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INTELLECTUAL PROPERTY RIGHTS PROTECTION UNDER SPECIAL 301

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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INTELLECTUAL PROPERTY RIGHTS PROTECTION UNDER SPECIAL 301

FRIDAY, MARCH 6, 1992

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus, (chairman of the subcommittee) presiding.

Also present: Senators Bradley, Chafee, Grassley, and Hatch.

[The press release announcing the hearing follows:]

[Press Release No. H–10, Feb. 28, 1992]

TRADE SUBCOMMITTEE PLANS HEARING ON "SPECIAL 301," BAUCUS CITES IMPORTANCE OF INTELLECTUAL PROPERTY PROTECTION

WASHINGTON, DC—Senator Max Baucus, Chairman of the Finance Subcommittee on International Trade, Friday announced a hearing on intellectual property rights protection and the "Special 301" provisions of the 1988 Trade Act.

The hearing will be at *10 a.m., Friday, March 6, 1992* in Room SD–215 of the Dirksen Senate Office Building.

"Special 301 is the United States' most effective weapon in protecting the international rights of U.S. intellectual property industries," said Baucus (D., Mont.).

"These industries, including producers of pharmaceuticals, films and software, are vital to the American economy. They are under attack by pirates around the world," Baucus said.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN OF THE SUBCOMMITTEE

Senator BAUCUS. The hearing will come to order. When we think about international trade, goods like automobiles, steel, and semiconductors most often come to mind.

But America's most successful export industries do not produce steel or automobiles: they produce intellectual property such as books, films, recordings, pharmaceuticals and computer software.

With the exception of agriculture, intellectual property producers make a larger positive contribution to the United States trade balance than any other U.S. industry. The American motion picture industry logs an annual trade surplus of $3.5 billion; pharmaceuticals produce an annual surplus in excess of $1 billion, and the list goes on.

Unfortunately, American intellectual property industries often are deprived of the fruits of their labor. In foreign markets, piracy of intellectual property is rampant. Pirated copies of first-run American films sometimes appear in Asian markets before the films are released in the United States. Pirated copies of American

computer software can be purchased in Guatemala, Poland, the United Arab Emirates, and many other countries.

All told, the International Trade Commission has estimated that foreign piracy of U.S. intellectual property costs the United States as much as $40-$60 billion annually. If this piracy could be eliminated, the lion's share of the U.S. trade deficit would disappear.

In order to combat this piracy, the Congress included a provision in the 1988 Trade Act that has become known as Special 301. Special 301 is a close relative of "normal" or "Regular" 301.

Special 301 directs the administration to identify the nations that allow the most egregious piracy of U.S. intellectual property as "priority countries."

The administration is directed to initiate negotiations with the priority countries to end piracy. If negotiations are not successful within 6 to 9 months, the administration is directed to retaliate against the exports of the pirate country.

In addition to identifying priority countries, the administration has also developed on its known what is known as "watch lists." Placement of a country on a watch list indicates that the United States will closely watch or scrutinize protection of intellectual property in the country, and possibly initiate a Special 301 case in the future. Special 301 determinations are made annually on or before April 30th.

I have not always been pleased with the Bush Administration's implementation of Special 301. In 1989 and 1990, for example, the administration published watch lists, but declined to initiate any Special 301 cases.

Finally, in 1991, the administration initiated Special 301 cases against three countries: China, Thailand, and India.

But even with a spotty record of implementation, Special 301 has been one of the most successful provisions in the 1988 Trade Act.

The threat of Special 301 action has spurred reform in a number of countries, including Mexico and Argentina. Progress has also been made with Thailand on copyright protection.

In the most important Special 301 victory to date, on January 16th, China agreed to protect U.S. intellectual property from piracy.

I have the highest praise for our trade negotiators' handling of the Special 301 case against China. They combined hard negotiations, solid deadlines, and the credible threat of retaliation to reach this agreement.

In the end, they were able to convince China to agree to a regime of intellectual property protection that is in some ways superior to what we were able to win in the draft GATT agreement.

Of course, we must see to it that this agreement is faithfully implemented. But all major U.S. intellectual property vendors have enthusiastically endorsed the new agreement with China.

Unfortunately, the administration has not always applied Special 301 as deftly as it did with China. Last April, the United States initiated a Special 301 case, for example, against India.

I am very disappointed with the administration's decision last week not to retaliate against India for its piracy of intellectual property.

India has distinguished itself as perhaps the most notorious pirate of U.S. intellectual property. In Geneva, India has been one of the chief opponents of a strong GATT agreement to protect intellectual property.

In addition to pirating U.S. intellectual property for its home market, India takes the more galling step of actually exporting pirated drugs to other countries. India has reported turned piracy of U.S. pharmaceuticals into a $200 million per year export industry.

To the credit of our trade negotiators, some progress has recently been made on convincing India to reform its copyright and trademark laws, and to provide access for U.S. motion pictures. But piracy of U.S. pharmaceuticals continues without apology.

In light of this, I had fully expected the administration to retaliate against India's exports to the United States when the final Special 301 deadline was reached last week. But I was disappointed. The administration took no action against India.

The United States previously has initiated cases against India under Super 301. In both cases—now under Super 301 and Special 301—India refused to end its protectionism, and, in both cases, the United States declined to retaliate.

Our failure to take action against India is particularly disturbing because the United States could retaliate against India without in any way violating its GATT commitments.

Last year, the United States imported more than $524 million worth of goods from India under a voluntary concessionary tariff program, known as a Generalized System of Preferences, or GSP.

The United States is in no way obligated to continue to provide India with special preferential tariff treatment. In fact, U.S. law contains a specific provision to end GSP for countries that do not protect intellectual property.

But the administration continues to provide India with special tariff breaks, even though it annually pirates several hundred million dollars' worth of U.S. pharmaceuticals.

I fear that our failure to retaliate against India, despite its intransigence, greatly undermines the credibility of Special 301 and U.S. trade law generally.

I cannot help but think the leaders of other countries under pressure to end piracy of intellectual property will take note of our failure to act against India and conclude that Special 301 is, indeed, a paper tiger.

The administration did leave the door open to take action against India in the future, but, unless progress is made, I call upon the administration to restore the credibility of Special 301 and retaliate immediately.

The administration is due to make another round of Special 301 determinations by April 30th. With piracy still rampant and the prospect of a GATT agreement on intellectual property still some distance off, I call upon the administration to make aggressive use of Special 301.

The U.S. intellectual property industry has urged action against Indonesia, Brazil, Hungary, Turkey, Poland, Taiwan, Venezuela, and the Philippines.

I was particularly disturbed to see Indonesia once again appear on this list, because last year Indonesia narrowly avoided action

under Special 301 by agreeing to a series of sweeping reforms regarding protection and distribution of U.S. films. Apparently, Indonesia has failed to fulfill some of these commitments.

In addition, the European community has now implemented its outright quota on U.S. television programs. This makes the EC a strong candidate for action under Special 301.

In a perfect world, the United States would not be forced to win intellectual property protection on a country-by-country basis. The United States has worked for years to negotiate a multilateral agreement on intellectual property protection under the GATT.

I strongly support the administration's efforts to conclude a GATT agreement, but thus far, those efforts have not borne fruit. In fact, the current draft GATT agreement prepared by GATT Director Dunkel has some serious deficiencies.

The reality is that we may have no alternative but to win intellectual property protection country-by-country.

Therefore, we must continue to vigorously employ and enforce Special 301. It is now our only defense against intellectual property piracy.

[The prepared statement of Senator Baucus appears in the appendix.]

Senator BAUCUS. I turn to Senator Grassley from Iowa for his statement.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman. I'm pleased that you have taken this opportunity to hold hearings on both the protection of intellectual property and Special 301 provisions of the Omnibus Trade and Competitive Act of 1988.

More importantly, I think it is important that these hearings are being held now as decisions at GATT hang in the balance.

As each of us know, the Special 301 intellectual property provisions call for the development of an overall strategy to ensure adequate and effective protection of our intellectual property rights. Specifically, it was designed to enhance our administration's ability to negotiate improvements in foreign intellectual regimes through bilateral or multilateral initiatives.

I was pleased to add my name as a co-sponsor to Senator Baucus and Senator Danforth's bill to extend the Super 301 trade law for another 5 years. I consider the bill to be one of the strongest recourses against unfair trade.

Yet, I am aware that our trading partners, and some within our own administration, would like to see the bill weakened and not passed into law. And with an overwhelming trade deficit, I do not understand this sort of thinking.

I personally feel that a strong Special 301 and a strong intellectual protection, contrary to other opinions, are important to this Nation if we are going to be able to maintain a viable high-tech and research-based industry in this country and still remain strong and competitive internationally.

Regardless of whether we are talking about our motion picture industry, computers, pharmaceuticals, our recording industry, or, for that matter, any industry that is being adversely affected by an

unfair trade practice, Special 301 is a tool that we can use indefinitely to upgrade protection of our intellectual property rights, and one in which I think we should make more use of.

My preference in this, of course, Mr. Chairman, as holds true in most trade matters: is to try to resolve outstanding disputes by working cooperatively with the countries in question.

However, failing to do that, I do not think we should hesitate to use the tools of our trade laws to quickly and effectively defend U.S. economic interests when and if it becomes necessary.

I see this hearing today sending that strong signal. And so, I commend you for your efforts in this area, and, of course, I look forward to working with you on this issue in the future.

Senator BAUCUS. Thank you very much, Senator. I now turn to the distinguished Senator from Rhode Island. Senator Chafee.

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Thank you very much, Mr. Chairman. I am glad you are holding these hearings. This is a very important area and it goes far beyond what most people think about when they think about intellectual property.

So, I look forward to learning a lot today and appreciate your having held these hearings.

Senator BAUCUS. All right. Thank you.

Our first witness is Mr. Josh Bolten, who is the Joint Counsel for the Office of USTR. Josh, welcome. You can proceed in any manner you wish.

STATEMENT OF JOSHUA BOLTEN, GENERAL COUNSEL, OFFICE OF THE U.S. TRADE REPRESENTATIVE, WASHINGTON, DC

Mr. BOLTEN. Thank you, Mr. Chairman. It is a pleasure to appear again before the subcommittee. You have my prepared statement for the record, and, with your permission, I will just present it in digested form here.

It is a particular pleasure, Mr. Chairman, to have the opportunity to discuss the administration's implementation of the Special 301 program because Ambassador Hills and the rest of the administration have attached an extremely high priority to the protection of U.S. intellectual property rights around the world.

And, we believe to that end we have implemented the Special 301 statute, about which you and the others have been speaking this morning, in a highly effective manner.

Mr. Chairman, you, and Senator Grassley, and Senator Chafee have already highlighted the importance of intellectual property and the kind of damage to our economy that results from intellectual property violations.

I would only underscore that intellectual property violations around the world truly sap the economic vitality of the United States. They slow the pace of progress; they put people out of work; they lower their standards of living; they hurt us individually and collectively. And by us I mean not just the United States, but all the nations of the world.

So, Mr. Chairman, improving the protection of intellectual property at home and around the world has, for some time, been a shared priority and a top priority of both the Congress and the executive branch.

