

Executive Summary
Testimony of Eric H. Smith
International Intellectual Property Alliance (IIPA)
before the Subcommittee on Courts, the Internet, and Intellectual Property
United States House of Representatives
“International Piracy: The Challenges of Protecting
Intellectual Property in the 21st Century”
October 18, 2007

The IIPA is a coalition of seven trade associations representing over 1,900 U.S. companies that rely on strong global copyright protection and enforcement. IIPA has been representing the U.S. copyright industries before the U.S. and foreign governments since 1984.

- Piracy continues to rage on a global basis, damaging the U.S. economy, reducing GDP, lowering growth and hurting U.S. jobs. The copyright industries are one of the fastest growing and most important sectors of the U.S. economy, contributing in 2005 over \$819 billion to GDP (6.5% of GDP), 5.38 million U.S. jobs (over 4% of U.S. employment), and \$110 billion in foreign sales and exports, larger than any other major sector of the economy. The copyright industries contributed over 13% of all economic growth in the U.S. in 2005.
- The cost of piracy to the U.S. economy, from a recently-released study, amounted to at least \$58 billion in 2006, cost 373,375 jobs and 16.3 billion in earnings, and resulted in lost government tax revenue of \$2.6 billion. Reducing piracy globally is an economic and policy necessity.
- Congress has provided many trade and other tools to help in this fight but our government cannot succeed alone in protecting U.S. creators, their industries and U.S. jobs. While there have been success stories over the last 20 years, we are not doing as good a job as we should be in reducing piracy losses globally. We must do better to meet the challenges facing these industries.
- These challenges and initiatives to meet them include (1) securing effective and deterrent enforcement in every trading partner; (2) creating the legal tools, enforcement mechanisms and political will to fight rapidly growing, global Internet piracy; (3) effectively regulating optical disc production in target countries to reduce vast excess production capacity fueling global trade in pirate products; (4) adopting new and effective techniques to fight the organized criminal syndicates that control so much of the piracy in many countries; (5) improving enforcement against government and enterprise use of unauthorized business software and of “end-user” piracy of other copyrighted products, particularly on the Internet; (6) escalating the fight against piracy of books and journals; (7) bringing countries into full compliance with their TRIPS obligations and with the improved standards of protection and enforcement in the Free Trade Agreements; and (8) securing full market access for legitimate copyrighted products -- a necessary condition to fighting effectively against illegal, pirate product.
- Countries which pose particularly significant challenges to the U.S. government and our industries are China and Russia, the subject of two prior hearings in 2005 before this Subcommittee.
- Problems in China are immense (\$2.4 billion in losses in 2006) and, while some progress has been made in improving the situation there for business software, U.S. cultural products continue to face 80%-90% piracy rates and onerous market access barriers. China’s flawed administrative enforcement system, with low deterrent fines, is not working and China must turn to relying on its criminal law if it is to significantly lower piracy rates as promised. This still has not happened.
- Russia is still a piracy hotspot (almost \$2 billion in losses), and despite the negotiation last year of a binding Bilateral IPR Agreement setting out what Russia needs to do to lower piracy rates, most commitments remain unfulfilled. These commitments must be met before Russia joins the WTO and, unless met, its GSP benefits should be revoked, pursuant to an IIPA petition filed seven years ago.
- Canada, among developed countries, is a major problem with an antiquated copyright law unsuited to the Internet world and an ineffective enforcement system. India’s economy is rapidly growing along with its piracy problem.
- There are, however, success stories, where effective enforcement has significantly reduced piracy rates overall, or piracy in key sectors. Countries include Singapore, Taiwan, and in some areas, Brazil and Pakistan



Written Statement

of

Eric H. Smith
International Intellectual Property Alliance (IIPA)

before the

Subcommittee on Courts, the Internet, and Intellectual Property
United States House of Representatives
on

“International Piracy: The Challenges of Protecting
Intellectual Property in the 21st Century”

October 18, 2007

Chairman Berman, Ranking Member Coble, and other distinguished Subcommittee members, I am Eric Smith and IIPA and its members thank you for continuing these oversight hearings, begun in May 2005, to review the key piracy markets of China and Russia -- and, at this hearing, the general state of protection and enforcement of our members products around the world. We are again honored to appear before you on behalf of the seven trade associations -- representing over 1,900 U.S. companies -- that make up the IIPA. These associations represent the motion picture (the major studios and the independents), music and recording, business and entertainment software, and the book and journal publishing industries. Virtually all of our members have appeared before this Subcommittee at some point and they all thank you for the support you have given them and their members over the years.

It will be no surprise to this Subcommittee that piracy continues to rage on a global basis, severely damaging the U.S. economy, reducing GDP, lowering economic growth and hurting U.S. jobs. China and Russia, countries about which you have heard much from our industries, from our government and in the press, are only the tip of an iceberg that should be shrinking, but instead continues to block the path of our country receiving the full economic benefits from the significant comparative advantage we have in the creative sector of the global marketplace.

