerce stated in Congressional testimony before the House Judiciary Committee in May of this year, intellectual property rights violations in China now severely affect virtually all industries, from consumer and industrial goods, including medicines, autos, auto parts, food, beverages, cosmetics, to copyright works.

As a result, on April 29, 2005, U.S. Trade Representative Nance, said that he had placed China on a special 301 Priority Watch List because of its failure to significantly improve intellectual property rights protection.

And last month the Administration took an even stronger step forward when U.S. Government filed, through the WTO, an official request, Article 63, to have China explain in writing what changes it is making in its legal system to fix the problem of intellectual property rights theft, and also to inform the United States of how many cases of IPR theft have been filed by U.S. companies in China.

China has until January of this next year to provide this information which could be helpful to the United States in building a case against China and the WTO.

I have some doubts whether the WTO is strong enough to carry out the enforcement mechanism necessary to protect American rights.

Various American companies have recorded over and over the struggles they are facing to have the Chinese government to take proper legal action to protect their intellectual property rights.

A great example is the manufacturing company Zippo that produces lighters. I do not know if you've heard of this, but it was reported by Assistant Secretary of Commerce William Lash in his press conference on April 14.

It was discovered during the raid in China that 40,000 Zippo lighters had been counterfeited; however, because they valued these lighters at 0.5, 1.2 remedy or 1, 6 to 15 cents a piece, the case fell under the criminal threshold.

Here's a company that has guaranteed for life its product that is made here in the United States. It is a high-quality product. They will repair it for the life of the product, and all of a sudden they find themselves flooded with products that do not work, that do not meet the standards, that have that name embossed on the bottom, with the trademark, an absolute complete copy, but yet the fine and the value of it fell below the threshold, so there is no consequences to copying.

So, therefore, the Administration is to be commended for taking a step forward at WTO on such actions, but we have to do more.

This problem is not going to go away. The U.S. trade deficit with China has grown significantly in recent years due largely to a surge of U.S. imports to Chinese goods relative to U.S. exports of China. That deficit rose from $30 billion in 1994 to $162 billion in 2004 and estimated to exceed $200 billion this year.

As my good friend Ambassador Rob Portman, U.S. trade representative, stated in his confirmation testimony, part of that deficit is because the Chinese do not play by the rules.

China is now the sixth largest market for U.S. exports and America's third largest retail trading partner overall. The U.S.

trade deficit with China is now larger than that of any other trading partner.

U.S.T.R. testified before Congress this past May that U.S. companies report billions of dollars in lost revenue, irreparable harm to the brands of future sales, all of which will ultimately affect U.S. workers to design and produce legitimate products forced to compete against the Chinese fakes.

In 2002 the value of Chinese counterfeits seized before entering the U.S. markets rose from $194 million to $234 million.

And U.S. Customs and border protection estimates that counterfeit merchandise worldwide is responsible for the loss of at least 750,000 American jobs.

The bottom line is American leaders in Washington need to get serious about how to handle this problem and take the necessary steps to put an end to it. America's jobs are at stake, and America's economy is at stake and is very vulnerable. So what do we do?

We talked about the WTO in terms of China joining it and their obligations associated with it. They agreed to fully comply with the related aspects of intellectual property rights, agreement obligations known as the TRIPS obligations, but China has not kept its word in doing that.

The Administration has filed a request to require information back from China on what it is doing to fix the problem. It will be incumbent upon the Administration to make sure China meets that deadline in 90 days and provide the required information in January when it is due.

There is a great question to ask. It is what do we do if China does not meet the deadline? What should be the Administration's position?

The Administration is going to have to make a decision based on the information it receives about whether or not to let the clock run. And the time has come for the United States to file against the Chinese government with the WTO.

When we debated the decision to grant China permanent most-favored Nation status, a prestigious designation, it means we trust you as a good faith trading partner. Some argued it was asking for trouble to get into a financial bed with a communist government that does not recognize individual rights. Individual rights are what property rights are based on.

They also, of course, are what human rights are based on. And we all know China's deplorable record on that front.

To my mind, it should come as no surprise that the communist Chinese regime has violated Americans' rights given that it does not even recognize its own citizens' rights.

[The prepared statement of Senator Coburn follows:]

Opening Statement, Chairman Tom Coburn, M.D.

**Subcommittee on Federal Financial Management,
Government Information, and International Security**

Ensuring Protection of American Intellectual Property Rights for American Industries in China

**Beverly Hills, California
Monday, November 21, 2005**

The Subcommittee on Federal Financial Management, Government Information, and International Security will come to order. Thank you all for being here. Today's Subcommittee field hearing will focus on the massive piracy and counterfeiting of American intellectual property that persists in China.

This field hearing is a follow-up to a previous hearing held by this Subcommittee this past June, where the Subcommittee took a snapshot of the direction of the World Trade Organization (WTO), where we asked the question about how U.S. economic interests are being served and sovereignty protected. One of the key findings at our hearing was the severity of the intellectual property vandalism occurring in China against American entrepreneurs, innovators, artists and consumers.

That's why we wanted to take the next logical step and zoom in on that issue specifically, and what better location than here in the great State of California, where major industries affected by intellectual piracy are located.

Opening Statement, Chairman Tom Coburn, M.D.

Today we will hear firsthand accounts of companies and representatives of various sectors who are experiencing intellectual property theft in China. One of the reasons why I like to hold hearings outside of Washington is that sometimes hearings are filled with a lot of dry, government speak. When something is as close to the pocketbooks of Americans as today's topic is, it's important that we don't obfuscate with inside-the-beltway jargon and mindset. Robbery from huge employers and industries as represented here today should resonate in the ears of the American people – it's their money. Money spent on higher prices for goods and services, jobs lost to foreign competitors and lower profit margins for employers, and everyday investors in these companies whose nest-eggs don't grow as they should. One of the primary points I believe needs to be emphasized in this hearing and in all discussion on this topic is how it is the middle-class American who suffers from these acts of corruption in China. American jobs are at risk when China violates our American intellectual property laws by copying or counterfeiting our American products and then undercutting American in the market by decreasing the market-value costs.

Why Is Protection of Intellectual Rights is so Crucial?

The dictionary defines intellectual property as: *A product of the intellect that has commercial value, including copyrighted property such as*

literary or artistic works, and ideational property, such as patents, appellations of origin, business methods, and industrial processes. [http://dictionary.reference.com]

Protecting the intellectual property of every American citizen is the cornerstone of America's innovation and the success of our nation's economy. American citizens must know that when they invest and dedicate their energy, resources, creativity to providing a product that has the potential to better and benefit our quality of life, their intellectual property rights will be protected by our nation's laws.

And as our nation engages with other nations in trade relations, it is the job of those of us in Washington to ensure that our international commercial partners abide by and protect America's laws on intellectual property rights.

The Founding Fathers rightly identified property rights as one of the fundamental rights upon which all economic and cultural life of a nation must be based. As James Madison stated: "The rights of persons, and the rights of property, are the objects, for the protection of which Government was instituted."

U.S. Government Efforts to Stop China IPR Theft

For some time now, the United States Government and its citizens have been engaged in a struggle to stop China from stealing the intellectual property of American citizens.

As the U.S. Chamber of Commerce stated in Congressional testimony before the House Judiciary Committee in May of this year, "intellectual property rights (IPR) violations in China now severely affect virtually all industries, from consumer and industrial goods – including medicines, autos and auto parts, food and beverages, and cosmetics – to copyright works."

As a result, on April 29, 2005, the USTR announced that it had placed China on the Special 301 Priority Watch List because of its failure to significantly improve IPR protection.

And last month, the Administration took an even stronger step forward when the U.S. Government filed through the WTO, an official request (Article 63) to have China explain in writing what changes it is making in its legal system to fix the problem of IPR theft, and to also inform the U.S. how many cases of IPR theft have been filed by U.S. companies in China. China has until January (90 days) to provide this information,

which could be helpful to the U.S. in building a case against China in the WTO.

Various American companies have reported over and over the struggles they are facing to have the Chinese government to take the proper legal action to protect their intellectual property rights.

Take for instance the example of the manufacturing company Zippo that produces lighters. As was reported by Assistant Secretary of Commerce William Lash during his press conference on April 14, 2005, it was discovered during a raid in China that 40,000 Zippo lighters had been counterfeited. However, because they valued these lighters at 0.5 to 1.2 RMB (6 to 15 cents), the case "fell under the criminal threshold," for legal action. [usinfo.state.gov]

So, therefore, the Administration is to be commended for taking this step forward at the WTO as such actions communicate to China and the rest of the world that the United States will protect its innovator companies, workers and investors.

After all, this problem is not going away.

The U.S. trade deficit with China has grown significantly in recent years, due largely to a surge in U.S. imports of Chinese goods relative to U.S. exports to China. That deficit rose from $30 billion in 1994 to $162 billion in 2004. [**Source:** U.S. Department of Commerce.]

As my good friend, Ambassador Rob Portman, U.S. Trade Representative, stated in his confirmation hearing testimony, "part of that deficit is because the Chinese do not always play by the rules".

China is now the sixth largest market for U.S. exports and America's third largest trading partner overall.

The U.S. trade deficit with China is now larger than that of any other U.S. trading partner. If current trends continue, the total U.S. trade deficit with China in 2005 could hit $213 billion. [**Source:** U.S. Department of Commerce 2005 projection based on January-August 2005 data.]

USTR testified before Congress this past May that "[U.S.] companies report billions of dollars in lost revenue, irreparable harm to their brands and future sales, all of which ultimately affects U.S. workers who design and produce legitimate products forced to compete against Chinese fakes."

According to USTR, in 2004, the value of Chinese counterfeits seized before entering U.S. markets rose from $94 million to $134 million. And, U.S. Customs and Border Protection estimates that counterfeit merchandise worldwide is responsible for the loss of more than 750,000 American jobs.

The bottom line is – America's leaders in Washington need to get serious about how to handle this problem and take the necessary steps to put an end to it. American's jobs are at stake and America's economy is vulnerable.

So how do we do that?

World Trade Organization (WTO)

Well, as I previously mentioned, one way to address this problem is through the World Trade Organization. The WTO was established to be an international trade organization that would help facilitate coordination and order among international trading partners.

When China joined the WTO a few years ago, they agreed to fully comply with trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement obligations. But China has not kept its promise to Americans.

As I mentioned, the Administration has filed a request to require information back from China on what it is doing to fix the problem. Of course, it will be incumbent on the Administration to make sure that China meets the deadline of 90 days and provide the required information in January when it is due. At that point, the Administration will also have to make the decision based on the information it receives about whether or not the clock has run and the time has come for the United States to file against the Chinese government at the WTO.

There is been much discussion on if and when the U.S. Trade Representative should proceed in moving forward with this action, but to date, the USTR has held back.

History of Trade with China

Let's not forget that when we debated the decision to grant China Permanent Most-Favored Nation status – a prestigious designation that means that we trust you as a good-faith trade partner – some argued that it was asking for trouble to get into financial bed with a communist government that does not recognize individual rights. Individual rights are what property rights are based on. They also, of course, are what human rights are based on and we all know China's deplorable record on that front.

To my mind, it should come as no surprise the communist Chinese regime has violated Americans' rights – given that it does not even recognize its own citizens' rights.

U.S. Needs to Ensure Other Countries Don't Follow Suit

I'm also concerned that the problem we face in China could set a dangerous precedent for our other trading partners. There are other not-so-reliable actors out there watching closely to see how we respond to China. We need to ensure the U.S. is not sending the wrong message to other potential or existing international violators of American intellectual property rights by appearing to be lackadaisical in our response to China. The question of how the U.S. Government needs to respond to China is a major point of discussion today.

Witness Testimony

I want to thank our distinguished guests and witnesses for being here before this congressional hearing. I look forward to hearing their thoughts on this very important issue. All witnesses written full statements will be inserted into the record.

Our first witness is the Honorable Dan Glickman, who serves as Chairman and CEO of the Motion Picture Association. As Chairman

and Chief Executive Officer of MPAA, Mr. Glickman represents the interests of the US filmed entertainment industry before the US government, as well as being the US movie industry's emissary to foreign capitals and foreign movie makers. MPAA's members -- Metro-Goldwyn-Mayer Studios; NBC Universal Studios, Paramount Pictures; Sony Pictures Entertainment; The Walt Disney Company, Twentieth Century Fox Film Corporation; and Warner Brother Entertainment – employ hundreds of thousands of US workers, entertain millions across the globe, and, unique among US industries, generate a positive balance of trade in virtually every country in the world. Dan Glickman came to the Motion Picture Association of America (MPAA) following a long career of public service. Before taking on leadership of MPAA, Glickman led the Institute of Politics at Hard University's JFK School of Government. He served with distinction in President Clinton's Cabinet, as Secretary of the Department of Agriculture. And prior this he served eighteen years in the U.S. House of Representatives.

Next we will hear from Nashville songwriter Gary Burr who represents the Recording Industry Association of America.

No stranger to the Nashville scene, Burr has penned numerous hit songs for an impressive roster of country artists, including Wynonna, Collin Raye, Doug Stone, Patty Loveless, and The Oak Ridge Boys.

Burr has been awarded 'Songwriter of the Year' on three separate occasions by three different organizations: Billboard, Nashville Songwriter's Association International, and ASCAP(AS-CAP). He has also received over twenty of ASCAP's recognition awards for radio play activity, and CDs featuring his songs have sold more than 50 million units world-wide.

Next we will hear from Mr. Jack Sabo who serves as Vice President of Market Data at the New York Board of Trade.

As Vice President – Market Data Services, Jack is responsible for Market Data revenue at the New York Board of Trade (NYBOT). The function entails technology, finance, education, anti-piracy, and marketing. NYBOT is New York's original futures exchange, where the world trades futures in Coffee, Sugar, Cocoa, Orange Juice, Cotton, and certain financial products.

He currently serves on the Board of the Software and Information Industry Association ("SIIA"), is on the Executive Committee of SIIA's Financial Information Services Division ("FISD"), where he is Co-Chairman of the Governance Advisory Committee, and Chairman of the Redistribution Advisory Committee.

Next we will hear from Mr. Loren Hillberg, who serves as General Counsel for the software company, Macrovision. Mr. Hillberg handles all corporate legal matters for Macrovision. Prior to joining this company, Mr. Hillberg served as vice president and general counsel of Macromedia. And prior to that Mr. Hillberg served as vice president and general counsel for Micro Focus Group, a UK based provider of enterprise software tools.

Next we will hear from Mr. Timothy Minor who serves as Vice President of Government Relations for Cummins-Allison Corporation. Mr. Minor was gracious enough to fill-in for the CEO of Cummins-Allison, Mr. William Jones, who at the last minute had to cancel his plans to be here today.

Cummins-Allison Corporation is an office equipment and security products manufacturer founded in Chicago in 1887. The founding families were prominent families from Iowa and Indiana respectively at the turn of the Century. Mr. B. F. Cummins, the first President of Cummins-Allison grew up in the State of Iowa. B. F. Cummins eldest brother Albert Baird Cummins served as the Governor of Iowa from 1902 to 1908 and was then elected to the United States Senate and served as a Senator from 1908 to 1926. Senator Cummins served as President Pro Tempore of the Senate during the 66th through the 69th Congress. Albert B. Cummins was a member of the progressive wing of

the Republican Party and thus was closely aligned with Theodore Roosevelt regarding legislative reform of the railroads and other powerful trusts and business interests.

Our next witness is author Ted Fishman. Ted C. Fishman's bestselling book *China, Inc.*, and *How the Rise of the Next Superpower Challenges America and the World*, has helped describe for the world the effects of China's momentous change on the lives and businesses of people everywhere. In addition to its success in America, the book, translated and published in 21 languages, is an international bestseller. In 2006, it will appear in Chinese editions in both The People's Republic and Taiwan. Fishman's has testified before Congressional committees and commissions and consults on China with a wide range of government officials, including some of the nation's most influential office holders. His essays and reports appear in many of the world's most prominent journals, including The New York Times Magazine, Harper's, Esquire, USA Today, GQ, The Times of London, Money, Worth, INC, Business 2.0, German GEO and Chicago Magazine. His commentaries have been featured on Public Radio International's This American Life and American Public Media's Marketplace.

Our final witness is the Honorable Patrick Mulloy Commissioner Patrick A. Mulloy was reappointed to the U.S.-China Economic and Security

Review Commission on March 25, 2003, by Senate Democratic Leader Tom Daschle to a two-year term expiring on December 31, 2006. Commissioner Mulloy previously served as a member from April 2001 to January 7, 2003.

The United States-China Economic and Security Review Commission (USCC) is a bipartisan Commission established by Congress in 2000 to investigate, analyze and provide recommendations to Congress on the economic and national security implications of the U.S.–China relationship. It recently released just two weeks ago 2005 Annual Report to Congress

Prior to assuming his current responsibilities, Commissioner Mulloy was nominated by President Clinton and confirmed by the U.S. Senate as Assistant Secretary for Market Access and Compliance in the Department of Commerce's International Trade Administration, where he served from 1998 to 2001. In that position, Commissioner Mulloy directed a trade policy unit of over two hundred international trade specialists, which focused worldwide on removing foreign barriers to U.S. exports and on ensuring that foreign countries comply with trade agreements negotiated with the United States. This latter activity involved discussions both in the World Trade Organization (WTO) and with individual governments. He traveled extensively, meeting with

foreign leaders to advance market-opening programs in the European Union, Eastern Europe, China, India, Taiwan, Indonesia, Canada, and Central and South America. He was also appointed by President Clinton to serve as a member of the Commission on Security and Cooperation in Europe.

I want to thank everyone for a very productive dialogue. I want to especially thank the Museum of Television and Radio for their graciousness in holding this event.

Senator COBURN. I want to thank our distinguished guests and witnesses for being here. I know many of you took time out of a busy schedule to do this. This is an important topic that the Congress has to face. We serve a function to be both a sounding board, but also an accountability board, to the Administration in carrying out the laws and treaties of this country and making sure we are protecting the future of this country.

I would like to introduce our witnesses and ask them to testify. Each of your full written testimony will be made a part of the record. And if you could summarize that in 5 to 7 minutes, and then we will spend some time with questions.

I would love to have some bantering going back and forth between the panelists as well as some questions so that we could actually develop this up into what needs to be done, how it needs to be done, when it needs to be done, and what the consequences are.

Our first witness is the Hon. Dan Glickman, who serves as chairman/CEO of the Motion Picture Association.

As chairman and chief executive officer of the Motion Picture Association of America, Mr. Glickman represents the interests of the U.S. film and entertainment industry before the U.S. Government, as well as being the U.S. movie industry's emissary to foreign capitals and foreign moviemakers.

MPAA's members are Metro-Goldwyn-Mayer Studios, NBC/Universal, Paramount, Sony, Walt Disney, Twentieth Century Fox, and Warner Entertainment.

MPAA members all employ hundreds of thousands of U.S. workers, entertain millions across the globe, and unique among U.S. industries, generate a positive trade balance in virtually every country in the world.

Dan Glickman came to the Motion Picture Association of America following a long career of public service. Before taking on leadership of MPAA, Congressman Glickman led the Institute of Politics at Harvard University's J.F.K. School of Government.

He served with distinguished distinction in President Clinton's Cabinet as Secretary of the Department of Agriculture. And prior to this, he served 18 years in the U.S. House of Representatives.

Mr. Glickman, we welcome you, and the floor is yours.

TESTIMONY OF THE HON. DAN GLICKMAN,[1] CHAIRMAN AND CEO, MOTION PICTURE ASSOCIATION OF AMERICA (MPAA)

Mr. GLICKMAN. Thank you, Senator, very much.

This is a very important hearing, I believe, to call attention to the Chinese authorities that you consider the theft of U.S. intellectual property to be a high priority.

The President is just coming back from China where I believe he raised the issue. Governor Schwarzenegger is just coming back where he's raised the issue. I think this hearing is extremely important.

Unless the Chinese government exercises the political will to address the rampant theft of U.S. intellectual property rights (IPR), all the tools that we have—effective enforcement, private sector initiatives, adequate laws—do not mean very much. This hearing

[1] The prepared statement of Mr. Glickman appears in the Appendix on page 53.

keeps IPR high on the U.S./China agenda, demonstrating in an important forum to the Chinese government the priority that you place on this.

First of all, in some sense the movie industry is the poster boy for this problem. You see that almost everybody who goes to China holds up that DVD they have bought on the streets.

The problem is shared by all the industries represented here and many others, in many respects, we are kind of the physical manifestation of this problem.

The source of the problem is twofold: First, China imposes strict limits on the number of foreign films that can be exhibited in its theaters on a revenue-sharing basis and applies burdensome regulations and confiscatory taxes on foreign home video and television content. This creates a market vacuum that pirates are only too happy to fill.

Second, China has not asserted the political will necessary to reduce the level of piracy.

Yes, it has conducted some raids and even put a few pirates in jail, but it has not materially reduced the level of piracy and the ready availability of pirated products in the shops and in the streets.

Regrettably, to coin a phrase, if you did not see a counterfeit DVD, you were not in China. Unfortunately, I fear our collective perception of China has become so ingrained with the notion that China is overflowing with pirate DVDs, we frequently fail to appreciate the magnitude of the problem.

The problem is ubiquitous—on virtually every street corner, packed to the shelves in audiovisual shops in every neighborhood. We estimate the piracy rate exceeds 90 percent, that is, over 90 percent of the DVDs sold in China are fake. More than nine of every ten DVDs in the Chinese market is a fake, stolen product.

Too many see this as an American problem. Well, we do bear the disproportionate share of the burden, because of the scale and size of the American movie industry. But, movie piracy in China affects filmmakers all over the world, and it is beginning to affect Chinese filmmakers as well.

It is clearly more than an American problem, and what we have to do is to convince the Chinese filmmakers, as well, that they have a stake in this issue.

As we dig deeper into this problem, particularly the global spread of China-sourced pirated material, we are coming to a disturbing conclusion: There is a growing link between piracy of motion pictures and organized crime.

Our Asia-Pacific Regional Office just completed a new study on these connections.

With your permission, Mr. Chairman, I have included a copy of that study in my statement. I think it will be helpful for you as you build the record, but let me cite a couple of findings.

Criminal theft of IPR dwarfs criminal revenues from narcotics trade: U.S. Government and international law enforcement records peg the illegal narcotics trade at $322 billion last year; criminal revenues from all IPR theft were significantly higher, $512 billion.

Part of the allure for organized crime to move into DVD piracy is the incredible profit margins, much higher than they are for

drugs. The markup of pirated DVDs made in Asia and sold in Europe, for example, averages an astounding 1150 percent, three times the markup of heroin that is sourced in Asia and sold on the same street corners. And the criminal risk, as you pointed out, is far lower.

The report cites two recent cases linked back to China with tentacles around the world, including into the United States.

In September of this year, a Federal grand jury in New York indicted 39 individuals tied to a syndicate based in New York, but funneled much of its $1 million per year in earnings back to China.

And an American was arrested in this case for leading this particular syndicate. When he was arrested, the Chinese authorities seized more than 210,000 DVDs in his possession.

I think it goes without saying that many of these revenues finance other illegal activities in which these criminal organizations are involved. This is not just an American problem. It is not just a motion picture problem. It is now underwriting activities that threaten all walks of life.

Our industry employs about 1 million American men and women directly and indirectly at all job levels. There seems to be a view, a myth, that buying a stolen DVD only means that a movie star earns a few dollars less on that movie.

Let me be clear. The notion is just a myth. Every dollar the pirate earns is one less dollar going to an American worker, a worker employed in an industry that is one of the few in this country bringing much more money back to the United States in export earnings than it sends overseas.

Chinese piracy of U.S. pictures also hits some of us personally. I was in China last May. I strolled the neighborhood across from my hotel and looked in one of the audiovisual stores. I admit I was not surprised to see all the DVDs that were there. Most of them were pirated. But one caught my eye. It was called "The Hitchhiker's Guide to the Galaxy."

At the time the movie was not available on DVD in the United States, so I knew it was a fake, taking the money out of a U.S. filmmaker's pocket. And that filmmaker is my son. He is a producer, and that was his most recent film.

I relayed the story to him, and he replied: "And what, Dad, Mr. Chairman of the MPAA, are you going to do about this as well?"

MPAA invests millions of dollars each year in fighting piracy. As I previously indicated, piracy in China is indeed a China problem, but it is also a problem with a global reach. A pirated disk made in China can, in a day or two, be on the streets in Los Angeles.

Someone can illegally camcord a movie in Moscow, send the file by way of the Internet to someone in Guangzhou, who then dubs and subtitles the Russian dialogue and then presses thousands of DVDs.

We fully appreciate the global reach of this problem, and we have aggressively pursued a strategy to stop the illegal camcording of movies, which is still the largest source of pirated product.

We are very appreciative of the action Congress took to make illegal camcording a federal crime, and that the President signed the bill earlier this year.

We seek to track the production of optical disks to make sure the plants are not making illegal discs. We are on the ground in China. Our representatives survey the market for information about the incidence of piracy, and in some cases this helps the Chinese authorities formulate raids on these sellers and distributors.

We are also participating in training sessions for Chinese authorities and jurists on IPR laws and enforcement, something that we hope can produce some benefit as well.

My statement talks to some of the other things that we have done with respect to a memorandum of understanding recently, but I wanted to give you some results of that.

On October 25, we met with Chinese officials to review the results of a memorandum of understanding with the MPAA and various Chinese departments regarding market piracy.

For our part we surveyed a small selection of shops in four cities: Beijing, Shanghai, Guangzhou, and Shenzhen. The surveys were by no means intended to provide a comprehensive assessment of any piracy, but what they showed is the following:

In Shanghai our survey showed that of the films covered under the agreement, under the MOU, no pirate versions were available at all, at the time the shops were surveyed. A positive trend. I do not know how long it will last, but at least at the time we surveyed, it was positive.

In Guangzhou the availability of pirated versions of the identified titles was down quite sharply from September, when almost all titles were available.

In Shenzhen, availability of pirated titles fell 50 percent from September.