The Special 301 statute, which you, Senator Grassley, Senator Chafee, and other members of the committee were instrumental in crafting in 1988, and its implementation, have been the clearest expression of the shared understanding between the Congress and the administration.

Our efforts pre-date the 1988 enactment of Special 301, of course, and have taken place at both the bilateral and multilateral levels.

We have worked together, Mr. Chairman, as you mentioned, to make adequate intellectual property protection a key criterion for the GSP program, and we have made strong intellectual property protection an essential element in our bilateral trade and investment agreements.

Our bilateral efforts have been complemented at the multilateral level by the Uruguay Round of GATT negotiations.

At the outset of the negotiations in 1986, the United States put the world on notice that we expected high standards for trade-related intellectual property rights—TRIPS, in GATT jargon—to emerge as a result of this Round.

And, in the negotiating objectives laid out in the first section of the 1988 Trade Act, this committee underscored the priority that the United States attaches to strong GATT rules on intellectual property.

The importance of achieving strong intellectual property rules multilaterally has been reinforced through our bilateral negotiations.

We have found that when adequate intellectual property protection is finally established in one country, the pirates do not disappear, they simply relocate. Asian pirates move to the Middle East; Latin American pirates move to other countries in Latin America.

The best way to eliminate this shell game and to raise global intellectual property standards and enforcement is through the multilateral process.

That is what TRIPS can do, and that is one reason why the administration has placed so much emphasis on the multilateral process, even as we proceed with bilateral negotiations. We have used Special 301 to reinforce our multilateral efforts in the Uruguay Round, and vice versa.

Mr. Chairman, you have already described—and I believe the committee is well familiar with—the procedures established in Special 301 to protect intellectual property practices around the world, and for the United States to identify its priorities and pursue them.

When we first began the annual review process under Special 301 in 1989, the administration built upon the blue-prints set out in the statute and created a priority watch list, and a watch list, and even another category of being mentioned in a press release.

This process of identifying priority countries, priority watch lists, watch lists, mentions in press releases, has been very important leverage to the administration in achieving our intellectual property goals.

Korea, Japan, Malaysia, Portugal and Chile—they are all examples of countries that have taken significant steps to improve their level of protection of intellectual property, in large measure as a result of administration efforts under Special 301.

None of these countries was actually named as a priority foreign country, Mr. Chairman. But the process of our Special 301 review and negotiations with those countries in connection with our watch lists help create the opportunity for important changes in each of their intellectual property regimes.

In determining which countries should be identified as priority foreign countries and which should be placed on watch lists, the administration has consulted widely: with the executive branch, with the U.S. business community, and with the Congress as well.

We view this hearing as an important part of those consultations. The process has proved both fruitful and bountiful as a source of information for the administration.

Mr. Chairman, my testimony lays out in some detail what we have done lately with the Special 301 statute. Despite the many successes that we have been able to achieve in the last few years without actually having to name any countries as priority foreign countries, the administration did find it necessary and appropriate to identify three countries last year: China, India, and Thailand.

First, with respect to China, I think that is an important success story. Prior to our bringing of that intellectual property case, China was the leading bad actor in the intellectual property world.

Piracy of all forms of intellectual property has been widespread in China, accounting for major losses to U.S. industry: at least in the hundreds of millions of dollars.

After several rounds of difficult and intensive negotiations, just a couple of months ago Ambassador Hills concluded a Memorandum of Understanding with China. When China implements this agreement, it will provide world-class patent protection.

China will also join the international copyright community. U.S. authors and sound recording producers will, for the first time, be able to protect their rights in China and receive protection consistent with international standards.

China has also agreed to submit trade secret legislation and provide effective enforcement procedures and remedies against infringement of intellectual property rights.

Mr. Chairman, I will leave the details of our agreement with China for the record. But any reader of that record will see that our agreement with China is an excellent one.

It demonstrates that diligent negotiating and carefully targeted use of our trade authorities can produce major improvements in China's domestic regime and major benefits for U.S. exporters.

It demonstrates that engagement with the Chinese can produce real results. The revocation of Most Favored Nation status, or the effect of revocation of Most Favored Nation status through conditional legislation, would be to discard these hard-fought gains. We would, in all likelihood, be left with a massive intellectual property pirate operating practically without the United States having any recourse or leverage to change that behavior.

The second priority country identified last year was India. On February 26th of this year, following a 9-month investigation, the

administration determined that India's denial of adequate and effective patent protection is unreasonable under the statute.

Ambassador Hills directed an inter-agency committee to prepare options for trade action. These options are now being evaluated.

At the same time, Ambassador Hills noted and welcomed progress made on other issues under investigation. For example, the Indian Government has decided to submit at its parliament's next budget session, legislation to provide rental rights for videos; improved protection for sound recordings; and improved enforcement of copyrights.

In the area of trademarks, foreign owners of trademarks have been guaranteed national treatment with respect to the use of their marks in India. Trademark legislation will also be submitted to the Indian parliament to provide statutory protection for service marks.

Finally, in a significant policy move, the Indian Government has decided to lift its restrictions on the importation and distribution of U.S. motion pictures, granting access to its huge cinema and video markets.

Despite this significant progress, the Indian Government has refused, as you noted, Mr. Chairman, to change its position on providing adequate and effective patent protection.

The administration is continuing to consult with the Indian Government on this matter, and we are fully prepared to act in the near term if progress is not forthcoming.

The third country named last year as a priority foreign country is Thailand, which was designated because of its government's failure to enforce copyright laws and because of deficient patent protection.

With respect to copyright enforcement issues, the Thai Government last year significantly increased enforcement efforts. However, none of the copyright infringement cases being prepared by prosecutors or pending before the courts had been adjudicated by the end of last year—the time of the statutory deadline for a determination in the investigation.

In these circumstances, Ambassador Hills determined that Thailand's acts with respect to copyright enforcement are unreasonable under the Special 301 statute.

The appropriate action and response was to monitor carefully their enforcement actions. We intend to assess the situation carefully during this year's Special 301 review.

If the Thai Government does not effectively implement its commitments, including concluding successful prosecutions of patent pirates, the administration is prepared to act expeditiously.

With respect to Thailand's patent law, Thailand's national legislative assembly last week enacted amendments to the existing law that we are currently reviewing.

The administration will evaluate the new legislation and the results of consultations being held this week in Bangkok before making its determination by March 13th.

As you noted, Mr. Chairman, in April the administration will announce the result of our fourth Special 301 review.

As before, in preparation for this year's Special 301 review, we requested submissions from the public. We received a total of nine

submissions from three companies, and four industry associations, many of them represented on the panel that will follow me.

I should emphasize at this point, Mr. Chairman, how much we value the cooperative working relationship we have with those who have provided submissions and how effective we have been able to be largely as a result of the cooperation of these industry groups.

In the weeks ahead, we will be following up with our embassies in the countries for which we have received submissions, and with the foreign governments themselves to resolve as many problems as possible. We will also be consulting closely with you and those interested in business sector.

Mr. Chairman, in the last 3 years, we, the administration and the Congress, have made the improvement of intellectual property protection around the world one of the United States' top trade objectives.

We have pursued consistent rules to achieve this objective in a variety of forms. Special 301, administered with the flexibility contemplated in the statute, has allowed us to achieve major improvements in intellectual property protection in a number of countries. Our major complementary objective, a strong TRIPS agreement in GATT, is within reach.

We remain committed to working closely with you and other interested members of Congress, the interested members of the business community, and we remain committed to using all the tools at our disposal to achieve effective intellectual property protection around the world. There is much work to be done, but we believe that the past 3 years have put us down the correct path.

Mr. Chairman, I would be happy to take your questions.

Senator BAUCUS. Thank you, Mr. Bolten.

[The prepared statement of Mr. Bolten appears in the appendix.]

Senator BAUCUS. I notice that Senator Bradley has arrived. Senator, do you have a statement that you would like to make at this time?

Senator BRADLEY. No, I do not.

Senator BAUCUS. Mr. Bolten, the key question I have is whether the United States' application of our trade law is or is not undermining U.S. credibility, particularly with respect to India.

As you well know, when the administration issued its announcement with respect to India—I think it was last week—the administration said that India's denial of adequate and effective patent protection is both unreasonable and burdens or restricts U.S. commerce.

As you also know, although India has made some concessions in some areas of intellectual property, it has not reformed its patent law.

And, as you also know, India is selling at least $200 million worth of pirated patented pharmaceuticals within the country of India, and also exporting at least $200 million worth of the same products, in competition with the U.S. producers that invented these products.

Should the administration not, at least in the interest of maintaining the credibility of our trade laws, enforce our trade laws—in this case, retaliate against India? India was on the watch list

in 1989, watch list 1990. They are stiffing us in the area where the greatest dollar amount lies.

Mr. BOLTEN. Mr. Chairman, I do not think that our implementation of the Special 301 statute has, in any way, called into question the credibility of the statute. We have used it extremely vigorously.

Ambassador Hills—I know you have had an opportunity to address this with her directly—is aware of your disappointment in not having implemented retaliation against India, but that option remains open.

We have made some very important progress with India outside the patent area in copyrights and trademarks, and, I think as Mr. Valenti will be able to testify, in access for motion pictures.

These are not trivial developments with India, and it was, I think, very important for the United States to be able to harvest those developments.

At the same time, we remain extremely disappointed, as do you, about the level of patent protection in India, and we continue to work with the Indians on the question, bilaterally, and in the context of the Uruguay Round.

Ambassador Hills has remaining to her the option of taking some trade action against India in the event that we do not make the kind of progress we seek, but those are options that remain to be used in the future in her discretion as the negotiator.

She will not hesitate to use those options if she believes that that is the best way to achieve our shared goal, which is the implementation of effective patent protection in India and everywhere else.

Senator BAUCUS. Now, for example, last year we imported nearly $520 million worth of goods from India that qualified for better than MFN treatment under GSP. And, as you know, the law states that a country shall not receive GSP when it violates basic intellectual property protections.

Mr. BOLTEN. Intellectual property is one of the criteria to be applied in determining who gets GSP benefits. And Ambassador Hills does have that option available in her arsenal when the appropriate time comes—and we hope it does not—to take some kind of trade action against India.

Senator BAUCUS. Let us assume you are prime minister of a country like Thailand and you see the United States not enforce its intellectual property laws with respect to another country—in this case, India and pharmaceuticals.

Would that not encourage you, as the Thai prime minister, to think, well, gee, they are not very aggressive. I can get away with a lot. I can take a harder negotiating position than I otherwise might?

Mr. BOLTEN. I do not think I would draw that conclusion from the way the administration has implemented the statute.

The first thing I would see is that the administration has made important progress with India and that making some concessions and making some progress with the United States can produce results from the standpoint of the country making those concessions: that the United States does not walk in and say, I want 100 percent here, get 75 percent, and then retaliate anyway.

The second thing I would see if I were the prime minister of Thailand is that the United States still has in its pocket the ability

to use trade retaliation, but is trying to work with my country in the most constructive way possible and in the way best designed to make it politically possible for the Indian Government, for the Thai Government, or any other government to make the kinds of changes in the intellectual property regime that we want to see.

