

Testimony of

# Mr James Mendenhall

March 23, 2004

Testimony of  
James Mendenhall  
Assistant U.S. Trade Representative  
Before the  
Committee on the Judiciary  
United States Senate  
March 23, 2004  
Counterfeiting and the Theft of Tangible Intellectual Property Rights:  
Challenges and Solutions

Good afternoon Mr. Chairman, Senator Leahy and Members of the Committee. Thank you for the opportunity to speak to you today about the challenges and solutions posed by counterfeiting and theft of tangible intellectual property rights (IPR).

The theft of intellectual property worldwide is an enormous and growing problem. As stated in the Administration's Special 301 report last year, U.S. industry losses due to piracy and counterfeiting are estimated to be around \$200-250 billion annually. As a result of this criminal activity, many foreign markets are simply evaporating. In China and Russia, industry estimates that piracy levels in many sectors are close to or exceed 90% of the market. Most countries are not quite at that level, and the situation in some countries has actually improved. Yet, while these changes have sometimes been dramatic, the piracy levels in many countries remain unacceptably high.

USTR and other agencies are working around the clock to resolve this problem - a problem made complex not only by its sheer scale but by the multiple underlying causes.

I will outline four key challenges facing the United States in this area. I will then outline five tools that USTR, working with other agencies, has successfully brought to bear on this issue.

## Four Challenges

### Devising New Solutions for Defeating Modern Pirate and Counterfeit Operations

First, pirates and counterfeiters exploit technological advances and employ modern business models to streamline and expand their operations.

Sophisticated, inexpensive copying technology is now available off the shelf, and pirates have been quick to put it to illicit use. For example, CD- and DVD-burners enable pirates to churn out thousands of illegitimate copies of music, software, and movies without significant investment in equipment and facilities. Similarly, the availability of cheap, high-quality scanners and photocopiers facilitates mass-production of pirated textbooks, journals or other written material.

Pirates have also become globalized. If they are shut down in one country, they simply move to the next. They run global production and distribution chains, exporting their illicit goods and displacing legitimate products from markets around the world.

The evolution of these criminal operations requires new solutions. As I shall explain later, we have led a counter-offensive on this front through the development of rigorous new rules in our trade agreements and by making use of other tools at our disposal.

### Strengthening the Rule of Law

Second, some large developing countries and economies in transition pose their own unique problems. The unshackling of markets and entrepreneurial talent in economies such as China and Russia present tremendous opportunities - unfortunately not always for the good. Criminal enterprises (including small operators and sophisticated organized crime syndicates) are growing up side-by-side with legitimate business operations. Whether through corruption, intimidation or neglect, the legal systems in these countries provide inadequate means and incentives to prosecute criminal offenders in all cases or deter future criminal activity. The solution to this problem

runs much deeper than the protection of intellectual property and requires the creation of a legal system and culture built on the rule of law.

#### Enhancing Effectiveness of International Rules

A third challenge is the creation of international legal rules to address this problem. The TRIPS Agreement was a watershed in the development of international IPR norms, and it has proven to be a tremendous success. While not all WTO Members have implemented their full TRIPS obligations, most have made significant strides.

Perhaps the chief complaint we hear today is not that countries' laws are defective (although that certainly remains a very large problem) but that countries are simply not enforcing their laws. While TRIPS contains provisions on enforcement, these obligations by their nature are not as black-and-white as other obligations. For example, it is relatively easy to determine whether a country grants patents for a 20-year term. It is much more difficult to determine whether a country has in place effective deterrent remedies to prevent IPR infringement. As I will discuss later, we have tackled this issue head on in our FTAs, which contain extensive provisions designed to strengthen IPR enforcement.

#### Promoting Awareness of the Benefits of Intellectual Property Protection

The final challenge is to rebut the skeptics in other countries who question the value of IPR protection.

We need to make it clear, for example, that trademarks are not simply names and symbols, but measures of the quality, trustworthiness and value of a product. IPR protection promotes consumer protection and safety. Trademark infringement can result not only in the counterfeiting of handbags and shoes, but can lure unwary consumers into purchasing defective windshields that shatter on impact or automobile brakes that malfunction. Anecdotal evidence of infringement is rife with horrible stories, such as counterfeit pharmaceuticals filled with paint or baby shampoo filled with industrial solvents.

IPR protection also promotes development. Copyright infringement can hinder the development of local cultural industries. As long as local artists can't make a living in their home markets because of rampant piracy, local talent will remain undeveloped. Patent and copyright infringement can cause a flight of investment out of the country, thereby eroding or preventing development of a local technological base.

#### Five Tools

The complexity of this problem calls for a comprehensive, multi-faceted solution. USTR has employed all tools at its disposal to bring pressure to bear on countries to reform their intellectual property regimes, and we will continue to do so.