The Importance of the Copyright Industries to the U.S. Economy and the Cost of Piracy

Before getting to the subject of the state of protection and enforcement in key markets around the world, we believe members could benefit from a review of some key statistics that demonstrate both the critical role that the creative industries play in our economy (and in other countries around the world) as well as a review of new work that has recently been done to measure the harm caused by global piracy to the U.S. economy.

Since 1990, when the seminal study was published by IIPA measuring the economic role of the copyright industries in our economy, these industries have steadily increased their percentage contribution to U.S. GDP, U.S. jobs and U.S. foreign trade, often at multiples of the rate of growth of the economy as a whole. In our most recent study, published in early 2007, the “core” copyright industries accounted for over \$819 billion or over 6.5% of the U.S. GDP in 2005 (\$173.7 billion in 1990). They accounted for 5.38 million jobs, or over 4% of U.S. employment (3.3% in 1990) and were paid average wages 40% higher than the national average. Contributions to foreign trade (foreign sales and exports) exceeded \$110.8 billion (\$22.3 billion in 1990), larger than any other major sector of the U.S. economy. To show the comparative advantage and overall strength of these industries, the author, Steve Siwek, was able this time to measure these industries’ contribution to overall economic growth occurring in 2005 -- almost 13% or double the contribution to GDP. In short, Mr. Chairman, almost no other industry sector occupies such an increasingly important role in the U.S. now and into the future.

We are the world’s leader in producing creative products. But our task is to convince our trading partners where high piracy levels persist that their economies are suffering, that their GDP and job growth is stunted by their failure to take this issue seriously. The World Intellectual Property Organization (WIPO) is working with about 20 countries on studies that use the same methodology as the U.S. study with the goal of illustrating one simple truism, that failure to protect copyright effectively from piracy is just bad economic and development policy, pure and simple. The studies completed this far show, to some surprisingly, that copyright industries represent from 3% to 5% of GDP even in developing countries and tend to create new jobs at a much higher rate than those economies as a whole, sometimes up to three times.

For the first time, data became available which allowed Steve Siwek, who also authors the IIPA studies, to measure the loss to the U.S. economy from global piracy. He could not do so for all the copyright industries, but that recent study, done for the Institute for Policy Innovation (IPI), concluded that global copyright piracy cost the U.S. economy at least \$58 billion in total output in 2006, costs American workers 373,375 jobs and \$16.3 billion in earnings, and costs federal, state, and local governments \$2.6 billion in tax revenue.

These numbers, which are conservative, are still staggering and make evident that the protection of one of our countries greatest assets -- our creativity and our entrepreneurial skills in bringing that creativity to the global marketplace -- is a policy "must" for our country.

Global Piracy and the Tools to Fight it

So how are we doing in redeeming these potential gains and potential growth for the American people as a whole? Unfortunately, and at the risk of understatement, the answer is not as well as we should be. Our Congress has provided the Executive branch with a panoply of tools to tackle this challenge and over the years since the mid-80's, huge strides have been made, through the tireless efforts of USTR and other U.S. trade and IP agencies in partnership with the private sector. At that time, most of the developing countries in Asia had piracy rates near 100%, and with a few exceptions that record is manifestly better after 20 years of very hard work. But there is only so much that one country, even the U.S., can do. Other countries must take the policy decisions, develop the political will and employ it through good legislation and effective and deterrent enforcement if those gains are to come to our people and creators and their citizens and creators. Increasingly, many countries have come to this conclusion, have taken the necessary steps, and the situation is improving. We will identify some of these. But others have just begun to make the necessary policy decisions and have yet to implement them effectively. We will identify some of them too; we have spoken at two prior hearings of this Subcommittee about two of them -- China and Russia. These countries have become the poster children for all those countries where progress just isn't being made at an adequate pace.

One of the great tools that this Congress has fashioned has been the Special 301 process. Another is Congress' support of the Free Trade Agreement process beginning in the last Administration. Still another is the TRIPS Agreement which sets the global minimum standards of protection AND most importantly now, standards of effective enforcement, some of which are currently being tested before the WTO in the dispute against China. Finally, Congress, in the Digital Millennium Copyright Act (DMCA), has implemented the WIPO Internet treaties concluded in Geneva in 1996. The U.S. has been joined now by 63 and 61 other treaty members (soon to be over 80 when many EU members join) in a global effort to protect high value content on the Internet. Over 100 countries have already implemented (or are about to implement, as FTA signatories) these treaty obligations, the vast majority of them in much the same way as the U.S. did. Indeed, the U.S. has led the way by establishing the global model that has worked and has persuaded other countries to adopt much the same legislative template. This subcommittee deserves major credit for this, and we appreciate your leadership.