And in Beijing, in August, with the exception of one shop that carried only 50 percent of the protected titles, pirated versions of the films still ran from 70 to 90 percent.

So this MOU is an attempt to try to get the Chinese to involve themselves on some enforcement. There have been a limited number of successes, but, by and large, we are very disappointed with the results.

Senator COBURN. Can you summarize for us?

Mr. GLICKMAN. OK. In any event, let me just mention a final thing in terms of how you can help.

Having surveyed the scope of the problem, I would say the following:

First, help make sure our government has the resources it needs. Not only do we need tough laws in the United States, such as the recent package from the Attorney General, we need people to enforce the laws, inspect imports, train foreign officials in IPR, and enforce international trade agreements.

Some of this is going to take money, realizing the problems with the Federal budget deficit, but we've got to have enforcement authorities overseas.

Second of all, why do we run a piracy problem at all? One of the reasons is because of these burdensome restrictions we have on doing business in China.

We have a positive balance of payment surplus with every single country in the world that we sell movies to except one, and that one is China.

The good news is that our movies made in China in 2004 doubled the amount they made in 2003. The sobering news is that the amount was only $10 million. One American movie on an opening weekend makes more, as we saw from this last weekend, where we had successful operations.

In recent years, in fact, two Chinese movies, "Kung Fu Hustle" and "House of Flying Daggers," made more in the United States than all the U.S. movies made in China for the years they were released, and, ironically, both were distributed in the United States by our member companies here at MPAA.

So these market barriers are critically important, and they're one of the reasons why we have so much piracy in China.

At the same time, you can buy any movie in China that you want, including movies that were not allowed into the Chinese legally.

So I would just finally say that what we need in this country is to continue our efforts to try to get the Chinese to enforce; the political will to move ahead if, in fact, they do not comply with the agreements; and to keep the pressure on.

When the Chinese want to stop piracy, they can be enormously effective. They do not need 20 more years' experience with IPR. They have the resources, they have the basic statutes, and they can make the changes needed to improve them. They need the political will to protect our goods as effectively as they are protecting the Olympic logo.

Thank you very much, Mr. Chairman.

Senator COBURN. Thank you.

Next we will hear from Nashville songwriter Gary Burr, who represents the Recording Industry Association of America.

No stranger to the Nashville scene, Mr. Burr has penned numerous hit songs for an impressive roster or country artists, including Wynonna, Collin Raye, Doug Stone, Patty Loveless, and The Oak Ridge Boys.

Gary Burr has been awarded "Songwriter of the Year" on three separate occasions by three separate organizations: Billboard, Nashville Songwriters Association International, and ASCAP. He has also received over 20 ASCAP recognition awards for radio play activity and CDs featuring his songs that have sold more than 50 million units worldwide.

We welcome your statement, Mr. Burr. Please summarize, if you would, and your full statement will be made part of the record.

TESTIMONY OF GARY BURR,[1] NASHVILLE SONGWRITER, RECORDING INDUSTRY ASSOCIATION OF AMERICA (RIAA)

Mr. BURR. Thank you, Mr. Chairman.

The last several years have been tough ones for my industry. The piracy of our music, physical, amd online—has been the major reason for this.

In rough terms, the combination of growing global physical piracy, easy Internet piracy, illegal CD-burning—it has made us go down by 20 percent. There has been a 20 percent decline in our industry sales since 1999.

[1] The prepared statement of Mr. Burr appears in the Appendix on page 61.

The impact of the revenue crash has been profound in human and creative terms. There are hundreds of large and small record companies in the United States which contribute to America's culture, cultural diversity, and our Nation's economic welfare that have been severely affected.

Successive rounds of job losses have occurred in the American record companies—the small and large ones. There have been additional losses with closing of thousands of retail stores.

Yet the creative cost is even more troubling. Artist rosters have been slashed dramatically. Piracy robs the industry of the capital it needs to invest, and the result is fewer artists finding the financial support they need to put food on their table.

American recordings are sold all over the world because—I'm biased, but American music is the best.

And the sales of this benefit everyone in the industry, and they add significantly to our Nation's trade balance and to our national welfare. And our Nation's welfare is reduced and our composers, artists, and all the employees of record companies, small and large, suffer when foreign governments permit our recordings to be pirated in their countries.

When it comes to ripping off American sound recordings, China is one of the worst. The magnitude of record piracy there eclipses any other country. This has been a point of conflict between our countries for years.

I understand that China has taken steps to improve its laws against copyright piracy. But China runs a few raids and it seizes lots of products, yet the problem remains as bad as ever.

Mass quantities of pirated Chinese CDs are found all over China, and all over the world, in large part because realistic, meaningful penalties are never imposed by the Chinese government on the pirate producers.

The challenge for us as Americans is to get China to impose penalties on large-scale pirating and to truly discourage such piracy. Unless and until they do, not much is likely to change.

Our own government is pressing China hard on this—that isn't the problem—But China isn't responding. I think we need to use all the tools available to get this problem solved.

I have no idea—I'm a songwriter. I have no idea what those tools are, but if the tools are out there, we really need to use them.

I also want to say a word about Russia, which is fast becoming the next China when it comes to the blatant piracy of our products.

Sound recording pirates in Russia are producing far more sound recordings than are needed for legitimate demand and exploiting them all over the world, ruining our industry's market inside and outside Russia. In addition, Russia is tolerating one of the world's worst online music pirates, an entity named "allofmp3.com." Nice name.

But we have a unique opportunity with Russia. They hope to join the World Trade Organization. And the U.S. Government should not agree to this until Russia effectively addresses these problems. I urge Congress to insist on this.

The U.S. Government must press China and Russia harder to strengthen their antipiracy enforcement regimes. The current systems in these countries do not work. Unless the United States uses

each and every option available to it, we will continue to face the same situation we do today for the foreseeable future: Overwhelmingly pirate markets and lost opportunities for legitimate U.S. companies.

Thank you, Mr. Chairman.

Senator COBURN. Thank you, Mr. Burr.

Next I would like to introduce Jack Sabo. He serves as vice president of Market Data at the New York Board of Trade. As vice president of Market Data Services, he is responsible for Market Data revenue at the New York Board of Trade. The function entails technology, finance, education, antipiracy, and marketing.

The New York Board of Trade is New York's original futures exchange where the world trades futures in coffee, sugar, cocoa, orange juice, cotton, and certain financial products.

He currently serves on the board of the Software and Information Industry Association, is on the executive council of that board, the Financial Information Services Division, where he's cochairman of the Governance Advisory Committee and Chairman of the Redistribution Advisory Committee.

We welcome your statement, Mr. Sabo.

TESTIMONY OF JACK SABO,[1] VICE PRESIDENT, MARKET DATA, NEW YORK BOARD OF TRADE

Mr. SABO. Thank you, Chairman Coburn. Good morning, everybody.

Chairman Coburn, I appreciate the opportunity to appear before you today to discuss the challenges faced by the U.S. financial community and, in particular, the New York Board of Trade. This problem is due to piracy of realtime market data in China.

While the issue of piracy in China is often dominated by high-profile industries, such as motion pictures, recording, and software and publishing, Chinese piracy also affects the financial industry by robbing exchanges of fees from the sales of market data and by robbing customers from licensed market data vendors, such as Bloomberg, e-Signal, Reuters, and others.

Revenue from market data can be as much as 25 percent of total exchange revenues. This market data that is provided by our derivative exchanges is vital information used by the global financial industry.

It includes brokerage houses, banks, fund managers, farmers, brokers of cotton, coffee, sugar, cattle, corn, orange juice, and many more.

As Senator Coburn mentioned, New York Board of Trade, commonly referred to as NYBOT, is an old part of the financial community.

In its pits on the trading floor, traders scream, yell, wave their hands, and jostle one another all for one reason: To get the best possible price for their customers.

Like many businesses, NYBOT has gone through some tough times. On September 11 its facility at 4 World Trade Center was destroyed and some of our people were killed.

[1] The prepared statement of Mr. Sabo appears in the Appendix on page 67.

At the time it appeared that our entire business, our entire franchise was destroyed, but, fortunately, we are in the risk management business, and as a result of the 1993 bombing of the World Trade Center, we had built a backup trading facility.

No one could have anticipated how much we would need it. We worked out of that limited facility for 2 years.

Now we have returned to lower Manhattan in an expanded state-of-the-art facility with 13,000 square feet packed with screaming traders.

I do not know if any of you have ever visited NYBOT's trading floor, but if you have not, please call me sometime and come visit. It is a unique experience, and you will love it.

More than 2 years ago, we discovered a Chinese firm very well known in Beijing that was offering realtime market data of the world's derivative exchanges on their Web site. To test it, we subscribed. The subscription for all those exchanges should have cost somewhere around $10,000 per month. We paid $600 for an entire year.

This firm is not a licensed vendor and, to my knowledge, does not remit any revenue to exchanges, certainly none to NYBOT.

If something like this were to happen in the United States or even in Europe, we would know how to stop it immediately. However, we had no clue how to proceed in China.

Now, we are members of the Software & Information Industry Association called SIIA, so we gave them a call and asked them to help. On our behalf, SIIA tried to contact the chairman of the offending firm and asked that the company cease and desist from their infringing activities. To date, there has been no response from the firm, and still any individual from anywhere in the world can today still subscribe at well below market rates.

Even as we have pursued and continue to pursue our own efforts to stop this piracy, we have appreciated the willingness of the U.S. Government to hear our concerns and work with us to put this on their agenda.

NYBOT is especially appreciative that Commissioner Sharon Brown-Hruska of the Commodity Futures Trading Commission has helped her government colleagues to understand the importance of the market data industry to our economy and explain some of the technical issues surrounding our operations.

With SIIA we have had constructive meetings with the Office of the U.S. Trade Representative who understands the issues and is working with us to raise them with their Chinese counterparts.

Right now the Web site is only in Chinese, but the company's chairman and CEO, ironically, got his graduate degree here in the United States, and we are very concerned that the Web site will soon be translated into English. If that happens I believe it will cause us to lose even more revenue.

Chairman Coburn, as you and your colleagues in the U.S. Government work to improve the environment for conducting business in China, we ask that the challenges facing the market data industry remain an important part of the agenda.

It is our hope that with your help, sometime in the near future the Chinese government will take concrete steps to prevent entities

from illegally obtaining and selling U.S. exchanges' proprietary Market Data.

I greatly appreciate this opportunity to appear before you today and would be glad to answer any questions you might have later.

Senator COBURN. Thank you very much, Mr. Sabo.

Next we will hear from Loren Hillberg, who serves as general counsel for the software company Macrovision. Mr. Hillberg handles all corporate legal matters for Macrovision.

Prior to joining this company, Mr. Hillberg served as vice president and general counsel of Macromedia. And prior to that, Mr. Hillberg served as vice president and general counsel for Micro Focus Group U.K., a U.K.-based provider of enterprise software tools.

Mr. Hillberg, thank you very much. Your entire statement has been made a part of the record, and if you would summarize that in 5 minutes, I appreciate that.

TESTIMONY OF LOREN HILLBERG,[1] GENERAL COUNSEL, MACROVISION CORPORATION

Mr. HILLBERG. Thank you, Chairman, Mr. Coburn.

I appreciate the opportunity to testify before you today on very significant piracy problems affecting the U.S. software and information technologies companies in China.

Macrovision is the world's leading supplier of digital distribution commerce and consumption solutions for software and entertainment content. Our media software and network-based solutions deliver protection and enablement capabilities to the home video, PC games, music, cable satellite, consumer software, and enterprise software industries.

Macrovision has delivered, installed, and managed software on over 500 million desktops. It serves all 1,000 of the Fortune 1000 companies and has enabled over 10 billion units of packaged media, 5 billion DVDs, a half billion CDs, and 300 million online games.

Macrovision is also a member of the Software & Information Industry Association.

Macrovision holds a total of 220 issued or pending United States patents and 1,200 issued or pending international patents and continues to increase its patent portfolio with new and innovative technologies in related fields.

In addition, and perhaps more relevant to this hearing, in China, Macrovision has 35 issued patents and another 25 applications pending. We also have registered or pending registrations for 10 trademarks and numerous copyrights.

As a company, we have been active in our efforts to preserve our intellectual property rights in China. Unfortunately, while the Chinese government has established portions of an infrastructure for intellectual property protection, they have not so far provided a critical element of that infrastructure: A clear and reliable enforcement process.

In order for the software industry to effectively protect and invest in China, this notable failure must be rectified.

[1] The prepared statement of Mr. Hillberg appears in the Appendix on page 69.

The proliferation of computers, internal computer networks, and the Internet has made illegal reproduction and distribution of protected material much easier to accomplish and more difficult for software companies to police.

Macrovision, as a software provider that protects the copyrights of media companies, is uniquely negatively impacted by the lack of the Chinese enforcement efforts. Our ability to provide effective solutions to our customers depends both on our technology and the ability to police the misuse of our technology in the marketplace.

The Chinese government is to be applauded for its efforts to join the world community respecting intellectual property over the past 10 years. Unfortunately, they have fallen down with respect to the most important aspect of such protection, and that is enforcement.

There have been initial efforts to address the piracy of intellectual property. Unfortunately, the appropriation of intellectual property in China has occurred on such a massive scale that these small initial steps are simply not sufficient to address the impacted international businesses.

Core technologies across the array of the information and communications industries have been copied in China without impunity.

Further, notwithstanding the commitment of China's leaders to require all governmental branches and agencies to use legally licensed software, the lack of compliance even within the government sector continues to be significant.

Closely related to these troubling intellectual property policies is the regulatory framework emerging around the development of tactical standards requiring the use of intellectual property in China standards and competition policies. These are commercial terms under which U.S. companies are unwilling to play.

What needs to be done?

The framework for success has a foundation. The outcomes of the Joint Commission on Commerce and Trade announced in July 2005 offer real opportunities for improvement, but only if the Chinese government plays the important role that it must.

A few of the important commitments intended to address U.S. concerns with respect to intellectual property include increasing criminal prosecution, reducing the exports of infringing goods, improving national police coordination, enhancing coordination across all law enforcement authorities, ensuring the use of legal software in the state-owned sector, and fighting software and end-user piracy.

What further steps are required?

The first and most important is a significant increase in enforcement resources. This year the Ministry of Public Security in China has increased somewhat its enforcement, but much more needs to be done to move intellectual property into the realm of law enforcement rather than leaving it solely within the purview of administrative agencies.

Legal authorities are now better armed with guidance that enables them to prosecute more cases of intellectual property infringement. Now the cases need to be pursued. In a country where in a single year more than 150 million pirated DVDs are con-

fiscated, 52,000 trademark violations are prosecuted, an average of less than 600 arrests is simply inadequate.

Another area of importance is anti-circumvention legislation. A critical element enabling the U.S. content profession are the circumvention provisions of the DMCA, the Digital Millennium Copyright Act.

Through the TRIPS process, China has agreed to implement similar legislation in this area. Until these laws are fully in place and provide a meaningful enforcement avenue for rights holders, piracy will remain a rampant problem.

In summary, China has made great strides over many years. Nonetheless, for an effective intellectual property protection system to exist, the most important aspects of the system are the need to allow the enablement to actually enforce the rights that are protected by the system. China needs to do much more to meet these obligations.

Thank you, Senator.

Senator COBURN. Thank you.

Next we will hear from Timothy Minor, who serves as vice president of government relations for Cummins-Allison Corporation.

Mr. Minor was gracious enough to fill in for the chief executive officer at Cummins-Allison, Bill Jones, who at the last minute had to cancel his plans here.

Cummins-Allison Corporation is an office equipment and security products manufacturer and currency protector founded in Chicago in 1887. The founding families were prominent families from Iowa and Indiana respectively at the turn of the century.

B.F. Cummins, the first president of Cummins-Allison, grew up in the State of Iowa. B.F. Cummins' eldest brother, Albert Baird Cummins, served as governor of Iowa from 1902 to 1908, elected to the U.S. Senate, and served as Senator from 1908 to 1926.

Senator Cummins served as president pro tem of the Senate during the 66th through the 69th Congress. Albert B. Cummins was a member of the progressive wing of the Republican Party and thus was closely aligned with Theodore Roosevelt regarding the legislation reform of the railroads and other powerful trusts and business interests.

Mr. Minor, welcome. Thank you for filling in for Mr. Jones. And your entire statement—his entire statement has been made a part of the record.

And if you would summarize.

TESTIMONY OF TIMOTHY MINOR,[1] VICE PRESIDENT OF GOVERNMENT RELATIONS, CUMMINS-ALLISON CORPORATION

Mr. MINOR. Thank you, Mr. Chairman. Good morning, fellow members of the panel, other attendees here today. My name is Tim Minor. I'm vice president of government relations for the Cummins-Allison Corporation, which is a privately held manufacturing company headquartered in the Chicago area.

Originally William Jones, chairman and my boss at Cummins-Allison, was invited and was scheduled to participate in this hearing.

[1] The prepared statement of Mr. Jones submitted by Mr. Minor with attachments appears in the Appendix on page 80.

It is quite ironic that a patent infringement suit against one of our Japanese competitors is finally coming to trial and forced him to remain in Chicago today.

Mr. Chairman, Mr. Jones asked that I extend his apologies to you. He very much wanted to be here and participate in the hearing, commends you for addressing these critical issues associated with the theft of intellectual property.

We thank you for the invitation to participate in this important hearing on the protection of intellectual property of American industries. Your work is crucial to the identification and implementation of meaningful—and I highlight "meaningful"—solutions to the expensive and debilitating problems associated with intellectual property theft by foreign governments and businesses.

Cummins-Allison was founded in 1887 by the Cummins and Allison families. Today Cummins-Allison is the last American-owned manufacturer of currency-processing equipment.

Our products scan, sort, denominate, and authenticate U.S. currency as well as many foreign currencies.

Cummins' currency-processing products are utilized by banks, retailers, governments, armored carriers, and casinos. The high-speed processing and counterfeit detection capabilities of our products help to protect the integrity of the dollar as a world reserve currency. This is critical to our Nation's economy and security.

The theft and utilization of America's intellectual property by foreign manufacturers and nations is only one component of an ineffective American trade policy. The U.S. trade deficit with China will likely top $200 billion this year, a clear indication that our policies are not working.

Beijing manipulates its currency to gain commercial value without consequence. Its manufacturers dump products into the United States without retribution.

The export of industrial and innovative capabilities to China, along with the theft of intellectual property, has done grievous damage to the U.S. economy.

When U.S. companies lose business to Chinese rivals or need to cut costs to the bone as their margins shrink, jobs are displaced, wages fall, taxable income vanishes, vital public revenue streams decline, and resources for new investment in research and development diminishes.

As far as Cummins is concerned, unlike our foreign counterparts, our American Government provides us with no industry support or protection. The Chinese government, on the other hand, has declared that currency and currency processing are matters of national security.

Therefore, even after their entry into the WTO, tariffs of 38 percent to 40 percent continue to be assessed by the Chinese government on Cummins-Allison products exported to China.

Compounding the problem, Cummins has no practical or effective means to protect our patents or intellectual property rights in China. As a result, China's currency-processing industry can and does copy Cummins technology with impunity.

Another trade barrier and threat to our intellectual property is a suit called the CCC safety certification, which was recently implemented by the Chinese government. China requires foreign

manufacturers to apply for and secure CCC certification for every imported electronic component or product.

In order to receive a CCC certification, Cummins would have to agree to let the Chinese government officials annually tour and inspect our facilities here in the United States and pay for all of their travel expenses.

In addition, they want full access to the engineering drawings and the design schematics for our products. They also require that we ship the finished product, intellectual property and all, to China for their evaluation.

Clearly, it is not in the best interest of our national security to provide Chinese government officials with access to Cummins product design and production especially when these technologies protect the integrity of U.S. currency and help to identify sophisticated counterfeit money.

As a result of trade barriers and potential loss of intellectual property, Cummins has chosen to withdraw from the Chinese market. Given the high tariffs, the government intervention, and the new so-called safety requirements, we have decided it is not practical or profitable for Cummins to export to China and risk compromising or losing our intellectual property.

Of course, fewer Cummins product sales resulting from the abandoned Chinese market translates into fewer research and development resources and jobs here in the United States.

Senator COBURN. Can you summarize for us?

Mr. MINOR. Sure.

For some time we have seen excellent counterfeits of American currency coming out of North Korea circulating around China and into South America and the Middle East. One of these pieces of currency that you're looking at, Mr. Chairman, is counterfeit; one is not.

Senator COBURN. I can't tell the difference.

r. MINOR. It is indeed a national security issue for the United States when foreign governments collaborate to produce and circulate excellent counterfeit U.S. currency. America, in fact, has a serious problem, as was confirmed in the recent story of "The Korea Times."[1]

Currency counterfeiting also creates potential security risk through the illicit financing of terrorist activities. As terrorist-funding resources have been eradicated, there is increased likelihood that terrorists will turn to counterfeiting as a means to purchase technologies and attain future objectives.

In short, counterfeiting and theft of intellectual property are very serious problems which threaten our economy, quality of life, and national security.

As a last remaining American-owned manufacturer of currency-processing equipment, Cummins-Allison believes that the United States lacks a complete, coordinated currency protection policy, which should be an important component of our national security.

We encourage Congress and the Executive Branch to develop and coordinate a substantive U.S. currency protection program which,

[1] The article from the Korean Times appears in the Appendix on page 92.

in part, recognizes the importance of protecting America's intellectual property in the currency-processing industry.

Thank you, Mr. Chairman.

Senator COBURN. Thank you.

I can't tell the difference.

Our next witness is Dr. Ted Fishman. Ted C. Fishman's best-selling book "China, Inc., and How the Rise of the Next Superpower Challenges America and the World," has helped describe for the world the effects of China's momentous change on the lives and businesses of people everywhere.

In addition to its success in America, the book, translated and published in 21 languages, is an international bestseller. In 2006 it will appear in Chinese editions in both The People's Republic and Taiwan.

Mr. Fishman has testified before Congressional committees and commissions, and consults on China with a wide range of government officials, including some of the Nation's most influential officeholders.

His essays and reports appear in many of the world's most prominent journals, including *The New York Times Magazine, Harper's, Esquire, U.S.A. Today, GQ, The Times of London,* and others.

Mr. Fishman, welcome. I have read both of your books. I appreciate you being here. And please try to keep your comments to 5 minutes.

TESTIMONY OF TED FISHMAN,[1] ARTHOR, "CHINA, INC., AND HOW THE RISE OF THE NEXT SUPERPOWER CHALLENGES AMERICA AND THE WORLD,"

Mr. FISHMAN. Thank you very much. I'm glad to be here. I'm so frightened from Mr. Minor's remarks, I do not know if I can speak. It was really chilling.

I'm going to speak off of my testimony. You have my testimony for the record, but I'm just going to speak based on what I've heard and some notes I made from reading a news article last night and today.

As you know, Mr. Chairman, I have a strong conviction that this is the most important issue facing our trade with China. And it is one of the most important issues facing the vitality of the American economy, not only because we lose sales, but because we lose vitality out of our economy.

And it affects everything up and down the architecture and contours of our economy, every decision from where a company invests to how a university student plans his future, whether he wants to be an engineer and produce world-leading knowledge products, or whether that kind of enterprise is threatened by China's theft of our intellectual property.

And it strikes me that California is a particularly important place for this hearing, not only because it is the home of the entertainment industry, but it is also the home of high-tech industries, biotech, software that serves the service industries, and also the

[1] The prepared statement of Mr. Fishman appears in the Appendix on page 93.

home of the greatest entrepreneurial boom, one of the greatest entrepreneurial booms in American history.

As you know, entrepreneurs begin their businesses because they have a new idea, and they aren't just mom-and-pop ideas. Sometimes they're world-class ideas. When those ideas are threatened, entrepreneurship, which is an engine of our economy, is also threatened.

We have made a bargain in this country which is that we are willing to shed low-cost manufacturing to other countries, cut and sews, simple assembly manufacturings, if we can move up the economic feeding chain into higher-value knowledge goods, but when those knowledge goods are threatened and when the world's fastest-growing economy provides no market for those goods because those goods are—simply migrate there at no cost, then this bargain that we have made with our own people is not working.

Instead, we just lose the low-end jobs, and we threaten the high-end jobs.

It is one thing to talk about the consumer in China as the beneficiary of a regime that does not police intellectual piracy—intellectual property, the piracy of intellectual property.

But I would encourage us all to think about what Mr. Minor said and maybe even broaden it to the shop floor in the United States and how China's intellectual property regime threatens the shop floor of the United States.

If you look at consumer software, consumer entertainment, they end up in the hands of an end user, but if you look at the means of production that are pirated inside China, they end up on shop floors and in factories. And one of the highest costs for American companies competing in the world market is the technology cost.

Often we can compete with low-cost labor around the world, like automating our factories. And we do this by making better and better investments in better and better technology. And a technology cost for an American company is often among its highest cost that it pays, but for a Chinese company, it is among the lowest cost that it pays because it does not pay them.

So when you go to an American factory, particularly the kinds of factories I'm familiar with and Mr. Minor must be familiar with in the Midwest, you go into a bread and butter manufacturing company, whether they are forging or injection-molding or creating any kind of product that goes into the 80 percent of American industry which provides parts for American industry, you are likely to see a row of CAD/CAM machines, all other kinds of sophisticated software, other machines on the shop floor. What you won't see is a lot of people on the shop floor.

But these machines, these CAD/CAM machines, can cost $60,000 to $100,000 a year in license fees. It can cost millions of dollars for a company that is not that big, and yet these companies must compete with Chinese competitors who pay nothing for that. We can compete against the low-cost labor, but we can't compete away the technology costs because American companies pay full bore for that.

Another issue I wanted to stress in listening to the other panelists was how are Americans partnered in the piracy that goes on

in China? And why our role as partner in the piracy also puts us in a unique role as a problem-solver for Chinese piracy.

One thing we shouldn't overlook is we benefit from the low cost of Chinese goods. I think it would be very hard to find a Chinese factory which was not running on pirated software, reverse-engineered machinery.