Senator BAUCUS. I do not know whether this is true or not, but it has crossed my mind that the administration has been lenient on India in order to try to entice India to be more cooperative in the Uruguay Round. India has been a bit difficult to deal with in many areas, as you know better than I.

And I am concerned that the administration is backing off on the Special 301 case in order to encourage India to be more cooperative in other areas. I do not think that is a good tack to take.

Mr. BOLTEN. That is not the tack we are taking, Mr. Chairman. We would take the progress anywhere we can get it—bilaterally or in the Uruguay Round. We want the intellectual property problem with India fixed, however, and we are not planning to trade off some other interests against protection of intellectual property.

Senator BAUCUS. I just believe you are going to get India to come along better the more you are fairly but firmly pressing the Americans' rights on intellectual property laws. I think you would find India would do better if you would press India more vigorously on pharmaceuticals. Senator Grassley.

Senator GRASSLEY. Does your department read the law that the Trade Representative has unlimited discretion in deciding whether to retaliate against a country for failure to protect intellectual property rights?

Mr. BOLTEN. That is the way the statute is written, in our judgment, Senator.

Senator GRASSLEY. Well——

Mr. BOLTEN. I should say, however, that the statute is designed to give the negotiator some flexibility in deciding when and whether to retaliate, because that flexibility is essential to the negotiator and I think it is recognized in the statute. That flexibility is absolutely essential to the negotiator in getting results.

Simply having a mechanistic deadline when a hammer falls is most likely designed to produce gridlock and trade retaliation without getting the results we want. We do not get the results and we get trade retaliation, which is, in essence, a failure.

Senator GRASSLEY. Well, have we pushed far enough and fast enough to find out that that has been a result to test our theories that that would happen?

Mr. BOLTEN. We have gone to the brink of retaliation many times, Senator Grassley, and this administration has actually retaliated. I think we have wielded the club much more often and effectively than any previous administration.

Senator GRASSLEY. All right. Well, then you say we have pushed to a point, but we never pushed to a point to see whether or not what you suspect would happen if we get tough has ever happened. Right?

Mr. BOLTEN. Sure, we have. I mean, in the case of China, for example, we went to the point of publishing a retaliation list in the amount of about $1.5 billion. We were able to avoid that retaliation because we ultimately reached agreement.

But when we published that list, Senator Grassley, you should know that we got letters from dozens of your colleagues—many members of this committee and around the Congress—saying, all right, I support your objectives, but please do not retaliate on my product.

So, we have problems of our own when we try to go out and threaten retaliation. But we have not been reticent about using that leverage when Ambassador Hills thought it would be useful to achieve a result. It was in the case of China.

Senator GRASSLEY. But I thought your point was that if we took tough stand against country A, country A would retaliate in some way against us. And you cannot point out that they have ever done that.

Mr. BOLTEN. I see. You are asking if we have ever experienced a situation in which we threatened retaliation and the country has counter-retaliated.

Senator GRASSLEY. Well, I thought that was your point. You did not want to take the tough action because you thought there would be retaliation against us in response.

Mr. BOLTEN. No, Senator. I may have misspoken. What I was trying to say was that retaliation often does not produce the result we want and ends up only with closing the U.S. market, which is a loser for everybody concerned. Now, there have been examples in the past——

Senator GRASSLEY. Yes. I heard you say that. So, I am asking you, have there been examples when you have gone that far that a country has retaliated against us?

Mr. BOLTEN. Yes.

Senator GRASSLEY. What country?

Mr. BOLTEN. Well, for example, when the United States retaliated against the European community several years ago in connection with steel.

Senator GRASSLEY. Well, we are talking about a law that has been on the books just since 1988. Are you talking about since 1988?

Mr. BOLTEN. No, sir. Not in the Special 301 context.

Senator GRASSLEY. Well, I want to talk about this law that is the subject of this hearing, Special 301. You are saying that you do not really want to push a country because something is going to happen negative to us as a result of that; they are going to hit back at us. So, I am saying you really cannot point out a country that has hit back. So, we ought to push, and push, and push till we make our point.

Mr. BOLTEN. I think, Senator Grassley, that is what we are doing. I do not think there is any disagreement on the policy.

Fortunately, we have had results good enough in the Special 301 context—and I think any fair reader of the record on Special 301 will see a lot of good results—and have threatened retaliation credibly enough so that we have not had to come to the point of retaliation.

So, that is why I think you do not see examples of countries counter-retaliating against us. It is precisely because we have been able to use the statute with the credible threat of retaliation.

Senator GRASSLEY. Yes. But you might get action faster if you move more quickly than what you have been moving, and I think that is what the Chairman is trying to say. You just said that we ought to do more on India right now, and what do we have to fear? Let us find out what we have to fear, rather than supposition. I am done.

Senator BAUCUS. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. Mr. Bolten, I am interested in how other nations handle this. I suppose none of them are on the scale that we are with the development of intellectual property rights and the availability of legal protection. But let's take sophisticated nations like Great Britain, Germany, or France—what do they do about intellectual property violations by India or Thailand, for example?

What sort of protection do the British employ? They do not have the hammer of Special 301. How do they get protection for their folks?

Mr. BOLTEN. Most of the other developed countries with an interest in intellectual property protection have been pursuing their rights principally through the Uruguay Round of GATT negotiations, just as are we.

We have had common cause—unfortunately not as consistently as we should have—with a lot of our developed trading partners for some time in the GATT negotiations, but other countries have not typically used the kind of 301 or Special 301 statute that we have available here in the United States.

Senator CHAFEE. Well, when you say we are pursuing it through GATT, are you saying that we are seeking to enlarge the GATT to include intellectual property? Is that what you are saying?

Mr. BOLTEN. Yes.

Senator CHAFEE. Now, let's say you get a country to agree, for example Sri Lanka or China. I suppose all of the enforcement efforts for copyrights, patents, or trademarks will be a very sophisticated business.

With all of the good will in the world, can one of these countries enforce what they have agreed to? Here in this country we have had experience with patents ever since we became a nation, and yet even for us it is an elaborate, intricate, and arcane subject area.

So for others—take Taiwan—who says it will start to protect our tapes and enforce against "knock-offs," the question is: Can they do it?

Mr. BOLTEN. They can do it, but it is often difficult and new to them. The panel that you will hear from after me, Senator, I think you will be able to get specific examples from each of them of problems, not in the law of the foreign countries in which they are trying to do business, but in the enforcement of those laws.

Thailand, for example, in the copyright area: our problem has been in the enforcement of copyright laws. That is one of the issues on which we are pressing the Thai the hardest right now.

Senator CHAFEE. I suppose this question should go to the next panel, but I am just curious whether you know anything about it. There must be right here in the United States certain companies

that knock off videotapes or recording tapes and sell them right here at home, are there not?

Mr. BOLTEN. It is very common on the street corner, and I am sure Mr. Valenti and others can give you chapter and verse. In fact, in dollar volume, there may be as much intellectual property piracy here in the United States as there is around the world, largely because we have such a large market.

But, in the United States, we have in place effective laws, and we have in place effective enforcement mechanisms. That is not true in so many countries around the world, and why we have pursued such a vigorous Special 301 program and why we have pursued a worldwide TRIPS agreement in the GATT.

Senator CHAFEE. Well, let us say that Taiwan has signed on and is now according intellectual protection. They are recent arrivals in all of this, are they not?

Mr. BOLTEN. Yes.

Senator CHAFEE. Suddenly Mr. Valenti reports to you that all kinds of videotapes are coming in—they have knocked off "Dances with Wolves"—and are selling them in the United States and in third markets.

So, you go to Taiwan and you say, shape up, stop this. And the Taiwan officials say, well, we are chasing after them but we cannot catch them; they are all over the place. Now what can we do?

Mr. BOLTEN. Well, we can do a couple of things. We can brandish some kind of retaliation and say you are not chasing after them effectively enough.

One thing we can and have done in a lot of countries is offer them technical assistance in how to pursue intellectual property violations, and I know a number of U.S. Government agencies have been active in that.

But we can also go in and brandish some retaliation and say it is your obligation to try to enforce the laws that you agreed to put in place. That is a hard thing to do piecemeal around the world.

And that is why a good GATT TRIPS agreement is the right answer. An agreed upon set of international rules that set the standard for intellectual property protection around the world—that does not exist today.

We need to get that agreement in place because it is so much easier to walk into a country and say, here are the standards that you have agreed to, please live up to them, rather than to walk in and say, here are the standards we think you should live up to, why do you not live up to them?

Senator CHAFEE. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman and Mr. Bolten. You are familiar with the Canadian Pharmaceutical Price Control Board.

Would you view the Dunkel text on the TRIPS section to require the Canadians to change their law in which they say if prices exceed a certain amount you lose patent protection for the particular drug?

Mr. BOLTEN. Yes, Senator. We do view the Dunkel text that way.

Senator BRADLEY. And is there a time limit in which they would have to change the law?

Mr. BOLTEN. There is a time limit: 1 year after the date of entry into force.

Senator BRADLEY. So, that means they can no longer use the loss of patent protection as a method of controlling prices?

Mr. BOLTEN. That is correct.

Senator BRADLEY. And they have expressed a willingness to do that, obviously.

Mr. BOLTEN. By agreeing to the Dunkel text, we believe they have—if and when they do agree to the Dunkel text, which is not yet the case for any country.

Senator BRADLEY. And the Dunkel text, how will it affect the phase-in on pharmaceuticals and also the pharmaceutical pipeline?

Mr. BOLTEN. Senator, you are asking what sort of time period is there?

Senator BRADLEY. Yes.

Mr. BOLTEN. In general, not just with respect to Canada?

Senator BRADLEY. Yes.

Mr. BOLTEN. There is a phase-in—I will need some technical help here, Catherine.

Ms. FIELD. Ten years.

Mr. BOLTEN. It would be immediate for developing countries. We have been disappointed with the phase-in available to developing countries.

Senator BRADLEY. It is what, about 10 years?

Mr. BOLTEN. Catherine Field, our Associate General Counsel, is advising me that it is 10 years for product patents.

Senator BRADLEY. Yes. And the patent is 10 years. That is the pipeline problem?

Mr. BOLTEN. No. There are two separate problems.

Senator BRADLEY. The phase-in problem and then the pipeline problem.

Mr. BOLTEN. Yes.

Senator BRADLEY. As I understand it, the Dunkel text does not really seriously deal with either.

Mr. BOLTEN. It does not deal with either nearly as effectively as we would want. We were disappointed—very disappointed—with the results of the Dunkel text on both the related pipeline and transition issues.

Senator BRADLEY. And what was your position?

Mr. BOLTEN. The administration's position?

Senator BRADLEY. Yes.

Mr. BOLTEN. We would have liked to have seen the whole thing become effective immediately. We would like to have seen pipeline protection effective immediately and to have the shortest possible transition period.

Senator BRADLEY. So, how do you see it evolving now we have the Dunkel text? In your view, is the pharmaceutical section closed, or, by agreeing to it, have you closed off further negotiations, or what is going to happen?

Mr. BOLTEN. We do not think the Dunkel text is closed off. We do know that we will have difficulty making changes in the Dunkel text, but this issue is on the top priority list of those changes we would like to see made in the Dunkel text.