The Special 301 process has been a critical component of the progress made to date and continues to be a principal tool to leverage and persuade other countries to adopt essentially fair trade practices with respect to U.S. intellectual property. The copyright industries have participated actively in this process since 1989 and have greatly benefited

from this process, in terms of legal reform and improved enforcement, leading to lower piracy levels in many countries and increased sales of our companies' creative products. In turn, this has led to additions to U.S. GDP and to more U.S. jobs.

Copyright Industries' Initiatives and Challenges in the Global Struggle to Reduce Piracy

Again, before turning to discussing some of our most challenging countries, and some of the successes, Subcommittee members might benefit from a brief summary of the broader overview of these issues that is contained in IIPA's 2007 Special 301 submission. I have appended to my written testimony a copy of our transmittal letter covering IIPA's comprehensive February 2007 Special 301 submission on piracy in sixty of our key trading partners. In this submission, we report on specific actions and inactions by the country, detail specific statutory and enforcement deficiencies, and highlight their impact on the overall U.S. economy and on the U.S. creative industries. The entire report can be found on the IIPA website at www.iipa.com. In our transmittal letter, IIPA sought to put the issues facing our industries in a broader context in the process of summarizing the key global challenges to our industries and our priorities on how to deal with them. It highlights that our industries conservatively lost an estimated \$16 billion in these 60 countries/territories in 2006 (data for all countries and all industries was not available).

Again it will come as no surprise that at the top of this list is securing improved and deterrent enforcement. Needed law reform to secure basic minimum rights globally has been a great success for the U.S., though further law reform to establish the legal infrastructure to fight Internet piracy remains a high priority. In that context then, IIPA has set out eight initiatives/priorities/challenges for this year, which cut across all countries.

- Securing **effective and deterrent enforcement** is at the top of the list. In addition to the use of the tools listed previously, it is critical that we make countries aware of the gains to them from reforming their enforcement systems. In addition, we highlighted the need for better coordination of enforcement training by the U.S. government, those governments in partnership with our and their industries. We called for the creation of global "best enforcement practices" which could serve as a goal that countries should reach and implement if they are to lower piracy levels.
- A major priority and challenge is the rapid growth of **Internet piracy**, as it impacts the future of electronic commerce. This growth is at alarming rates as more and more of the world's population gets connected to the Internet. The first order of business to combat this problem is to establish an effective legal infrastructure which includes ratification and full implementation of the WIPO Internet treaties (the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty). While the treaties now have 64 and 62 members, respectively (with new EU members expected soon), and even more countries have implemented their provisions, this process must continue and create a truly

global infrastructure where piracy havens cannot exist. We must also work to develop public policies that address a disturbing and growing global consumer attitude that the theft of digital content is an acceptable outgrowth of deeper Internet penetration. The healthy growth of e-commerce – critically dependent on securing a safe environment for the global transmission of valuable data, much of it protected by copyright laws – hangs in the balance.

- **Optical disc piracy** and the effective regulation of optical disc production in countries that have been unable to effectively deal with this problem is another key challenge and priority. Russia and China are a key examples of this problem. Global production capacity far outstrips global demand; using that excess capacity for pirate production has flooded the world's market with pirate optical discs containing all types of copyright material. While we have made great progress in the last ten years in reducing this threat, this work is by no means finished. Today, Internet piracy now shares the limelight with this long-standing problem. Securing effective regulation of plants in problem countries, like Russia, accompanied by deterrent enforcement is an ongoing initiative and challenge for the U.S. government and the copyright industries.
- **Piracy by organized crime syndicates** is rife particularly throughout Asia, Mexico, the states of the former Soviet Union and in Eastern Europe. Because piracy is so lucrative¹ and in many of these countries enforcement is weak and where governments are not strong enough to combat these syndicates effectively, they have taken over the business of piracy, as but another part of their illegal activities including the financing of terrorism. Our report details many examples of how organized crime syndicates go about the business of piracy. Only government intervention and government cooperation internationally can stem this growing problem – the private sector is unable to do so on its own. The U.S. government must be at the center of this effort.
- The unauthorized use of business and productivity software by governments, state-owned enterprises and private sector companies causes the largest losses globally to the business software industry -- one of the most productive and fastest-growing sectors of our economy. IIPA member, the Business Software Alliance, reported in the spring that the personal computer packaged software industry (beyond just U.S. software publishers) lost more than \$32 billion globally in 2006 (counting both business and consumer software). This “**end-user copyright piracy**” also affects other copyright sectors where the ultimate business or individual consumer can now directly engage in piratical acts -- all our industries are directly affected by the ease with which copyrighted works can be copied or otherwise exploited by using the Internet. The recording and movie

¹ An always surprising statistic is that the profit margin on DVD piracy, for example, is estimated at 1150%, far exceeding the margins for trading in heroin (360%) and cocaine (1000%). See IIPA's 2007 Special 301 submission at p. 13.

industries are particularly affected. The book industry faces widespread commercial photocopying, particularly in and around universities; the entertainment software industry faces piracy in the context of the geometric growth of online games globally.