Chinese research institutes exist, in essence, to reverse-engineer the world's leading technology, and yet about one in six dollars of the Chinese GDP cycles through the United States. That is the size of our trade deficit with China.

And we benefit from the low cost that comes out of these factories that use this pirated and reverse-engineered technology, and yet we do not police the factories.

Often the legitimate goods that arrive on our shores look legitimate when they get here, but the environment they come out of is wholly illegitimate.

There is an interesting case that is been covered by the papers lately about a Chinese-born American businessman who owes half a billion dollars to a Chinese television company presumably for not paying the license fees for DVD players.

Well, those DVD players came at steeply cut prices into America's big-box retailers for Thanksgiving specials, for Christmas specials. Nobody asked at those retailers, how are you selling DVD players for $30 when a license fee on a DVD chip costs about $14?

In a way there is a wink and a nudge that comes from the American buyer into the Chinese marketplace who bring those products here, and we have to think about that.

And with due respect to Mr. Glickman, while we complain about pirated DVDs, we might also raise a flag on the DVD player market also, which is part of the issue.

It is interesting to look at when the United States tolerates and does not tolerate piracy. All poor countries are forced to pirate in some degree. They simply can't afford the drugs, the entertainment, and the means of production that they need to bootstrap themselves up. And we have benefited from the growth of China's economy. But now we are at an inflexion point where we have to think anew about it and say, how are we creating these massive competitors?

And one thing I would propose is that we think deeply about creating an economic incentive about how—why China should stop piracy rather than a police incentive. And we might think about how American companies can reach back into the Chinese workplace, look to see whether the workplace itself is legitimate, and if it is not, do not allow those goods inside the country.

Create the kind of certification regime that exists against child labor, that exists against rain forest lumber, that exists against environmental degradation. These are effective enforcement regimes that exist around the world, and it is something that we can benefit from.

Thank you, Mr. Chairman.

Senator COBURN. Thank you.

Our next witness is Commissioner Patrick Mulloy. He was reappointed to the U.S.-China Economic and Security Review Com-

mission on March 25, 2003, by Senate Democratic Leader Tom Daschle, to a 2-year term expiring on December 31, 2006.

Commissioner Mulloy previously served as a member from April 1, 2001, to January 7, 2003.

United States-China Economic and Security Review Commission is a bipartisan commission established by Congress in the year 2000 to investigate, analyze, and provide recommendations to Congress on the economic and national security implications of the U.S.-China relationship.

And recently, just 2 weeks ago, it released its 2005 Annual Report to Congress.

Prior to assuming his current responsibilities, Commissioner Mulloy was nominated by President Clinton and confirmed by the U.S. Senate as Assistant Secretary for Market Access and Compliance in the Department of Commerce's International Trade Administration where he served from 1998 to 2001.

In that position he directed a trade policy unit for over 200 international trade specialists which focused worldwide on removing foreign barriers to U.S. exports and on ensuring that foreign countries comply with trade agreements negotiated with the United States.

Commissioner Mulloy, welcome. And if you would, limit your comments to 5 minutes. Your complete testimony will be made a part of the record.

TESTIMONY OF COMMISSIONER PATRICK MULLOY,[1] U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Mr. MULLOY. Thank you, Mr. Chairman, for having this hearing on this most important issue.

I want to just use my time to briefly highlight a few key points about China's continued violations of the obligations it assumed when it joined the WTO.

China is enjoying enormous economic benefits from being in the WTO. The United States permanently gives most-favored nations tariffs to China. If you do not have most-favored nations tariffs, goods coming from China would face about a 40 percent tariff coming into our market.

Because they have M.F.N., which we have now locked in place through their WTO entry, their average tariff coming into the United States is about 2.5 percent. This does not mean that U.S. goods going to China have a 2.5 percent tariff. We bargained too. I think their average tariff on our goods going to China is about 10.5 percent. So there is a discrepancy. But that is the agreement that was made when they joined the WTO and we are living up to it.

But what we did, we wanted them to sign on to the WTO TRIPS agreement, the Trade Related Intellectual Property Rights Protection. That was one of the reasons we wanted them in the WTO.

Prior to them coming into the WTO, we could have used Section 301 of our trade laws to limit their exports of goods into our market if they continued to violate their copyrights and patents of our companies in China.

[1] The prepared statement of Mr. Mulloy with attachments appears in the Appendix on page 100.

We gave away that leverage when we got them in the WTO. We can no longer unilaterally use Section 301 to force them to live up to their obligations.

Our only option now is to take them into WTO dispute settlement if we want to stay within the system that we have signed up to.

So that is an enormous gift that we gave to the Chinese.

Mr. Chairman, you talked about the enormous trade deficit that we have with China. Let us just look at this.

Last year, 2004, our total trade with China was $231 billion, $197 billion of that was imports coming from China into this country. We had about $35 billion going off to China. That is an enormous discrepancy, and this year it is going to be much larger. Our trade deficit with China is going to be over $200 billion.

Now, it is not just T-shirts and it is not just tennis shoes. We are running an increasingly large trade deficit in advanced technology products as defined by our own Commerce Department. Last year, 2004, our trade deficit with China in advanced technology products was $36 billion. This year it will be over $40 billion, I assure you.

From 1990 to the end of 2005, our total trade deficit with China is over a trillion dollars. The Chinese now have about $700 billion of U.S. dollar assets which they can now directly invest in our Treasury bills as part of their scheme to keep their currency undervalued, but it also gives them enormous leverage over American interest rates.

So that is something. If we do not turn this situation around, we will, as the old Tennessee Ernie Ford song goes, be another day older and deeper in debt.

Now, what can we do?

Oh, there are two things that you have to think about.

We want to try and get them to enforce intellectual property protection for our companies doing business in China. We can't enforce our laws in China. The TRIPS agreement requires them to put the laws on the books and to enforce them, including criminal penalties. That is what the TRIPS calls for.

But what we can do, we can police our own borders and our own market and stop those counterfeit goods from coming into our market.

Two-thirds of the counterfeit products in the world market are of Chinese origin.

That means we will have counterfeit medicines coming into this country, counterfeit parts for automobiles, maybe even, God forbid, counterfeit parts for airlines. This is an enormous health and safety hazard to the American people, and this is an area that we really should beef up tremendously.

Now, you heard the different industries, the entertainment industry, the software industry. It is not just them, though. It is our manufacturing firms whose patents is being ripped off as well.

Now, can the Chinese really enforce these laws? Let me put into the record, Mr. Chairman, an article that appeared in *The Wash-*

ington Post on November 4.[1] The Chinese have this Olympic logo that they make money from. They enforce those laws. There is not a lot of pirating of their Olympic logo.

They can do it if they want to do it, but they do not want to do it. Why? Because there is no economic incentive.

We should give them an economic incentive by, one, keeping those goods out of our market and, two, bringing a WTO case and getting the right to put tariffs on selected products from China. If we win a case, we would then show how much damage their violations caused, and then we would have a right to put tariffs on that amount of goods coming from China into our market.

And we would select which goods we could put the tariff on to get the most leverage on them. I think it is a no-brainer that we have to go ahead and bring a WTO case against them.

Now, let me tell you one of the problems with that. USTR and others, they love this WTO so much that they're afraid that if they bring a case and do not win it, it will show that the WTO does not work.

Well, for me, my view is bring the case. If it does not work, then we have to do something else because we cannot let this situation continue.

I would just note that today there was a report on President Bush's and Secretary Rice's visit to China. We have been after this issue for 15 years negotiating with the Chinese on WIPR violations. Here's what the *U.S.A. Today* quotes:

"Secretary Rice, Mr. Hu promised to do more to end piracy of U.S. movies, music, and other products. Secretary Rice said the discussion on intellectual property rights was, 'much more detailed, much more specific than previous talks.'"

I guarantee you, if we do not bring a case and we do not get some leverage on these guys, people will go over there another year from now and they will have the same discussion.

Finally, Mr. Chairman, when Mr. Portman, your former colleague, finally began to use the WTO mechanism and filed that Article 63 request for information about what their enforcement activities are, here is the way *The Wall Street Journal* reported that, and this is what really makes you wonder.

"In a move expected to ratchet up tensions with China . . ."

Why should that ratchet up tensions with China? We are asking China to live up to agreements that it assumed as part of its WTO commitment. This is an organization that gives them enormous benefits, as we just went through, in terms of their access to our market. We should not let our media and people who want to keep this situation—many of our companies are making enormous amounts of money—beginning to make money in China by making things in China and shipping them back here.

But we can not let them run our policy toward China. Because if you look at the size of these deficits, you know what it is doing to our overall economy. Ted Fishman went through that, what that does, and some of these other folks as well.

So we have to get very tough and focused on this issue, Mr. Chairman. And it is not just IPR. It is exchange rates. It is sub-

[1] The article from *The Wall Street Journal* appears in the Appendix on page 112.

sidies. We tried to go into this, Mr. Chairman, in the report that we recently sent up to the Congress.

I appreciate very much the opportunity to be here with you, Mr. Chairman. As I said in the report, in my additional views, we have to rely on the elected representatives of our people to be more active in our China policy.

In my view, for too long we have subcontracted our China policy to corporate interest. And they are not necessarily working in the national interest. They will work for the interest of that corporation. They are not charged to look out for the national interest. They are charged to make money for their shareholders. It is the elected representatives of the people who have to get into this.

And I worked in an administration, and I know what goes on in these meetings in the Executive Branch.

You need to have the Congress very active and pushing on these issues or nothing will get done. Thank you.

Senator COBURN. That is why you are here, Commissioner Mulloy.

Mr. MULLOY. Thank you.

Senator COBURN. Thanks to each of you.

A couple of thoughts. The situation with intellectual property is pretty grim. And I heard Mr. Fishman say that—I think his comment was that the Chinese are forced to pirate.

I take a little bit of issue with that in terms of nobody is forced to steal. Nobody—that is not the only option that they have.

As a matter of fact, by their own signatories through the WTO, they say that they will not steal. And so I do not want to give them that out. They are not forced to pirate. They can be good actors.

What I am concerned about more than anything is a couple of things Mr. Glickman said, is that organized crime seems to be getting into the intellectual property duplication.

And if anybody has any comments on that, I would love to hear that, because that portends a much greater problem and a much more difficult solution if, in fact, that is the driving force behind it, other than economic advance for a country is that individual economic advance in terms of organized crime.

The other thing that I am concerned about and I would love to have the input is what is the response to the Chinese government, when you all have interacted with them in terms of you say, well, you are going to do this and you are going to do this and then you go around the streets and they are better and then you send somebody a month later and they are right back where they were. What's the answer to that? And what is the response?

Are we dealing with somebody that we can deal with, or are we dealing with somebody that is not—we can not deal with?

The decision for the Congress to make, is if you lie to me once, that is my problem. If you lie to me twice, then it is our country's problem, and we can not trust you anymore.

And the TRIPS agreement, the WTO, the most-favored nation status, we are down that road, but we went down that road on the basis of knowing that there is a participation by everybody on both sides of this agreement. And what we have heard today would seem that there is much less of a participation on the part of China and others in Asia than there is this country.

And the real concern is the long term. As Commissioner Mulloy said—if the WTO does not work and as we lose over the next 10 years our ability to compete worldwide, as we lose our manufacturing base, and as our intellectual property is whittled away because we can not protect it, then the creation of intellectual property is going to go where it can be most cheaply created.

And all you have to do is look at several U.S. businesses today—3M is one and many others—where they are moving their intellectual property development there so that you can develop it there. And so you start from that basis.

So we undermine our economy both not at the workplace and small-piece job, but we also undermine our economy intellectually.

And then the other thing that is concerning me is the short-term philosophy of many American businesses and our government, which means we make hay in the short term, but in the long-term our country is depleted and undermined, and our ability to protect ourselves, which is really the only true function of government, is to protect our national security. The ultimate No. 1 is undermined because we do not have a manufacturing base with which to defend ourselves.

So anybody that wants to comment, I am going to let you go back and forth a little bit and just comment as you would, and then we will get into some specific questions.

Mr. FISHMAN. If you do not mind, I would like to start with a thought. I do not want to overstate the forced to steal. Of course, no one is forced to steal. It is just the how—what makes you go to rationalize the theft.

Governments are charged with certain functions. They have to provide for the health of their people, the economic well-being of their people, the entertainment of their people, and the education of their people.

If you are the leader of 1.3 to 1.6 billion people, most of whom are desperately poor, and you could save millions of lives by having them spend pennies on the dollar for drugs, you could give them a presence in the global economy by having them spend pennies on the dollars for software, you can make your students smarter by taking textbooks for pennies on the dollar and expect to pay no consequence for that behavior, all of us might make the same decision.

Senator COBURN. That is the question, whether or not there is a consequence, and that is what this hearing is all about.

Can China continue to ignore the TRIPS agreement? Can China continue to ignore the world norm in terms of intellectual property? Can China continue to ignore the fact that you do not have free trade when you do not have a free-forming currency? Can we allow China to continue to do that as the U.S. Congress? And, therefore, if we do, then, I would say, yes, we can rationalize that it is OK for them to steal that because we have not said there is a consequence.

Mr. FISHMAN. Yes. Here, here. I agree. All that more important that the solution come from us.

When Mr. Glickman was in China—I think you should just live in China, because when you were there, there were no pirated DVDs on the street, and it was very hard to find even the shops.

But they used that little brief time to make their shops that much nicer so when you left, they all looked like Blockbuster.

Mr. GLICKMAN. I have no desire to live there, but I do appreciate the suggestion. Maybe I can go there more often.

Mr. FISHMAN. You seem to be somebody capable of keeping them in line.

But that is why I think the enforcement we should expect should not necessarily be from Chinese police, but we have to create a culture of compliance.

So if you want to sell $200 billion worth of goods to the United States, you have to do it out of a factory that is I.P.-compliant. And then those factories, those tens of thousands, hundreds of thousands of factories will not want to compete in an economy where their competitors are stealing I.P.

And you would get pressure internally inside of China to comply. And we have to have a strategy that creates that. And one way to do that is to put conditions on the goods that we buy from China, which is a huge amount of their GDP.

Mr. GLICKMAN. Can I just comment on that?

Senator COBURN. Sure.

Mr. GLICKMAN. I used to be chairman of the Fair Labor Association, and one of the things we did was to—we were—it was a private sector group composed of apparel companies. And what they would do is they would certify companies and investigate their human rights violations to determine if mostly apparel that was coming in met those specifications.

I think that is what you are talking about here, is some sort of internal certification process. And that is an interesting idea.

And the other thing I think you mentioned, which I think is important, is the whole issue of consumer electronics coming in in this country and maybe we are taking advantage of those.

There is this big annual consumer electronics show in January. I do not know to what extent antipiracy—we raise it there, but I do not know to what extent it is embedded in the entire subject of billions and billions of dollars in consumer electronics that are sold in this country. I think that is an interesting point.

I also think this issue of the Beijing Olympics logo—and I would be interested to know what Mr. Fishman might think about the Olympics as being——

Senator COBURN. A leverage.

Mr. GLICKMAN [continuing]. A leverage point to maybe work the Chinese, if you think there is any realistic possibility there.

Mr. FISHMAN. Yes. It reminds me of a story of a book author in the audience of one of my talks, and he says my book has been pirated into China. What do I do about it?

And I said, you should insert references to Tibetan independence. Because the Chinese do clamp down when they see a political need to, and they have the ability to do it.

And I think as you get closer to the Olympics, they will be embarrassed by cameras going everywhere finding these pirated DVD shops, and they will disappear from Beijing.

Now, what happens in the west of China, I have no idea, because it seems like it is only the glare of the cameras in any given place that makes it stop temporarily.

But we can hope that the Olympics will be kind of a coming-out party for more responsibility.

Senator COBURN. But the point is, is that the Chinese government does have the ability, should they so desire, to enforce intellectual property in China.

Would the panel agree with that?

Mr. MINOR. I am not sure they have the legal infrastructure.

Senator COBURN. Well, where they want to enforce it, they can. So they obviously have the legal infrastructure when they selectively enforce if it goes against either what they do not want in terms of political, like Guangdong and several of the others.

Mr. HILLBERG. I think the key is that the government can enforce certain intellectual property rights. I think the regime does not necessarily permit companies or other participants in the marketplace to be successful.

Senator COBURN. The government does have the power to do it. It may not run as smooth as it does here, but they—if they choose to do it, they could do it.

Would anybody disagree with that?

Mr. FISHMAN. I would disagree with that on this, that there is a lot of jurisdiction shopping in China. And there is a lot of different kinds of enforcement from jurisdiction to jurisdiction. Andrew Mertha at Washington University in St. Louis has written at length about it.

When you clamp down in one area, activities move to another. There is also the difficulty of driving an economic wedge between conflicts of interest. In pharmaceuticals, for example, the government is the No. 1 producer of drugs and the No. 1 buyer of drugs.

As a buyer, it has the huge incentive to get the lowest price possible. As a producer it has incentive to take drug technology as its own and sell it for pennies on the dollar. And it is very hard to drive a wedge in between those conflicts of interest.

Mr. MULLOY. Mr. Chairman, in my view, you need to give them the economic incentive to enforce their laws. If you are able to bring some WTO cases and win them and then you target key exports and put quite high tariffs, as you will be permitted to do, then you have economic leverage on them, and they will then pay more attention and begin to find ways to enforce those laws.

Remember how much talk there was that the Internet was really going to free up that society?

They are putting an enormous amount of money into controlling the Internet in that country. They have an interest in controlling the Internet, and they do it. If they had an interest in getting after this issue, they will do it. But they are not going to do it if we continue to talk rather than see if this mechanism in the WTO will work.

We strongly recommended that we work with both the E.U. and Japan to bring these WTO cases because then there will even be more leverage.

It is very interesting on that request filed by Mr. Portman, the Japanese joined us, the Swiss joined us, but the E.U. did not. I think we need to work on the E.U. and get them into this ball game a little bit more. And that is what we strongly recommended.

Senator COBURN. This also does not just play in terms of trade. One of the great proprietors of Iran's progression in terms of the uranium enrichment happens to be the Chinese.

And so if we do not take a stand on our economic intellectual property, then we are perceived as weak in every other area of our foreign policy as well. And so it is important that we take that stand so that we hold them accountable.

Mr. MULLOY. I would think that they must wonder that we have the President of the United States over there saying, pretty please, do this for us, and this has been going on for 15 years with no results. I mean, they must not take us seriously about these things.

Senator COBURN. So it is not a Republican or Democratic thing? It is this policy stinks in terms of enforcement of the things we do?

Mr. MULLOY. Absolutely. There was a requirement in the law that the Banking Committee wrote in 1988 requiring Treasury to identify currency manipulators. Early on the Bush Administration, Bush 1, actually identified Korea, Taiwan, and China as currency manipulators.

Beginning in 1992 that passed under both Clinton and now Bush 2. Nobody's identified China as a currency manipulator, although everybody knows they are a currency manipulator.

When Tim Adams, our undersecretary of the Treasury, complained to the IMF and said, why aren't you working to stop China's currency manipulation, the IMF came back and said, you have not even named them a currency manipulator in your reports to Congress.

Because we have not been truthful, then we get bitten. We have to be truthful, and then you can deal with the reality or you find policies that deal with the reality. If you pretend it is not happening and you put your head in the sand, it is just going to get worse.

And one last thing, on Ted Fishman, he talked about the big-box retailers. They are bringing in this stuff—maybe some of it is pirated or counterfeit goods. We ought to have a law that says if American companies are going to be part of this process and they know or have reason to know that the goods they are bringing in are counterfeit goods and can be threatening to our people, that they should be faced with punishment for doing that.

That is what we did on bribery. When our companies were out bribing people, we put a law on the books and forbade them to do so. Now, they may find ways around it, but at least it is out there and I think it is a real deterrent on that behavior and we could do the same thing here.

Senator COBURN. Mr. Sabo.

Mr. SABO. Senator, all I can say, based on everything I have heard today, is that this is something we better address right now because if it continues like this for 5 more years without addressing it and addressing it strongly, our economy is really going to be hit hard.

Mr. MINOR. It is not only our economy; it is our national security that is at risk. As we transfer technologies to China, as we transfer the ability to manufacture key military mechanisms to protect ourselves, we become weaker and weaker each day.

So far the policy with the Chinese has been to ask politely and hope for the best and that just can not continue.

I was wondering if we could share those pieces of currency, Michelle, with the other members of the panel.

Senator COBURN. I thought I was going to get to keep them.

Mr. MINOR. Well, one of those you do not want to keep, Senator.

We have known as a company for some time through our customers of our products that the very good counterfeits are coming out of North Korea and likely manufactured by the North Korean government. Only recently a major Chinese bank was charged in the United States for funneling and laundering these counterfeits.

But we are finding them all over the world: Central America, South America. And if our currency and our military are compromised through intellectual property theft, there is no turning around. Five years might be too long.

Mr. FISHMAN. Here is a scenario you might think of, which is imagine we do get some sort of redress on intellectual property, possibly through this compliance regime that I have talked about.

You get a double advantage. One, you chip away at China's low-cost manufacturing advantage because factories have to buy technology. Two, is you inject some vitality into our tech sector because you create a market for technology where a market didn't exist before. And it is not just any market; it is the fastest growing market in the economic history of the world. And right now we do not sell into it.

Senator COBURN. And three, is if we had a free-floating currency, the price of our technology would go down to the Chinese, and the price of their products would come up.

Mr. FISHMAN. Absolutely. Exactly.

Mr. GLICKMAN. One thing that is interesting. My whole life being involved in agriculture, we often had disputes with Chinese on certain sanitary issues. But by and large—this is one area that the Chinese, need us to feed their population, particularly to increase as their standard of living goes up, their protein consumption goes up, and, therefore, they've got to have feed and meal to feed those animals over there. It is an interesting dichotomy here.

Because where they need us, they will take advantage of what we have to give them. I do not know if anybody's ever really explored the relationship between agriculture and the peasants on the revolution side of the picture with the manufacturing-industrial side of the picture that we have here, and I think we should.

The other point I would make is it goes back to something Mr. Fishman said. I went to the Fortune Conference in Beijing in the spring, and it is a tricky situation because everybody wants to be polite when they are there.

But what I saw, by and large, is not a very confrontational atmosphere between the American private sector and the Chinese authorities.

Now, I was not looking for people to pick a gratuitous fight with them, but it is an interesting juxtaposition when you look at globalization in this world. The internationalization of a lot of American companies have made them a lot, I think, less likely to want to pick a fight.

And I do not think the government can do this by itself. I think you have got to have the people who are employed Americans involved in this fight as well.

Mr. MULLOY. Can I speak on that?

Senator COBURN. Yes. Let me just put something in. One of the real disappointments for me was that you do not see a Microsoft here today, the leader who has lost more in China than all the other software firms combined. And I am set to presume that they do not want to offend the Chinese because it might hurt their short-term business interest.

That is where we are in terms of the government. How do you not offend the Chinese, but yet hold them accountable?

And if the short-term price of your stock is more important than the long-term future and security of our country, then that is a terrible scenario for American business.

And I can tell you it does not just apply there. It applies in asbestos litigation and in all these other things that we are trying to solve.

What we are seeing is a change in perspective by American business, that they have chosen to go the short run instead of the long run. And they have chosen to make profits in the short term instead of secure the future of their firm and their country and their employees by doing what is in the best long-term interest of their firm.

And so it is very concerning to me that people want to duck this discussion because it might have a negative reverberation in China on their business.

And if it does, then what it says is, who are we dealing with? And what is the long-term quality prospects for fair trade with China if, in fact, you can not be critical of somebody who is supposed to be doing something who is not and because you happen to be critical it hurts your business? You are not dealing with somebody that you really want to deal with or—unless you are going to hold their feet to the fire, you never win on that.

And so it is concerning to me that we have seen that philosophy take over in terms of our international business company—the companies that do international business, that the short term is more important than the long term.

Mr. MULLOY. Senator, the American companies can try and use the Chinese legal system like GM went after Chaney. I saw in the *Los Angeles Times* today that they settled that case.

It was a big article about how Chinese automobile production has expanded. They are going to be the third largest auto producers in the world next year. So they are coming on pretty fast in autos, and we expect them here.

But the thing we have to understand is we can go after them to live up to their international agreements both on IMF currency, WTO, IPR, or other issues. Our companies are in a system where they have to make profits, and they are going to make profits if they want to survive.

The Chinese have figured out how to incentivize our companies and other foreign companies to build their industrial base.

Sixty percent of China's exports are from foreign-invested companies. We were over there in August. We went through these sci-

entific and industrial parks. It is amazing. You had it exactly, that the R and D is beginning to flow over there now as well.

So they figured out how to incentivize them. We have to do some going back to understanding our own system. How do we incentivize our guys to serve our interests rather than the Chinese interests?

I heard on NPR, somebody talking the other night. It was not Ted—you were on NPR, but another show coming from China, was saying that the American corporations in China are almost like spokesmen for the Chinese government. They are like an echo chamber. You will hear the government say things, and then before long the American companies were saying the same things.

Mr. FISHMAN. That was me.

Mr. MULLOY. That was you? OK.

I found the same thing when I am over there traveling around, meeting with these people.

Mr. BURR. Mr. Chairman.

Senator COBURN. Yes, Mr. Burr.

Mr. BURR. A few years ago when music lovers started to discover that they could use the Internet and basically just take songs off it for free and not have to pay for them, that was the beginning of a huge decline of our industry and everyone was really scared about it and it started this—retail stores and the mom-and-pop record stores were all closing. And we all had a very doomsday scenario in our heads.

And the organization—the RIAA and NARIS and organizations like that, they all got together and they started suing 14-year-old kids. And it got ugly, but it worked.

Everyone said, Oh, how can they do this? It is just these kids. But I tell you what, you throw a lawsuit where the father has to pull out $20,000 to settle a lawsuit for the 15-year-old stealing Oasis songs, pretty soon that kid finds his computer unplugged.