Senator BRADLEY. As close to immediate as possible?

Mr. BOLTEN. Yes. Now, in the course—I will have to consult Ms. Field again—of negotiations, I am sure we were prepared to accept various compromises. Our original position would have been we want the protection in place immediately now.

We would be glad to submit for the record or for your staff a briefing on where we were prepared to go. But our last position did not go nearly as far as the Dunkel text ultimately did in providing transition periods for developing countries.

Senator BRADLEY. What areas do you feel have the most progress with regard to motion pictures, software, and recordings, under the TRIPS section; what are you proudest of and what do you still see to be the biggest remaining problem that we did not address?

Mr. BOLTEN. We are actually proud in all of those areas. I would not want to draw invidious comparisons among them, because they are all extremely important: in software, in copyright protection; even in patent protection there have been some important developments.

Our principal disappointment in the TRIPS text was precisely in the area you have just described, which is the pipeline and the transition periods.

Senator BRADLEY. So, in terms of motion pictures and software and recordings, are you fully satisfied with what you have done?

Mr. BOLTEN. Not fully satisfied, but we made a tremendous amount of progress. There were a couple of issues, including one involving contractual rights in the European community that we were disappointed were not addressed in the Dunkel text. But overall, I think any fair reader of that text will see really dramatic improvements in the three areas you have just mentioned.

Senator BRADLEY. And how will the TRIPS section be enforced?

Mr. BOLTEN. Well, there will be an obligation on countries to put into place in their laws actual enforcement measures.

And if we, the United States, find that a country is not enforcing its obligations under the TRIPS text, we can, under a new dispute settlement mechanism in place in the Dunkel text, effectively pursue our rights.

Senator BRADLEY. And how do we find that out? Let us say they pass copyright protection in country X and you say, well, they passed the law, but they do not enforce it. I mean, that has happened.

Mr. BOLTEN. And that is a problem that happens constantly around the world. We rely, in part, on our embassies, but principally on U.S. businesses that have shown not the slightest bit of reticence to let us know when they are having problems.

Senator BRADLEY. All right. Thank you.

Senator BAUCUS. Mr. Bolten, just following a bit on Senator Bradley's question about phase-in and the pipelines, has the American pharmaceutical industry informed you that it opposes the GATT agreement as a consequence of those provisions?

Mr. BOLTEN. I do not believe so, but I know PMA is represented here and they have expressed extreme disappointment with what they view as the deficiencies in the tax, and we largely share their view of disappointment.

Senator BAUCUS. What is the remedy? I mean, the Dunkel text, as you said, is going to be difficult to change because changes will require agreements of other countries——

Mr. BOLTEN. Yes.

Senator BAUCUS [continuing]. Which I doubt India is going to have changed. So, what is the remedy for the pharmaceutical industry with these two glaring loopholes; the phase-in and the pipeline problem?

Mr. BOLTEN. The opportunity for us now is to work extremely hard, as we are doing, with all of our key trading partners to try to get the kinds of changes we want to see in the Dunkel text to put pressure on India, to put pressure on other developing countries to try to bring themselves around to seeing that a transition period that amounts to 10 years is——

Senator BAUCUS. But the administration is aggressively pushing for a change?

Mr. BOLTEN. Absolutely.

Senator BAUCUS. Let us assume that the administration is unsuccessful, and let us assume the Dunkel text is adopted. What remedy would there then be available under Special 301? Would Special 301 not be limited?

Mr. BOLTEN. No, I do not think so. First of all, if the text does come out with some of these disappointments——

Senator BAUCUS. Well, in respect to the 10-year phase-in problem.

Mr. BOLTEN. If the text comes out to say that countries may have a 10-year phase-in period under our international obligations?

Senator BAUCUS. Right. That is my assumption.

Mr. BOLTEN. Then countries would, under our international obligations, have the right to phase-in over 10 years. But I should emphasize that the situation today is that countries have no obligations whatsoever.

They can have a 100-year phase-in period as far as their international obligations are concerned today, and, under current international rules, there is nothing we can do about it.

Senator BAUCUS. Well, the question is, to what degree would the Dunkel text—if it is agreed to and adopted by the Congress—limit the ability of the United States to apply Special 301. I mean, at least today we have Special 301.

Mr. BOLTEN. Well, but the Dunkel text is an international agreement. The status quo is that there is no international agreement.

Senator BAUCUS. That is right. But we Americans do have Special 301. I am asking the question, would the Dunkel text limit United States' action under Special 301? That is my question.

Mr. BOLTEN. As a legal matter, certainly not. We do not need to make any changes in Special 301 as a result of the Dunkel text, with the exception of some changes in the timeframe within which we pursue our cases.

Senator BAUCUS. As a practical matter.

Mr. BOLTEN. As a practical matter, I think we can expect that our moral authority to complain to a country about the speed with which it is putting in place patent protection is limited if we have agreed to an agreement that expressly gives them 10 years.

But our international legal authority is under no circumstances any less. There is now no international agreement requiring these countries to provide any patent protection whatsoever.

So, when we show up on the door and say, we want patent protection within 3 years, they say, what gives you the right to demand that? The Dunkel text at least will give us the right to demand it.

The current Dunkel text, we think, will give us the right to demand it in too long a timeframe and we are trying to shorten it, but it will create international obligations where none now exist.

Senator BAUCUS. You are pleased, as you should be, with respect to China. That is, the deadlines in Special 301 were effective leverage in encouraging China to reach an agreement with you. Why not apply that same pressure more broadly? Why is the administration opposed to a Super 301?

Mr. BOLTEN. Special 301 should be characterized, I think, as a special case. It has been an opportunity in once place to draw together a comprehensive administration and business sector review of intellectual property protection to identify our priorities and pursue them. I think the statute has worked effectively; I think we have implemented effectively.

Super 301 we also implemented effectively for the 2 years that it was in place, but it is, in our judgment, a statute that we do not really need at this point.

Senator BAUCUS. Why?

Mr. BOLTEN. Industries may come in and petition at any time when they have complaints about market access, or any other problem. Industries always have an open door at USTR. We aggressively go out and seek our own 301 cases.

I think we have found that the Super 301 statute, while it served a purpose while it was in place, could be truly counterproductive to our efforts to open markets overseas.

Because what happens when we designate a country under Super 301 is that the focus is all entirely on the designation; entirely on the United States' unilateralism and name-calling, and not on the bad practices of the countries designated.

Senator BAUCUS. But was it not very effective in encouraging countries like Korea to open up so as to avoid being named under Super 301? I think there are other examples in addition to Korea, as I recall, too.

Mr. BOLTEN. There are examples of effectiveness. I think we used the statute effectively. But I think effectiveness is limited and it ought not be extended in the future.

Senator BAUCUS. Well, any other Senators have questions?

Senator Grassley?

Senator GRASSLEY. No.

Senator BAUCUS. Senator Chafee?

Senator CHAFEE. Well, Mr. Chairman, I just want to say we have had a lot of experience with Josh Bolten up here before the committee, and I admire his candor and his knowledge, and I am very glad he is with USTR.

Senator BAUCUS. Thank you.

Mr. BOLTEN. Thank you, Senator Chafee.

Senator BAUCUS. Thank you very much, Mr. Bolten. We appreciate it.

Mr. BOLTEN. Thank you, Mr. Chairman.

Senator BAUCUS. Our next panel consists of Mr. Harvey Bale, with the Pharmaceutical Manufacturers Association; Mr. Robert Holleyman, of Business Software Alliance; Ms. Hilary Rosen, with the Recording Industry Association of America; and Mr. Jack Valenti, president and chief executive officer of the Motion Picture Export Association of America.

Senator BAUCUS. It is my understanding that the panel has caucused and decided that Mr. Valenti is going to lead off. A wise choice.

STATEMENT OF JACK VALENTI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE EXPORT ASSOCIATION OF AMERICA, WASHINGTON, DC

Mr. VALENTI. Thank you, Mr. Chairman, Senator Grassley, and Senator Chafee. I know Senator Grassley is also on the Copyright Subcommittee of the Judiciary Committee, so I am doubly glad he is here.

Senator GRASSLEY. And I will bet you want to talk about disclosure legislation, right?

Mr. VALENTI. We will do that at a later time, sir. You may be sure of that.

Senator GRASSLEY. Well, I will be glad to talk with you about it. I think you are on the right side on that one.

Mr. VALENTI. Thank you, Senator.

This committee asks a question of whether or not the 301 and the Special 301 have value. The short answer is: you bet it does.

Let me give you a little background. The Cold War is over, but I can tell you without any peradventure of a doubt, we are in another war. It is the world war of trade. And what is being deployed out there are not bombs that can incinerate us, but a new kind of troop that is moving around the world that can cause us great economic hardship.

Almost in every domestic arena where we once were dominant we now find ourselves stretched to the snapping edge—our stores and our malls invaded by goods not made in this country—and beyond our shores what we make and market collides with an ever-avalanching tide of competition and quality design and cost.

But there is one American product—I know you cannot wait to hear what this one is—that is supreme in the world, literally without global rivals. What American product, other than Boeing Aircraft, captures 40 percent of the Japanese marketplace?

And what American product is usually number one wherever it is available; not only in Western Europe, but in Asia and in Latin America?

And the answer, of course, is American movie and television programs, which return to this country about $3.5 billion in surplus balance of trade, when the words "surplus balance of trade" are seldom heard in the corridors of this building.

No wonder, it seems to me, that that trade asset, a glittering trade prize, ought to be protected as strongly, as firmly, and as un-

ambiguously by the Congress and this administration as any product I know.

This is one reason why foreign governments are keen to shrink the American visual presence and to achieve this, these countries have constructed, in an ingenuity that just boggles the mind, all kinds of trade spikes and hedge-rows and restrictions, all aimed at reducing the impact of the American movie on their shores.

And, if that was not enough, too many countries are languid in the way they protect our property: with feckless laws, irresolute enforcement of those laws.

Some countries say, well, come right on in, we do not have any restrictions. Then, once we get there, we find out that all that we own and market is being stolen—counterfeit copies flooding the country, rendering worthless what we own—which means if you cannot protect what you own, you do not own anything.

So, it is a double whammy, not only trade restrictions, but also the theft of our property.

Now, this is why, at least for the American movie and television program, the trade war is in full thunderclap gallop: we face it everyday.

Now, if the final results in GATT about which Mr. Bolten spoke sanctify quotas as a way of trade life—if they bar us from national treatment; if they ignore, distort, or reduce our version of what we call contractual rights—then I promise you, this committee must understand that this trade prize is going to be wounded and that wound will widen, without any question.

Now, my own feeling is we will finally be enfeebled, not because our creative zest has decayed; not at all. It is because too many countries and too many people in those countries have discovered that the only way to defeat the American movie is to cage it, or exile it, or bar it, or restrict it, or steal it; or, as we say in some of the political prose, all of the above.

Now, let me give you a few examples of what is going on, to be specific. Thailand—Mr. Bolten talked about Thailand. 301 was filed against Thailand by the American Motion Picture Industry—and behind me is Eric Smith, executive director of the International Intellectual Property Alliance, which bands together records, and books, and software, and movies and television programs. That 301 has been stonewalled by the Thais.