- **Piracy of books and journals**, in English and in translation, by traditional printing means, by commercial photocopying of entire editions, and through online and digital piracy, is a major problem for the U.S. publishing industry. Increasingly sophisticated technologies allow for pirate hard copies of books that are becoming more and more competitive with authorized editions. In addition, publishers are suffering from significant online piracy, mostly in the form of peer to peer trading or commercial sale of scanned versions of bestsellers and academic texts. Online piracy also affects professional and scholarly journal publishing, a mainstay of progress in the sciences, when journals which have already been put into electronic form by the legitimate publisher, appear on sites available to the ultimate, but unauthorized, user.
- A cross-cutting priority/challenge, affecting all our industries, is bringing all countries into compliance with their **enforcement obligations in the WTO TRIPS Agreement** and by using the U.S.'s **Free Trade Agreement process** to raise the level of statutory protection to encompass new technological challenges, like the Internet, and to obligate governments, in return for more open access to the U.S. market, to open their markets by significantly improving the enforcement of their copyright and related laws to significantly reduce high rates of piracy.
- Finally, all the gains we could achieve to reduce piracy would be worth little if countries do not afford all of our industries **full market access** to sell legitimate copyrighted products and to meet the incredible demand for them -- demand that fuels piracy around the world. Indeed, there is an intimate interconnection between market access and reducing piracy levels. We would cite China as a prime example of this interrelationship. But the problem is not limited to China.

Industry and the U.S. government have employed available tools to meet these challenges for over twenty years. We would now like to turn to reviewing the results, particularly in some key countries that IIPA has testified about previously before this Subcommittee.

The Piracy Scorecard: China, Russia and More

China: A Flawed Enforcement System Allows Piracy to Continue

Mr. Chairman, this will be our third report on the situation facing our industries in China. In my December 2005 testimony before you, IIPA's conclusion was "there has been some minor incremental progress but no significant reduction in piracy levels, either

domestically or for export.” Piracy rages on in China and I am sorry I cannot report to you a different conclusion close to two years later.

Copyright pirates continue to control 80%-90% of the market in most copyright sectors. In addition, in the music, recording, motion picture and entertainment software industries, U.S. companies are doubly handicapped by the restrictions the Chinese government places on their ability to compete fairly and effectively in the market. IIPA estimates that losses to the copyright industries in China exceeded **\$2.4 billion** in 2006.²

This doesn't mean, however, that some progress hasn't been made: Last year, for example, China's software piracy rate dropped four percentage points for the second year in a row, and it has dropped ten percentage points in the last three years. Much of this decline can be attributed to China's implementation of its JCCT commitments to legalize government software use and require preloading of legitimate operating system software on PCs sold in China. By reducing China's piracy rate by ten percentage points over three years, \$864 million in losses was saved. The legitimate software market in China grew to nearly \$1.2 billion in 2006, an increase of 88% over 2005. Since 2003, the legitimate software market in China has grown over 358%.

On the legal front, China adopted new regulations in 2006 to deal with protection of content over the Internet and adopted many of the suggestions made by IIPA and our members in a surprisingly transparent regulatory process. This was followed by China's accession to the WIPO Internet Treaties, fulfilling another of China's JCCT commitments.

Industry used these new regulations to engage websites and ISPs to take down infringing materials. The authorities took administrative action in some of these cases, and while a number of websites have closed, administrative penalties have been low and the resources devoted by the government have not been nearly adequate to the task, the punishments have not been deterrent, regulatory obstacles remain and the problem continues to get worse. The administrative authorities have not, for example, taken action against ISPs that have failed to promptly remove infringing materials. In addition, those authorities have recently issued non-binding rules setting onerous requirements for notifying ISPs and getting them to execute promptly take downs. These “rules,” even though not binding, have given comfort to ISPs and they have increasingly failed to cooperate with right holders. The authorities are even suggesting that notifications must be via physical letters with much supporting materials rather than by e-mail as is done in every other country. These requirements undermine the efficacy of the procedures to either removing the infringing material at all and certainly cripple our members' ability to see prompt action.

² This loss number does not include losses due to piracy of motion pictures or entertainment software for which 2006 data was unavailable. See <http://www.iipa.com/pdf/IIPA2007TableofEstimatedTradeLossesandPiracyLevelsfor2006ASIA060607.pdf>

To illustrate how serious Internet piracy in China has become, according to surveys, one of the largest Internet sites in China, Baidu, is alone responsible for 50% of all of the illegal downloads of music in China. While Baidu holds itself out as a mere search service, it engages in practices such as compiling "top 100 lists," including of American chart music, and then providing "deep links" directly to infringing files on other illegal services, thereby engaging in the kind of "inducement" of infringement that should be held illegal. Unless Baidu is prevented from continuing such unfair and illegal practices, legitimate Internet distribution of recorded music will never take place; no company will be willing to enter the market with a legitimate service under such conditions. This remains a number one priority for the U.S. record industry and is a threat to all legal Internet services dealing in legitimate content.