And I think that we are going to have to—with China, I think we are going to have to sometimes maybe treat them like a 14-year-old and it is going to get ugly and we can not be afraid to have it get ugly for a while. Because on the other side after it gets ugly, they will get the message.

Senator COBURN. I think that is good input. Anybody else?

Mr. FISHMAN. Yes.

I would say something to that point, which is it is essential on this issue to get a public consensus on it. And it is very hard to get the public consensus around it on the consumer issues because consumers also steal when they can.

But if we talk about it more and more in terms of the shop floor, in terms of the jobs lost—I know Mr. Minor brought an article from the *Chicago Tribune* which talked about the $6,000 drop in the average paycheck in Illinois because of the loss of manufacturing. Michigan actually lost more. And there have been 3 million manufacturing jobs lost from the United States since 2000.

This is even a higher cost to pay than what you pay for your 14-year-old.

Senator COBURN. Sure.

Mr. FISHMAN. And this is one place where I think we can get national consensus on it by really stressing that the workplace is in danger, not just the home theater.

Senator COBURN. Right. Middle income America is at risk.

I thought it was interesting to note that we have talked about movies, recording, financial, software, core technologies, patents, manufacturing, currencies, macroeconomic, and advanced technology. Every aspect of our economy is under attack——

Mr. FISHMAN. Agriculture.

Senator COBURN [continuing]. In terms of intellectual property rights being ignored. It is not just recording a movie. It is every aspect of our economy.

The same thing is happening—we see it more visible because it is easier to see the results of it in terms of the recording industry or the movie industry because it is out there and it is also shipped back here.

But the subtleties of the other is there is not an area of our economy that is not under attack.

Mr. FISHMAN. Well, there is a kind of war in industry in this country, and it is between large corporations and this 80 percent of American industry, which is medium and small businesses.

Large corporations have the resources to go into China to fight their intellectual property battles. Small industry, which sees the rug being pulled out from under them as their large clients move to China and find suppliers in China and benefit from pirated technology in the Chinese workplace are really at risk here, and they do not have the resources to fight their own battles inside China.

It is impossible as a company that is 50 million and under to have played a Chinese legal system for years.

Senator COBURN. Let me put the question out to you. So let us say we are going to do the TRIPS, we are going to enforce, we are going to file through the WTO. What happens when we lose? What happens if we lose, knowing the truth, knowing the facts? What happens when we lose?

I do not have a lot of confidence in some of the WTO rulings, as we have seen from the past. What happens when we lose? What do we do?

Mr. MINOR. Hopefully we would reassess our membership in the WTO.

Senator COBURN. But what do we do?

Mr. SABO. Is not that our only choice?

Mr. MULLOY. Secretary Glickman.

Mr. GLICKMAN. Well, you have to fight the battles. We fought them for years on the agriculture front, and we certainly have not won every battle there. And we fought them on consumer issues and international financial issues.

We also have to have a good case too. It does not mean we do not file the case, but we have to have the data there. We have to have the facts there. That is what the Administration has finally done. Now we have to keep pushing them to make sure that they follow through on that kind of thing.

China has wanted for years to get in the WTO. They are now in this organization. It means a lot to them. And, I do not think that

they want to ignore the WTO. They kind of do that at their peril if they really become—if they want to play roles around the world.

That is one of the reasons I thought that when Mr. Burr talked about Russia was so important.

Russia is not in the WTO, and the Russians are actually in a much more lawless situation even than the Chinese are. So we have an opportunity with Russia maybe to advance the situation.

But, I am not going to presuppose whether we should file the case or not, but my belief is we are probably not going to get the attention of China without filing the case. And we just have to have the best case we can possibly do.

Senator COBURN. Is there a function that the Congress can do outside of the WTO in terms of carrying forward—both sending signals to China, but also in terms of setting meaty legislation that will have an impact on them, and what is that?

Mr. MINOR. The currency bill would send a message, I think.

Senator COBURN. You mean in terms of floating of the currency?

Mr. MINOR. Right.

Mr. MULLOY. Revaluing—upward revaluation of their currency is enormously important.

We can put laws on our books to control what comes into our country in terms of counterfeit goods.

Senator COBURN. Yes.

Mr. MULLOY. There is no right to bring counterfeit goods into this country, and we can pass good, tough legislation so that does not happen.

Then the next step is only the government. USTR is the only place that can authorize bringing a case to the WTO. Private companies can not do it. It has to be the government. So we have to go ahead and see if it works. It will take 2 years to bring one of these WTO cases before you are even in a position to put the tariffs even if you win it. So get started.

Now, what Senators Schumer and Graham, in their currency bill, have done—do you remember how they said, we will put immediate tariffs on you if you do not stop manipulating the currency? They went to Article 21 of the WTO agreement, which provides that you can protect your national security as an exemption to everything else that is going on.

So your obligation—you always have the national security out. Sweeney at one time used Article 21 to protect its footwear industry. In the GATT it was always held self-judging, a country can make its own judgment as to its national security.

Now, that is an enormous step to go. I would prefer to get the case in the WTO to find out what happens first.

Senator COBURN. Let me question you on that for a minute. Going to be a quarter of a billion dollars—quarter of a trillion dollars that flow out of this country this year in China. We are going to lose another 200,000 or 300,000 manufacturing jobs because of intellectual property that is not protected in terms of small businesses. We are going to lose the ability to fund and grow our own economy and fund our own intellectual property for the future, and development of R and D.

Why is that not a national security and national emergency issue for us right now? Not 2 years from now, right now.

Mr. MULLOY. Do you want me to comment?

Senator COBURN. Sure. I want anybody to comment on that.

Mr. MULLOY. Well, I think it is, and that is why I was very happy with—we endorsed the concept of the Schumer-Graham bill on currency because we think it is a national security issue.

One more thing I want to tell you, Senator.

In our report we do not blame everything on China. There is much that we have to do here at home with our emphasis on science and technology, getting our economic house in order. That also has to be a part of this.

Just getting our economic house in order is not going to do this because we can not get it in order unless we deal with this other issue. The two have to be done at the same time.

So our commission endorsed using Article 21 on the currency issue.

Senator COBURN. Anyone else?

Mr. FISHMAN. I have a comment. One is—what can you do at home? One is to shed daylight on some of the practices that keep China's regime going. China's had this enormous benefit from the way it has done business.

Senator COBURN. That is what we are having this hearing for.

Mr. FISHMAN. And one thing that the Subcommittee can do is—and I do not know the legal structure of the Subcommittee. But if you have subpoena power, you can go into some agreements and look at what is the dynamic.

There is this great case where Huawei, which is a Chinese telecom firm, basically built itself into a multi-billion-dollar company by copying virtually everything in the Cisco catalog, including the catalog.

And then it entered the United States market and Cisco sued it, filed suit. Well, that suit was settled. We do not know the terms of the settlement. And, it will be very interesting to know whether part of the terms of that settlement was access to the Chinese market by Cisco, but there was no redress on the piracy itself.

Instead, Whawei, which is now a global player in telecom, competing against our best companies, went out and bought the Qualcomm patent portfolio, which gives it 30,000 legitimate patents.

So these intellectual piracy regimes in a way become like the Mafia buying the liquor store. They can legitimate themselves once they grow to scale. That is quite a threat. So if you have the investigative power to look at that, I would encourage it.

Also, it would be interesting to look at the pricing demands that big-box retailers put on their suppliers.

Factories that supply big-box retailers are asked every year to cut their prices sometimes 15 percent a year. Do you think with those demands for the price cuts there is also a demand that you pay full bore for technology? You are forcing your suppliers to cut your costs somewhere. It would be interesting to know what is the chain of events that leads to that piracy.

Mr. MULLOY. Well, we did a hearing on that, Senator, in New York to look at the role of the big-box retailers. There is tremendous pressure on the smaller manufacturers if they want to stay

in the supply chain of the larger manufacturers who are in China. In order to meet the China price to stay in, they are forced also.

So there is a tremendous incentive from the big guys and Wal-Marts and others, those big-box guys, to force the smaller guys who want to stay in their supply chains to move their operations to China. That is the situation we are now in.

Mr. GLICKMAN. I think this whole idea—I do not know what the criminal laws are, but knowingly importing counterfeit material, in the same way that—knowingly importing material that is done with human rights violations or improper labor violations, it is, I think, something the Subcommittee could explore looking at the laws.

I would like to mention, however, part of the issue is they do not buy anything that we—or very little we produce. It is the reverse. I want to go back to the situation because here we are in Los Angeles, the entertainment business.

The WTO provided that the Chinese would allow into their market—we saw it as a minimum of 20 foreign movies a year for domestic distribution. They saw it as a maximum.

Out of that 20 movies, the United States gets in roughly about 14 movies a year, and they—the Chinese determine, based on a lot of different formulas, what those 14 movies a year are.

On the streets of Beijing, Shanghai, Guangzhou, and all the other cities, on the average there are probably 2,000 to 3,000 of titles a year on the streets. So all these movies we are trying to get in, legally we can not, and there they are.

Senator COBURN. Now they are creating the demand.

Mr. GLICKMAN. They create the demand for this kind of stuff.

So in addition to them selling us stuff that may be counterfeit—there is a tremendous need for market opening stuff on our part as well.

Senator COBURN. All right.

Senator Carper could not be here. He had made a commitment. And we work in a bipartisan fashion. He's a partner—he's the Ranking Member, Senator Carper from Delaware, and he will look at this material as well.

Any other final closing comments?

Mr. MULLOY. I just want to let you know, Senator, that we are a Commission created by the Congress, bipartisan. And our last report came out 11 to 1. All six Republicans and six Democrats were on that report.

We are here to be of assistance to you and your staff in any way we can in dealing with this larger phenomenon of how we are going to deal with the U.S.-China economic relationship.

Because when you transfer the amount of resources we are transferring to China now, it enables them to have a much stronger power projection militarily as well.

Senator COBURN. Right.

Mr. MULLOY. You can not decouple these things. And I am not saying that we want to demonize those people, but we better start getting our act together and enforce what we bargained for.

Mr. FISHMAN. If I could add one more thing, it is about the culture of compliance at home.

We have Fortune 50 companies in the United States that have paid hundreds of millions of dollars to settle patent and copyright infringement cases because these drag through our courts just as long as any cases drag through the Chinese courts.

If we could take this more seriously at home, then we would certainly be taken more seriously abroad.

Senator COBURN. I agree.

Mr. MINOR. Congressman Glickman suggested that China needed to develop political will to address some of these issues, and I would add to that, that both within the Executive Branch and the Legislative Branch we need to develop the political will to get tough on trade and fix these problems.

Large multinationals, Fortune 50, Fortune 500, 750 companies have the resources to fight patents and litigate. When you are a smaller manufacturer, medium-size manufacturer, you do not have the resources, and you certainly do not have the time. We need the help from our government.

Senator COBURN. All right. Thank you all very much.

Mr. MULLOY. Mr. Commissioner, can I ask permission to put the three articles that I referred to in my testimony to be made a part of the record?

Senator COBURN. They will be made part of the record if you will submit it.

Mr. MULLOY. Thank you, Mr. Chairman.

Senator COBURN. And the hearing is adjourned.

(Whereupon, at 11:50 a.m., the Subcommittee was adjourned.)

APPENDIX

Statement Prepared For Delivery By

DAN GLICKMAN
Chairman and Chief Executive Officer
Motion Picture Association of America, Inc.[1]

Before a hearing of the

Subcommittee on Federal Financial Management,
Government Information, and International Security
of the
Senate Committee on Homeland Security and
Governmental Affairs

"Ensuring Protection of American Intellectual Property Rights For American Industries in China"

10:00 AM, PST, Monday, November 21, 2005

John H. Mitchell Theater
Museum of Television and Radio
465 North Beverly Drive
Beverly Hills, California

CHAIRMAN COBURN AND MEMBERS OF THE SUBCOMMITTEE: One of the most important actions you and your colleagues can take to help us protect our intellectual property rights in China is to continue to call attention to the Chinese authorities that you consider the theft of US intellectual property a high priority.

Adequate laws and resources, effective enforcement, and private sector initiatives and cooperation with the US government and Chinese government are all important tools in this fight. However, unless the Chinese government exercises the political will to address the rampant theft of US intellectual property rights (IPR), those tools are meaningless. This hearing keeps IPR high on the on the US-China agenda, demonstrating, yet again in a yet another forum, to the Chinese government the priority you and your colleagues attach to seeing satisfactory results.

The source of this problem is twofold: First, China imposes strict limits on the number of foreign films that can be exhibited in its theaters on a revenue-sharing basis, and applies burdensome regulations and confiscatory taxes on foreign home video and television content. This creates a marketplace vacuum that pirates are only too happy to fill. Second, China has not asserted the political will necessary to reduce the level of piracy. Yes, it has conducted some raids and even put a few

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[1] The Motion Picture Association of America (MPAA) represents the major producers and distributors of motion picture and television programs in the United States; its members are Metro-Goldwyn-Mayer Studios; NBC Universal City Studios, Paramount Pictures Corporation, Sony Pictures Entertainment, The Walt Disney Company, Twentieth Century Fox Film Corporation, and Warner Brothers Entertainment.

pirates in jail, but it has not materially reduced the level of piracy and the ready availability of pirated products in the shops and in the streets.

As I will elaborate, fighting piracy, especially in a restricted market such as China, means more than simply enforcing laws and going after the counterfeiters – the traditional anti-piracy tools. Getting better access to the Chinese market is a critically important tool in the fight against piracy. The controls the Chinese government imposes upon legitimate film producers and distributors have no effect whatsoever on the pirates. Until we have the same unrestricted access to that market, we will not be able to compete effectively and stop the theft of our content.

On behalf of the member studios and the hundreds of thousands of Americans who earn their livelihoods in this industry, thank you for your interest and the opportunity to address the Subcommittee.

SCOPE OF THE PROBLEM

Regrettably, to coin a phrase, if you did not see a counterfeit DVD, you were not in China. Unfortunately, I fear our collective perception of China has become so ingrained with the notion that China is overflowing with pirate DVDs we frequently fail to appreciate the magnitude of the problem.

The problem is ubiquitous – on virtually every street corner, packed on to the shelves of audio-visual shops in every neighborhood. We estimate that the piracy rate exceeds ninety percent – more than nine of every ten DVDs in the Chinese market is a fake, stolen product. That would be like, Mr. Chairman, going to Northcutt Chevrolet in Enid and learning that nineteen out of every twenty of the cars and trucks on the lot are fakes. Counterfeit, stolen motion pictures cost our members nearly $300 million annually, in China alone.

Too many, especially some around the world who should be allies in the fight against piracy in China, view this as an American problem. While we certainly bear the disproportionate share of the burden of this problem, movie piracy in China affects film makers all around the world. Our research indicates that almost half the pirated product is actually Chinese product. We also find stolen copies of Japanese, Korean, French, and Indian movies in China.

A few weeks ago, a young Chinese film producer visited my office. When asked to define his number one problem, he did not mention financing, distribution, or any of the other obstacles film producers must overcome: He said piracy is his biggest problem -- the theft of his movies, in his home country.

It is clearly more than an American problem, it is a problem afflicting film makers no matter where they live and make movies, in more than one way. Not only are the pirates sapping legitimate movie makers in the China market, they are encroaching on legitimate markets all around the world. Our analysis of pirated DVDs seized from around the world traced their production back to over fifty plants in China.

As we dig deeper into this problem, particularly the global spread of China-sourced pirated product, we are coming to a disturbing conclusion: There is a growing link between piracy of motion pictures and organized crime. Our Asia-Pacific Regional

Office just completed a new study on these connections. With your permission, Mr. Chairman, I have included a copy of that study with my statement and would like to have it included in the record. Let me cite a few of its findings:

> Criminal theft of IPR dwarfs criminal revenues from narcotics trade: US government and international law enforcement records peg the illegal narcotics trade at $322 billion last year; criminal revenues from all IPR theft were significantly higher, $512 billion.
>
> Part of the allure for organized crime to move into DVD piracy is the incredible profit margins, exponentially higher than for drugs: The mark-up on pirated DVDs made in Asia and sold in Europe, for example, averages an astounding 1150%, three times the mark-up of heroin sourced in Asia and sold on the same street corners, and the criminal risk is far lower.
>
> The report cites two recent cases linked back to China, with tentacles around the world, including into the US. In September 2005, a federal grand jury in New York indicted thirty-nine individuals tied to the Yi Ging Syndicate, based in New York but which funneled much of its one million dollars plus a year earnings back to China. Next January, an American, Randolph Guthrie, will stand trial in the US for his role in leading a criminal syndicate, based in Shanghai, that made and distributed hundreds of thousands of pirate DVDs around the world; when he was arrested last summer, Chinese authorities seized more than 210,000 counterfeit DVDs.

I think it goes without saying that many of these revenues finance other illegal activities in which these criminal organizations are involved, making the reach of piracy even more pernicious: This is not just an American problem, and it is not just a motion picture industry problem, it is now underwriting activities that threaten all of us, in all walks of life.

Of course, it affects some of us more directly than others. As I said at the outset, our members employ nearly one million American men and women, at all job levels. We employ thousands of laborers, electricians, technicians, truck drivers, as well as professionals in finance, legal positions, and specialized support services.

There seems to be a view – a myth – that buying a stolen DVD only means a movie star earns a few dollars less on that movie. Let me be clear: That notion is just that, a myth. Every dollar the pirates earn is one less dollar going to an American worker, a worker employed in an industry that is one of the few in this country bringing more money back to the US in export earnings than it sends overseas.

Chinese piracy of US motion pictures also hits some of us very personally. I was in China the last time in May. I strolled the neighborhood near my hotel, and looked into one of the audio-visual stores I came across. I admit I was not surprised to see shelves of pirated DVDs, disappointed, but not surprised. I was, however, taken aback when one title caught my eye: *"The Hitchhikers Guide to the Galaxy."* At the time, the movie was not available on DVD in the US, so I knew it was a fake, taking the money out of a US film maker's pocket. That film maker: my son. He is a producer and that was his most recent film. I relayed the story to him, and he replied: "And what Dad, Mr. Chairman of the MPAA, are you going to do about this?"

WHAT THE MPAA IS DOING TO PROTECT ITS CONTENT

MPAA invests millions every year in fighting piracy, in China, and around the world. We go after the pirates, we work with governments to enact and then enforce adequate laws, we work to educate the public about the consequences of piracy, and the legal alternatives to piracy, and we are constantly seeking new ways to prevent the problem through technology, education, and changing business practices.

As I have indicated previously, piracy in China is indeed a China problem, but it is also a problem with global reach. A pirated disc made in China can, in a day or two, be in the street markets of Los Angeles. Someone can illegally camcord a movie in Moscow, send the file by way of the internet to someone in Guangzhou who then dubs and subtitles the Russian dialogue, and then illegal presses thousands of DVDs.

We approach the problem fully cognizant of its global reach, with a seamless strategy of going after the producers, distributors, and sellers of DVDs and the machinery they use to make the fakes. We have aggressively pursued a strategy to stop the illegal camcording of movies, which is still the largest source of pirated product. We are very appreciative of the action Congress took to make illegal camcording a federal crime and that the President signed the bill earlier this year.

We seek to track the production of optical discs, to make sure the plants that make them are legal, registered, and their product produced with internationally recognized identifying codes. Increasingly, we are beefing up our internet strategy to go after the thieves who think they can anonymously down load and send stolen movies over the internet.

We are also on the ground in China. Our representatives survey the market for information about the incidence of piracy and pass on this information to the Chinese authorities. In many cases, this information helps Chinese authorities formulate cases for raids on sellers and distributors, and often, those authorities invite our representatives to accompany them on such raids.

We operate and participate in training sessions for Chinese authorities and jurists on IPR laws and enforcement, in the US and in China. We also work closely with US officials in elevating the importance of IPR enforcement; for example, our representatives participated in the IPR Roundtable our Embassy conducted in Beijing at the first of this month.

One of the most significant initiatives we have been able to launch with the Chinese government was the joint anti-piracy memorandum of understanding (MOU) we executed with three entities of the Chinese government: Ministry of Culture (MOC), State Administration of Radio, Film and Television (SARFT), and National Copyright Administration (NCA).

This MOU was signed last July 13, in connection with the most recent discussions held under the auspices of the Joint Committee on Commerce and Trade (JCCT). Under its terms, every three months MPAA will submit to the MOC and SARFT a list of motion pictures scheduled to be screened in China by its member companies. All home video products that are available in the marketplace prior to the legitimate

home video release date in China will be deemed illegal audio and visual products and forfeited, and when a criminal copyright infringement offense has been committed, the case will be prosecuted.

On October 25, we met with the Chinese side to review the results of the MOU. For our part, we surveyed a small selection of shops in four key cities: Beijing, Shanghai, Guangzhou, and Shenzhen. The surveys were by no means intended to provide a comprehensive assessment of anti-piracy enforcement progress across China; merely an indication as to whether the needle had moved at all:

> Specifically, during October, the surveys of target outlets in Shanghai showed that of the films covered under the agreement, no pirate versions were available at all, at the time the shops were surveyed.
>
> In Guangzhou, the availability of pirated versions of the identified titles was down quite sharply from September, when almost all titles were available.
>
> In Shenzhen, availability of pirated titles fell fifty percent from September.
>
> In Beijing, in August, with the exception of one shop that carried only fifty percent of the protected titles, pirate versions of the six films ran from seventy to ninety percent. In September, the original shops continued to offer pirated versions of the protected titles. In October, the original ten shops had cleaned up remarkably; however, an additional ten shops surveyed showed piracy rates averaging around eighty percent.

The MOU only covers a handful of movies, and though it applies to the entire country, we have only been able to survey a limited number of cities and only a selection of retailers in each. We are disappointed with the results.

In spite of their formal commitment to protect specific US movies, the Chinese authorities failed to demonstrate meaningful progress even within the limited review we conducted. Our next review of the MOU will occur in January and we would be pleased to keep the Subcommittee apprised of our progress.

In addition to the work we are doing with the Chinese government and industry, and with other US copyright industries, I might add, most notably the sound recording industry, our key partner is the US government. I commend this Administration for the priority it has given this problem, and its willingness to work with us. I want to mention some of those key officials:

> Secretary Guiterrez has been an incredibly forceful advocate during his travel in China. In Washington, a few months ago he appointed Chris Israel to take on the job of coordinating US government efforts. Also, the Undersecretary for Patents and Trademarks has been deeply involved.
>
> Attorney General Gonzales just last week announced a series of initiatives to strengthen IPR enforcement, including a new IPR task force; while aimed at the US, piracy is a global problem demanding a seamless, global response.

The State Department has been a key ally, particularly the work of Undersecretary Shiner. Our Ambassador gives this high priority, as evidenced by the IPR roundtable I mentioned, and we have an extraordinarily capable IPR attaché in Beijing.

The US Trade Representative (USTR), Ambassador Portman, personally has been extremely helpful, raising IPR as a top priority during his visit to China immediately preceding the President's trip. USTR's general counsel's office, intellectual property office, and China office have all been invaluable. They are on the front lines and we deeply appreciate their work and support.

In addition, USTR's analysis of trade barriers around the world ensures that this problem in China stays a top US agenda item. Just last week, we filed our comprehensive submission of the barriers to trade in US motion pictures and it includes an extensive discussion of the details of the problems we have in the China market. Mr. Chairman, with your permission, I would ask that the China portion of that report be included in the record of this hearing and I have attached a copy of it to my statement.

Finally, credit goes right to the top, too. President Bush made IPR a top agenda item during his summit with President Hu. Having our views and concerns addressed at this level is invaluable in elevating the priority of IPR on the bilateral agenda and in motivating that crucial ingredient I noted: political will, the political will of the Chinese government to act.

Our work with the US government goes on virtually every day on this problem, and we are currently working very closely with the USTR on our next steps to secure adequate protection of our product in China.

HOW CAN YOU HELP?

Mr. Chairman, having surveyed the scope of the China problem, the steps the US motion picture industry is taking, I want to bring my statement to conclusion with some points for you and your colleagues to consider for ways you can help protect American IPR in China.

First, help make sure our government has the resources it needs. Not only do we need tough laws in the US, such as the package from Attorney General Gonzales I mentioned, the agencies who enforce those laws, inspect imports, train foreign officials in IPR, and enforce international trade agreements need resources.

I know full well the difficulties the Congress has been dealing with on controlling the deficit, I also know that it ought to be in our national interest to promote and protect winning industries, and this industry is a winner. As I have said, we employ nearly one million Americans, in good, well paying jobs, and we have a positive balance of trade in every market where our countries do business, except one: China.

Why do we run a movie trade deficit with China? Piracy is certainly a key reason, though another is the onerous, burdensome restrictions we have on doing business in China, and even in getting into that market.

Consider some facts about our access to the China market: The good news is that the money our movies made in China in 2004 doubled the amount they made in 2003. The sobering side is that that amount was only $10 million. One American movie on an opening weekend makes more, as we saw this past weekend with *"Walk The Line," "Harry Potter and the Goblet of Fire,"* and with *"Chicken Little"* a couple of weeks ago, and we will see every weekend for the rest of the year.

In recent years, in fact, two Chinese movies *"Kung Fu Hustle"* and *"House of Flying Daggers"* both, individually, made more in the US than all US movies made in China for the years they were released, and, ironically, both were distributed in the US by one of our member companies.

The primary barrier is the quota the Chinese impose on the number of foreign films they permit into their market under normal business terms, what we call revenue-sharing whereby the US producer shares the box office with the Chinese distributor. The Chinese allow only twenty such films into China a year, from all countries, not just the US. That means film makers from France, Japan, the UK, Korea, and the US together can only hope to get a part of that twenty-film quota.

Once into the market, the government controls the distribution of the movies. A state agency, through two divisions, distributes all the films in China, and dictates the terms of the revenue sharing with US film makers.

There are many other restrictions, detailed in the attachment to my statement, but the net effect is critical. When fighting piracy and protecting IPR, most are familiar with what I call the traditional methods – effective laws, enforcement, raids, and the like. In China, getting better access is just as critical and intertwined closely with our strategy towards that market.