At this moment, I think they can be described as the worst piracy area in the entire world. And boy, that is one Academy Award that I do not want to win.

On December 20, 1991, 1 year after this was filed, USTR found them in violation and then sort of said, well, we will see what is going to happen. That is one of the few times that I have disagreed with USTR.

The Thais now think they are home free. I am hopeful that in the next month or two the USTR will examine what has happened there, because they have done nothing to rectify that situation.

Either USTR takes the gloves off with Thailand, or the 301 will have been severely blunted.

In Poland and Greece, piracy is unbridled. I have been to Greece and I have been to Poland with Secretary Mosbacher, who did a

wonderful job in allowing me to go before the highest-ranking people in those countries to tell our story.

If you would give me one more minute without guillotining me, Mr. Chairman.

Senator BAUCUS. You have got it. It is a good performance.

Mr. VALENTI. In Indonesia, we filed with USTR asking Indonesia to open up their borders. Do you realize they have a $1.5 billion surplus with this country, selling their goods without any impairment?

We cannot even open an office there. Cannot get in. An impenetrable shield lies at the border, and our noses are pressed against that windowpane.

In what may be formally called the former Soviet Union, it is Dodge City, deja vu, with no signs saying, "Guns must be checked at the door."

Piracy is 100 percent rampant, which is why I had announced some months ago that the MPAA companies are not going to send any more films there until copyright laws are in place and enforced.

Italy's copyright laws are as porous as a wicker basket. We estimate losses of almost $600 million there. And the Walt Disney Company just recently has been stung with the most audacious, and up till now, unpunished theft you can imagine.

Hundreds of thousands of copies of Fantasia and Snow White have been stolen, with the government standing passively by, mute and unable to intervene. What is visited on Disney is an outrage that grazes the meaner edges of absurdity and it ought not be allowed to continue.

Now, I have so many more fascinating things to tell you, Mr. Chairman, that I do not want to stop. But I will, though.

Let me sum up. 301 and Special 301 only work if the U.S. Government makes clear that it is deadly serious. We must have stern convictions about this, because if you do not have convictions, you are going to be right only by accident.

And I cannot laud Carla Hills too highly. I just think she has been, in a global nest of complexities, she has been a mostly triumphant captain, and I salute her.

She has been very supportive of all we are trying to do, and she has with her a first-class staff of professionals. And I will match them against any group in the government.

But I promise you, Mr. Chairman, one thing this Congress can do: they need more people. Negotiations take time—great chunks of time—and you cannot do it blithely and casually. You have got to get into the entrails of this business.

So, meanwhile, I say thanks to 301 and Special 301, we have a counter-weapon. Because every day we have to be vigilant because, like virtue, we are everywhere besieged. And on that jubilant note, I will pause and let someone else speak.

[The prepared statement of Mr. Valenti appears in the appendix.]

Senator CHAFEE. Mr. Chairman.

Senator BAUCUS. Senator Chafee.

Senator CHAFEE. Mr. Chairman, unfortunately I have to go. I wonder if I might ask Mr. Valenti one quick question.

Senator BAUCUS. Certainly.

Senator CHAFEE. Mr. Valenti, you talk about Italy as being as porous as a wicker basket, and this gets to the point I was making before.

You were here when I was asking Mr. Bolten questions about enforcement. It is all well and good if nations agree to adopt intellectual property protections, but if they do not enforce them, where are we? What is the Valenti solution for Italy? What would you do if you were Carla Hills, whom you have lauded? You mentioned that you would match her USTR staff against anybody in the government, with the exception, of course, of the Finance Committee staff.

Mr. VALENTI. I meant any administration group, not the Congress, sir, of course.

Senator CHAFEE. In any case, what would you do, if you were Carla Hills, with Italy?

Mr. VALENTI. The problem of Italy is one of a court system where we know who the pirate is, we cite him, the Italian police find him, and now he appeals, and then there is a counter-appeal, and you go through the courts. It is like cold molasses off of a tile roof; it just goes on, and on, and on.

Senator CHAFEE. So, that is the situation.

Mr. VALENTI. Yes, sir.

Senator CHAFEE. Now what do we do?

Mr. VALENTI. Well, at this moment we are working very strenuously with the Italian government. There is a separation of powers in Italy, too.

We are trying to find out some other way to deal with this fellow—and we know who he is—without having to go through the long, laborious, time-consuming court system there that frankly stems from the Middle Ages and works at that speed.

Senator CHAFEE. But are you suggesting that we should brandish Special 301 against Italy?

Mr. VALENTI. No, I am not suggesting that. I am not suggesting that. We are working right now—MPAA, with the administration—in Italy.

Even as I speak to you, discussions are now going on to try to find innovative ways to do this. It may be that at some point I come back to the USTR and say, look, we have exhausted all of our possible remedies, we have got to try something else. Let us put our heads together and see what we can do.

Senator CHAFEE. All right. Thank you very much, Mr. Chairman.

Senator BAUCUS. Thank you. All right. Among the many panelists, who wants to follow Mr. Valenti.

Dr. BALE. Looks like I have got the microphone, Mr. Chairman.

Senator BAUCUS. All right. Dr. Bale, go ahead. You bet.

STATEMENT OF HARVEY E. BALE, JR., Ph.D., SENIOR VICE PRESIDENT, INTERNATIONAL DIVISION, PHARMACEUTICAL MANUFACTURERS ASSOCIATION, WASHINGTON, DC

Dr. BALE. Thank you very much. The source of the hearings today, Special 301, to us, is a very welcome development on the part of the committee in its review.

Strong intellectual property protection worldwide is extremely important to the competitiveness of high technology manufacturing

industries, and it is absolutely critical to the success of the U.S. research-based pharmaceutical industry which I represent.

This industry devotes an extraordinary 16 percent of its total revenues to research and development, and, without patents, this industry could not succeed and patients would not receive new medicines.

PMA subscribes fully to your statement, Mr. Chairman, that Special 301 is "the most effective weapon" in advancing strong intellectual property protection. The administration has used Special 301 well up till now in such regions of serious pharmaceutical piracy as Asia and Latin America, but there is still much to do.

Recently, Ambassador Hills announced that India does not live up to international patent standards for pharmaceuticals, and that she is reviewing a number of options to respond to India's continued piracy, and production and export of sub-standard pharmaceuticals.

Furthermore, we understand by her statement that a decision on India will be pending soon regarding a review of progress in that country, and we urge that review be done very quickly, as you, sir, have also urged.

Furthermore, a decision on Thailand is expected next week. To date, that country has produced the draft law which is totally inadequate.

And, finally, PMA has identified six countries that should be designated this year as priority countries under the Special 301 law. These countries are: India, Thailand, Brazil, Hungary, Turkey, and Venezuela. There are five more that deserve to be placed on what USTR calls a priority watch list.

Meanwhile, there is a pending Uruguay Round draft text on intellectual property protection, or TRIPS, as it is commonly called. This text is highly deficient and is less valuable, frankly, to the U.S. pharmaceutical industry than continued Special 301 negotiations.

While the draft TRIPS text provides some benefits, the bottom line is that those benefits would largely be put off for at least another decade because of delayed application and the absence of effective transitional protection.

Under its provision, valuable research revenues would be lost, and consumers in Third World countries would continue to receive pirated and often harmful medicines soured from countries such as India and Thailand.

Make no mistake, our trade partners want to neuter the whole 301 process, whether it is called Special, Super, or just plain Section 301. The Dunkel text, we believe, would do that to Special Section 301.

PMA urges the Congress and the administration to reject any approach that would effectively weaken Special 301, at least until such time as the GATT is demonstrated to provide an effective alternative system of strong intellectual property protection.

I think I will stop here, Mr. Chairman. Thank you.

Senator BAUCUS. Thank you very much, Dr. Bale.

[The prepared statement of Dr. Bale appears in the appendix.]

Senator BAUCUS. Well, I will just choose someone. Ms. Rosen, why don't you go next?

Ms. ROSEN. Everyone was being so good about summarizing. I will cut out half of my statement.

STATEMENT OF HILARY B. ROSEN, EXECUTIVE VICE PRESIDENT, RECORDING INDUSTRY ASSOCIATION OF AMERICA, WASHINGTON, DC

Ms. ROSEN. Thank you, Mr. Chairman. I want to tell you how pleased the RIAA is that you are holding this hearing today. The 301 provision of the 1988 Act that this committee had the wisdom to craft has proven to be a most effective tool to fight for improved copyright protection around the world.

We have made significant headway—notably, as stated frequently today, our recent agreement with the PRC—but much remains to be done. We have to continue to struggle for adequate standards, and we must make sure that once in place, these laws are vigorously enforced.

Your active participation is a critical element of the ultimate success of these efforts. In this regard, Mr. Chairman, I note with great appreciation your recent statement on the Senate floor concerning the need for aggressive administration action on Special 301. We concur.

I also want to add RIAA's strong endorsement of Jack's proposal to institutionalize an inter-agency team dedicated to the protection of intellectual property around the world. We also think that Carla Hills, her staff, and others in the administration have done a superlative job in proceeding with relatively few resources.

We consistently applaud her efforts. But it is time to establish a more comprehensive force. An investment in human resources like this will have a huge pay-off for the U.S. economy.

At this point, Mr. Chairman, I would like to request that a copy of the International Intellectual Property Alliance submission to the USTR be placed in this hearing's record.

Senator BAUCUS. That will be done. The appendices to the submission will be retained in the committee files.

[The information appears in the appendix.]

Ms. ROSEN. We hope that the submission will serve as a blueprint for 301 negotiations over the course of the next year. Rather than cite a country-by-country analysis, I would like to talk about the bigger picture facing the record industry.

Our music obviously touches the hearts and minds of those far from our shores. It is a vital export and produces a highly favorable balance of trade. Unfortunately, the demand for American music in every market around the globe has led, in far too many instances, to misappropriation of the work of our musical creators.

Our music is too often copied; too often sold, rented, and broadcast without authorization, control, or compensation. Inadequate, ineffective—I was not going to say feckless, but I like that—feckless laws——[Laughter]

Coupled, in many cases, with government indifference concerning enforcement, has led to massive worldwide trade in illicit recordings. This ends up costing the American music community $1.5 billion in lost revenues each year.

According to numbers created by the Department of Commerce and frequently cited by USTR, addressing this problem would create 30,000 more jobs in the U.S. music industry alone.

Because the worldwide problem is so great, this committee must maintain its close involvement in the implementation of Special 301.

Yes, we have had successes with the PRC and other places, but when 301 is not used consistently, it also fails to produce results—such as in the case that Jack stated, of Thailand, where, despite our industry's 301 petition and Special 301 designation last year, the situation in Thailand remains unchanged: it is still a 95 percent pirated market and we have had absolutely no success with conviction of known pirates.

To finally convince Thailand to enforce their laws, or to get Taiwan to prevent their compact disc facilities from manufacturing and exporting massive quantities of compact discs, or to establish an adequate law in Poland, requires the sustained attention of this committee.

It is you, the Congress, that provides the administration with the leverage it has in conducting bilateral negotiations, same sentence for, ultimately, this leverage is dependent upon the perception of the particular foreign country of the level of Congressional concern, as well as the realistic likelihood that sanctions may be imposed.

