

US-China Economic Security and Review Commission

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Remarks Of

Chairman Donald A. Manzullo

Committee on Small Business

U.S. House of Representatives

Opening

Chairman D'Amato, Co-Chair Houston, and other distinguished Commissioners, and ladies and gentlemen, thank you for this opportunity to discuss intellectual property rights and the dangers posed by pirate goods coming into the U.S. I'm going to focus my remarks on the unique impact of China.

As Chairman of the US-China Interparliamentary Exchange since 1999, I have had the privilege of representing Speaker Hastert on 8 official delegations to China to meet with various NPC parliamentarians and policy makers.

Our next delegation will be Round 9 of the Program in November. I have seen the evolution of China first-hand, and I in so doing I have traveled the length and breadth of this enormous country. How many of you have ever heard of HoHot (pronounced HoHoHa)?

Chinas' Growth

Let me tell you a little bit about China. The country is evolving with enormous speed. It has raised 200 million people out of the depths of poverty. It is now one of the world's largest trading partners. Trade between the United States and China has become increasingly fundamental to the economy of both countries. Chinese exports account for nearly 40% of their GDP, with exports to the United States accounting for a quarter of that, or \$243 billion.

Conversely, the US exports \$41 billion worth of goods to China. To date, China is the third largest single country exporter and importer in the world, valuing imports at \$631 billion and exports at \$752 billion.

One of its biggest challenges in the face of this rapid development is to implement a new-born IP regime that is less than 20 years old. Historically, China has failed to adequately regulate and enforce protections for IPR, despite rampant violations occurring across the country.

But China's role as an emerging major player in the global trading economy carries with it the responsibility to participate on a level playing field with the rest of the world. Many have come to question China's ability to meet this obligation, especially in the area of intellectual property rights

How Counterfeiting has Changed

The piracy that is going on today is not your father's fake tennis shoes. Things have changed. When we talk about counterfeiting and piracy, many people still think about fake ten dollar Fendi handbags or twenty dollar Rolex watches purchased from some sleazy guy standing at a roadside table.

Hey, this is a great deal, they think, I'm going to fool my friends into thinking I wear designer labels without having to spend the money! How could it hurt anyone to wear a cheap Rolex knock off? Rolex is huge and rich, and buying this fake won't hurt anyone but these deep pockets.

Lots of people seem to take this view, because there is a huge demand for fake brands. Obviously if there wasn't such a huge demand, counterfeiters and pirates would not make so many of them.

But the issue has gone well beyond knock off of clothing, shoes, movies and music. Counterfeiting and piracy has become such big business that it now threatens the very livelihood and creative process of artists of every form, whether fashion artists, designers, musicians or movie makers.

And one other thing. The counterfeiters and pirates are very entrepreneurial people. They are aggressively moving up the value-added food chain. Not content with decimating the fashion and content industries, they are aggressively moving into pharmaceuticals, car parts, aircraft engine parts and just about everything you can imagine. They are combining these broader product fakes with advanced supply chain and manufacturing know how. Pirates no longer peddle their cheap wares primarily from roadside tables. Now they replicate entire supply chain, distribution networks and retail outlets. In this respect, it is a whole new ball game. And it is a new ball game that is financing terrorism, supporting organized crime and outright killing innocent people.

It's hard to get too exercised about fake handbags and CD's. But when the market is flooded with fake drugs, fake brake pads and phony aircraft engine parts, using a sophisticated distribution network tied into organized crime and terrorists networks, we must take action!

Recently, Dateline NBC ran an expose on fake drugs imported from China. These included cancer drugs, cholesterol drugs, and life-saving drugs of every type or description. The unscrupulous people who peddle these wares care little for the harm they inflict on innocent people. Piracy and counterfeiting can no longer be considered a victimless crime.

The Scope of the Problem

The problem is enormous. Counterfeiting in China constitutes an estimated one-fifth of all products manufactured in China, accounting for 8% of their GDP. In some industries, namely the motion picture and music industry, piracy levels in China have reached almost 90%. With an annual exchange of goods worth over \$285 billion, this creates a bilateral trade issue of the utmost importance between the US and China.

Last year over 69% of the counterfeit goods seized at the border were traced back to China. The value of the confiscated Chinese imports was over \$64 million. The total number of counterfeit goods seized by US Customs and Protection last year was valued at over \$138 million. By some estimates, that number likely reflects less than 5% of the counterfeit goods actually entering the country. China's share of these goods is more than ten times greater than any other US trading partner.

The effects of counterfeiting on all US businesses are substantial. According to the U.S. Customs Service counterfeiting activity costs U.S. companies up to \$250 billion per year and has resulted in the loss of 750,000 American jobs. Of this, small manufacturers are hit the hardest. Manufacturing companies end up paying for the counterfeits with more than just lost revenue. They suffer from loss of good will and reputation. For some companies, this is their most valuable asset. In trying to preserve their reputation, some companies end up repairing or replacing defective counterfeit products out of their own pocket. All of this drives the cost of doing business up and some companies are forced to either pass it on to their customers or close up shop.

As Chairman of the House Small Business Committee, let me give you some real world examples of the effect that counterfeiting has on my small business constituents.