My second recommendation is that we want the same access to the Chinese market as the pirates have. The barriers I outlined and that are enumerated in the attachment do not, at all, restrict the number of movies in China. Virtually any movie Chinese consumers might want is available, not necessarily through legitimate channels, controlled by the restrictions applied to us, but from pirates who have no such restrictions and who operate largely without deterrent sanctions applied to offenders. Not only are our movies being stolen, we face an enormously unbalanced playing field, at distinct competitive disadvantage.

We are convinced access to the Chinese market on fair terms, the same terms as the pirates, is central to fighting piracy in China and protecting our rights there. We want to be able to compete, not bound by quotas, government restrictions on distribution rights, black-out periods when only Chinese movies are screened, nor onerous taxes, and we want transparent clearance procedures.

Third, let me come back to where I started: political will. Just as the US government needs adequate resources and strong laws, so do the Chinese. However, for the most part, that is not the main problem. With a few notable exceptions, the Chinese IPR statutory regime is adequate and with changes, can easily be brought into compliance with World Trade Organization (WTO) standards.

The problem is political will, and keeping the pressure on is a key way to bolster that will. For example, we know the Chinese can stop pirates. When the Chinese open a film the government wants to promote and protect, pirated copies of it are non-existent; the word goes out that piracy will not be tolerated. Even when we surveyed results of the MOU, we saw some modest improvements in some places – evidence that the Chinese can crack down on the pirates if they want.

The Chinese frequently recite this rationale for the IPR problems: The US, they say, has over 200 years experience with IPR; China has only twenty. China needs time to grow and develop. True. I acknowledge the problems with developing an adequate and effective IPR system, and culture. On the other hand, I have seen what China can accomplish when it makes something a priority. My first trip to China was about twenty years ago. The changes I saw between then and my last visit last May are breath taking. The lesson here is that when the Chinese have the will and desire to change and reform, they can, a lesson I am convinced can be applied to making changes to protect better American IPR.

I saw another personal example of how the authorities can act when properly motivated. Last May, the day after I discovered the pirated copy of my son's movie, *"The Hitchhikers Guide to the Galaxy,"* I met with the mayor of Beijing and told him. The next day, the shop where I got the movie was raided and closed: political will in action. Unfortunately, it was short-lived; our China representative informed me the other day that the shop is back in business.

A couple of weeks ago, *The Wall Street Journal* carried a telling story, about the paucity of counterfeit Olympics-logo goods in China. The production, distribution, and sale of those goods is tightly regulated and policed, and fakes are not tolerated. It is virtually impossible to find counterfeit Olympics goods in China. Why? As one of the Chinese officials said, it is because fakes dilute the value of the logo, the intellectual property upon which the Chinese have invested to finance the games.

The lesson: When the Chinese want to stop piracy, they can be enormously effective. They do not need twenty more years experience with IPR, they have the resources, they have the basic statutes, and they can make the changes needed to improve them. They need the political will to protect our goods as effectively as they are protecting the Olympic logo.

Please keep the pressure on; this hearing is one way to do so. Make sure you mention this when meeting with Chinese authorities. Above all else, unless the Chinese know this is a priority for all of us, we fear they will fail to exercise the political will to protect our IPR.

Mr. Chairman, members of the Subcommittee, I appreciate again your attention to the acute problems we are facing in China and the chance to share with you the perspective of the US motion picture industry.

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Testimony of Gary Burr, Songwriter

On behalf of Himself and the Recording Industry Association of America

Before the

United States Senate

U.S. Senate Committee on Homeland Security and Government Affairs

Subcommittee on Federal Financial Management, Government Information and International Security

On

"Ensuring Protection of Intellectual Property Rights of American Goods and Services in China

Novermber 21, 2005

Testimony of Gary Burr, Songwriter
Before the
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November 21, 2005

America's song writers, performing artists and recording companies have a long history of working with the Congress and the Administration to protect and defend this uniquely successful sector of the U.S. economy. As a participant in and representative of this industry, I very much appreciate the efforts of this Committee, the rest of the Congress and the dedicated officials within the various Executive Branch agencies who have worked closely with our industry.

The importance of the U.S. recording industry, and intellectual property protection, to the U.S. economy

A critically important aspect of our nation's competitive strength lies in the creation of knowledge-intensive intellectual property-based goods and services. This is one of those economic activities that Americans do better than others. The "core" U.S. industries that rely on copyright protection account for more than six per cent of US GDP.[1] The foreign sales and exports of these industries are nearly $90 billion, an amount greater than almost any other U.S. industry sector, including automobiles and auto parts, agriculture and aircraft.

International markets are vital to America's creative talent and record companies. Exports and other foreign sales account for over fifty percent of the revenues of the US record industry. This strong export base sustains American jobs.

In this respect, the protection of our intellectual property rights abroad is essential to promoting America's competitive advantages in world commerce. The sale of our recordings abroad makes a major contribution to America's current account balances. Each and every sale of a pirated product abroad that substitutes for the sale of a legitimate American product increases our current account deficit. As our trade deficit has soared, Congress should consider more closely the relationship between our widening trade and current account deficits and copyright piracy and to take steps to enable us to more

[1] These industries include recording, music, motion pictures, book and newspaper publishing, computer software (including business and entertainment software) and radio and television broadcasting.

effectively protect our intellectual property rights and to sell our products at home and abroad.

The Effect of Music Piracy

Music is the world's universal form of communication. It touches every person of every culture on the globe to the tune of $34 billion annually, and the U.S. recording industry accounts for more than one-third of that world market. America's record companies—small and large—create employment for thousands of people, including composers, singers, musicians, producers, sound engineers, record promoters and retail salespersons, to name only a few.

The intellectual property of the United States is like a warehouse full of ideas and creativity. For someone to walk in and steal them should be no more tolerable than theft of physical goods.

The piracy of music is almost as old as the music industry itself, but historically it was difficult for the criminal to reproduce copies as good as the real thing. Now with the advent of digital recordings, computers and high-speed internet access, criminals can reproduce perfect copies of any recording. There is massive manufacture and traffic of illegal CDs, both in the form of molded CDs that are produced in factories, and increasingly pirated CD-R's produced on blank optical discs by computer CD-R burners.

The illegal music trade is feeding the profits of international organized crime syndicates who are involved in drugs, money-laundering and other criminal activities. Music piracy is costing governments hundreds of millions of dollars in tax revenues.

The battle against intellectual property theft must be unrelenting. Digital technology and internet piracy have greatly exacerbated our problems. Our country must employ every tool at its disposal, including the critically important leverage provided by international trade agreements.

Our Problems in China

America's creative industries are under attack, especially in China where high levels of piracy in conjunction with market access barriers plague our industry.

Last year, the record industry lost over $200 million in China to pirate sales. Eighty-five percent of the sound recordings sold in China were pirated. This means an astounding 17 of every 20 sound recordings sold in China are sold by pirates.

Demand for American musical recordings in China is enormous, as evidenced by the massive piracy of our products across China. The result has been a colossal lost opportunity for American writers, performers and record producers to benefit from the fast growing Chinese society and economy. Here's why:

1. China is swamped with pirated recordings because the penalties imposed on pirates are simply ineffective. Chinese pirates also export pirated versions of American recordings all over the world. Chinese authorities might raid one of these manufacturing facilities, a warehouse or a retail store and seize the pirate product—and they seize millions—but the resulting penalty, if any, is almost always just a small fine. Pirates are entrepreneurs who see raids and seizures as a cost of doing business –a "slap on the wrist"—and the occasional interruptions are built into their business model. The penalties do not deter or punish or in any way incapacitate the thieves.

2. On top of the blatant piracy of our products, the record industry faces severe restrictions its ability to do business in China. Frankly speaking, it will be very difficult to ever significantly reduce piracy in China if the Chinese will not let our companies expand their ability to sell legitimate products to Chinese consumers. China must abolish these restrictions.

3. Internet piracy is growing rapidly in China. China has 100 million internet users and 600,000 websites, only 8,000 of which were legally registered. Many websites offer the unauthorized downloading of music files, some for a financial charge, others for free. Certain China-based ISPs have become online "warehouses" for international pirate syndicates. Many of the legal deficiencies that enable physical piracy to flourish in China plague the on-line environment as well.

China's Commitments in the US-China Joint Commission on Commerce and Trade—the "JCCT"

In meetings of the US-China Joint Commission on Commerce and Trade – the JCCT – in April 2004 and July 2005, China made a number of potentially important commitments to improve intellectual property enforcement for our industry, but they will actually be important only if they are vigorously implemented. .

Perhaps most importantly, China committed in April 2004 to "significantly reduce IPR infringement levels". Under any measure, this has not happened. The legitimate market, while it has improved somewhat over the past year, remains under siege. Piracy of sound recordings remains at an astounding 85%.

One reason why piracy has remained so high for so long is that China almost never criminally prosecutes anyone for committing these acts, no matter how extensive the piracy or counterfeiting may be.

As part of the JCCT China agreed to mount a nationwide enforcement campaign to stop the production of pirate product and punish violators.

A campaign was launched last September that resulted in increases in the number of inspections and product seizures. However, the usual remedies are being still applied—

product is seized and modest administrative fines are sometimes levied. Not only is this campaign ineffective, it is set to expire at the end of this year. What then?

Our Recommendation

China's current reliance on administrative inspections, seizures and modest fines does not work. China's criminal enforcement authorities must become actively involved in the fight against piracy in China. Unless this occurs, we foresee matters either staying the same or become even worse.

The US Government—our Executive Branch and the Congress—must increase pressure on China toward this end. This hearing helps in this regard. The U.S. music industry is calling upon our Executive Branch to confront China to fully implement the commitments it made in last year's JCCT—especially to significantly reduce piracy. Our industry is also working with the Office of the U.S. Trade Representative to prepare the necessary elements of a possible WTO legal complaint against China.

Russia: the Next China

As serious as problems are in China, and they are serious indeed, the challenges we face in protecting our intellectual property in Russia are even more daunting. Lawlessness, physical danger, and corruption are part of the daily challenges we face in trying to protect our rights in Russia. These types of problems are even more prevalent in Russia than in China.

Russia is one of the largest producers and exporters of pirated CDs and other copyrighted products in the world. In fact, the statistics demonstrate a dramatic increase in music theft, certainly not a crackdown.

- There are now 42 optical disc replication plants in Russia, most of which are involved in piracy. Five plants would be sufficient to meet the needs of the legitimate Russian market. As a result of that excess capacity, Russia has become the world's largest exporter of pirated music.
- At least 9 of these production plants are located on so-called "Russian State Restricted Access Regime Enterprises" in which the Russian Government itself is the owner of the premises. Local law enforcement authorities are not permitted access to these facilities.
- Russia is now home to some of the world's only Internet-based pirate *pay* download services – including a particularly notorious one known as "allofmp3.com."

The case of allofmp3.com helps illustrate the music industry's frustration. Through its online services based in Russia, allofmp3.com sells music to anyone in the world willing to pay ten cents a song. But allofmp3.com has not secured the rights to do so – and doesn't bother to pay the people who wrote and own the songs being sold. There is no question about the law – at the very least allofmp3.com is violating the reproduction

rights afforded by Russian Copyright Law and Criminal Code, and the laws of the countries where the songs are being downloaded. But our industry's request for legal action against allofmp3.com have been routinely denied by Russian courts.

What Should Be Done?

We need to change the political calculus so that failure to control piracy has clear ramifications for the Russian Government – ramifications that outweigh the costs associated with stopping piracy. Specifically:

(1) USTR should reexamine Russia's eligibility to participate in the Generalized System of Preferences until it has satisfactorily protected intellectual property from theft. It is wrong that U.S. taxpayers should, in effect, be helping to finance Russian exports to the U.S. while the interests of U.S. intellectual property owners are being systematically undermined. The United States needs to point out how failure to address copyright piracy will impede Russia's goals, whether such goals relate to attracting foreign investment, joining the WTO, or other matters.

(2) We must learn from the China experience. Congress should insist upon demonstrated and sustainable reform before supporting Russia's accession to the WTO. By every measure, the steps taken before China was admitted to WTO have failed America's inventors and creators. The U.S. should ensure that relevant legal and enforcement measures are in place and implemented before we accept Russia into the WTO. WTO accession is not a political prize -- it represents a commitment to abide by international rules. The WTO institution and global confidence in world trade rules is quickly undermined when WTO parties openly mock trade discipline.

Let's face it – today Congress has some bilateral leverage because Russia wants to enter WTO. Once they are in, the leverage diminishes significantly, as we have seen with China. One aspect of Russia's accession to the WTO, known as granting them "Permanent Normal Trade Relations" or "PNTR" must be approved by Congress. We urge Congress to inform our Executive Branch that it will not approve PNTR unless and until Russia acts to significantly clean up its copyright piracy mess.

Conclusion

Sound recording piracy in China, and in Russia, remains rampant. Much more needs to be done by each of these countries. Our industry urges the United States—and the rest of the international trading community—to bring greater pressure on China and Russia to combat much more effectively the rampant piracy in their countries. This must not be allowed to continue. It has already gone on for far too long.

Prepared Statement of

Jack Sabo

Vice President – Market Data Services
New York Board of Trade (NYBOT)

Before the

Senate Subcommittee on Federal Financial Management,

Government Information, and International Security

Field Hearing on

"Ensuring Protection of American Intellectual Property Rights for American Industries in China."

November 21, 2005

Chairman Coburn, I appreciate the opportunity to appear before you today to discuss the challenges faced by the U.S. financial community – and, in particular, the New York Board of Trade -- due to piracy of real time market data in China.

While the issue of piracy in China is often dominated by high profile industries such as motion pictures, recordings, software and publishing, Chinese piracy also affects the financial industry by robbing exchanges of fees from the sale of market data and by robbing customers from licensed market data vendors, such as Bloomberg, e-Signal, and others.

Market data provided by derivative exchanges is vital information used by the global financial industry which includes brokerage houses, banks, fund managers, cotton, coffee, sugar, cattle, corn, orange juice brokers, and many more. They depend on reliable information, whose integrity can be undermined through unauthorized access and piracy of this data. Revenue from market data fees can be as much as 25% of total exchange revenue.

As New York's original futures exchange, the New York Board of Trade (commonly referred to as "NYBOT") is an historic part of the financial community. It is a traditional futures exchange where traders buy and sell futures on Coffee, Sugar, Cocoa, Cotton, Orange Juice, wood pulp and a variety of financial instruments such as the US Dollar Index. It's "open-outcry" where traders scream, yell, wave their hands, and jostle one another, all for one reason -- to get the best possible prices for their customers.

Like many businesses, NYBOT has gone through some tough times. On 9/11, its facility at 4 World Trade Center was destroyed and some of our people were killed. At the time,

it appeared that our entire business was destroyed. But, fortunately, we are in the risk management business, and, as a result of the 1993 bombing of the World Trade Center, we had built a fully operational backup trading facility. No one could have anticipated how much we would need it; we worked out of that facility for two years. Now we have returned to Lower Manhattan, in an expanded, state-of-the-art facility with 13,000 square feet packed with screaming traders. If you've never visited NYBOT's trading floor, please call me and come visit. You'll love it.

More than two years ago, we discovered a well-known Chinese firm that was offering real-time market data of the world's derivative exchanges on their website. To test it, we subscribed. The subscription for all those exchanges should have cost somewhere around $10,000 per month. We paid $600 for an entire year. This firm is not a licensed vendor, and, to my knowledge, does not remit any revenue to exchanges, certainly none to NYBOT. If this were to happen in the U.S., we could stop it immediately. However, we had no clue as to how to stop it in China. We are members of the Software & Information Industry Association ("SIIA"), so we asked them to help. On our behalf, the SIIA tried to contact the Chairman of the offending firm directly and ask that the company cease and desist from their infringing activities. To date, there has been no response from the firm [and any individual from anywhere in the world can today still subscribe at well-below market rates].

Even as we have pursued, and continue to pursue, our own efforts to stop this piracy, we have appreciated the willingness of the US Government to hear our concerns and work with us to put this on their agenda. As a regulated industry, NYBOT is especially appreciative that Commissioner Sharon Brown-Hruska of the Commodity Futures Trading Commission has helped her government colleagues understand the importance of the market data industry to our economy, and explain some of the technical issues surrounding our operations. With SIIA, we have had constructive meetings with the Office of the US Trade Representative who understands the issues and is working with us to raise them with their Chinese counterparts.

Right now, the website is only in Chinese, but the company's Chairman and CEO got his graduate degree here in the U.S., and we're very concerned that the website will soon be translated into English.

Chairman Coburn, as you and your colleagues, and the US government, work to improve the environment for conducting business in China, we ask that the challenges facing the market data industry remain an important part of the agenda. It is our hope that, with your help, sometime in the near future, the Chinese government will take concrete steps to prevent entities from illegally obtaining and selling U.S. exchanges' proprietary Market Data.

I appreciate this opportunity to appear before you today. I will be glad to take any questions you may have.

Statement

of

Loren E. Hillberg
Executive Vice President, General Counsel

on behalf of the

Macrovision Corporation

Before the

Committee on
Homeland Security & Governmental Affairs

U.S. Senate

Intellectual Property Climate in China

November 21, 2005
Los Angeles, California

Statement Text

Senator Coburn, I appreciate the opportunity to testify before you today on the very significant piracy problems affecting U.S. software and information companies in China. I am Loren Hillberg, Executive Vice President and General Counsel of Macrovision Corporation. Macrovision is the world's leading supplier of distribution, commerce and consumption solutions for software and entertainment content. Our media, software, and network-based solutions help to power critical aspects of the home video, PC games, music, cable/satellite, consumer software, and enterprise software industries. Macrovision has delivered, installed and managed software on over 500 million desktops, serves all 1000 of the Fortune 1000 companies, and has enabled over 10 billion units of packaged media, 5 billion DVDs, a half billion CDs, and 300 million online games.

Macrovision is also a member of the Software & Information Industry Association (SIIA). With over 800 member companies, SIIA is the principal trade association of the software code and information content industry. Its members are software companies, ebusinesses, and information service companies, as well as many electronic commerce companies, all of whom depend at least in part on there ability to monetize intellectual property rights for the success of their businesses.

Macrovision holds a total of 220 issued or pending United States patents and 1,200 issued or pending international patents and continues to increase its patent portfolio with new and innovative technologies in related fields. In addition, and perhaps more relevant to this hearing,

in China, Macrovision has 35 issued patents and another 25 applications pending. Also, we have registered or pending for registration ten trademarks, as well as numerous copyright registrations. As a company, we have been active in our efforts to preserve our intellectual property rights in China. Unfortunately, while the Chinese government has established portions of an infrastructure for intellectual property protection, they have so far not provided a critical element of the infrastructure, a clear and reliable enforcement process. In order for the software industry to effectively protect and invest in China, this notable failure must be rectified.

During the past two decades, systematic software piracy has become an increasing concern to businesses and software developers throughout the world. Recently, the problem has grown much worse. The proliferation of computers, internal computer networks and the Internet has made the illegal reproduction and distribution of protected material much easier to accomplish and more difficult for software companies to police. As a software provider that also protects the copyrights of media companies, we are uniquely negatively impacted by the lack of effort. Out ability to provide effective solutions to our customers depends both on our technology and our ability to police the misuse of our technology in the marketplace.

The Chinese government is to be applauded for its efforts to join the world community respecting intellectual property over the past 10 years. Unfortunately, they have fallen down with respect to the most important aspect of such protection: Enforcement. There have been initial efforts to address the piracy of intellectual property. Unfortunately, the appropriation of intellectual property in China has occurred on such a massive scale that these small initial steps are simply not sufficient to address the impacted international businesses. The USTR noted in its

2005 Out of Cycle review that value of Chinese counterfeits coming into the Unites States that was seized increased 47% in 2005, from $94 million to $134 million. This is truly the "tip of the iceberg" when it comes to losses for the software and IT industry as it represents only US directed export activity.

U.S. software and information companies have had their intellectual property appropriated within China even without engaging with China through exports or investment, and many U.S. companies, particularly in the media, entertainment and software industries, see their copied products migrate into mainland markets even while the legitimate product remains barred by regulation. Few American films, popular music albums or business applications remain unavailable in China for longer than two or three weeks after their U.S. release; most types of U.S. software can be purchased on the streets of any Chinese city for less than $1. While similar types of issues exist around the world, the key difference is in the scale, in China it is massive, and the government response to the issue, which in China has been lacking.

Core technologies across the array of the information and communication industries have been copied in China with impunity. In some cases, when technologies cannot be successfully replicated, Chinese government agencies have designated an organization to negotiate prices on behalf of Chinese companies that are ostensibly unaffiliated with the government. Further, notwithstanding the commitment of China's leaders to require all governmental branches and agencies to use legally licensed software, the lack of compliance even within the government sector continues to be significant. Closely related to these troubling intellectual property policies is the regulatory framework emerging around the development of technical standards, the use of

intellectual property in China's standards, and competition policy. These are commercial terms under which U.S. companies are unwilling to play. Nor need they do so, as China's commitments under the TRIPs Agreement require protection of private intellectual property rights.

Intellectual Property Laws

As a participant in the process, Macrovision believes that China benefits from the positive, initial steps it has taken in recent years to pass improved intellectual property laws and regulations, especially in the area of patent, trademark and copyright protection. Despite these improvements, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain at significant levels due to inadequate penalties, uncoordinated enforcement among local, provincial, and national authorities, and the lack of transparency in China's administrative and criminal enforcement system. The software industry through entities like the SIIA can and would like to work with the Chinese government to achieve deterrence of piracy in practice, including through meaningful criminal penalties and greater administrative penalties, as well as on the research, drafting, and revisions of China's intellectual property laws. Work is acutely needed to facilitate cross-border cooperation between Chinese enforcement agencies and their non-Chinese counterparts, as well as between the private and public sectors, including through greater voluntary information sharing.

What needs to be done? The framework for success has a foundation. The outcomes of the Joint Commission on Commerce and Trade (JCCT) announced in July 2005 offer real

opportunity for improvement, if the Chinese government plays the important role it must play. Important commitments intended to address U.S. concerns with respect to IPR included: increasing criminal prosecution, reducing exports of infringing goods, improving national police coordination, enhancing cooperation between law enforcement authorities, ensuring use of legal software in the state-owned sector, fighting software end-user piracy, establishing a Chinese embassy IPR ombudsman, promising to take steps to join global Internet treaties in 2006, and clarifying the judicial interpretation regarding criteria for criminalization of IPR infringements issued at the end of 2004. The judicial interpretation was indeed issued, as promised at the 2004 JCCT meetings, but it does not uniformly resolve concerns regarding both substance and procedure. USTR and other U.S. government officials need to work to achieve the goals laid out in the JCCT Outcomes.

Enforcement

Vice Premier Wu Yi's Market Order Rectification Office (MORO) has taken concrete steps to strengthen inter-agency coordination on intellectual property enforcement issues in 2004-2005. The foreign investment community appreciates the rare openness with which MORO has operated, soliciting public comment and suggestion quarterly. Supporting MORO's work, on December 22, 2004, the Supreme People's Court and the Supreme People's Procuratorate issued a judicial interpretation on the enforcement of intellectual property rights that lowered the monetary thresholds for criminal prosecution of trademark and copyright infringements and reiterated penalties for theft of business secrets. This type of transparency is needed in other aspects of China's efforts.

The Judicial Interpretation lists the criteria for conviction and sentencing for seven major types of IPR infringements described in China's Criminal Law: counterfeiting registered trademarks; selling counterfeit trademarks; illegally producing or selling registered trademarks; violating copyrights; forging patents; breaching business secrets; and selling pirated products. The Interpretation lowers the threshold for criminal prosecution. Now, an individual who has 50,000 RMB in revenues or 30,000 RMB in profits from selling counterfeit goods or otherwise infringing intellectual property rights may be charged in criminal court. Previously, the threshold was 100,000 RMB in illegal revenues.

Nevertheless, the revised thresholds still place a heavy burden on enforcers. One factor contributing to this problem is the continuation of different thresholds for individual and entity ("work unit") infringers, since many "individuals" found infringing can work through "entities" and thereby avoid prosecution under the higher thresholds establish for the latter category. As someone who must attempt enforcement around the world, issues like this can reduce a company's ability to bring about and ongoing enforcement results, since just as in a shell game the pea can be moved from place to place. In addition, rules that have little logical market sense exist, for instance, illegal business volume is apparently calculated using the price of the infringing work instead of the price of the genuine work. It remains unclear how the Judicial Interpretation effectively deters repeat offenders and how the thresholds apply to online piracy, despite the recognition that "Online copyright infringement problems have become increasingly serious," according to Cao Jianming, vice president of the Supreme People's Court.

Even with the lowering of the criminal thresholds, effective enforcement will not become a reality if there is inadequate attention, investment and training by the Public Security Bureaus (PSB). The PSB needs to treat criminal enforcement of intellectual property offenses as a top priority. Enforcement remains slow, cumbersome, and rarely results in deterrent fines. Although Chinese authorities have undertaken some administrative enforcement actions against pirates, the government's refusal to share information about the activities of compact disc plants or the ultimate outcomes of these actions makes it very difficult for rights-holders to assess the deterrent impact of China's enforcement efforts.

There have been some recent successes in bringing civil actions, but meaningful sentencing in criminal courts continues to be ineffective and does not result in actual deterrence, as required by TRIPS Articles 41, 50, and 61, which provide that China must provide enforcement that deters further infringement, must allow for effective civil search orders, and must provide specific criminal remedies that act as a deterrent to continued theft of intellectual property. Again as someone who manages different types of enforcement activity around the world, it is simply not possible to pursue action, where there is no reasonable expectation on the likelihood of the appropriate outcome.

At the July 11, 2005 meeting of the Joint Commission on Commerce and Trade in Beijing, China's government followed the Judicial Interpretation with further commitments to improve IPR protection. Key to the interests of the U.S. tech sector were two commitments: to criminalize piracy of software by end-users rather than only by purchasers and to ensure that exporters of pirated products—not just manufacturers--are held liable for infringing activity.