If we are to be successful in breaking down barriers to U.S. entertainment, all must understand that although it is clear that the purpose of Special 301 is not to impose sanctions, you will not tolerate the failure to do so when unfair trade practices continue.

In conclusion, I would like to add our views to those who have said that multilateral agreements which compromise existing standards, or provide inadequate standards, or a services agreement which exempts cultural industries is much too high a price to pay in the GATT. Bilateral tools like Special 301 must be maintained to keep pressure on foreign governments.

Finally, the attention provided us by this committee, Mr. Chairman, is very much appreciated. The progress we have made to date is due, in no small part, to the involvement of the members of this committee and your staffs, and we thank you.

With your continued help and support, we will be in the competition worldwide to continue to provide American music, which is what the world wants to hear.

Senator BAUCUS. Thank you, Ms. Rosen.

[The prepared statement of Ms. Rosen appears in the appendix.]

Senator BAUCUS. Mr. Holleyman.

STATEMENT OF ROBERT W. HOLLEYMAN, II, MANAGING DIRECTOR, BUSINESS SOFTWARE ALLIANCE, WASHINGTON, DC

Mr. HOLLEYMAN. Mr. Chairman, thank you. My name is Robert Holleyman, and I am the managing director of the Business Software Alliance.

My testimony this morning is presented on behalf of the BSA and the Software Publishers Association, which collectively represent publishers of nearly 70 percent of the software for personal computers published in the world.

Our industry is a very young industry. The world's largest PC software company is only 16 years old. It has only been 10 years since the first personal computer was mass marketed.

In that time, we have seen an explosion in demand for personal computers and an explosion in demand for software which has been filled by U.S. publishers.

Our industry sustained the highest growth rate of any copyright industry between 1987 and 1989—15.5 percent—and it continues to grow.

The most rapidly growing segment of the U.S. software publishing industry is the foreign market. In 1989 and 1990, we averaged foreign sales of $12 billion per year.

Yet, to put the right perspective on this, as we sold $12 billion a year worth of software, we were losing between $8-10 billion a year as a result of foreign piracy of software. In other words, for every dollar we made abroad, we were losing—and continue to lose—between 50 and 75 cents abroad.

The situation is intolerable. It is easy to understand how it happens, however, when you consider that every personal computer is, in fact, a software copying machine and that instantaneously, by pressing a button, you can get an exact copy of a computer program.

So, the challenge for us in the international marketplace is twofold. One, to ensure that laws are enacted that provide copyright protection for computer software; and, second, to ensure that there is adequate enforcement of those laws.

From our industry's point of view, Special 301 represents the best current hope for the protection of software and the prevention of piracy in the international marketplace.

The case with the People's Republic of China is the clearest example of why Special 301 works. Little more than 7 weeks ago, the bulk of our industry had essentially written off China as a prospect for doing business. We were then, and we continue to sustain, annual losses of $225 million per year in China.

But, because of the impact of Special 301, because of the very significant concessions the Chinese were willing to make hours before the deadline of trade sanctions, we now have the prospect for opening markets in China—opening doors with China.

And, I am convinced that in China, as everywhere else in the world where there are open market opportunities, U.S. software publishers will produce the programs of choice and will meet the market demand.

For this year, the largest problem the software industry faces is in Germany. In Germany, piracy of computer software is costing publishers and distributors $1.86 billion per year. U.S. software publishers directly lose $721 million per year in Germany.

For a country as developed as Germany and as strong of a trading partner as Germany is, losses of this magnitude to the U.S. industry are entirely unacceptable.

Last year, the U.S. Trade Representative's Office placed Germany on the Special 301 watch list for this specific problem—a problem caused because there is no effective enforcement mechanism in Germany to prevent piracy.

Unfortunately, in the year that has intervened, while we have had promises from German Government officials that they would address this problem, we have seen no concrete action taken to solve this problem. We have not even seen a draft of legislation from Germany that would remedy the problem.

So, for that reason, we have petitioned USTR this year to elevate the level of attention given to Germany by putting Germany on the priority watch list. We ask this Congress to join in making resolution of this problem one of the highest trade priorities for the United States, as it is the highest trade priority for the U.S. software industry.

There are other countries I could list that are in my testimony: Thailand, with a 98-percent rate of piracy; Korea, with above 80-percent rate of piracy; Taiwan with a 90-percent rate of piracy; and Italy, with a 82-percent rate of piracy. Collectively, through these and other countries, we are losing billions of dollars each year due to inadequate means of protection.

At this point in time, Special 301 is our best hope. We congratulate and applaud this committee for enacting the legislation that has shown, in China, that it has the prospect of opening a door to free trade.

We applaud Ambassador Hills and her quite able staff for the work that they have done in countless hours of negotiations for U.S. industry.

In conclusion, Mr. Chairman, I will simply say that all of these efforts will be for naught unless we remain vigilant.

And, for the U.S. software industry, with a highly positive balance of trade, it is indeed not only in the industry's interest, but I think in the U.S. Government's interest and the U.S. population's interest to eliminate these losses.

There has not been a single market in the world where the U.S. software industry has not been able to lead and fulfill the market demand, if there is an open market. Special 301 provides the opportunity for continued leadership in open markets.

Thank you for the opportunity to testify today.

Senator BAUCUS. Well, thank you, Mr. Holleyman.

[The prepared statement of Mr. Holleyman appears in the appendix.]

Senator BAUCUS. That is very interesting to learn about Germany. I did not realize that it was that much of a problem in Germany. Would the Dunkel text, if it is agreed to, solve the Germany problem?

Mr. HOLLEYMAN. The first thing that would solve the German problem—from which, actually, we could benefit even earlier than the Dunkel text—is the European Community Software Directive. The directive, as approved by the EC, last year was drafted specifically to require Germany to change their standard of proof, and it would, if implemented properly, give us the tools we need to bring enforcement actions in Germany.

Senator BAUCUS. So, you think probably the EC Directive in this area will be sufficient?

Mr. HOLLEYMAN. Ultimately, it should be sufficient. The problem is that Germany has not even presented draft legislation to implement the directive.

Senator HATCH. Mr. Chairman, could I just say a word or two, because I have to leave.

Senator BAUCUS. Go ahead.

Senator HATCH. If you would just defer to me for a minute. I have really enjoyed this testimony.

All of you are friends, and frankly, I have worked closely with every one of your industries, as you know, as Ranking Member on the Patents, Copyrights, and Trademarks Subcommittee of the Judiciary Committee, and I really am enjoying being on this committee with Senator Baucus, and others on the full Finance Committee.

I wanted to mention to you, Senator Baucus, just to give you an idea of the magnitude of the problem in the area of software, I spoke with the officials of WordPerfect in Orem, Utah, one of the largest software manufacturing companies in the world.

And they estimate the total losses for U.S. software publishers due to copyright pirating in just Taiwan, Korea, and Thailand alone, to be in the neighborhood of almost $1 billion; just those three countries. And I knew Germany was prominent, but I did not realize they were such a major infringer.

Now, these figures do not include literature, motion pictures, videos, and pharmaceuticals in those three countries; that is just software alone—$1 billion in those three countries.

So, I am greatly concerned by this and it simply should not go on. Therefore, I will be encouraging the administration to continue using the Special 301 provision of the 1988 Trade Act.

I think it is an effective tool and can be even more effective, certainly, as you have pointed out in the case of China. And I think we cannot afford not to use it to enforce fair and equitable copyrights protection around the world.

I wanted to make these comments and tell all of you that the subcommittee appreciates your testimony because this is what helps. Wherever I travel in the world I talk about intellectual property and the protection of it. In fact, I travelled to South America last fall.

But I can tell you, when I am in Germany the next time, I will certainly raise this issue a little stronger than I have before. And I want to compliment the Trade Representative for the work that she has been doing, because I think she and her staff have done a terrific job thus far. I think it is just the beginning of what needs to be done, as you do.

Mr. Chairman, I thank you for letting me make these few remarks.

Senator BAUCUS. Thank you, Senator. Each of you represent industries which are really success stories for America. We have many industries that run trade deficits. In pharmaceuticals, in computer software, in the recording industry, and motion pictures—the U.S. runs surpluses. Is that not correct in each of your industries?

Mr. VALENTI. Yes.

Ms. ROSEN. Yes.

Mr. HOLLEYMAN. Yes.

Dr. BALE. Yes, sir.

Senator BAUCUS. So, you are the real American success stories.

I guess you are saying generally that, even though you are successful, that to maintain and expand your surplus position, we just need very aggressive enforcement of our trade laws so that other countries do not take advantage of us. That is basically what you are saying. Is that correct?

Mr. VALENTI. Yes.

Ms. ROSEN. Yes.

Mr. HOLLEYMAN. Yes.

Dr. BALE. Yes.

Senator BAUCUS. Now, turning the tables a little here, one of the big discussions today in America is the degree to which we Americans should enforce our trade laws because other countries have taken advantage of us and, on the other hand, the degree to which we Americans have to work harder, and smarter, and increase our productivity, et cetera.

What lessons do your industries have for those American industries that are not doing as well in international trade?

I mean, why is it the pharmaceutical industry, computer software, recording industry, and motion picture industry are doing relatively well, at least compared with other industries in the context of international trade. What did you do that was right?

I am just curious of what lessons that any of you may have here, or any observations you might have here.

Mr. VALENTI. Well, Mr. Chairman, I cannot speak for the other people at this table, but we are not protected by patent. We are protected by copyright, but not my secret formula or anything like that that is buried beneath Spago's out in Beverly Hills.

But what we do is we are a global industry. We do not make movies for people just in Wichita Falls, Texas, and Clairmont, California. We make them for Kuala Lumpur, and Santiago, and Paris, and Toronto. We make them for the world. And I think that it is this global outlook on the part of the American motion picture industry that gives it its sustenance. And perhaps its enduring strength is that we are on a world market, we do not exist in a domestic market.

And what sets us apart many times from the Europeans, whose talent is just as splendid as ours, whose craftsmen are just as technically innovative of ours, but they tend to make movies parochially.

That is, tell stories that might do well in Dijon and Lyon, but do not do that well in Shanghai. I think it is the global outlook of the American living in a hotly, deadly competitive world, and we think globally.

Senator BAUCUS. Dr. Bale.

Dr. BALE. Thank you, Mr. Chairman. I think I would add to what Jack has said by saying that it is the creativity of these industries, in part, plus the protection which is provided under international law, which is too inadequately respected.

We do believe that by devoting 16 percent of revenues in our industry to R&D, which, if you compare that, for example, with the average industry ratio—which, according to the latest statistics that I saw are about 3.5 percent; that is overall U.S. industry; 3.5 percent—even in some relatively high technology manufacturing in-

dustries, such as computers—and I spent a little bit of time in that industry—it is about 7 or 8 percent.

This is an industry in pharmaceuticals that the average is 16 percent and in some biotechnology companies it is 30, 40, 50 percent. So, that is an important part of it.

But the importance of the intellectual property issue is so great because if you put all of these expenditures up front—and I think this is also true for my colleagues at the table—if you do not have that back end principle that you can protect that creative idea, that property also includes ideas, then I think you are lost.

