

**Congresswoman Diane E. Watson - Testimony U.S.-  
China Economic and Security Review Commission  
IPR Issues and Dangers of Counterfeited Goods Imported into the U.S.  
Wednesday, June 7, 2006**

I want to thank Commission Co-Chairs Richard D' Amato and Kern Houston for holding this important hearing on China's enforcement of intellectual property rights (IPR) and for inviting me to present testimony. I also want to acknowledge Chairman Larry Wortzel and Vice Chairman Carolyn Bartholomew as well as the other Commissioners here today.

Protection of intellectual property is of central importance to the current and future economic health of the United States as well as to the future of global trade. According to the *2006 Economic Report to the President*, intellectual property accounts for more than one-third of the value of all US. corporations, an amount equal to almost half of the United States' GDP. Chris Israel, Coordinator of IP Enforcement at the US. Department of Commerce, is on point in characterizing the US. capacity for innovation as one of our nation's greatest comparative advantages. IP protection is the key to our nation's future.

Unfortunately, intellectual property piracy has become the scourge of international trade. It is a disturbing and potentially debilitating by-product of the emerging global economy. By some estimates, counterfeiting now accounts for 5% to 7% of world trade. It shows no signs of abating, is highly lucrative, and represents a growth industry for criminal cartels as well as terrorists. Some now contend that counterfeiting and piracy are as profitable as trading in illegal narcotics and a lot less risky.

China is widely viewed as the model country for intellectual property piracy, and for good reason. US. companies lose an estimated \$2.5 billion a year due to piracy of copyrighted material. Roughly 95% of all CDs and DVDs manufactured in China are counterfeit. Amazingly, counterfeit products account for 15% to 20% of all products made in China, or approximately 8% of its GNP. Moreover, many of these counterfeit products end up reentering our domestic US. market. US. Immigration and Customs Enforcement estimates that nearly 70% of all pirate goods it seizes at our borders originate in China. This is a sobering statistic. The adverse impact of pirate goods is directly felt by American producers, consumers, and workers in terms of higher prices and lost revenues, wages, and jobs.

The theft and piracy of software in China is equally staggering. The Business Software Alliance estimates that for every two dollars' worth of software purchased legitimately, one dollars' worth is obtained illegally. The Entertainment Software Industry notes a growing problem with software piracy in the estimated 200,000 to 300,000 Internet cafes in China. On average, each cafe contains 200 computers. Tens of millions of clients use the computers annually. Internet cafe owners typically purchase one piece of legitimate software and then illegally upload the software to their other computers.

As you know, I represent the 33<sup>rd</sup> Congressional District of Los Angeles and Culver City, California, home to a number of major entertainment companies, including Sony Studios, The Culver Studios, Capitol Records, Raleigh Film and Television Studios, and American Film Institute. According to figures compiled by Americans for the Arts, approximately 30,000 people are employed in creative industries located in my congressional district. More than 18,000 people who work in the 33<sup>rd</sup> Congressional District make a living from film, radio and television - industries whose profits and future viability are dependent on strong IPR protection and enforcement.

My congressional district also includes parts of Hollywood, the historic home of our nation's movie industry. The Motion Picture Association of American (MPAA) estimates that, in 2005, its member companies lost approximately \$244 million in revenue to Chinese piracy. The cost of Chinese piracy to the entire copyright community was more than \$2.3 billion with losses more than \$10.6 billion over the last five years.

Also according to the MPAA, piracy has reached almost 100% of the retail market in China, with pirate DVDs of the latest U.S. theatrical release titles available within days of international release. The export and transshipment of pirate optical discs continue to grow. The MPAA reports that there are 1,500 registered cable and television systems that pirate U.S. motion pictures to every corner of the world.

The loss of jobs and revenues in my congressional district from IPR piracy has, to my knowledge, never been calculated. But I would conservatively estimate that the loss of jobs is in at least in the multiples of hundreds, if not thousands, and the loss of revenues is easily in the multiples of millions. When you consider the economic multiplier effect and the number of subordinate workers - caterers, transportation specialists, make-up artists, and extras, for example- that make a living from the entertainment sector, the losses are more staggering. Let me assure you that many of my constituents do not view IPR piracy as an abstract concept or a victimless crime. It is very real to them. It means the difference between having a job and unemployment.