The Judicial Interpretation had set out sanctions against those complicit in intellectual property infringement, including landlords and trade agencies.

One positive change to the environment is a result of the efforts of MORO, which will help China develop a statistical foundation for evaluating the improvement or worsening of intellectual property infringement. A wide range of government agencies is now tasked with reporting on confiscations of pirated products, civil cases brought against IPR infringers, criminal prosecutions, case disposition, and a range of other indices.

With the Judicial Interpretation and the JCCT meeting outcomes, the Chinese government has taken important steps to improve intellectual property enforcement. The most important aspect of the required change is what we will be waiting to see, and actual improvement in the operating environment. A number of possible actions would likely lead to measurable results:

- Criminalization of patent infringement: The Judicial Interpretation lists only actions involving the use of a patent number (e.g., on products, advertising or contracts) or the forgery or alteration of patent-related documents as examples of acts which constitute counterfeiting of the patents of another that may arise to the level of a criminal offense. This definition should be expanded to include intentional copying of patented products on a commercial scale, even if the patent number is not cited on or in relation to the product, Patent infringement is at least as damaging to our industry as trademark and copyright infringement and should be dealt with in an equivalent manner.

- Methodology for calculating unlawful revenues: While a primary objective of intellectual property enforcement is consumer protection, the protection and encouragement of innovation are also important objectives. The value of copyrighted or patented materials should not be based on the actual sale price of the infringing products, but rather should take into account the intangible value underlying the genuine product. The existing valuation methodology should be refined and extended with respect to the valuation of trademarked materials to cover semi-finished products, whether by calculating unlawful revenues for semi-finished goods based on the actual production cost of the semi-finished infringing product or, if the actual production cost cannot be quantified, the actual production cost of the equivalent semi-finished infringed product.

- Significant increase in enforcement resources: This year, the Ministry of Public Security has increased somewhat its enforcement through "Operation Mountain Eagle," but much more needs to be done to move intellectual property into the realm of law enforcement rather than leaving it solely within the purview of administrative agencies.

- Increase in cases brought: Legal authorities are now better armed with guidance that enables them to prosecute more cases of intellectual property infringement. Now, cases need to be pursued. Over the four years between 2000 and 2004, China made a total of 2,500 arrests for intellectual property violations. In a country where, in a single year, more than 150 million pirated DVDs are confiscated and 52,000 trademark violations were prosecuted, an average of 600 arrests per year seems too few.

- Greater transparency in criminal prosecutions. "The lack of transparency in criminal prosecutions further complicates the situation. Industry does not have information on a regular, open and transparent basis for discussing with the Chinese government the actual number of prosecutions, the jail terms or penalties rendered, whether products are by domestic and foreign right holders, or whether the basis for bringing action is piracy or other laws. Although there are regular announcements of seizures and destruction of pirated products, particularly from optical disc factories, these announcements are rarely (if ever) accompanied by a jail term or fine imposed as a result of criminal prosecution. Meaningful deterrence will be accomplished only when prosecutions and related penalties are directed publicly at combating piracy."

In summary, China has made great strides over many years. Nonetheless, for an effective intellectual property protection system to exist, the most important aspect of the system is the ability to actually enforce the rights which can be protected in the system. China needs to do much more to meet its global commitment as it relates to enforcement of rights.

Thank you.

Testimony of William J. Jones
Chairman, Cummins-Allison Corporation

The United States Senate Committee on Homeland Security and Government Affairs Committee

Subcommittee on Federal Financial Management, Government Information and International Security

November 21, 2005

Los Angeles, California

Good morning Mr. Chairman, Members of the Subcommittee, fellow members of the panel, and other attendees. My name is Bill Jones, and I am Chairman of the Cummins-Allison Corporation, a privately held manufacturing company headquartered in the Chicago area. In addition, I am the immediate past Chairman of the United States Business and Industry Council (USBIC) a Washington-based non-profit lobbying organization representing small to medium- size American manufacturers.

Thank you for the invitation to participate in this important hearing on the protection of intellectual property of American industries. Your work is crucial to the identification and implementation of meaningful, and I highlight meaningful, solutions to the expensive and debilitating problems associated with intellectual property theft by foreign governments and businesses. Thank you for holding this hearing today.

Cummins-Allison was founded in 1887 by the Cummins and Allison families, both prominent leaders in the industrialization of the United States. The Allison family of Indianapolis was instrumental in founding Allison engineering. You are probably familiar with Allison transmission and other Allison power-generation products and components. In addition, one of the Cummins' brothers, Albert, served as the Governor of Iowa from 1902 to 1908, and subsequently was a United States Senator for approximately 18 years, from 1908 to 1926. Throughout the generations, we have worked to promote American policies that protect our nation's manufacturing base, jobs, and national security.

Today, the key product line manufactured by Cummins-Allison Corp. is equipment used to scan, sort, denominate, and authenticate U.S. currency -- as well as many foreign currencies. Cummins' currency processing products are utilized by banks, retailers, governments, armored carriers, casinos, and others to count, sort, and verify the authenticity of currency. Our currency processing products are among the most sophisticated and technologically advanced in the world. Their high speed processing and counterfeit detection capabilities help to protect the integrity of the dollar as a world reserve currency, which is critical to our nation's economy and security.

The design and engineering of Cummins' currency processing products takes place at our research facilities located in Chicago, Philadelphia, and San Diego. Ninety percent of the products Cummins sells around the world are manufactured and produced at our factories in the Chicago area. Eighty percent of our products are sold in the United States, while the balance of our

production is sold in other markets around the world. Cummins has sales and service locations in nearly 50 states, including two here in the Los Angeles area. We have international sales and service offices in Canada, France, Germany, and Great Britain. Cummins' currency processing products are utilized in more than 70 countries.

Cummins-Allison Corp. is a "main street" company, by which I mean it is heavily invested in our local communities. We have a strong desire to keep all of our production in the United States and to continue to provide jobs and opportunities for the people of Chicago and the other communities where our facilities and technicians are located. Cummins-Allison directly employs nearly 1,000 Americans, and another 15,000 Americans are additionally employed at our 300+ U.S. supplier/vendors throughout the United States.

With that as background, I would like to proceed to the main body of my testimony, which is divided into two sections. The first section addresses the theft of intellectual property as a component, or symptom, of our nation's weak and ineffective trade program and policies. The second section provides a few specific examples of how these policies and the threat of intellectual property loss impacts my company, Cummins-Allison, and companies like it.

American Trade Policy

The theft and utilization of America's intellectual property by foreign manufacturers and nations is only one component of very short-sighted, ineffective, poorly enforced, and ill-conceived American trade policies. A prominent example of ineffective policies is the United States trade deficit with China, which will likely top $200 billion this year. Beijing manipulates its currency to gain commercial value without consequence; its manufacturers dump products into the United States without retribution.

American exports, although they have grown substantially over the last decade, continue to be swamped by a much more sizable increase in imports – as foreign markets remain relatively much more closed to our goods than we are to theirs. The end result is an overall American decline in manufacturing and its associated (and all-important) research and development. High-paying manufacturing jobs, which help to stabilize our communities, are evaporating from the American economic landscape and, while all of this is taking place, we also permit foreign manufacturers and nations to pirate our intellectual property. The United States cannot continue this course of "trade inaction" without very serious and dramatic consequences involving our economy and national security – as well as the world economy.

Today it is no exaggeration to say that there is a global assault on the American market by foreign firms, most of which have the strong support of their governments. Meanwhile, foreign markets remain closed or difficult to penetrate for American firms, which receive little or no useful help from the U.S. government. The export of industrial and innovative capabilities to China, for example, along with the theft of intellectual property, has done grievous damage to the U.S. economy. When U.S. companies lose business to Chinese rivals, or need to cut costs to the bone as their margins shrink, jobs are displaced, wages fall, taxable income vanishes, vital public revenue streams decline, resources for new investment in R&D diminishes, and new plant and equipment

purchases decline.

The communities where these companies are, or too often have been, located – and whose economies they often anchor – lose major sources of employment, income, and tax revenue. At the same time, they tend to be hit by rising demand for social services. Former taxpayers become tax consumers as they turn to unemployment insurance, job training, food stamps, Medicaid, and welfare. The education and physical infrastructures suffer. Nationally, the migration of supply chains depresses exports, boosts imports, worsens the trade deficit, increases America's cumulative foreign debt, and puts further downward pressure on the dollar. In many respects, the **costs** of unchecked and poorly managed free trade policies seem to outweigh the benefits for America.

The national security effects of the shriveling or lost supply chains are even more worrisome. As the Defense Department has begun to recognize, small and medium-size businesses are a leading engine of innovation for the economy, and for the military in particular. The health of this sector is essential for ensuring that America's armed forces are equipped with the world's most technologically advanced weapons and other military systems.

With China, of course, a double-whammy emerges. The United States loses industrial and technological advantages critical to maintaining military strength. In addition, it gives away these resources to one of the few foreign powers capable of threatening our national security and our international interests. This year, China's trade surplus with the Untied States represents about 50 percent of our defense budget. That's right. Our defense budget is about $441 billion and our trade deficit with China is likely to be about $220 billion – money that buys the Peoples Liberation Army lots of modernization and a lot of Russian weapons, weapons that are designed to defeat American carrier battle groups, inter alia.

Cummins-Allison and other small to medium size manufacturers are often reminded by the U.S. government that means are available to help them deal with predatory Chinese competition and the piracy of intellectual property. Unfortunately, most of these means are available more in theory than in practice. Specifically, the U.S. trade law system designed to help U.S. companies combat unfair foreign trade practices suffers structural flaws that have rendered it almost useless. The slow, unworkable system suffers from a process that is both unresponsive and extremely expensive to engage. There are very limited government resources available to help American businesses fight illicit trade practices, including the theft of intellectual property. Consequently, the U.S. government helps the largest, most egregiously impacted companies, thereby, leaving small and medium-size manufacturers to fend for themselves.

Even when cases can be legally brought, companies routinely face sky-high legal bills plus long waits as cases wind their way through the Commerce Department and the International Trade Commission. More often than not, smaller companies simply can't afford to wait this long. Their problems are too pressing, and they lack the financial reserves of much larger firms. Just as important, the bureaucratically controlled political systems of many of our chief trading partners can put into effect new trade barriers much faster than U.S. officials and businessmen can even identify them, much less fashion quick responses and overcome the sluggish process.

Small and medium-sized companies are also frequently advised to explore more vigorously

opportunities to export to and invest in China. The market is enormous today and has even greater potential, we are repeatedly told. In addition, the bureaucrats promise that U.S. government export and investment promotion programs stand ready to assist us. Yet the obstacles and risks facing smaller firms, including the loss of intellectual property, are so great that entering the Chinese market is not worth the risks and potential price we would have to pay.

The microeconomic obstacles to doing business successfully in China are far greater than small and medium-sized companies can endure. The China chapter in this year's annual report on foreign trade barriers from the U.S. Trade Representative's office totals 58 pages and is the longest single chapter in the report. Japan's chapter is the next longest, at 45 pages. The USTR's trade barrier report card for both countries deserves a failing grade. The Chinese trade barrier report is astounding and underscores one primary point: the Chinese system of government is especially user-unfriendly to non-Chinese.

In China, there is no reliable, impartial legal system. There is not even the pretense of a reliable legal system. Many laws and regulations are never written down; they exist only in the minds or the confidential records of bureaucrats. Other laws are created and enforced in one locality, but not recognized by neighboring localities or the national government. Laws and amendments to laws can be made or dispelled with a simple phone call.

The Chinese will tell you that their government is transparent while foreign businesses, particularly small and medium-size businesses, are for the most part incapable of retrieving information, let alone cooperation. With no government infrastructure to support a reliable and efficient legal system for patenting technologies, intellectual property from the United States and elsewhere is routinely stolen, copied, and remarketed throughout the world. It is clear that creating a level playing field in China for international businesses is the furthest thing from the minds of Chinese leaders and officials. Rather, the exclusive aim is to promote the interests of Chinese producers, and assist them to dominate the international marketplace, especially the American market.

It is now an open secret that for many years and several Presidential administrations, the United States has done a terrible job of monitoring and enforcing trade agreements and policies. More specifically, America has inadequately protected its manufacturers from trade abuses, including the theft of intellectual property. There are many nations that have taken advantage of America's trade policies, but what we have allowed China to do has been our greatest failure. It is doubtful that much will be done to improve the situation until the Chinese government, through significant economic threat or force, determines that there is more to be lost than gained vis-à-vis their current course of action.

Cummins-Allison Corporation

Twenty years ago, five U.S. owned manufacturers provided approximately 90% of the domestic requirements for technology adapted to automatically sort, denominate, and authenticate U.S coin and currency. U.S. manufacturers dominated many sectors of the industry worldwide, ranging from the manufacture of large sophisticated equipment for use by Central Banks, down to

the desktop equipment used in branches of commercial banks. This vibrant U.S. industry also exported significant amounts of equipment around the world. In addition, U.S. industries printed and produced bank notes for use by many foreign countries. These domestic industries enabled the United States to maintain the critical technology necessary to support the integrity of the United States dollar.

Today, all but one of the U.S.-owned manufacturers, Cummins-Allison Corp., have been eliminated. Over the last 20 years, most of the U.S. manufacturing facilities and U.S.-based R&D has been discontinued and shuttered. During the same timeframe, all of the European and Japanese, as well as Chinese firms, have survived and increased their market presence in the United States to about seventy percent. Cummins, now the sole U.S. manufacturer, has a reduced market share that is down to thirty percent. The large majority of the United States export business for our industry has been lost.

How did this happen? I can assure you that it was not unplanned – or simply the "invisible hand" of the market at work, rewarding the efficient and punishing those slow to adapt to new market conditions and new technologies. No, it was planned in detail in capitals other than Washington. The Chinese, Japanese, and European governments believe that currency processing and authentication is a national security issue and, in a variety of ways, they strongly protect their industries.

The theft of intellectual property and other trade barriers are enormous problems in China, but they also inhibit the export of our products to other countries. Let me address China, Europe, and Japan independently.

China

Unlike the American government, the Chinese government has declared that currency and currency processing are matters of national security. Therefore, even after their entry into the WTO, tariffs of thirty-eight percent to forty percent continue to be assessed by the Chinese government on Cummins-Allison Corp. products exported from the U.S. into China. A recent tender issued by commercial banks in China for 10,000 machines appeared to be an attractive export opportunity for Cummins. However, the Chinese government stepped in and informed the Chinese commercial banks that the banks could not purchase these machines from a foreign supplier, and specifically could not source them from Cummins-Allison in the United States. The tender was in effect a form of import substitution and internal manufacturing and technological development for Chinese firms.

The Chinese government, however, does recognize that Cummins-Allison Corp. is the world leader relative to technology for processing currency at high speeds and low costs. I cite a specific article that is attached and was published in the Chinese equivalent of the Wall Street Journal. I quote, ***"for example the U.S. Cummins Corporation produces a complete product line…. This equipment can be used at the counter or in the vault …. This is probably the most advanced money processing equipment that exists today."*** The article goes on to say, ***"We (China) should learn the merits from the importing money processing equipment and overcoming their drawbacks shall be our winning factor. We will move forward at full speed and enrich ourselves***

with technology and productivity hoping one day we can replace imports (that being Cummins) and then begin exporting money processing equipment bearing Chinese brand names."

Compounding the problem, Cummins has no practical or effective means to protect our patents or intellectual property rights in China. Some have suggested that our own U.S. government failed to negotiate adequate protection of such rights as a condition of China's entry into the WTO. As a result, China's currency processing industry can and does copy Cummins' technology with impunity.

Another trade barrier and threat to our intellectual property is the so called CCC "safety" certification recently implemented by the Chinese government. China claims that CCC is their version of our UL safety requirement. China requires foreign manufacturers to apply for and secure a CCC certification for every imported electronic component or product. In order to receive a CCC certification, Cummins would have to agree to let Chinese government officials annually tour and inspect our facilities here in the United States and pay for all of their travel expenses.

In addition, they require us to give Chinese officials full access to our engineering drawings and schematics relative to the design and production of our products. They also require that we ship a finished product, intellectual property and all, to China for their "evaluation." Somehow, it does not seem to be in the best interests of our national security to provide Chinese government officials with access to Cummins' product design and production information, when the technologies we have developed are intended to protect the integrity of U.S. currency and identify sophisticated counterfeit currency.

As a result of trade and entry barriers, in addition to the potential loss of intellectual property, Cummins has chosen to withdrawn from the Chinese market. Given the high tariffs, the government intervention, and the new so called "safety" requirements, we have decided that it is not practical or profitable for Cummins to export to China and risk compromising or losing our intellectual property. Of course, fewer Cummins product sales, resulting from the abandoned Chinese market, translates into fewer research and development resources, and jobs, here in the United States.

Europe

The Europeans control trade and market access through the setting of standards. An excellent illustration of close government cooperation with industry and standards setting can be illustrated by the introduction of the Euro. Five years prior to the release of the Euro, the European Central Bank established a committee to design the new Euro and invited the European currency processing equipment industry, our competitors, to participate. When Cummins-Allison Corp., an American manufacturer, learned about the existence of this committee, we specifically asked to be included and contacted the appropriate authorities at the European Central Bank. In addition, the U.S. Bureau of Engraving and Printing wrote a letter of recommendation to the European Central Bank suggesting that Cummins-Allison Corp. should be included in these deliberations. We received correspondence from the European Central Bank declining our request.

As a result of being denied entry into the exclusive European club of manufacturers capable of handling the Euro currency, when asked by European commercial banks about Cummins-Allison's ability to handle the Euro, we had to be honest and tell the banks we had not been permitted to see the Euro and, as a result, did not have the technology to process the currency. European banks were somewhat surprised and indicated that the European manufacturers had received early access. Consequently, when the Euro was introduced, Cummins-Allison was effectively shut out of the market, obtained absolutely no initial business for processing the new Euro and lost, potentially, hundreds of millions of dollars in sales.

Furthermore, during the Euro's five-year design phase, European manufacturers essentially enjoyed a five-year head start in the development of currency processing technologies and equipment. They took advantage of the five-year head start by applying for and securing patents covering the best and most cost-effective technologies available to process the new Euro currency. Therefore, by the time the Euro was released and Cummins was able to begin developing equipment to process the Euro, it was too late. The European manufacturers' patents had been issued and effective, legal road blocks prevented Cummins from developing competitive products. It is important to note that the issued patents were not the result of the Europeans' superior innovation or technology. The European manufacturer's advantage was due solely to their five-year head start, exclusive access to the standards of the new currency, and the utilization of "insider information" to obtain intellectual property protection.

Japan

The Japanese market for currency processing equipment is completely closed to Cummins' products. The Japanese government will purchase currency-processing equipment only from Japanese manufacturers. Other potential Japanese customers have been instructed by the government to buy only Japanese-manufactured products. In addition, when releasing a new currency design, the Japanese Central Bank only shares critical, advance information with the domestic Japanese producers. There are no foreign suppliers of currency handling equipment within the Japanese market.

As far as intellectual property theft is concerned, Cummins has frequently received inquiries from the Syrian government to purchase our equipment for the processing of U.S. currency in the Middle East. Because Syria is under a trade embargo, we refuse to sell this technology to Syria. One of our competitors from Japan, who has repeatedly infringed Cummins patents here in the U.S., has perfected and copied our technology and equipment. Currently, this same company is turning around and selling their equipment, containing our technology, to the Syrian government.

It is difficult to understand why the U.S. government stands idly by while foreign manufacturers replicate U.S. technology and perfect it in the U.S. market. Furthermore, our government then permits the foreign manufacturers to sell the technology to adversarial and militant governments in other parts of the world. The U.S. government should do more to enforce American trade law and better protect U.S. manufacturers from the theft of intellectual property. In addition, foreign manufacturers of currency-processing equipment who sell their products in the U.S. should be banned from our markets when they sell to embargoed or adversarial governments. Foreign

manufacturers can either sell to the U.S. market or our adversaries but should not be permitted to undermine America's security.

Japan, Europe and China maintain that their currency processing equipment is a component of "national security." As a result of their protected markets, foreign manufacturers are able to make all the money they need in their domestic markets. In addition, over the last 20 years they have used the advantage of home-market protections to dump their products in the United States at prices that are only one-half to one-third of their home market prices.

As a result, as I mentioned previously, all of the U.S. manufacturers in our industry, with the exception of Cummins-Allison Corp., have been eliminated. Cummins-Allison Corp. has only been able to survive because we recognized that the deck was stacked against us and elected to operate only in smaller niche markets offering products that are protected by comprehensive patents in the United States. If Cummins did not have patent protection, we too would have been driven out of business. It is important to note that at some point Cummins' patents will expire and at that point the United States may be faced with the loss of its only currency-processing equipment manufacturer.

The Counterfeiting of American Currency

In repeated appearances before Congress over the past several years, the United States Department of the Treasury has maintained that there are no serious U.S. currency counterfeiting problems. However, it has now been widely reported that the North Korean government is printing very high quality U.S. currency counterfeits and other governments may be doing the same. In addition, a Chinese bank was recently cited by the U.S. government for assisting in the circulation of North Korean counterfeits. This fits in with the observations that Cummins made sometime ago and is consistent with feedback we have received from our international distributors and commercial bank customers around the world.

For some time we have seen excellent counterfeits of American currency coming out of North Korea, circulating around China and into South America and the Middle East. It is indeed a national security issue for the United States when foreign governments collaborate to produce and circulate excellent counterfeit U.S. currency. America, in fact, has a serious problem as was confirmed in a recent story that was published in the Korea Times. This story quotes a Congressional Research Service employee as saying that North Korea's government may be subsidizing itself through the annual worldwide circulation of $20 million worth of high quality counterfeits. We also know that the North Korean counterfeiters are using the same model printing presses as those used by the Bureau of Engraving and Printing.

Currency counterfeiting also creates potential security risks -- through the illicit financing of terrorist activities. As terrorist funding sources have been eradicated, there is an increased likelihood that terrorists will turn to counterfeiting as a means to purchase technologies and armaments to further their objectives. Preventing the circulation of high quality American counterfeit currency and drying up the financial resources of terrorists is a far more effective means to stifle and cripple terrorist activities than military action.

Of perhaps greatest concern is that an organization or adversarial government has already produced a large stockpile inventory of excellent U.S. counterfeits to flood the consumer, commercial and financial markets throughout the world. The circulation of large quantities of high-quality counterfeit currency would generate economic instability and threaten the status of the dollar as the world's reserve currency. We encourage Congress and the Executive Branch to more thoroughly investigate international currency counterfeiting. We also suggest, in this post 9/11 era, that American policy makers more fully recognize the importance of protecting American currency and reducing the threat of terrorist financing through counterfeiting.

Summary

In short, counterfeiting and the theft of intellectual property are very serious problems, which threaten our economy and our national security. As the last remaining American- owned manufacturer of currency processing equipment, Cummins-Allison believes that the U.S. lacks a complete, coordinated currency-protection policy, which should be an important component of our national security. I encourage Congress and the Executive Branch to develop and coordinate a substantive U.S. currency-protection program, which, in part, recognizes the importance of protecting America's intellectual property and the currency processing industry.

European and Asian governments do much to coordinate currency protection policies with their commercial banks, currency equipment manufacturers, academicians and others. Foreign governments believe that the intellectual property inherent in its currency-processing industry is a component of their national security. Our national security is important too. America should follow suit.

In looking at our national intellectual property and trade policies, for years the United States has turned its back on abusive governments and foreign businesses that do not play by the rules and never will. Those implementing U.S. trade policies either lack the will or the firepower to deter these abuses and, as a result, the U.S. is weakened a little more each and every day. Jobs are being lost, our security is being compromised and our economy diluted through the pirating of information and products.

Why do we permit foreign interests to copy our technology and sell it to our enemies? Why do we allow foreign interests to reverse engineer our products and then dump their counterfeits into the U.S. without consequence? Why can't Cummins-Allison receive meaningful and enforceable patent protection in China, but a Chinese company can easily and quite successfully do so in the U.S.? Something must be done, but nothing will be achieved if our weak trade polices and practices continue to be based on asking politely and hoping for the best.

Mr. Chairman and Members of the Subcommittee, American manufacturing and its corresponding jobs will not survive without improved government programs and a concerted effort to fully enforce existing trade laws. This includes ambitious, aggressive programs to stop the rampant proliferation of counterfeiting and intellectual property theft. Our trade policies are not working and small and medium-size American manufacturers, along with the public and their communities, are paying the price. We can survive, but not without a level playing field here at home, in China, and in other export markets abroad.

Thank you for the opportunity to speak before you today.

Newspaper Clipping

Source: China Financial Times, June 26, 2001, Tuesday
Financial news / Advertisement Section

Title: Further development + Overcome our shortcomings = Success
- production of our own money processing equipments
by Wang Zhi Ying

Nowadays, all our (the Chinese) commercial banks are still mainly using domestic manufactured money processing equipments such as note counter, detector, counters with counterfeit detection, and strapping machines; imported equipments such as USD detector, note sorter for different currencies and purposes, deposit machines, exchanging machines, and ATMs complete the automated banking picture. Our Renmenbi (RMB) are mostly processed by local machines, meanwhile, foreign currencies primarily USD are done by imported detector and sorter. Cash currency is indeed the most important means of our economy, and we have a humongous volume of RMB currency flow. As our country is slowly opening up, our foreign currency cash volume, especially USD, will increase and hence creating a large demand for money processing equipments will increase also. We cannot rely on imported equipments, and must rely on ourselves to develop hi-tech money processing equipments to satisfy our unique market requirements. Therefore, domestic production of such equipment is inevitable.