The bottom line, Mr. Chairman, is that the Chinese government stubbornly continues to adhere to a flawed enforcement system, relying on administrative inspections, raids, seizures and low, non-deterrent sanctions imposed by administrative enforcement authorities rather than employing its police and prosecutors to bring criminal actions against piracy, with deterrent penalties. China can rightfully point to massive raiding activity by many agencies of the government. Unfortunately, since these raids lead only to small administrative fines, all of this enforcement activity has had little impact on street-level piracy.

Over the last two years the motion picture and recording industry have conducted three detailed surveys of the retail marketplace for their products in the key major cities in China. In the last half of 2006, China undertook a heavily publicized "100-day campaign" against piracy. The surveys these industries took both before and after the "campaign" showed little, if any, change in the actual retail market.

Retail shops either moved physically or moved their pirate product to the back of the store. While some stores closed, others were opened and many raided stores reopened. Why? Because there was no effective incentive to get out of the piracy business, fines were small and criminal actions, which could have had a deterrent effect -- as they have in almost every other country in Asia -- were non-existent.

In part this was because the threshold for criminal liability is set so high that retail piracy is simply not a criminal act in practice. This is one of the claims in the WTO IPR case now pending in Geneva.

Even if the thresholds did not exist at all, the Chinese government has shown, with regard to manufacturing of pirate optical discs, that it is not -- yet at least -- willing to employ criminal sanctions in even serious cases.

An example of this failure is the recording and motion picture industry's almost Herculean efforts to try to persuade Chinese enforcement authorities to bring criminal actions against 20 optical disc plants against which there was dispositive forensic evidence infringing discs found in markets all over the world were produced in those

plants. Our latest information is that none of these 20 cases are being prosecuted; the criminal authorities almost invariably sent the industries back to the administrative authorities. "This is their job," they said. These are large factories sending millions of units of pirate product throughout China and globally. Until the police and prosecutors make it their job, little will change.

The record, as far as we are able to ascertain it in China's non-transparent enforcement regime, is that there have been only six criminal cases involving U.S. copyrighted works (and only a few more actions involving works of other WTO members) since 2001, when China joined the WTO.

In addition, Customs enforcement is simply not a priority for the government, and as such, pirated and counterfeit products continue to flow largely unabated out of the country.

We recognize that, for the most part, this is a grim report and the Chinese regularly accuse us of exaggeration and "misunderstanding the Chinese system." But many of our industries run anti-piracy programs in 100 countries around the world. We look for results, not process. While there has been some progress, those results simply are not there, Mr. Chairman.

That said, as an overall assessment, I must highlight some of the areas where we have seen progress for some industries. As noted above, the business software industry has benefited from the government's efforts to legalize software use in the central and provincial governments, that industry's biggest customers. Those efforts should continue, and become institutionalized within the budgeting and procurement processes for all government entities. The industry benefited when the Chinese passed a regulation forcing all computer manufacturers in China and those companies importing hardware into China to load only legal operating systems on those computers. As noted above, this has resulted in increased sales for that industry. China has committed to extend its legalization efforts to enterprise software use, and it is our hope that those efforts will be stepped up considerably. With regard to enforcement against the business software industry's main piracy problem – "end-user" piracy – industry's efforts have been hampered by an endemic lack of resources for the agency charged with enforcing administrative regulations against such piracy. Additionally, the Chinese have failed to interpret their criminal law as covering this "end-user" piracy.

The book and journal publishing industry has benefited from some increased administrative enforcement against piracy of textbooks in the university environment, but much more needs to be done and the industry is seeking high level engagement with the Ministry of Education. But it should be noted that while administrative enforcement has made a minor dent here, the nature of these "infringers" is far different than those we are talking about for the industries that face optical disc manufacturing, export and retail piracy and counterfeiting.

The entertainment software industry has been able to take significant advantage of the massive demand for online gaming in China and piracy has been minimized in this market by the effective use of “technological protection measures.” However, the “hard goods” marketplace is virtually non-existent for most of these companies, with piracy at very high levels, the same as for other “hard goods” industries.

Mr. Chairman, we reported to this Subcommittee in December 2005 that industry is severely hampered by the lack of meaningful statistics available on enforcement in China. By not publicizing to us or to its own citizens that piracy per se is a serious crime and that it imposes very heavy penalties on these illegal acts, it gives comfort to the pirates, who know that the government is in effect turning a blind eye to their infringements. China is fully experienced with stamping out illegal conduct – when it wants to and when it threatens a political value that it considers fundamental. China is using this lack of transparency to wage a propaganda war that is cheating its own creators and hiding its non-deterrent enforcement system from public view. We must continue to insist that China’s system become far more transparent at every level – and that it be effective.