So, I think it is a combination of the creativity, the devotion to R&D, plus the protection that U.S. law and the constitution raised in the principle back in 1789 that is really key to these industries.

Senator BAUCUS. Mr. Holleyman, what about your industry?

Mr. HOLLEYMAN. I would simply say for software I think we have had success because we have created products that met the market demand, and, through that, essentially became the de facto standard worldwide.

Wherever I am—and I was in Bangkok, for example, at the end of last year—U.S. software publishers are the names that are known everywhere in the world.

Now, 98 percent of the computer users in Thailand are not paying for our products, but they are using them on their PCs. So, we, in fact, develop good products that meet the market demand.

But until we contain the losses and convince Thailand and other countries of the world that it is also in the interest of their indigenous industry to protect intellectual property, then we will not only sustain losses, but there will be no hope that foreign countries will develop their own software industries.

Senator BAUCUS. All right. Ms. Rosen.

Ms. ROSEN. Well, music starts as an individual effort, and it starts in the heart and the soul of an individual songwriter or composer, and that is an international language. And that language appeals to people all over the world, as Jack said. And we have an advantage in that.

I think also from the economic perspective, Harvey raises a key point. We take a lot of risks. Eight-five percent of all the records we release fail to make back their costs.

The 15 percent that are hits subsidize all of that R&D. And we are willing to take those chances, because when you have a hit, when you discover a Bruce Springsteen or a Madonna, it pays for a lot of young, talented artists to get their shot. And I think that is something that prevails in the United States and prevails in other countries with their own domestic industry.

Senator BAUCUS. This is not really the subject of this hearing, but what device do you have for this Congress to help your industries continue to do what you are doing well? That is, looking at the general question of competitiveness, whether it is tax laws or how the government is organized.

As you look down the road and look into the next century, you want to stay number one.

Mr. VALENTI. I will take a shot at that, Senator, because I think I have a specific response.

If we can keep a full, unstinting, seamless web of support from the U.S. Congress—from the Finance Committee, from the Ways and Means Committee, Commerce, Foreign Relations and all of the other committees whose writ runs worldwide—I think that is indispensable.

And I just got back from Brussels the night before last. And in all of my conversations with high ranking commissioners, I pointed out to them that we have the full support of our Congress, and our Congress will not allow us to be shrunk, or laid to the side, or exiled, or distorted, or restricted.

And, if that GATT agreement comes out that has any of those deficiencies in them, that our Congress will not ratify that treaty, and they must understand that.

And I must tell you, it is the largest arrow in my quiver and it is also confirmed by the fact that you and others who have gone there——

Senator BAUCUS. I was going to say that. We have more arrows in our quiver.

Mr. VALENTI. You have made it clear, I cannot certify you the worth of that kind of a commitment. It is incalculable.

Senator BAUCUS. It is a point I often made in Europe last year. That is that we, in the Congress, are not going to ratify any agreement that does not meet these standards, and I make that point over and over again. Any other thoughts?

Ms. ROSEN. Well, for the record industry, technology challenges us. We are consistently in the position of hoping that our copyright laws keep up with the advance of technology as it becomes easier to broadcast, and copy, and the like.

We have a peculiar problem in the record industry, because we do not have the full panoply of copyright protection that other intellectual property communities have, and that is the lack of a public performance right. That is something that hopefully is being addressed in another forum in the Judiciary Committee. It would allow us at least to stay level.

Senator BAUCUS. Right.

Ms. ROSEN. From your perspective, I think the issues you have raised today about making sure we have equality between a multilateral agreement and our bilateral opportunities is critical.

That if we compromise ourselves in the United States and agree to a standard worldwide, then our industry will not be able to have the potential and the growth that it deserves and that America deserves.

Senator BAUCUS. What about the Dunkel text? Does that give you the protection you need, or not?

Ms. ROSEN. Well, I was dismayed to hear Josh's comments that he was relatively satisfied with the level of copyright protection afforded us in the Dunkel text. We think that that draft expressly allows discrimination against U.S. record companies.

The problem of national treatment is one that we all share. When a country is not required to live by the principles of national treatment, American record companies directly suffer.

Obviously, we also are concerned about the rental provisions. We have had a particular problem with record rental in Japan. That

problem is not only not served well by the Dunkel text, it is made worse by providing a loophole for Japan to slip through.

Senator BAUCUS. So, what is your remedy? What are you doing about that?

Ms. ROSEN. Well, we have communicated this with USTR, we have communicated with you and your colleagues, and we were hopeful that we were going to make some progress with the administration in their continuing efforts, although I guess now after their comments today, we are going to have to go back and re-think our strategy. But we will not support a GATT agreement that brings a TRIPS——

Senator BAUCUS. That is the next question that I was going to ask.

Mr. VALENTI. I want to support Hilary, and I brought this up when I was in Brussels. Number one, the Dunkel text is too loose-fibered to be worthy.

It says a lot of pious things in the text, and then in the preamble it says, oh, by the way, any country can pass legislation to promote its own national objectives. And, of course, the bottom falls out when you say that.

The TRIPS text is totally insufficient. It ignores works-for-hire contractual rights in this country. And the idea of giving a 5-year transition to people is like saying, today in Washington, DC we are going to pass a law that says you cannot steal anymore, but between now and the next 5 years, steal all you can. It does not make any sense. The Dunkel text, as it now stands, is, to us, insupportable.

Senator BAUCUS. Dr. Bale.

Dr. BALE. Mr. Chairman, I think you and Senator Bradley touched on issues of transition and pipeline protection in the pharmaceutical area.

Senator BAUCUS. Right.

Dr. BALE. I think you have hit the nail right on the head. I would add to that by saying that there are provisions in that text that weaken the text considerably more, because even with the 10-year transition for developing countries—such counties as India, Brazil—these are countries which, in 10 years, will be hardly developing countries. They are certainly players on the international trade scene.

There are provisions in there which, during this transition period if a local pirate makes a "substantial investment" then all the benefits of that treaty would be postponed forever for a particular product in which that particular "substantial investment" was made.

This is a transition provision which is a feature which is not very well noticed, which could make the real transition in this agreement 20 years, and not 10 years.

So, with provisions like that in which investments can be made by local pirates, it would postpone this agreement well into the next century.

Senator BAUCUS. Now, if this agreement were adopted, to what degree would it preclude us from continuing Special 301?

Dr. BALE. I think it would be rather significant. I think your dialogue with Josh Bolten pointed to some of the problems. If we sign

onto an agreement which permits certain activity, we can hardly call that activity unfair or unreasonable if we are party to an agreement that permits that.

In effect, the Dunkel text provides a safe harbor of 10 years for countries such as India and Brazil to continue doing what they are doing.

Well, how can we, and how can the State Department, and how can other agencies of the U.S. Government who are defending our foreign policy interests, sit by and say, well, if we sign such an agreement, we would be abrogating that agreement if we then retaliated under Special 301.

In our view—and we certainly have listened and heard the USTR view of this, which is somewhat different from ours and we respect that view—we believe that Special 301 would be significantly weakened by the Dunkel text.

Senator BAUCUS. All right. Mr. Holleyman, your view of the Dunkel text and 301's applications?

Mr. HOLLEYMAN. The Dunkel text for software would, for the first time, establish a multilateral obligation to protect computer software. So, for us, that is a positive development.

We have two principle concerns. One we share with our colleagues today is an excessively long transition period. We are also concerned about a loophole in the provision for protection of computer software against unauthorized rental, which we feel needs to be tightened.

In terms of the relationship between a TRIPS agreement and 301, it is our view that if problems can be taken care of for the intellectual property community, then we would ultimately be willing to exchange these protections under Special 301 in favor of strong protection under a TRIPS agreement. I do not think we are there yet, but ultimately it is an exchange we would be willing to make.

Senator BAUCUS. I know this is a little bit of an artificial construct, but if you were, in each of your industries, forced to choose—you had no alternative—between either Special 301 or the Dunkel text, which gives better protection for your industry? Mr. Valenti.

Mr. VALENTI. Special 301.

Ms. ROSEN. Same. No question.

Mr. HOLLEYMAN. That is a close call. Perhaps the Dunkel text.

Dr. BALE. Well, it may be a close call, but I think with the 10-year provision, I think our companies would take the bird in the hand versus one that is flying around in the bush somewhere. And I think Special 301 gives us better protection.

Senator BAUCUS. All right. Thank you very much. I appreciate the testimony of all. You have been very helpful and very constructive here. I think your joint effort is going to help us enforce our laws.

Dr. BALE. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you.

Dr. BALE. Thank you.

[Whereupon, the hearing was concluded at 11:45 a.m.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF HARVEY E. BALE

INTRODUCTION

Thank you very much for providing me the opportunity to testify at this important hearing today on Special 301 and its vital importance in current international trade negotiations to improve intellectual property protection worldwide. The pharmaceutical Manufacturers Association (PMA) is extremely grateful for the support of Chairman Baucus, and his colleagues on the Subcommittee on International Trade in helping to ensure that the international trade environment becomes more conducive to the sale of U.S. research-based medicines and U.S. goods and services in general.

The establishment of the Special 301 provision in the 1988 Omnibus Trade and Competitiveness Act has ushered in an important positive approach for ensuring that countries that allow or condone the theft of intellectual property must be accountable for such policies. More importantly, Special 301 has introduced a powerful and effective voice for the U.S. Congress that ensures that the U.S. maintains a precise bilateral instrument at the same time this nation pursues a multilateral solution to the devastating problems caused by intellectual property theft. The multilateral route, of course, currently is the Uruguay Round of the General Agreement on Tariffs and Trade (GATT).

Last year, the USTR utilized Special 301 for the first time to identify and designate as "priority foreign countries" China, India and Thailand. As the GATT talks are entering their final stages, the U.S. needs a credible and palpably effective bilateral instrument. And U.S. negotiators have used this instrument to demonstrate that there was no place to run nor any place to hide for these countries, even if they try to hide behind a weak and unacceptable GATT TRIPs text.

THE HIGH TECHNOLOGY PHARMACEUTICAL INDUSTRY

PMA companies will spend nearly $11 billion dollars in research and development funds in 1992, up by 14 percent over the level spent in 1991. While it is often reported that U.S. industry is generally reducing its R&D spending, ours continues to grow, driven by the effort to discover new cures. Bringing a single new drug from laboratory to market costs on average $231 million, with a 10 to 12 years required for research and development and regulatory approval.

In 1991, PMA member company global sales exceeded $60 billion, about a third of which were comprised of sales in overseas markets. The industry maintains a positive trade balance, including one with Japan. PMA member companies put its revenues to good use, spending 16 percent of total sales on research and development.

INTERNATIONAL CHALLENGES: THE LACK OF ADEQUATE INTELLECTUAL PROPERTY PROTECTION

Without adequate patent and trademark protection, our industry's investment in cures for diseases such as AIDS, cancer, Alzheimer's and malaria would simply not take place. Several years ago, an academic study was published showing the degree of dependence of various industries on patent protection to bring new products to market. The results of this study are reproduced in Chart 1. As you can see, the pharmaceutical industry ranks at the very top of that list. Although this analysis probably understates the dependence of pharmaceutical innovation on patent protection for its existence, an important point can be drawn from this chart nonetheless.