Two years ago I introduced a bipartisan resolution (H.Res. 576) urging the Government of the People's Republic of China to improve its protection of intellectual property rights. It passed the House overwhelmingly by a vote of 416 to 3. The resolution recognized China's efforts to deal with the serious problem of IPR violations as well as strongly encouraged China to redouble its efforts to rectify a serious problem. It recommended that the Chinese government implement more effective customs and border measures to prevent the export of pirate goods to the U.S. and other countries; encouraged the Government of China to fully and comprehensively implement a legal framework to protect intellectual property rights; and urged the Government to provide greater market access to foreign producers of legitimate products to reduce the demand for counterfeit goods.

Two years later, China has not made appreciable progress in the enforcement of IPR laws.

Despite the fact that China has strengthened many of its IPR laws since its accession to the WTO in 2001, it has failed, for example, to reduce the level of pirate goods seized at the US. borders or to decrease the incredible level of CDs and American motion pictures illegally reproduced within its borders and distributed worldwide. To date, the Government of China has not prosecuted a single criminal case against software end-user piracy. It has also failed to prosecute one criminal copyright case involving sound recordings. It is therefore not surprising that piracy rates of physical copyright products in China remain the highest in the world.

The playing field for the US. entertainment sector in China is not flat, but has been turned nearly upside down. Almost a year ago, the MP AA launched a joint anti-piracy memorandum of understanding (MOU) with the Chinese government in connection with the most recent JCCT discussions. Disappointed with the results, the MP AA attributed the failure to a lack of political will on the part of the Chinese.

Many members of Congress have reached a similar conclusion. As you are aware, there is a groundswell of sentiment in Congress that the administration must take a harder line on China's trade practices as well as its monetary policies. I therefore welcome the fact that the USTR has once again included China on its Priority Watch List of countries that are the most egregious violators and that it recently conducted a top-to-bottom review of US.-China trade relations.

As noted in the USTR's 2006 Special 301 Report, China's IPR laws are often toothless. The government relies heavily on administrative rather than criminal enforcement. When China prosecutes a counterfeiter, the sentence is not commensurate with the offense. The decision to prosecute an offender in an administrative or criminal court is determined by the monetary value of items seized from the counterfeiter. A criminal prosecution requires a higher valuation of goods seized than those for an administrative prosecution. Not surprisingly, the courts usually value counterfeit items at a level that does not meet the threshold for a criminal indictment and trial. The vast majority of offenders end up paying fines in an administrative court that amount to a slap on the wrist and are back in business in short order.

The USTR's report also notes that piracy and counterfeiting are products of China's market access restrictions, which artificially limit the availability of foreign content. As a result, consumers are driven to the black market. Demand is present, but supply is kept artificially low. It is a dream scenario for counterfeiters and black marketers.

Stronger enforcement measures and greater market access are two fundamental keys to heightening China's compliance with its WTO obligations. Another key, I believe, is the administration's decision to step up consideration of WTO dispute settlement options. To date, China has faced only one WTO dispute, which, I understand, was quickly settled by China before it was brought before the WTO.

It is my understanding that the USTR may be in the process of bringing a case for dispute resolution before the WTO that addresses China's failure to comply with its obligations under the

TRIPS Agreement. If this is the case, I am supportive of the process. I will be watching any potential developments closely. I will be particularly concerned if the Government of China seeks to take retaliatory action. It must instead choose the responsible option of complying with its WTO obligations in a straightforward and transparent manner, which includes the sharing of all pertinent data. To use Ambassador Zoellick's turn of phrase: China's compliance with its IPR obligations under the WTO will demonstrate whether or not it chooses to be a responsible stakeholder.

China can no longer take the view that IPR violations are a foreign problem or victimless offense. IPR piracy is an issue that must be addressed by every nation of the world for the sake of the health and security of the global economy. If China wants to be a world leader in technological innovation, and not just a manufacturer of other nation's goods and technology, it must first ensure that intellectual property is a valued and respected commodity and that it will vigorously enforce strong and effective IPR laws within its own borders.