China: No Movement on Market Access for Most Industries

As we have noted here and in our previous appearances before the Subcommittee, there is a direct symbiotic relationship between piracy and China’s severe market access restrictions on the motion picture, music, entertainment software and book publishing industries. The plain fact is that U.S. copyright products have almost total access to the Chinese market, in pirate copies with billions of dollars being earned by pirates, not by the rightful owners of that product.

Efforts were made in the two most recent JCCT meetings to improve this situation for U.S. copyrighted cultural products -- to liberalize market access commitments enshrined in the WTO Accession Protocol and to persuade the Chinese to bring other practices which we believe violate its WTO commitment into full compliance. U.S. government efforts on this front met with total resistance. The Chinese government made crystal clear that they had no intention of opening up its market further to cultural products beyond their minimal commitments in the WTO. It is this unwillingness to move at all on either front that formed the motivation, we believe, for the U.S. government’s market access claims on behalf of some of the copyright industries which were brought to the WTO consultation process and are poised to move to the panel stage, if the consultations fail.

China is the most closed market in the world for the U.S. cultural industries. Given the massive trade deficit which this country has with China, it is inexcusable that one of our country’s most productive sectors is effectively denied entry to one of the largest markets in the world – a market where the demand for our products is deep and growing. China is allowing the pirates to steal money straight out of the pockets of the millions of creators and workers in our industries and of Chinese creators as well.

Market access restriction are myriad and serious. The publishing, motion picture and recording industries face restriction on their trading rights (right to import), and on distribution within the country. The recording industry faces discriminatory censorship requirements not imposed on local record companies. The entertainment software industry faces slow censorship procedures for its hard goods and online game products, giving the pirates an almost insurmountable lead in this fast-moving, hit-driven videogame market. The motion picture industry also faces censorship delays as well, plus the Chinese only allow twenty foreign films, from all sources, into their market every year and constrain the distribution of those films to a government-owned and controlled duopoly.

China: Conclusion

At the December 2005 hearing, IIPA was asked to list those actions which we wanted the Chinese government to take to get a handle on its piracy and market access problems. We do not need to repeat them here. Our recommendations would be virtually unchanged from almost two years ago.

Russia: A Good IPR Agreement with the U.S. in Need of Implementation

Russia is at a critical juncture in the development of its IPR regime. On November 19, 2006, Russia signed a Bilateral IPR Agreement (“IPR Agreement”) with the United States. The IPR Agreement is a free-standing bilateral trade agreement, as well as Russia’s roadmap to WTO accession, with respect to intellectual property protection and enforcement.

The Agreement reflects Russia’s acknowledgment of the many legal reforms and enforcement steps it needs to implement in order to develop a modern and effective copyright system. Russia’s full compliance with the IPR Agreement is essential for the high piracy rates in Russia to come down and in order to develop a healthy environment for U.S. (and other foreign) copyright-based businesses to operate in Russia. The IPR obligations require Russia to implement very specific legal reforms, to undertake “meaningful enforcement,” and to do so “on a priority basis.”

Russia has undertaken some legal reform and enforcement measures in the past few years, and more since the IPR Agreement was signed. Unfortunately, Russia is presently not meeting its obligations under the IPR Agreement especially with regard to Russia’s dual problems of optical disc (“OD”) and Internet piracy. In fact, since our last testimony before this subcommittee regarding piracy in Russia two years ago, piracy rates have continued to hover around 65%-80% of the market for the copyright industries.

As a result of these enforcement problems and the high piracy rates in Russia, the IIPA recently testified in support of denying Russia’s continued benefits under the

Generalized System of Preferences (GSP) program.³ In 2006, Russia benefited from over \$512 million in duty free GSP imports into the United States. In contrast, U.S. companies suffered losses of over \$1.95 billion due to copyright piracy in Russia (as detailed in our February 12, 2007 Special 301 filing).⁴

The number of optical disc (i.e., CD and/or DVD) plants in Russia has more than tripled in just the last three years, so that at present there are close to 50 plants. Production capacity has nearly tripled as criminal operations have encountered little hindrance in expanding their activities. In short, Russian optical disc piracy is a massive problem. Russia agreed to address the optical disc problem on a comprehensive basis, with the objective of permanently closing down illegal plants. Russia was supposed to conduct “repeated, unannounced inspections” of all known OD plants. These inspections were to “take place regularly, without prior notice, and at any time, day or night.” Criminal proceedings were to be initiated “[i]f evidence of unauthorized production of optical media bearing content protected by copyright or related rights on a commercial scale is found...” In addition, Russia agreed to adopt an effective OD licensing law. However, Russia has not met these obligations. Instead, according to IIPA’s information, this year, Russian authorities have inspected only three out of an estimated 50 manufacturing facilities under the old inspection law, and have not yet released a draft of any new law or regulations.