Philadelphia Arts and Crafts Show

Several months ago I went up to Philadelphia to attend the largest trade show on the East Coast for home-made American arts and crafts. The arts and crafts industry is made up almost entirely of small businesses. They pay well above the national average in terms of wages, are primarily headed up by women, and on aggregate are an almost \$6 billion dollar industry. Thousands of small American artists with 2, 3 or 4 employees earn their living celebrating uniquely American styles and crafts. Perhaps you've seen some Navajo silver or a Shaker style rocking chair from Pennsylvania by Amish craftsmen.

During the show I talked at length with a small company that was producing hand-made whimsical art sculptures for the lawn and garden. We talked about the thousands of dollars this small businessman had to pay in lawyer's fees to fend off the Chinese knock offs. Well, the next day one of my staff flew to Beijing as part of my China program, and while walking in a Beijing market he came across an entire stall of identical sculptures. The Chinese had completely copied this Illinois' businessman's designs and were selling the sculptures for 1/10 the cost. There was virtually nothing that my Illinois small business could do to stop it.

Our Experience in Kunming, China

Last summer I took a large Congressional delegation to China as part of my China Interparliamentary Exchange program. I ended up in Kunming, China with my dear friend Congresswoman Marsha Blackburn. While there, we found many examples of counterfeit goods just about everywhere we went, but we were surrounded by massive security and they would not let us explore around. So even though Marsha took lots of pictures, I had to lure off the security one night so that my staff could peeled off from the group. They went back into the back rooms and ally ways and collected hundreds of hours of videotape documenting the open sale of any kind of product you can imagine. Pirated Nikes, clothing, Zippo lighters, Rolex watches...you name it. We have the tape if anyone wants to stop by and see it.

The Car Industry

Some counterfeiters have matured beyond consumer goods and have started recreating entire cars. Last year, General Motors settled a lawsuit against Chinese automaker Chery Automobile Co. after alleging that Chery's model QQ compact car was an exact copy of the Chevy Spark, which GM sells in China. GM alleged that Chery stole its trade secrets to make the QQ. At \$1,000 less, Chery's car outsells the Chevy Spark by nearly five to one.

Cheery just announced that it intends to introduce its first car into the US market this coming fall. They can easily undersell anything Detroit has to offer because they can use stolen technology and don't have to bear the costs of having to do original research and development. This is not fair trade!

How Sophisticated Have the Chinese Become?

Counterfeiters have now grown into a higher level of sophistication, taking piracy to a new level - counterfeiting entire companies. After complaints about fake CD and DVD products on sale in Beijing and Hong Kong, officials from the consumer electronics firm, NEC, set out to expose the counterfeit operations. After two years of investigation, the company discovered not only that their products being duplicated, there was an entire NEC company impersonating them inside of China. They had hijacked the entire company!

The phony NEC had set up networks with over 50 electronics factories to produce NEC products including entertainment systems, MP3 players, CDs, DVDs, batteries, microphones, even creating their own versions of the electronics. The New York Times reported that the counterfeiters carried NEC business cards, commissioned product research and development in the company's name and signed production and supply orders. The scheme covered everything from product design, to manufacture and distribution, all diverting profits from the real NEC.

What can we do?

This is obviously a very difficult issue. As I've said, the Chinese only have about 20 years of history with IPR. I genuinely believe that the Central Government gets it. Vice Premier Wu Yi is a formidable lady, and she has staked her personal reputation on making changes regarding IPR inside of China. For them, it's the smart thing to do. They realize that they are never going to develop Chinese home-grown technology in an environment of rampant IPR theft and piracy. And growing their economy up the value-added food chain is a top priority for the Chinese leadership.

So in my view we should help the Chinese help themselves.

- First, we need to secure our own borders. We must make it impossible for counterfeits to get into the U.S. I am proud to have partnered with my friend Congressman Knollenberg on HR 32, an important bill that plugs some loopholes and beefs up remedies against trademark thieves.
 - Second, we should beef up internal government enforcement resources on the domestic front. I strongly support the good work of the interagency government program called the STOP initiative. I think this initiative shows how effective a well-coordinated interagency task force can actually be when all the right pieces fall into place. Chris Israel is to be commended for his leadership in reinvigorating this and other government-wide IPR enforcement measures.
 - Third, we should engage the Chinese in greater law enforcement capacity-building. In other words, we should help them to develop a more-effective criminal enforcement regime. It is key that the Chinese aggressively criminalize counterfeiting behavior. In this regard, I want to urge the USPTO and the Commerce Department to get their “boots on the street” inside of China by placing additional IPR Attaches throughout the country. I know they are busy recruiting for those positions and these can make a great deal of difference.
 - As for myself, Congresswoman Marsha Blackburn and I have formed the first-ever US-China Interparliamentary IPR Working Group with the Chinese National Peoples Congress. We have contacted a famous Chinese singer and songwriter, Madam Gu (Goo), who is an outspoken advocate for singer/songwriter rights, to join with us in November to kick off the Working Group in Beijing. This Working Group is the first ever Member-to-Member dialogue between lawmakers on both sides about this important problem.

This is going to be a long and tough road. But it is essential that we keep at it. Thank you for this opportunity to state my views.