Imported machines can be seen at headquarters or large branches where volumes of cash are high, especially sorters and detectors to handle USD. Imported equipments have the following advantages and merits:

1. Machines are hi-tech, stable, reliable, multiple features, high speed, and have small number of errors. For example, there is a digital spectrum analyzer, utilizing the latest electronics and optics technology to analyze and verify the USD paper material content and ratio, as well as paper thickness, and its unique tint. Not only can the detector function as a counterfeit finder, but also a sorter for different denominations.
2. Offers a multiple models for a complete solution. For example, the US Cummins Corp. produces a complete product line including the 4022 USD counterfeit counter, 4028 multi-currency counterfeit counter (USD, JPY, HKD, GBP, EUR...), 4065 USD Scanner (petite sorter), as well as the 4095 USD Scanner (sorter). These equipments can be used at the counter or in the vault. They can sort different series, denominations, facing, at the same time, catch counterfeits of each series, sort out the dirty notes, and tally the total amounts of different denominations. This is probably the most technically advanced money processing equipment that exists today. (to be continued)

However, there are also drawbacks and disadvantages of imports:

1. High prices. Import equipments can be several times or even ten times more expensive than the domestic equipments. An USD sorter can cost more than RMB100,000.
2. Some distributing companies cannot provide spares parts or maintenance. Several years ago, some distributing companies for the British De La Rue and some other Japanese note counter manufacturers could not repair their equipments. Machines were scrapped as soon as they started to fail. Some detectors could not handle the 1996 or later series of USD, and ended up being put aside and large amount of purchasing money was wasted.

We should learn the merits from the imported money processing equipments, and overcoming their drawbacks shall be our winning factor. As a matter of fact, we should concentrate our resources to develop more sophisticated technology to fill in the foreign currency detector void in the domestic manufacturing market. Recently, a local manufacturer has successfully developed an USD detector for all denominations, all series, usual counterfeits, as well as "Super Dollars". By utilizing "intelligent detection", results are almost as stable and reliable as imported equipments, and selling price is only 1/3 of the imported. This is great news for us. We shall move forward in full speed and enrich ourselves with technology and productivity, hoping one day, we can replace imports and then begin exporting money processing equipments bearing a Chinese brand name.

FINANCIAL NEWS 投资理财/广告

星期二 2001.6.26 —

扬长补短 才有可为

从进口现金处理设备看国产化

机具国产化

目前，我国各商业银行主要还是使用现代产现金处理设备，包括点钞机、验钞机、鉴伪点钞机、捆钞机等；部分是进口机具，主要是美元验钞机、各种类型的纸币清分机及自动存款机、外币兑换机、自动柜员机等。人民币处理一般都是用国产机具，而外币尤其是美元鉴伪，部分大多是使进口机具。我国是一个现钞大国，人民币的现钞量很大，随着我国改革开放的进一步发展，外币现钞量，尤其美钞量也在增大，对各种现金处理设备的需求也会越来越多，而且量大。我国不能依赖进口设备，必须调动自己的力量，研制出符合我国国情的高科技的现钞处理设备。因此，机具国产化势在必行。

进口机具，在此各量较大的商业银行总行和省分行都能见到，尤其美元的清分机和验钞机应该得设多。进口机具的主要优点是：

一、大多技术含量较高，技术性能较稳定，功能多，速度快，误差小。比如美元验钞机，有一种电子数码处理分析仪，利用最先进的电子技术和光学分析仪原理测试美钞纸质材料的组成及配比，钞票的新旧，钞票的磁性，不仅能分辨真伪，还能起到清分的作用。

二、机器品种多，有的已形成系列产品。比如美国康明斯(CUMMINS)公司生产的系列产品，有4000型美钞鉴伪点钞机、4025型多种货币鉴伪点钞机(美元、日元、海币、英镑、欧元等)、4065型美钞扫描仪（美元小型清分机）、4095型美钞扫描仪（美元大型清分机）。本套机具有的是密度台使用，有的是单独使用，对美元有多种分不同版面、不同面值、正反面，同时，识别近年来版的伪钞，也能检出假票；在点数方面，能分别面值计数，又能汇总计数，是当前世界上较先进的现钞处理设备。

进口机具也有些问题，突出是：

一、价格太高，在现阶段比国产设备高出几倍甚至十几倍，如一台美元大型清分机，价格超过10万元。

二、有的代理公司不负责任，没有零配件，比如有几年美国德利兵公司，自己一些厂家生产的点钞机，代理商不能修理，银行只好闲置不用，坏了无法处理，只能报废。一台美元验钞机只能查到1996年以前各版美钞的真伪，1996年新版本刚发行不能查到，花了很多钱购买一大台设备，不能查到1996年版本版美钞，只好闲置一边所买所的。

进口现金处理设备的优点值得我们学习，其不足之处正是我国机具生产企业开拓市场的"突破口"。其实，只要加大研发力度，我国生产现金可以大有作为，外商静态鉴别位置以前在我国是一个空白，现在得知国内某公司已研制出美元验钞仪、可检测各种面额（包括1996年以后发行的新本刚钞票）假币伪钞、假彩伪钞（印刷版）、在用高科技智能鉴别，性能比较稳定，不逊于进口的先进设备，而价格仅相当于进口设备的1/3，这是一个可喜的开端。我国机具生产企业应发奋图强，进一步开展研究，生产出各种技术含量高的现金处理设备，逐步在国内市场取代外国厂商的产品，并努力开拓国际市场，尽早创立中国现金处理设备的名牌。

文/王志英

Note!

THE KOREA TIMES

NK Earns $20 Million a Year From Counterfeiting: Expert

SEOUL (Yonhap) - Using state-of-the-art technology, North Korea earns $20 million each year by trading high-quality counterfeit dollar bills dubbed ``supernotes," an American expert said on Friday.

Raphael Perl, an analyst at the U.S. Congressional Research Service, said that counterfeit currency and the arms trade represent the two biggest sources of income for the cash-strapped communist regime.

``The estimates that we have are between $15 and $20 million, and we assume the trade is growing as North Korea's need for hard currency is growing," he said in an interview with Radio Free Asia.

He argued that Pyongyang is increasingly dependent on counterfeiting to offset the reduction in its income from the narcotics trade, with countries ever vigilant to its drug smuggling activities.

Perl's claim comes amid widespread suspicion that North Korea operates a state-sponsored program to counterfeit U.S. dollars, an illicit cash cow that also serves to destabilize the U.S. economy.

Pyongyang is suspected of churning out the supernotes and circulating them through diplomats and high-ranking officials who make overseas trips.

A North Korean defector who used to work as a senior official at Pyongyang's intelligence agency said that the regime has manufactured counterfeit bills since the early 1990s and circulates them via nearby areas, such as China, Taiwan and Macau.

Perl described North Korea as a global superpower in terms of its counterfeiting technology.

``For example, you can buy Viagra manufactured in North Korea that looks like U.S.-manufactured Viagra. One cannot tell the difference," he said.

05-13-2005 18:12

Prepared Statement of
Ted C. Fishman

No subject is more important to the vitality of the American economy than the protection of our knowledge economy. Americans have made a bargain with the world in which we relinquish low-cost, labor-intensive manufacturing, suffer the closing of thousands of factories and the shedding of millions of jobs provided we replace our old cut and sew and rust belt jobs with higher value knowledge industry and service jobs. I stress that the bargain Americans expect is that lost jobs will be replaced by higher paying ones. To date, that has not been the case, and the practices that are the topic of this hearing, which we might label "China's Loose Intellectual Property Regime," are at the heart of why the this bargain is sending millions of Americans backward economy instead of ahead. At the hearing today the woes of the entertainment industry will get a thorough and welcome hearing. And yet, the problems of movie makers, recording artists and authors may well pale, in economic terms, to those of Americas thousands of manufacturers, their owners, workers and communities.

Allow me to begin by lauding and thanking the *Subcommittee on Federal Financial Management, Government Information and International Security* for taking up the topic of China's lax enforcement and its implications for Americans. Also, I ask your understanding. Because of the urgent nature of this hearing, and the short notice necessary to its scheduling, my remarks are more prone to assertion than usual. I look forward to probing this topic deeper, to following the subcommittee's work and helping the members in any way I can.

In preparing for these hearing I made calls to some of the many industry and trade associations that I have spoken with over the last two and a half years as I reported several pieces for the New York Times Magazine and prepared for my book, *China, Inc.* Trade associations, as you know, speak for collections of companies and interests, but need not necessarily identify individual companies that feel the impact of negative trends in their industries. As a result, the issue, though essential to our economic future, often seems as though it is doomed to exist in a kind of shadow in which general harms are articulated but the victims themselves are hampered from describing the particulars. The dangers to victimized companies are many. Complaining too loudly, many fear, will jeopardize any future plans of penetrating the Chinese market. Government and business interests are often so closely bound up that officialdom, so the fear runs, can and will act punitively against foreign firms that out Chinese counterfeiters and pirates. There are also the consequences at home to fear. Acknowledging a threat from counterfeiters shows weaknesses that companies do not like to make public. They also alert corporate clients to alternatives in the marketplace and may send a companies' best customers shopping. There are also legal liability issues to consider, and the mere acknowledge of a threat from counterfeiters may bring an added, and perhaps prohibitively expensive, burden to police supply chains.

I thought I would expand on a few of the issues related to China's intellectual property regime that I often hear articulate by manufacturing trade associations and by companies to speak to me, sometimes publicly and sometimes confidentially, about their concerns.

First, companies routinely find that is simply impossible to protect their proprietary products and processes in the Chinese market. The monetary harm to lost sales is self-evident for those trying to build businesses in China. But there is another broader implication. China's loose intellectual property regime stands as a giant informal trade barrier to American companies. The fear of theft prevents American firms from wading into the world's fastest growing economy with valuable products they would otherwise be enthusiastic about selling, and even developing or improving. I recently spoke at a large conference of Silicon Valley CEOs and was surprised to learn how few of them were willing to brave the China market, particularly if they were in possession of advanced, disruptive technologies. The reason was fear of theft. In a conversion I had just prior to this hearing, an executive at the Society of Plastics Industry said that one of that group's members was negotiating in China with a potential partner who happened to be an established player in the local market. When the negotiations came around to intellectual property protection, the partner simply refused to offer any assurances that the American company's proprietary goods or methods would be safe. Indeed, the Americans were assured that they would be copied. The competitive reality in China all but demands that companies play pirate, because if they do not, their competitors will.

Second, companies find that their products and processes are expertly mimicked in China and then introduced into legitimate supply chains worldwide. In one common scenario, a purchaser of industrial parts walks into an America factory he has long dealt with and is shown samples and prices from a Chinese manufacturer and told to meet a price. The goods, are often exact copies of products that were developed at great expense by the American supplier, but copied at little cost by a Chinese factory. This is a scenario that should kept in mind at this hearing, because it is piracy and counterfeiting in the business-to-business realm that is often overlooked. As much as eighty percent of the trade in American industry is business to business, and piracy and counterfeiting hit this realm hard. The willingness of Chinese manufacturing to turn out fake autoparts is well-documented. The Motor and Equipment Manufacturers Association estimates that U.S. suppliers lose $12 billion a year due to fraudulent parts. In December 2003, authorities uncovered a $700,000 shipment of counterfeit brake parts on their way to shops servicing New York taxis. Writing in *Automotive Industries* in January last year, Maryann Keller noted that "As foreign automotive investment increases in China, local Chinese companies will have easier access to up-to-date technology of parts and components as well as entire cars that they increasingly have the skill to copy. The legal system suggests that foreign companies have little recourse while consumers, be they Chinese of otherwise, care more about the price than they will about the way that goods were developed and brought to market." Then, raising one of the most ominous questions of all, Keller asks, "Will U.S. auto companies complain if a local Chinese company offers them a copy of a part at a fraction of the price they were paying to the company that did the engineering and design work originally?" If history is prelude the answer is yes. Honda, for one, found that the companies counterfeiting its parts in China did such a superb job, and were so aggressive on price, that is was forced to join with the counterfeiter.

Drug companies report that they are seeing an increased threat from counterfeit drugs entering the legitimate supply chains. Working with Chinese authorities, offiacials at

Pfizer have "seized millions of units of counterfeit pharmaceuticals and thousands of kilos of compounds' used to make them. The drugs appear identical to those they're copying, and come in packages that indistinguishable from the real thing. In the worst cases, the fakes are commingled with legitimate products. In May of 2003, 200,000 bottles containing counterfeits of Pfizer's cholesterol controlling drug Lipitor that were sold by mainstream pharmacies in the U.S. were recalled. Fakes can be a death sentence for patients and possibly for companies. We can all be relived that in this case the Lipitor fakes, did no serious harm to patients or Pfizer shareholders. But a report in yesterday's Chicago Tribune (November 20, 2005) by reporters David Greising and Bruce Japsen offers an unsettling view of the future. The story describes the reporters journey into Chinese shops in search of counterfeit Viagra. The drugs were easy to find, though often impossible to distinguish from originals. When submitted to labs, some of the fakes proved to be nothing but look-a-likes, but surprising others were not just copies, but "supercopies," with added doses of Viagra's active ingredient formulated into the pills, presumably, to keep customers loyal. When counterfeiters start trying to augment drugs, they can feed black market channels with compete with legitimate ones on price and potency, but also threaten users with dire consequences to their health.

One other concern is the speed and sophistication Chinese counterfeiters and pirates bring to their enterprises. It is commonly observed that American and other global companies must stay ahead of the competition through constant and bold innovation. This is undoubtedly true. Certainly, those American firms that fail to adapt and innovate will fall to those that do. Yet, there is a catch to the lead by innovating strategies created by China's copiers. Technology leaders must spend valuable time, brainpower and financial resources to develop their leading products. Copiers can move faster and at much lower cost. The paradox of successful innovation in a knowledge economy is that ideas and processes, exist nowhere and everywhere at the same time, thus making the new almost instantaneously old hat. To learn American ideas and processes is the same as owning them. Unless, that is, law effectively prohibits their cooption. The style of our economy makes America more vulnerable to the Chinese copying our goods than the other way around. Most of the stuff China makes that finds its way onto the world market is physical. The Chinese can borrow and steal our best stuff all they want. Some of our most valuable products—software code, pharmaceutical processes, car designs, the digital files that put movies on disk—weigh nothing and move at the speed of light as email attachments. If Americans want to borrow and steal what China makes we would have to march in with an army and commandeer Chinese factories and workers. Western powers and the Japanese tried that already, in the mid-19th and early twentieth centuries, and won't likely repeat the experiment. China, however, can colonize the developed world's best production simply with careful study and a willingness to go its own way on intellectual property protection.

Of course, American innovation often finds its way into physical products, but it is idea work nonetheless. When General Motors develops a compact car for the Korean market, and sinks hundreds of millions of dollars into its development and design, the Chinese copier, Chery Motors, can simply copy the design and processes and save all the time and money GM spent. The copies Chery produced were not gestures in GMs direction, but so

expert that a door from one of the Chery models fit perfectly into the space for a door in GMs Korean car. Right now, an American entrepreneur is attempting to bring Chery cars—not the GM copy—into the United States. This repeats a scenario that legitimizes Chinese copiers and is becoming increasing common. The American importer is counting on consumers to remember that Chery is the company the copied a GM car so expertly, so that when buyers come into a showroom and see Chinese cars for thousands less than their American, Japanese or Korean counterparts, they will see a copy as worthy of their money as the originals.

With the previous observation a lead, I would like to suggest a tone for American efforts to reverse China intellectual property regime and create a culture not of avoidance, but of compliance. There is an easy temptation to demonize the Chinese over their practices. We would also do well to understand the motivation for copying, which often are far from demonic. Some commentators argue that there is a cultural predilection in China to copy. Historically, the argument goes, the Chinese revere masterworks and in school learn to copy literature and art. Under the communism of Mao, there was no right to protect one's intellectual property since everything of economic value belongs to the state and practical, industrial ideas, were to be shared by all. There is also the darker side of the argument, one with ethnocentric ugliness. It paints the Chinese as unique sorts of thieves. I strongly urge the committee and any others taking up the issue of China's intellectual property regime to banish the cultural and ethnic arguments. The Chinese have solid, practical, non-cultural determinant reasons for acting as they do. The simple reason patented, copyrighted and trademarked gods are copied is because they can be. In the United States, before the law and enforcement began to catch up with online music services, like Napster, that allowed songs to be downloaded for free, nearly everyone in America with access to the internet and an interest in music, took their music free. There were, and remain, mountains of logic and rationalization that downloaders use to justify the practice. Recently a group of New York University students marched outside a Manhattan Virgin Megastore to demand their so-called digital rights. Some of their arguments may have merit, but are rooted in the desire to swap and share music at no cost. One way to think of China is as Napster Nation. They take because they can, because there is no consequence to their action and because they profit from it. Dare I say that any of us, if we were granted super powers to take anything in this world we wanted without consequence, might find ourselves yielding to temptation? We don't need 5,000 years of history behind us to know that stealing is cheaper than buying.

Even as leaders we might make the same choice as the Chinese leadership. Here's a simple thought experiment. Imagine you were the leader of between 1.3 and 1.6 billion people, most of them desperately poor and modestly educated. Suppose you could transfer to your people the jewels of the world's advanced industrialized nations, paying nothing for much of it and pennies on the dollar for some more. Suppose, in other words, you could steal the best technology, copyrighted materials, brand names and top entertainment for your wanting people. And imagine further that you had little expectation of being held to account for that theft. In contrast, you would be rewarded for it. In fact, that theft would make your country an ever-more desirable home for the very international fashion, technology and knowledge enterprises you were so liberally

borrowing from. Anyone here would make that choice—the choice which the Chinese government and people made and still do make every day. One of the precepts of good leadership is to make one's people prosperous and capable, and the Chinese practices have followed that hands down. Remember, the incomes of the Chinese have risen four-fold in twenty years, the use of personal computers is widespread and expert and Chinese factories routinely run on the very same software that their competitors in America use. In all, China's creation of an extremely loose intellectual property regime has paid off handsomely. And, we must admit, impressively. It has been a key element of China's growth. Rather than fault the Chinese for the method of their progress, I suggest we offer admiration, grudgingly, but sincerely. Conceding their success, however, does not mean conceding. It is now time we exercise what means we have to enforce global rules that will also serve the American economy.

Grudging admiration can wake us up to what ought to be our chief grudge against China's loose intellectual property regime. With due respect to the entertainment industry and to those that make consumer software and electronic games, the harms done to those industries are unlikely to move the American people to action. If we are looking to popularize the issue of intellectual property protection, it may be hard to convince the American consumer, fairness aside, that the likes of Hollywood studios and Microsoft deserve to be richer. Indeed Hollywood seems to pit itself, venially, against its most loyal buyers. The case of Sony's CD copyright protection scheme, revealed over the last two weeks, is a sad case in point. On its latest CD releases, Sony inserted what computer experts describe as spyware, a program that was unleashed when music was played on CD which allowed Sony, and hackers, to monitor a user's machine. The program also wreaked havoc with some computer hardware. That was not a wise course for an industry looking for public consensus on it most important issue.

It is possible to build consensus on the issue by beginning not in Americans' home theaters, but on our shop floors, and in our laboratories and offices. Once one looks there, it is possible to see far beyond the harms usually associated with Chinese piracy. Most often, the harm from piracy is quantified by tallying the lost sales of items that could be sold by legitimate producers if China did not make fakes. Using this way of counting, the U.S. Commerce Department estimates that the world's legitimate intellectual property holders lost around $80 billion to China in 2003-4.

But still the numbers do not begin to describe how piracy is essential to the competitive edge that makes China such a tough competitor. Nearly every good turned out of Chinese factory for export benefits from the country's loose intellectual property regime. That includes the goods that will make America's estimated 2005 $200 billion-plus trade deficit with China. Trade deficit numbers are scary, but they are also a good, albeit indirect, measure of how well American companies—the ones that bring in Chinese goods—profit by taking advantage of China's low-cost manufacturing.

Ron Hollis, the CEO of Quickparts, an Atlanta company that makes custom parts that go into other machines, recently returned from China. There he scouted for new business. On his factory visits he routinely asked whether any of the software in use was legitimate.

Almost none was, he was told nonchalantly; as if an admission that software were legitimate were also an admission that the factories were wasting money.

"In a U.S. factory like mine where engineers spend their days on sophisticated work station with advanced industrial design software, the yearly cost to run software at a single station can cost $60,000," Hollis says. "It can add up to millions a year and be a shop's highest cost. Chinese factories pay nothing for that."

Pirated technology is so common in China, that it is a competitive disadvantage to pay full boat for it. Software used without license fees, reverse engineered advanced machinery, often created with the help of Chinese government research institutes, and proprietary processes and production lines are all common features of the Chinese workplace.

How do we address the problems we face with China's IP regime? First we must acknowledge that bullying is getting us nowhere. China's practices are growing worse over time not better, despite a recent rash of laws that ostensibly address the issue. Also, like any nation that sees itself world power, China does not react kindly to external scolding and ultimatums. Then, too, there is the mixed message Americans deliver to China. We buy $200 billion more worth of goods from China than we sell to the country because China gives American businesses and consumers what we demand most, ever lower prices. The picture of Chinese cargo ships off American ports waiting unload increasing numbers of low-cost goods is not a complete one. Before those dships arrive, American have had to order the goods. If the orders come from powerful buyers, they are usually joined by strong demands to keep prices low. Big box retailers often demand that their suppliers cut their costs every year, threatening them with anathematization if they do not. The question of how those costs are cut is rarely asked, and the insistence that costs not be cut by resorting to technology piracy is never made. Instead, with a wink and a nudge, American buyers insist that Chinese producers cut costs any way they can, and thus put pressure of their suppliers to cut corners and steal technology. The benefit to consumers is great. Americans, on average, save around $600 a year on account of China's low-cost manufacturing. But there is a cost, too, that can be measured in factory closings and lost jobs at home. In the long run, we will see the cost in our collective economic might and political power. Chinese counterfeiting and piracy hits the heart of American industry two ways. First it is an essential element of China's low-cost manufacturing machine, because piracy saves Chinese companies from having to pay the technology costs that weigh heavily on American factories. Americans have learned how to compete against low cost Chinese labor. We do it by automating. But we cannot compete away technology costs, because our legal system demands, rightfully, that they be paid. On the American shop floor, and in the American office, technology is among the highest cost items and American firms spent a high proportion of their budgets on it. In China, technology is a very small component of costs.

Or this problem at home, we need a solution at home. The U.S. could insist that corporate buyers of Chinese-made goods certify that their goods were not made in factories were pirated technology runs the show. This kind of monitoring is already used by U.S.

companies who inspect their suppliers in low-wage countries to make sure they are not using child labor or abusive management techniques. The system is not perfect, but it has made a difference in how American companies and their suppliers do business.

If Americans want to continue to shed old-fashioned manufacturing and move into evermore sophisticated knowledge work, then we must find a way from keeping our "New Economy" from transferring to China at no cost. For a short time we still matter enough to the Chinese to effect a change. Our trade deficit alone with that country is nearly 15 percent of China's economy. If we don't protect our economy now, we will find we have far less economic clout after the most vital parts of our economy has been cloned in China.

Testimony of Patrick A. Mulloy, Commissioner, U.S.-China Economic and Security Review Commission

Before the Subcommittee on Federal Financial Management, Government Information, and International Security of the Senate Committee on Homeland Security and Governmental Affairs

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Hearing on "Ensuring Protection of American Intellectual Property Rights for American Industries in China"

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November 21, 2005
Beverly Hills, California

Thank you Chairman Coburn for inviting me to testify today before the Subcommittee on Federal Financial Management, Government Information, and International Security which you chair. I would like to submit the following prepared remarks for the record, and will use my time this morning to briefly highlight a few key points about China's continued violations of the obligations it assumed to protect intellectual property rights – patents, trademarks, industrial designs, and copyrights – when it joined the World Trade Organization.

China is enjoying enormous economic benefits from having joined the WTO, such as being assured of very low tariffs on the goods it ships to the United States. This has brought increased investment to China and a huge increase in the exports it ships to the United States. This has brought increased investment to China and a huge increase in the exports it ships to our country.

China, by joining the WTO, has become a wealthier country. It should, therefore, carry out its WTO obligation to protect intellectual property rights which is something we bargained for both in

supporting the creation of the WTO and in subsequently agreeing to China's entry into it. Since China is failing to do so, at an enormous cost to our citizens, our government should be much more aggressive in using the tools available to us to put pressure on them to fulfill their commitments. This could include putting higher tariffs on Chinese goods that they most want to send to our market. If we bring a WTO case against China and win it, we can be authorized to do just that. We should also strengthen our efforts to keep counterfeit goods made in China out of our market. These goods, such as pharmaceuticals and auto parts, pose a health and safety risk to our citizens.

Let me talk a bit about the benefits China is reaping from its trade with the United States, and then discuss the deleterious impact its failure to carry out its obligations to protect intellectual property rights is inflicting on our economy, and what the U.S.-China Commission has recommended we should do about it.

I. Highlights of the U.S.-China Economic Relationship

- In 2004, total U.S. goods trade with China was $231 billion, making China the United States' third largest trading partner, behind Canada and Mexico. China was the United States' second highest source of imports, behind Canada, and its fifth largest export destination, behind Canada, Mexico, Japan, and the United Kingdom.

- The U.S. goods trade deficit with China hit a record $162 billion in 2004 and was the United States' largest bilateral trade deficit – more than twice that of the U.S. goods deficit with Japan, which ranked second. Imports from China reached $197 billion and U.S. exports to China totaled $35 billion. These figures represent an increase over 2003 in imports from China (28 percent), exports to China (22 percent) and the overall U.S. goods trade deficit with China (31 percent). Since 2001, the year that China joined the World Trade Organization (WTO), U.S. exports to China have increased 81 percent, and U.S. imports from China have increased 92 percent, leading to an increase in the U.S.

bilateral goods deficit of 95 percent. From 1990 to the end of 2005, the United States will have accumulated over $1 trillion in trade deficits with China. The Chinese government now controls U.S. dollar reserves of over $750 billion. It invests some of these dollars in U.S. Treasuries; by doing this – which helps keep U.S. interest rates low – they have gained some leverage over the United States.

- The U.S. goods trade deficit with China represents nearly a quarter of the overall U.S. goods deficit and grew at a faster rate in 2004 (31 percent) than the overall U.S. goods trade deficit (22 percent). In fact, the increase in the U.S. goods trade deficit with China of $38 billion in 2004 accounts for nearly one-third of the $119 billion total expansion of the U.S. goods trade deficit during that year.