In 2006 and 2007, IIPA members witnessed some improvements in enforcement, primarily at the retail level against vendors of illegal optical disc materials and companies involved in the installation and use of pirated software, and some large-scale raids against warehouses storing illegal material. In another improvement from prior years, some deterrent sentences and prison terms have been applied by Russian courts, including some (albeit a few) aimed at serious repeated offenders. Over the past few years, a few people employed by the plants were convicted – after extensive delays in criminal investigations – but most have received suspended sentences. In the business software area, BSA reports an increase in the number of civil actions commenced by right holders that have had a deterrent effect on illegal activities to the benefit of legitimate software distributors.

While these improvements are important, overall, there is little deterrence – by way of criminal penalties – against those who continue to conduct large-scale commercial piracy in Russia. Clearly, the priority for IIPA members in Russia is to step up significantly enforcement activity to provide adequate and effective enforcement of IPR violations, including the imposition of criminal deterrent penalties. In short, Russia is undertaking some enforcement activity – and by some measure, more than in prior years, but still much more needs to be done to meet the requirements of the IPR Agreement.

³ <http://www.iipa.com/pdf/IIPARussiaGSPPre-hearingBriefSept2007.pdf>

⁴ <http://www.iipa.com/rbc/2007/2007SPEC301RUSSIA.pdf>

The IPR Agreement obligates Russia to combat the growing threat of Internet piracy “with the objective of shutting down websites that permit illegal distribution of content protected by copyright or related rights” (and especially for websites whose servers are situated in Russia). Russia has taken some action in this regard (according to the Russian Government identifying 166 offending sites and closing 72 of them). In June, the most notorious website (even noted in the IPR Agreement), allofmp3.com, was taken down, and to this point has not resurfaced at that Internet address. However, another site, nearly identical and apparently owned and operated by the same company has sprouted up in its place, and the illegal distribution of copyrighted material continues there, as well as on many other sites. Investigation of Internet distribution of other types of works, such as business and entertainment software, books, as well as music and film material, by a variety of technical means, must be stepped up by criminal investigators. Few, if any, criminal cases have been pursued against illegal website operators.

Last, while IIPA notes the many legal reforms that Russia has undertaken (see the IIPA’s recent Out-of-Cycle Review and GSP filings),⁵ Russia has agreed to many key reforms that have not yet been adopted. The list of legal reforms (more fully detailed in those recent IIPA filings) include: (1) improvements to Russia’s basic copyright code (now a part of Civil Code at Part IV); (2) the Criminal Code which needs to be amended to make legal entities liable for IPR crimes; (3) the Customs Code which must be amended to add *ex officio* authority (IIPA understands this amendment is now pending in the Duma); and (4) the complete implementation (in the Civil Code) and ratification of both digital treaties – the WCT and the WPPT. In addition, and most importantly, are the long-promised optical disc regulations, which would properly regulate the licensing of plants (and their equipment and raw material used in production), the (surprise) inspection of plants, the closure of illegal plants and the sanctions to be imposed – including criminal penalties – for violations.

Russia: Conclusion

IIPA members sincerely hope that the U.S. government and the Russian government can make progress in implementing the comprehensive IPR Agreement. Only the full implementation of this Agreement will result in improving Russia’s IPR regime for the benefit of U.S. and Russian authors and producers, and will permit Russia, by fully complying with TRIPS, to accede to the World Trade Organization. We look forward to working with the Russian and U.S. governments, and members of this subcommittee to meet these goals, to see the IPR Agreement fully implemented and the Russian IPR regime improved.

⁵ <http://www.iipa.com/pdf/IIPARussia2007OCRSubmission.pdf>;
<http://www.iipa.com/pdf/IIPARussiaGSPPre-hearingBriefSept2007.pdf>

Beyond China and Russia: Canada

Enforcement and law reform problems are not limited to countries like China and Russia. The situation in Canada, for example, is truly disappointing. Not only is enforcement inadequate but Canada is one of the last countries in the developed world to adopt modern law reforms to deal with the new technological environment of the Internet. Canada is clearly behind the times.

The U.S. government has been urging Canada to address its piracy problems for years. Canadian law enforcement has at least acknowledged the problems, including the role of organized criminal gangs; but Canada's inadequate laws have left them handcuffed. Bills to modernize Canadian law and enforcement practices, particularly with respect to the Internet, have been mysteriously stalled within relevant Ministries, notwithstanding the public support of the relevant Ministers and the issuance of a number of Parliamentary calls to act.

Canada recently adopted a much needed amendment to outlaw camcording in theaters. This was a significant and welcome development in the fight against the piracy of motion pictures.