#### Trade Agreements

First, Ambassador Zoellick is pursuing the President's ambitious agenda of free trade negotiations, bilaterally, regionally and multilaterally. In less than two years, we have completed and won Congressional approval of free trade agreements with Chile and Singapore, launched bilateral free trade negotiations with 14 more nations (concluding talks with eight of them), and announced our intention to begin free trade negotiations with six more. At the same time, we are working toward a Free Trade Area of the Americas (FTAA) encompassing 34 countries in the Western Hemisphere. We require that our free trade agreement partners bring their IPR regimes up to world-class standards. Our FTAs contain the highest level of IPR protection of any international agreements in the world, and they directly address many of the key challenges I discussed earlier. They contain provisions dealing with the whole range of IPR, including such issues as curbing the use of equipment used to circumvent anti-counterfeiting technology and dealing with sector-specific problems such as optical disk or broadcast piracy. They also strengthen enforcement by streamlining procedural rules for bringing copyright and trademark claims, and providing for stronger damages (including statutory damages), expeditious ex parte searches to gather evidence, and civil remedies to seize and destroy infringing goods. They also provide for improved border enforcement to stop imports and exports of pirate and counterfeit goods and stronger criminal enforcement.

#### Special 301/Section 301

Second, in April of each year, USTR issues the Special 301 report, which catalogues the IPR problems in dozens of countries around the world and places them in a hierarchy of wrong-doing - ranging from the lowest ranking of Watch List to the mid-level Priority Watch List to the ranking reserved for the worst offenders, Priority Foreign Country. A country's ranking in the report sends a message to the world, including potential investors, about a country's commitment to IPR protection. We have used this name-and-shame exercise to great effect, as each year we see countries coming forward with reforms or reform proposals to avoid elevation on the list.

In last year's report, we gave special attention to counterfeiting and piracy, and we have seen results. For example,

we elevated Poland to the Priority Watch List, and the Polish Government almost immediately took steps to address several long-standing U.S. industry concerns, including efforts to reduce the amount of pirate and counterfeit goods being sold at the Warsaw Stadium.

In the most serious cases, countries identified as Priority Foreign Countries can be subjected to a Section 301 investigation and face the possible threat of trade sanctions. China is a prime example. In 1995 and 1996, persistent tolerance of piracy led us to threaten \$1 billion in trade sanctions, which helped us to win a bilateral IPR agreement in 1995 and further action in 1996. We have also imposed Section 301 sanctions on Ukraine.

#### WTO

Third, USTR is the lead agency, working closely with other agencies, in addressing IPR issues multilaterally through the WTO.

The initiation of dispute settlement proceedings is the most forceful expression in the WTO of dissatisfaction with a country's IPR protection and can be an effective way to achieve reform. USTR has brought 12 TRIPS-related dispute settlement cases against 11 countries and the EC. Of these 12 cases, two are in consultations, eight were resolved by mutually-agreed solutions between the parties, and two resulted in favorable rulings for the United States. In nearly all these cases, U.S. concerns were addressed via changes in laws or regulations by the other party.

We also regularly review countries' IPR laws and practices through the Trade Policy Review (TPR) Mechanism. Countries recently reviewed include Turkey, Chile and Thailand. In addition, the TRIPS Council regularly reviews implementing legislation, providing a forum for USTR to provide comments on existing and draft legislation and an opportunity for bilateral meetings to discuss specific concerns.

#### Preference Programs

Fourth, USTR administers the Generalized System of Preferences (GSP) program and other similar programs, which allows us to withhold tariff preferences if a country fails to adequately protect IPR. The "carrot" of preserving GSP benefits is an effective incentive for countries to protect IPR. In fact, the mere filing of a GSP review petition or the initiation of a GSP review has produced positive results. For example, industry withdrew its petition on Peru after Peru made commitments to improve enforcement. Moldova also enacted stronger enforcement measures after the initiation of a GSP review. Colombia implemented measures to provide data exclusivity and ensure the legitimate use and licensing of software by government agencies in order to qualify for benefits under the Andean Trade Preferences Act.

#### Diplomatic Leverage

Finally, USTR, the State Department, the Department of Commerce and other agencies have used diplomatic pressure to encourage IPR reform around the world. We spend significant resources traveling the world and meeting with foreign leaders and officials to impress upon governments the importance of committing the political will and resources necessary to deal forcefully with piracy and counterfeiting.

For example, we have made IPR protection and enforcement in China one of the top priorities in our trading relationship. The United States has sent numerous high level delegations to China, and the President himself raised the issue of IPR enforcement with Premier Wen. Ambassador Zoellick has repeatedly emphasized the importance of this issue with the Chinese Government, and Deputy USTR Josette Sheeran Shiner has made multiple visits to China in the past few months alone. In the coming days, she will return to China to prepare for the U.S.-China Joint Commission on Commerce and Trade meeting next month, where IPR will be high on the agenda.

Interventions have also recently taken place at senior or staff levels with Russia, Pakistan, Thailand and other foreign governments.

#### Conclusion

Dealing with the problem of piracy and counterfeiting requires a comprehensive, intensive and sustained effort. Ambassador Zoellick is strongly committed to continuing to bring all of USTR's weapons to bear on this issue and to maintain the pressure year after year. We have made progress, but enormous challenges remain.

I look forward to working with you and your staffs to continue to devise solutions for dealing with this critical matter.

Thank you.