- The U.S. goods trade deficit with China is spread across nearly all major product categories. Of particular significance is the growing U.S. deficit with China in goods designated by the Department of Commerce as advanced technology products (ATP). U.S. ATP imports from China grew more than 55 percent in 2004, leading to a U.S. ATP deficit with China of more than $36 billion. Since China joined the WTO, the U.S. ATP deficit with China has increased six-fold, from $6 billion to $36 billion.

II. China's Weak Intellectual Property Rights (IPR) Protections and Enforcement

IPR piracy in China remains rampant and is a paramount trade concern for a broad array of U.S. firms whose intellectual property is central to their business success. U.S. exporters are concerned about the theft of their intellectual property and its reproduction and sale in China at a fraction of the cost, while U.S. producers are concerned about having to compete against Chinese firms that can make technology and design advances at low cost using pirated intellectual property.

Notwithstanding legal improvements, IPR violations in China continue virtually unchecked. Piracy rates in China remain above 90 percent across all copyright industries.[1] Counterfeiting in China has reached such epidemic proportions that two-thirds of the counterfeit products in the world are of Chinese origin.[2] Of the $94 million worth of counterfeit goods seized at the U.S. border in 2003, 66 percent originated in China.[3]

Take the example of the U.S. software industry, an industry that should be enjoying enormous market opportunities in China. Instead, the Business Software Alliance estimated that loses to the U.S. software industry due to piracy in China amounted to $1.47 billion in 2004.[4] According to industry testimony, U.S. software sales to China have stalled due to IPR concerns:

> *Rampant piracy has effectively stalled growth in U.S. software exports to China, despite China's escalating use of computer and software technologies. Consider that in 1996 China was the sixth largest market for personal computers and the twenty-sixth largest for software; it is now the second largest market for personal computers but still only the twenty-fifth largest market for software. This growing gap between hardware and software sales is the inevitable consequence of a market that does not respect intellectual property rights or reward the significant investment required to develop and market innovative software products.*[5]

The U.S. entertainment industry is another whose competitiveness has been heavily affected by the current IPR situation in China. The Motion Picture Association of America (MPAA) reports that China's piracy rate reached 95 percent in 2004 and that during 2003 69 percent of the VCD

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1 U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Assessing and Enforcing Compliance*, testimony of Eric H. Smith, February 4, 2005, p. 312.
2 U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Assessing and Enforcing Compliance*, testimony of Terence P. Stewart, February 3, 2005, p. 82.
3 Congressional-Executive Commission on China, *Intellectual Property Protection as Economic Policy: Will China Ever Enforce its IP Laws?*, testimony of Daniel C. K. Chow, May 16, 2005.
4 International Intellectual Property Alliance press release, *U.S. Copyright Industries Concerned about USTR's 2005 Special 301 Decisions on China and Russia* (Washington, DC: April 29, 2005).
5 U.S.-China Economic and Security Review Commission, *Hearing on U.S.-China Trade and Investment: Impact on Pacific Northwest Industries*, testimony of Jesse M. Feder, January 13, 2005, p. 109

and 85 percent of the DVD discs manufactured in China were pirated product.[6] The industry estimates that U.S. film companies have lost over $1 billion in revenue due to piracy in China over the past seven years, with $280 million of those loses coming in 2004.[7] Particularly troubling is the MPAA's finding that exports of pirated goods from China to the United States, the United Kingdom, and other countries have increased steadily over the past several years.[8] Commenting on its competitive concerns, the MPAA told the Commission that "[n]o legitimate supplier of films, whether local or foreign, can compete with pirates who pay no taxes, endure no censorship obligations, and bear none of the costs of running a studio."[9]

This past July, the Motion Picture Association (MPA), an international association with which MPAA is affiliated, entered into an agreement with China's Ministry of Culture (MOC) and State Administration of Radio, Film and Television (SARFT) whereby every three months MPA will submit to MOC and SARFT a list of movies scheduled to be screened in China by its member companies and the Chinese agencies will focus IPR enforcement efforts on seizing and prosecuting pirated videos of these movies that enter the market before their video release date.[10] Both the industry and the Commission await evidence that the promises are being fulfilled. That the industry had to negotiate for its own protection is a troubling sign that the U.S. government has failed in its role as guarantor of the economic rights of its citizens and companies.

While China's domestically produced films also suffer from piracy, there is evidence that when the Chinese government has chosen to do so, it has been able to control piracy in certain areas. In the case of domestic films, where the government has a financial stake in the films or the theaters

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[6] U.S.-China Economic and Security Review Commission, *Hearing on China's High Technology Development*, testimony of John G. Malcolm, April 22, 2005, pp. 241-242.

[7] U.S.-China Economic and Security Review Commission, *Hearing on China's High Technology Development*, testimony of John G. Malcolm, April 22, 2005, p. 243.

[8] U.S.-China Economic and Security Review Commission, *Hearing on China's High Technology Development*, testimony of John G. Malcolm, April 22, 2005, p. 242.

[9] U.S.-China Economic and Security Review Commission, *Hearing on China's High Technology Development*, testimony of John G. Malcolm, April 22, 2005, p. 241.

[10] "MPA press release, "China's Ministry of Culture, SARFT Sign First Anti-Piracy Memorandum with MPA," (July 15, 2005). http://www.mpaa.org/MPAAPress/2005/2005_07_15.doc.

showing them, the government has reportedly been able to control piracy so the films can be viewed only in theaters, resulting in a large theater viewership that pirated films are generally unable to realize.[11] This suggests that the Chinese government has considerably more power to enforce IPR protections than it has exerted to date.

IPR violations in China go well beyond the software and entertainment industries, with many U.S. industrial firms now being heavily affected. As noted above, General Motors is suing Chinese automaker Chery for illegally copying the design of one of its models. IPR infringements have also affected products like pharmaceuticals and gauges, raising health and safety concerns. The Commission heard testimony on this from a U.S. gauge manufacturer:

> *For the first time, to the best of my knowledge, Chinese counterfeiters have approached domestic customers for our product in an attempt to sell them copies of our instruments. I recently came into possession of one of these counterfeit gauges. These clones bear our name and address, as well as a label with a CE stamp on it certifying that the product has passed a battery of tests that are required in order for the product to carry this designation and be exported to the EU. In addition, the label on the case of the fake gauge also carries our catalog part number, and the initials of a calibrator as well as a final tester—all misrepresentations. When the product was checked on a test station it was found to be grossly inaccurate. One of the ramifications of this, beyond solely the ethical consideration, is that of creating a potential safety issue for whoever uses the faulty instrument.*[12]

China's lack of adequate IPR protections also give Chinese firms a competitive advantage over U.S. firms by allowing many to obtain key technology and design inputs – from software to

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[11] U.S.-China Economic and Security Review Commission, *Hearing on China's High-Technology Development,* testimony of Darcy Antonellis, April 22, 2005, pp. 258-259.

[12] U.S.-China Economic and Security Review Commission, *Hearing on U.S.-China Trade and Investment: Impact on Pacific Northwest Industries,* testimony of David A. Blackburn, January 13, 2005, p. 168.

assembly line design – at a fraction of the cost to their U.S. competitors. Removing the need to shoulder comparable production costs gives Chinese firms in many sectors the ability to heavily under-price U.S. firms, in capital-intensive as well as labor-intensive industries. Some observers contend that for these reasons the Chinese government views a lax IPR enforcement regime as part of its industrial policy:

> *China's failure to police its intellectual property rules often looks less like ineffective government than a conscious policy to shift the highest value goods from other economies into the country. It is, in essence, the largest industrial subsidy in the world, and brilliantly, it costs the Chinese nothing. In 2005, China will most likely be the world's third-largest trading nation, and counterfeiters give the country's increasing number of globally competitive companies the means to compete against powerful foreign rivals that pay for their use of proprietary technologies.*[13]

The U.S. government has spent the last 15 years working with China to improve its IPR protection and enforcement regime with little to show in the way of concrete results. This has been the case despite the fact that bilateral agreements on IPR were concluded with China in 1992, 1995, and 1996, China's accession to the WTO and its accompanying agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS), and high-level IPR enforcement commitments by China in the 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT). Improving China's enforcement of IPR was again the major topic of the JCCT talks that took place this past July. The Commission remains skeptical that China will make any substantial progress in curbing its level of IPR violations without aggressive U.S. enforcement efforts under U.S. law and in international venues.

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[13] U.S.-China Economic and Security Review Commission, *Hearing on China's High Technology Development*, testimony of Ted C. Fishman, April 22, 2005, p. 275.

III. Enforcing China's Compliance

Despite incomplete compliance with WTO obligations, China has faced only one WTO dispute to date. As discussed in Section 1, the United States filed a dispute in March 2004 concerning China's discriminatory VAT on semiconductors that favored domestic producers. Japan, Taiwan, Mexico, and the European Union all joined the complaint after it had been filed. China quickly settled the dispute to the satisfaction of the petitioners before the case reached adjudication.

A number of China's practices in other areas are similarly ripe for WTO adjudication.

Intellectual Property Rights

As detailed in Section 1, violations of intellectual property rights (IPR) in China continue virtually unchecked. However, this is no longer primarily a function of lax IPR laws: China has improved many of its laws regarding IPR since its accession to the WTO. The major remaining legal loophole is a high monetary threshold that must be cleared before criminal charges apply. This threshold contradicts provisions of the WTO's TRIPS Agreement that calls for criminal treatment of IPR violations on a commercial scale irrespective of the value of the loss.[14]

China's principal IPR deficiency is effective enforcement of its laws, which is among its WTO commitments.[15] To date, with industry sources citing piracy rates above 90 percent, it is starkly

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[14] Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Part III, Section 5, Article 61: "Members shall provide for criminal procedures and penalties to be applied at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity. In appropriate cases, remedies available shall also include the seizure, forfeiture and destruction of the infringing goods and of any materials and implements the predominant use of which has been in the commission of the offence. Members may provide for criminal procedures and penalties to be applied in other cases of infringement of intellectual property rights, in particular where they are committed willfully and on a commercial scale."

[15] Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Part III, Section 1, Article 41: "Members shall ensure that enforcement procedures as specified in this Part are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which

apparent that China has failed to fulfill those commitments.[16] China pledged to enact a specific plan for protecting IPR during the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT). Subsequently, USTR conducted an out-of-cycle review of IPR protection in China and determined that China had not delivered on the promises made at the 2004 JCCT.

USTR maintains a watch list of countries with the most egregious failings in IPR protection. Those countries with the most egregious IPR violations that "are not engaged in good faith negotiations or making significant progress in negotiations to address these problems" are designated "Priority Foreign Countries" and face the possibility of U.S. sanctions.[17] Priority Foreign Countries can move to the less severe, transitional category of Section 306 monitoring if they enter into good faith negotiations or make significant progress in addressing cited problems. As a result of USTR's out-of-cycle review, China was demoted from Section 306 monitoring to the Priority Foreign Countries list.[18] This change in designation reflects the conclusion that China's participation in negotiations regarding IPR issues has not been in good faith, as evidenced by unabated IPR violations.

The July 2005 JCCT meeting resulted in more promises by China to take specific actions intended to reduce the theft of intellectual property. The Commission recognizes that these steps, if completed, would improve the status of IPR in China, but reiterates that China repeatedly has made similar pledges to no effect.

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constitute a deterrent to further infringements. These procedures shall be applied in such a manner as to avoid the creation of barriers to legitimate trade and to provide for safeguards against their abuse."
In the 2005 JCCT, China agreed to increase the ratio of criminal prosecutions to administrative prosecutions, which may have some practical effect but will not satisfy China's obligations under the TRIPS article above.

[16] U.S. Trade Representative, *2005 Special 301 Report* (Washington, DC: 2005).

[17] U.S. law provides for the possibility of sanctions, but any sanctions applied under U.S. law would still be subject to U.S. obligations under the WTO.

[18] U.S. Trade Representative, *Out-of-Cycle Review Results - China* (Washington, DC,: April 29, 2005).

China's failure to protect IPR is clearly within the jurisdiction of the WTO, given China's explicit obligations under the TRIPS agreement. Because China is not making satisfactory progress in this area, the United States should initiate action through the dispute resolution process at the WTO to address China's failure to comply with both the criminal penalties and enforcement provisions of TRIPS. In October 2005, USTR requested information from China regarding China's IPR enforcement efforts.[19] USTR's request exercises U.S. rights under the WTO's TRIPS agreement, but it will not automatically result in WTO consideration of action to require China to alter its approach to IPR protection. The U.S. can and should pursue further steps toward this end.

Related U.S.-China Commission Recommendations:

Challenging China's IPR Violations

- The Commission recommends that Congress support the U.S. Trade Representative in taking immediate action under U.S. law and in international venues pertaining to China's violation of IPR obligations, particularly China's failure to meet the requisite standards of effective enforcement, including criminal enforcement, explicitly imposed by the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement.

Coordinating with the European Union and Japan on China Trade and Security Matters

- The Commission recommends that Congress work with the Administration to undertake more active efforts to coordinate with the EU, Japan, and other interested nations as appropriate to address mutual trade- and security-related concerns with China. Among these areas should be the following:
  - European governments and Japan share U.S. concerns about continuing large-scale IPR violations in China. Brussels, Tokyo, and Washington should coordinate their

[19] U.S. Trade Representative press release, "USTR Pursues WTO Process to Probe IPR Enforcement in China" (Washington, DC: October 26, 2005).

strategies on improving Chinese IPR compliance, particularly through joint action in the WTO.

Thank you for your leadership in this important matter, and for giving me the opportunity to present the views of the U.S.-China Economic and Security Review Commission concerning it.

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HEADLINE: Bush's 4-nation Asia trip yields mixed results

BYLINE: Judy Keen

DATELINE: ULAN BATOR, Mongolia

BODY:
ULAN BATOR, Mongolia -- During President Bush's historic stop in Mongolia today, he'll probably be given a horse, a gift that has signified the remote country's pride since the days of warrior Genghis Khan.

The horse will be left in the care of someone in Mongolia, but Bush has something else to take home when he returns to Washington tonight: some progress on key issues. Sunday, there was movement in talks with Chinese President Hu Jintao on trade, currency and the piracy of movies and other copyrighted material.

Bush also heads home from a weeklong trip to Asia with unresolved issues and concerns:

*Secretary of State Condoleezza Rice said Sunday that "one has to be concerned" about **China's** modernization of its 2.5 million-member army. "There's a question of intent," she said.

*The United States has objected to **China's** detention of dissidents in the days before Bush's arrival and will "quite vociferously" continue to do so, Rice said. Bush broached the issue with Hu during their talks. Also, at a United Nations meeting in September, Bush gave Hu a list of political prisoners the United States believes should be released. None of them has been. "We've certainly not seen the progress that we would expect, and I think we will have to keep working on it," Rice said. "But obviously, this is a long conversation and a long haul."

*During Bush's stop in Busan, South Korea, that country's defense ministry announced plans to ask its national assembly to withdraw a third of its 3,200 troops from Iraq, creating a diplomatic embarrassment for Bush. U.S. officials were not notified before the announcement.

Bush attended services Sunday at Gangwashi Protestant Church in Beijing. It was "an affirmation of my

strong belief that people should be able to worship freely, and I shared that with President Hu," Bush said later. He said Hu "took it on board in a very thoughtful manner."

Bush advised Hu to invite the Dalai Lama, an exiled Tibetan religious leader, and representatives of the Roman Catholic Church to **China** to discuss religious freedom.

Political furor at home over Iraq followed Bush across Asia. Thursday, Rep. John Murtha, D-Pa., called for the immediate withdrawal of U.S. forces. White House spokesman Scott McClellan said Murtha, a former Marine colonel who served in Vietnam, had endorsed "the policy positions of Michael Moore and the extreme liberal wing of the Democratic Party."

Sunday, Bush called Murtha "a fine man, a good man who served our country with honor and distinction." Murtha's call for troop withdrawals, Bush told reporters in Beijing, "was done in a careful and thoughtful way. I disagree with his position."

Bush made some headway, but no breakthroughs, on other issues:

*Hu told Bush that **China** will try to "gradually achieve" a more equitable trade balance with the United States. The U.S. trade deficit with **China** may hit $200 billion this year. **China** announced before Bush's arrival that it plans to buy 70 jets from Boeing.

*Hu also said he will "unswervingly press ahead" with overhauling **China's** undervalued currency, which keeps Chinese exports artificially cheap. He also promised to do more to end piracy of U.S. movies, music and other products. Rice said the discussion on intellectual property rights was "much more detailed, much more specific" than previous talks.

*Rice said Hu made it clear that he "very much wants" to help persuade North Korea to end its nuclear activities. "They understand ... that a nuclear-armed North Korea would be a very bad and destabilizing force," she said.

*Japanese Prime Minister Junichiro Koizumi told Bush in Kyoto that progress is being made on the U.S. request for Japan to lift its two-year ban on imports of U.S. beef.

*Bush told Russian President Vladimir Putin in Busan that he would support a Russian proposal to allow Iran to perform some steps in the process of producing nuclear fuel if it promises not to enrich uranium. The concession could help break an impasse over Iran's nuclear activities. If Iran rejects the proposal, support for U.N. sanctions against Iran might increase.

Today, Bush becomes the first sitting U.S. president to visit Mongolia. The stops appeared to be wearing on him. When a reporter asked whether something was bothering him Sunday, Bush replied, "Have you ever heard of jet lag?"

China's Logo Crackdown

11/3/2005 - *Wall Street Journal, Print Edition*

BEIJING -- On the second floor of the Silk Street Market, Beijing''s crowded counterfeit center, Xu Chao peddles knockoff Adidas, Mickey Mouse and Diesel T-shirts. But shoppers won''t find fake versions of products bearing the 2008 Beijing Olympic Games logo at his stall or anywhere else at the market, a few steps from the U.S. Embassy.

"The penalties for selling Olympic items are several times higher than for other brands," Mr. Xu says. The red logo of a running Olympian is the one brand peddlers of fakes can go to jail for stealing, he says.

China is notorious as a knockoff haven, where poor law enforcement has turned a potentially huge consumer market into a land of 75-cent pirated DVDs and $10 fake Louis Vuitton handbags. Yet even amid growing consumer demand for 2008 Games trinkets, counterfeit Olympics goods are hard to find. Now, U.S. trade officials, business groups and intellectual-property lawyers want to know why the Chinese government can''t make other counterfeit goods just as scarce.

U.S. trade officials say it is a case of separate and unequal treatment. For example, the Beijing government provides special protection to a list of 48 frequently copied famous foreign trademarks, including Prada, Chanel and Burberry. But last year, only 10.6% of the trademark-violation cases China investigated involved foreign trademarks, according to a Chinese government white paper released in April.

China''s motivation to protect the red running man, which doubles as a Chinese stamp of the character for capital city, is clear: The real thing has massive economic value.

"We have no fixed assets," says Liu Yan, deputy director of legal affairs for the Beijing Organizing Committee for the Olympic Games, which operates under the Beijing city government and various national government agencies. "So the Olympic logo is the most valuable thing we own." Through merchandise, sponsorships and other commercial applications, China''s logo is largely paying for the Games. Organizers of the 2004 Olympic Games in Athens raised $796 million from domestic sponsors buying rights to use its logo, and an additional $87 million from licensing its logo on products.

"The number of counterfeit Olympic goods has been kept to a very small number," Mr. Liu says.

Yet the organizing committee and other government officials scoff at the notion that they are giving domestic brands special treatment. Mr. Liu says "Chinese and foreign enterprises have been protected equally in China." China''s State Administration of Industry and Commerce, which is responsible for finding and eliminating counterfeits, says it is doing all it can to protect foreign brands.

"Every time when we get a report, we will definitely punish the violators," a SAIC spokesman says. "But peddlers at markets such as Silk Alley are playing guerrilla tactics with us. When our officials...do inspections there, they will hide the products away, but when we leave, they will sell again. Being short of hands, we couldn''t stay in the market all day long." Before they even launch criminal investigations, Chinese police must find thousands of dollars of counterfeit goods; otherwise, they can only impose fines and close factories.

The government made the logo an official priority in 2002, passing a national law exclusively to defend the intellectual-property rights of Olympic symbols. That law technically just collects existing laws in one place, applying them to Olympic logos for all levels of government.

"Regulations tend to be more general, so these [2002] details make it easier to enforce the law for the administrative authorities," Mr. Liu says. "But the decree hasn''t given us any additional powers."

Silk Street peddler Mr. Xu isn''t any likelier to go to jail for selling a few fake Olympic items than for selling any

other knockoffs, according to the organizing committee; SAIC wouldn''t comment on jail time. Imprisonment is technically possible for some major criminal intellectual-property violations in China, but so far, the committee says, it isn''t aware of any imprisonments for violations of its brand, which total about 200 to date.

Committee members say they are just better than other brands at protecting what is theirs. Among their key tools is engaging manufacturers in protecting the whole supply chain, those manufacturers say -- a tactic that helps keep factories from making, say, a few thousand extra thousand items such as Olympic beer mugs and selling them under the table through the black market.

"They are very strict," says Peter So, whose company, Yue Wing Cheong, makes 50 Olympic items. For Nike Inc., he says, "I don''t know how they are going to control when and where the goods will be sold. For the Olympics, we know every step along the way." In general, he says, the more diffuse a company''s supply chain, the more problems it has with piracy.

Most foreign fashion companies don''t talk publicly about their approach to intellectual property in China, fearing that the mere association with such talk taints their brands. Still, a group of five foreign luxury brands recently filed a civil lawsuit against the Silk Street Market itself, trying to force the market''s owners to police the problem themselves. Many also put controls on manufacturing, particularly knowledge of coming designs. That doesn''t stop counterfeiters from simply slapping a known trademark on their own design of shirt or bag, though.

So Olympic merchandise also carries sophisticated tags featuring holograms, watermarks, barcodes, serial numbers and other devices. Holographic tags are expensive to produce, but pirates have been known to copy them, too. The organizing committee''s tags, which are added to items after they have left manufacturers'' hands, are done by China''s printer of money and stamps. "You can feel the quality of them," Mr. Liu says.

Such technology helps government inspectors more than it does consumers, but then, there are only 24 official legitimate places to buy Beijing Olympics items, compared with thousands of outlets for, say, Nike goods.

Beijing also has fiercely nationalistic Chinese pride on its side, since residents may be less inclined to steal something they feel is owned by the whole country.

"I don''t really see any foreign companies teaching consumers how to identify the real from the fake," Mr. Liu says.

China isn''t the only nation to jealously guard its Olympic icons; other countries, including Australia for the 2000 Sydney Games, have passed special laws to protect their Olympic logos.

In fact, that example may bode ill for the organizing committee, which still has three years of policing to do before the Beijing Games. By the time the Sydney Games started, Australia, normally no haven for counterfeiters, was awash in fake goods.

U.S. to Pressure China at WTO on Piracy Fight

by: Greg Hitt, Staff Reporter for The Wall Street Journal

In a move expected to ratchet up tensions with China, the U.S. today will announce that it is initiating action at the World Trade Organization aimed at pressuring Beijing to toughen its enforcement of intellectual-property rights.

At the direction of Trade Representative Rob Portman, who said in an interview that he wants "to put the Chinese on notice that we're serious," the U.S. is planning to invoke rarely used WTO authority to force China for the first time to detail steps it has taken to crack down on piracy, including descriptions of cases it has pursued as well as the penalties imposed on infringers.

The move, expected to be supported by Japan and Switzerland, reflects sharply rising concern within the Bush administration that Beijing has yet to seriously confront complaints of corporate piracy. U.S. officials long have pressured China to strengthen enforcement of property rights, amid estimates that American companies lose billions of dollars a year from the rampant copying of items such as movies, software and auto parts.

Chinese officials routinely assure the U.S. that they have investigated thousands of cases of patent and copyright infringement. Last month, Chinese President Hu Jintao gave President Bush public assurances that China would aggressively strengthen antipiracy efforts, and the issue is expected to come up next month when Mr. Bush visits Beijing.

U.S. officials have grown frustrated with what they see as a lack of progress, and in recent months have actively looked for ways to notch up pressure. In May, the Bush administration, complaining of "epidemic" infringements, placed China on a "priority watch" list of nations with inadequate protection of intellectual-property rights.

The decision by Mr. Portman to pursue action through the WTO raises the stakes even further. The decision to make use of the WTO discovery mechanism will allow the U.S. to verify China's enforcement claims and identify any gaps in Beijing's record -- and could set the stage for the filing a WTO trade-sanctions case against Beijing.

"It's a matter of sort of applying pressure where you can on the Chinese," Mr. Portman said. "It does enable us to begin to build a case for" possibly "taking additional actions."

The U.S. is the only nation to file a WTO case against China. Last year, the administration brought -- and settled -- a complaint that China was unfairly taxing U.S. producers of semiconductors, which were gaining a foothold on the mainland.

Mr. Portman portrayed China's piracy as a world-wide problem, and said had he hoped to enlist the European Union's backing of the initiative. Mr. Portman said he is "honestly not sure" why the 25-nation bloc didn't step forward. The action against China comes amid heightened tensions between the U.S. and EU over how to curb farm subsidies and tariffs as part of the so-called Doha Round of global-trade talks.

Mr. Portman, portraying the Doha talks as a "once-in-a-generation opportunity" to shape global trade, said he expects a new EU offer on the key issue of widening access to the highly protected European agriculture market as soon as tomorrow.

U.S-China economic tensions have risen sharply in recent months. Fueled in part by concern over the swollen U.S. trade deficit, the countries have sparred over Beijing's restrictive monetary policy, which critics say gives Chinese manufacturers big advantages over U.S. competitors in the world market. U.S. officials have pressured China to crack open its market to American exports, and moved to blunt surging imports of Chinese-made apparel and textiles.

Mr. Portman said he hopes to finish by the end of the year a "top-to-bottom" review of U.S. economic policy toward China.

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