Other needed laws, however, are only in the drafting stage with no one knowing what these drafts will provide. Customs enforcement in Canada is inadequate and it is extremely difficult to get ISPs to cooperate in taking down infringing material given, in this respect, the woefully inadequate copyright law. Illicit filesharing is not clearly illegal and Canada is now a center for servicing this activity, damaging the U.S. market and others around the world.

Canada must move quickly to solve these problems.

Beyond Russia and China: India

India is fast becoming an economic powerhouse like China and increasingly investment is moving there. The situation facing our industries continues to remain stagnant with over **\$750 million** in estimated losses and continuing barriers to entry into the market. The courts continue to be overburdened with little improvement in sight, at least on the key criminal side of the enforcement equation. India is desperately in need of law reform not only to deal with the Internet (like Canada it has yet to adopt legislation implementing the WIPO Internet treaties) but to deal with optical disc piracy (both draft laws have languished for years), and enforcement should be strengthened for all industries. India could be a great market for the copyright industries if needed legal and enforcement reforms are made soon. The Indian government at both the federal and state level must muster the political will to push through long-needed reform. USTR has commenced a bilateral "Trade Policy Forum" with India and IPR is solidly on that agenda.

Have Any Countries Dealt Successfully with Piracy?

While piracy will never be eliminated in any country, there have been some notable success stories, both in key areas and overall.

Singapore: Singapore was a pirates' haven in the 1980s but it soon recognized that its economic growth path depended critically on IPR protection. It passed a reasonably good law in 1987 and was one of the first countries to sign and implement an FTA with strong protection and enforcement provisions. But probably most important has been its willingness to support effective criminal actions against piracy. Piracy rates are among the lowest in Asia (5%-10% for audio and video piracy, 39% for business software).

Taiwan: Taiwan without question was the "Counterfeit Capital of Asia" in the 1980's but through effective and deterrent criminal enforcement, in most sectors, piracy rates came down significantly to 10-15% in the late 1990s, but then increased to over 50% in these areas by 1992-3 as a result of its allowing OD piracy and organized crime to take over. It has since tackled this problem effectively, again through aggressive and deterrent enforcement, such that today, pirate OD exports are virtually non-existent. Even Internet piracy has been put at the forefront of government attention. A major pirate service, Kuro, was criminally convicted and Taiwan recently adopted a law criminalizing peer to peer piracy. While the struggle is constant, and vigilance is still required when it comes to Taiwan's domestic market—especially on its university campuses, Taiwan has come a very long way from its notorious beginnings.

Brazil: Recent successes in Brazil on copyright enforcement have been significant. Brazil has done a noteworthy job of tackling physical piracy, especially optical disc piracy, with a significant number of raids and seizures of pirated product. Moreover, despite its political rhetoric (Brazil has been on the opposite side from the U.S. on almost every IPR issue at the international level), its copyright law is a modern one, even implementing many aspects of the WIPO Internet treaties (which it still needs to ratify). Importantly, good cooperation with copyright industries exists within the CNCP (National Council to Combat Piracy and Intellectual Property) on work plan prioritization and operational matters. There is increasing enforcement cooperation between federal and state authorities.

Despite these welcome successes, however, work must continue to address the high levels of copyright piracy and ineffective criminal enforcement that have marked the Brazilian market for many years. Piracy remains prevalent at the same hot spot locations due to the failure to prosecute and hold offending parties accountable. Internet piracy is on the rise, and more engagement regarding book piracy on university campuses.

Pakistan: Three or four years ago, Pakistan was a major global exporter of pirate OD product manufactured in unregulated plants throughout the country. Under pressure from

the U.S., it took on this challenge and OD exports have all but ceased. However, its record in other areas, particularly book piracy, remains abysmal.

Ukraine: While no one would hold up Ukraine as a success story across the board, it has taken effective action against its version of *allofmp3.com*, setting a good example for its reluctant neighbor, Russia

FTAs: As noted above, this process has been a major success for our industries. The copyright standards in the FTAs are truly excellent and models for all countries.

Conclusion

As this Subcommittee knows so well, meeting the challenges faced by the copyright industries in a globalized -- and online -- world will require resolute action by the U.S. government and by the governments of our trading partners. While it is essential that copyright owners throughout the world join together with their governments to protect and nurture these industries which are, and will increasingly be, critical to global growth and trade, we cannot meet these challenges alone. Focused, effective government action is a necessary component in fighting the scourge of piracy.

The U.S. government has risen to meet these challenges and we are grateful for the long-standing support we have enjoyed from USTR, from the State and Commerce Department and from the Copyright Office and the Patent and Trademark Office over the years. This Subcommittee has been at the forefront, not only in recognizing the importance of intellectual property to growth and jobs, but in exercising constant vigilance to see that U.S. interests are protected. We thank you, Mr. Chairman, Ranking Member Coble and all the members of the Subcommittee for all the support you have given our companies and these issues over the years.

I would be pleased to answer any of your questions.