



**Testimony
of**

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before the**

**U.S.-China Economic and Security Review Commission
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Mr. Chairman and Members of the Commission, IIPA and its members thank you for the opportunity to appear today to review China's compliance with its WTO commitments in the intellectual property area. IIPA represents the U.S. copyright industries. Its six member trade associations consist of over 1,300 U.S. companies, accounting for millions of U.S. jobs. The copyright industries, in 2002 contributed over \$625 billion to the GDP, or 6% of the U.S. economy and for almost 5.5 million jobs or 4% of U.S. employment. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50% of their revenue from outside the U.S.

First of all, let me apologize for not providing you, prior to this hearing, with an extensive written submission reviewing the entire copyright and enforcement situation in China. I had told Mr. Mulloy that this submission would be available but, because USTR extended the original January 31 deadline for submission of recommendations in the out-of-cycle review of China under Special 301, we have not yet fully completed our filing or finally settled on our collective recommendations

for action. We hope to have this submission to you early next week and we believe you will find it most useful for your deliberations and your report.

In this testimony I will be reflecting the views of Alliance members. I will focus primarily on the filmed entertainment, business and entertainment software and book publishing industries. The recording industry is a critical part of the Alliance and a key component of the overall copyright industries, but I am pleased that you have asked Jay Berman to testify today and he will speak to the situation facing the U.S. and the global record industry.

Before turning to your specific questions, and to summarize, since China joined the WTO, it has fallen short of compliance with its international enforcement obligations under the WTO/TRIPS Agreement. It has done so in two respects: Piracy rates across all copyright industries continue to hover around 90% of the market – an estimated 9 out of 10 copies of our products are pirate copies. We do not have as yet a complete estimate of trade losses for 2004 but they have been running well over \$2 billion per year and are likely to remain at that level. Because of accompanying onerous and persistent market access restrictions – restrictions that are even more onerous than those still in place for many other economic sectors – it is difficult, at best, for any of these companies to do business profitably in the Chinese market, despite massive demand for our products. The principle reason for these high piracy rates is the failure to date of the Chinese enforcement system to meet TRIPS standards by providing meaningful deterrence that would result in a reduction of these piracy rates.

Therefore, in terms of WTO compliance, first, the Chinese enforcement system has yet to meet the standards set out in Articles 41-61 of the TRIPS Agreement when it comes to providing effective and deterrent enforcement in practice. Second, the TRIPS Agreement requires all WTO members to subject to “criminal” remedies all “copyright piracy on a commercial scale.” China’s current

Criminal Law, which I will speak to in more detail shortly, fails, on its face, to meet this test. Many acts of commercial piracy are not subject to criminal action in China, rendering that part of its law in direct violation of the obligations in the TRIPS Agreement.

I must add, however, that China's copyright law is generally good and China has, through amending its law, sought to keep pace with modern technological developments. Over the last few years, the Chinese authorities have increased the number of actions taken to raid and seize pirate product in a good faith effort to improve the piracy situation. Unfortunately, these activities, while laudable, have not had a significant impact in the marketplace – new pirate product, much of it produced on optical discs at pennies a unit – simply replaces that which is seized and destroyed. The low risk and high profits associated with pirate activities can only be countered with coordinated and effective – and TRIPS-compatible – criminal enforcement, including deterrent penalties that are absent today from the Chinese enforcement system.

Let me now address your specific questions:

- 1. What is the overall assessment of compliance with the WTO's IPR rules? What if any, changes have occurred over the past year and what are the prospects for the future?**

As summarized above, China's enforcement regime has not yet been brought into compliance with its TRIPS obligations. Vice Premier Wu Yi's commitments to our government in the JCCT process last April gave reason for some hope, however. Raiding activities were increased and total seizures of optical disc product, by Customs and by the national provincial and local authorities, reached the highest level of any country in the: reported to have exceeded 240 million units, a 2 to 4 fold increase from seizures in 2002 and 2003. Our members report, however, that this has had only minimal impact in the Chinese marketplace due to the lack of any meaningful deterrence which I have mentioned earlier. Some of our members did undertake confidential market surveys which

showed that there may be a positive trend at work but it remains much too early to even predict that these rates may come down “significantly” as Wu Yi promised they would.

Even though the Supreme People’s Court new Judicial Interpretations of China’s Criminal Law provisions in the IPR area were finally amended in December, we have yet to see any criminal prosecutions for piracy per se. Administrative enforcement is up, but fines remain way too low to make a dent in piracy in the marketplace.

As to the future, all will depend on the will of the Chinese political leadership to reorganize its enforcement machinery and begin a major round of very public piracy prosecutions matched by unprecedented deterrent criminal penalties. We know this is the right formula because it has worked in other countries which have started from a base of excessively high piracy rates and an ingrown culture of piracy. But there is a new threat: China now has 94 million Internet users, the highest in the entire world. Internet piracy is growing in China and it just recently became clear, via the new Judicial Interpretations, that certain infringements on the Internet could be dealt with criminally. China must also update its legal infrastructure again, and organize its enforcement machinery much more rationally if it is to avoid being faced with traditional types of piracy plus massive Internet piracy.

2. At the April, 2004, meeting of the U.S. – China Joint Commission on Commerce and Trade (JCCT), China made several commitments to improve IPR enforcement. What are the concrete results to date?

As to “significantly reducing piracy levels” – the key commitment – this has not happened. We hope it will, but for many reasons, we remain skeptical that the right actions will be taken to achieve this result.

Wu Yi also committed to see lowered the criminal thresholds contained in a 1998 Supreme People's Court's interpretation of the Chinese Criminal Law. This was also promised as part of China's commitments to the U.S. when it joined the WTO. IIPA has carefully reviewed the new interpretations and while, again, political will has a way of jumping all hurdles, the changes made were minimal and because the changes seemed to have been so grudging and so long in coming, we all wonder whether they will make a real difference on the ground. If the change is meaningful, then we should see immediate criminal prosecutions of major pirates. So far this hasn't happened. It should be noted, also, that criminal penalties were not increased, nor were administrative penalties. We do not view this as a good sign either. Finally, the new Interpretations do subject online infringement to criminal remedies. However, because the criminal law requires that the infringement be "for profit" (which violates the TRIPS standard) and because all the new thresholds must still be met (and it is even more difficult to meet these thresholds with respect to Internet infringements), we also retain a healthy dose of skepticism that this will prove meaningful in practice. We hope we are wrong.

3. What should the U.S. be doing to ensure compliance? Has technical assistance been provided? Is there a particular problem area that could be the subject of a WTO dispute case?

We have not finalized our recommendation to USTR but we can say at this point that we are leaning in the direction of recommending that USTR commence consultations with China in the WTO and that they be moved to the Priority Watch List (from the 306 monitoring list where they have resided for the last 8 years) with a new out-of-cycle review to be conducted sometime this summer. If significant progress is not made by the time USTR concludes this OCR, then the available bilateral and multilateral tools -- Section 301 or establishing a panel for a dispute settlement case -- remain options that the U.S government could take. What is critical is that we want China to know how serious our community is about significantly improving the piracy

situation there. We want to send a signal to them that it is not “more of the same” -- that resolute action must be taken now.

Technical assistance is being continually provided to the Chinese authorities at all levels by our members and by the U.S. government. We do think that the Chinese can do what we are asking right now. Technical assistance is part of our ongoing program, but it should not be used as an excuse for further delay in taking action.

4. Who should the U.S. be cooperating with in terms of trading partners?

We would hope that if USTR agrees with our tentative recommendation that both the Europeans and the Japanese will join in these consultations. If we all act together, we think the Chinese will get the message that this theft cannot continue unabated. Both Europe and Japan have now realized that they also have a big stake in this issue. We hope we can all work together to this common end.

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In our written submission to USTR, we will be setting out a series of benchmarks that we believe are essential to achieving the ultimate objective of “significantly reducing piracy rates.” That submission will provide great detail, with statistics and anecdotes, on what the market looks like for the movie industry, the entertainment or videogame industry, for record companies, for book and journal publishers and for publishers of all types of software. Right now, it is not a pretty picture.

We will also go into some detail on the range of market access restrictions that our companies face in the Chinese market. Market access and reducing piracy go hand in hand, it is difficult for piracy to be reduced when legal product is kept out of the market. We need our government to press for

further and major liberalization of market access for copyright based companies. I would be pleased to elaborate on these points in response to your questions. Thank you.