Not only is pharmaceutical innovation highly dependent on patents, but, also a national patent law is not very meaningful if it does not provide process and product protection to pharmaceuticals.

Chart 1

IMPORTANCE OF PATENTS TO PHARMACEUTICAL INNOVATION

Pharmaceutical Manufacturers Association

Industry	Percent That Would Not Have Been Introduced	Percent That Would Not Have Been Developed
Pharmaceuticals	65	60
Chemicals	30	38
Petroleum	18	25
Machinery	15	17
Fabricated Metal Products	12	12
Primary Metals	8	1
Electrical Equipment	4	11
Instruments	1	1
Office Equipment	0	0
Motor Vehicles	0	0
Rubber	0	0
Textiles	0	0

Source: E. Mansfield, "Patents and Innovation: An Empirical Study, *Management Science* (February 1986).

Despite the overriding need for effective patent protection in this increasingly interdependent world, there are pharmaceutical pirates and infringers whose intellectual property theft is actually condoned by their governments. In 1991, the International Trade Commission (ITC) and USTR estimated that losses of PMA member companies to patent piracy worldwide approach $5 billion. Clearly, without adequate and effective patent protection worldwide, the research-based pharmaceutical industry will be unable to continue its success in developing new, safe and efficacious medicines to treat a wide range of debilitating and deadly diseases.

PROBLEMS IN ASIA

Some of the worst intellectual property offenders in the world are in Asia. Recognizing this, on May 26 last year, USTR designated three countries—China, India and Thailand—as priority foreign countries under Special 301 because of notable deficiencies in their respective intellectual property regimes and their market access policies and practices.

The People's Republic of China

On January 16, 1992, the Special 301 investigation involving the People's Republic of China was successfully concluded. Through the tireless efforts of Ambassador Hills and her staff, the Chinese Government promised to vastly improve Chinese intellectual property laws. Chinese commitments to safeguard foreign intellectual property are to become effective as of January 1, 1993 and entail:

- 20 year product patent term for pharmaceuticals;
- non-discriminatory compulsory licensing;
- importation to satisfy working of a patent; and
- 7½ years marketing exclusivity for medicines patented on or after January 1, 1986 but not yet marketed in China.

The positive results obtained from these Special 301 negotiations with the Chinese Government further demonstrate the skill of U.S. negotiators, and the foresight of the Congress in ensuring that bilateral initiatives, such as Special 301, remain an integral component of overall U.S. trade policy. PMA is hopeful that China's commitment to reform its intellectual property laws will serve as a catalyst for similar change in other countries both inside and outside the region, as well as within the GATT.

India

If any country can be labeled as a central player in patent piracy throughout the world, it is India. India's Government has given free rein to latent pirates which hold claim to many millions of dollars in pirated sales of patented pharmaceuticals inside India, and could claim five times this amount in sales of pirated pharmaceuticals to markets in developing and newly industrializing countries. If India were to implement an effective patent law, sales of U.S. companies in India could reach at least $200 million per year.

To date, India has played a key role in the GATT TRIPs negotiations by leading an effort by developing countries to ensure that transitional or pipeline protection is left out of the final TRIPs agreement, and by ensuring that countries like their own are provided at least ten years to adapt their own laws to meet the basic conditions of the same agreement.

Last week, Ambassador Hills announced that she had determined that India's denial of adequate and effective patent protection is unreasonable and burdens or restricts U.S. commerce. While deciding not to move ahead with retaliation right away, Ambassador Hills left the door open to future actions and has asked an interagency group to develop options for consideration of such actions.

No one would like to throw the "book" at India more than PMA, yet PMA also understands the reasons why the USTR has delayed its decision in taking punitive action against India. However, if India is not forthcoming in the very near future in improving its dismal state of intellectual property protection for pharmaceuticals, PMA believes that the U.S. Government should move to enact full retaliation against that country for its past and present acts and practices.

Thailand

Thailand has been investigated separately from China and India on the basis of PMA's regular 301 petition, submitted in January 1991, although Thailand too was included in the list of Special 301 priority countries.

We are aware that the new patent law amendments have passed the second and third readings of the Thai National Legislative Assembly and are awaiting signature by the Royal Thai Government. Unfortunately, these amendments are unacceptable in many respects: they provide no pipeline protection, establish overly broad compulsory licensing provisions, and set up a Canadian-like price monitoring board to grant compulsory licenses based on "alleged" pricing abuses by the patent holder. Unless Thailand is able to provide the research-based pharmaceutical industry some form of transitional protection, and to nullify that part of the law which permits broad compulsory licensing, PMA would recommend that the U.S. Government undertake retaliation against the RTG. Thailand has until March 15 to respond positively to the U.S. Government investigation of its practices and acts.

OTHER "PRIORITY" COUNTRIES

While Special 301 seems to have been utilized up to now with a principal focus on the countries of Asia, PMA believes that there are other countries which deserve the special recognition of priority foreign country status under Special 301. With this in mind, on February 20, PMA nominated six countries to be considered for this status in 1992 because of their egregious practices regarding IP protection for pharmaceuticals, or because they have failed to respond to the best efforts of U.S. negotiators to convince them to change their ways.

Besides re-nominating India and Thailand for this status, PMA has suggested that Brazil, Hungary, Turkey and Venezuela be considered for self-initiated 301 action by the USTR this year. I would like briefly to explain the rationale behind these nominations.

Brazil

The Government of Brazil continues its policy of not providing either product or process patent protection for pharmaceutical substances. Brazil was the subject of a Section 301 petition filed by PMA on July 23, 1987, which resulted in a 1988 Presidential determination that such practices were unreasonable and burdensome, and the initiation of trade sanctions on certain imports from Brazil. On June 27, 1990, the U.S. suspended its Section 301 investigation of Brazil.

On May 1, 1991, the Government of President Collor introduced its draft patent law into Congress. Unfortunately, the law is seriously flawed and falls short of the commitment made by the Brazilian Government to introduce an adequate patent law in exchange for the elimination of U.S. trade sanctions. The law has languished in the Brazilian Congress with little support from the Collor Government since its introduction.

In addition to the lack of action to improve its patent regime, Brazil joined with India and other obstructionist countries in a successful effort to weaken the GATT TRIPs agreement.

When announcing the termination of the trade sanctions against Brazil in 1990, Ambassador Hills announced she would continue to monitor closely the Brazilian Government's efforts to enact an adequate law. Due to Brazil's inaction on the patent issue, PMA recommends that sanctions be reconsidered.

Hungary

While the Hungarian patent law provides for a 20-year patent term protection, such protection is not extended to pharmaceutical and chemical products. The Hungarian patent law must be amended specifically to provide for all classes of subject matter, including pharmaceuticals and chemicals. Equally important is the need to provide transition provisions affording protection for products not yet marketed in Hungary but which are covered by unexpired product patents in other countries.

Hungary's persistent refusal, in ongoing negotiations with the U.S. Government, to provide this basic protection to pharmaceutical products is indicative of its continued desire to insulate its pharmaceutical industry—long regarded as major suppliers of infringed pharmaceutical products—from the basic tenets of fair trade and respect for intellectual property rights.

Turkey

The Government of Turkey does not provide patent protection for pharmaceutical products, a deliberate decision on the part of the Government made almost 30 years ago. Turkish officials have promised both the U.S. Government and pharmaceutical industry representatives that they will be introducing a new patent law covering pharmaceuticals "very soon." Despite such promises, which have been made regularly over the last two to three years, no draft has ever been made available to anyone outside the Government of Turkey for even a cursory inspection.

Turkey's consistent refusal to extend patent protection for pharmaceuticals adversely affects investment decisions in this important sector, and in fact, in recent years, the number of international pharmaceutical companies operating in Turkey has declined from twelve to seven. Only two U.S.-based companies remain with direct operations in Turkey.

Furthermore, Turkey's current law is deficient not only insofar as it does not provide patent coverage to pharmaceuticals, but it also provides a patent term of only 15 years rather than the international standard of 20.

Venezuela

Unlike its Andean Pact neighbors, Venezuela was never bound by Decision 85 and always had the option to unilaterally enact an adequate pharmaceutical patent law. Unfortunately, contrary to repeated indications made by the Government, Venezuela has yet to commit to introduce a product patent law for pharmaceuticals. The attitude of the Venezuelan Government is troubling because, like Colombia, it has elected to maintain a third-world intellectual property regime rather than lead the Andean Pact in following the example of countries like Mexico.

OTHER COUNTRIES

In addition to these countries, PMA has suggested that five other countries be kept on a "priority watch" list, because their acts and practices regarding patent protection for pharmaceuticals still are objectionable, but not so critical as to earn them the status of priority country. These include: Argentina, Colombia, Egypt, Indonesia and Korea.

Finally, PMA suggested that there are nine countries which should be kept on a "watch" list to ensure that their current commitments to improve IP protection are fulfilled, or that refinements to current laws are made to ensure appropriate protection for pharmaceuticals. These countries include: Canada, Chile, China, Commonwealth of Independent States, Ecuador, Mexico, New Zealand, Peru and Taiwan.

THE URUGUAY ROUND

The GATT negotiations are entering their final stage. As the Uruguay Round moves towards conclusion, we hope that our industry can continue to work closely with the USTR and the Congress to arrive at an acceptable and world-class TRIP's agreement. Our industry is pleased with several of the provisions provided in the December 20, 1991 draft put forward by GATT Secretary-General Arthur Dunkel. These include a 20-year patent term and a prohibition of discrimination in patent practices, including compulsory licenses. This latter point serves to address some of the major problems that PMA companies face with respect to Canadian patent law.

Essentially, the current draft text would enhance the existing patent laws in developed countries. However, due to the long transition period developing countries would have to implement the TRIPs agreement, it offers virtually nothing to improve the egregious lack of patent protection in countries such as India, Thailand, Brazil, and even Turkey.

Worst yet, the TRIPs text's most serious flaws threaten to undermine the significant progress the United States has achieved bilaterally, such as with Mexico. The current TRIPs text provides for an unacceptably long period of implementation for developing countries (10 years or more) and contains no provisions for "pipeline protection." As written, the draft text would protect only patents filed in the future, perhaps as early as 1993. More likely, protection would not take effect until 2003.

Pipeline protection, the protection of medicines patented abroad but not yet marketed in countries where pharmaceuticals do not receive adequate patent protection, is of critical importance to the U.S. research-based pharmaceutical industry and, therefore, continued pharmaceutical innovation. Given the 10 to 12 years of R&D time necessary to bring one new drug to the market, lack of pipeline protection would leave an entire generation of products now under development without any patent protection, costing our industry many billions of dollars over the next decade.

EFFECTS ON SPECIAL 301 OF THE PROPOSED GATT DISPUTE SETTLEMENT MECHANISM

There is a particular aspect of the Dunkel text that could affect the efficacy and strength of Special 301. As I have indicated throughout this testimony, PMA believes that Special 301 has provided leverage enabling the United States to achieve substantial improvements in the protection of patents for pharmaceutical products. An issue of significant concern to us then, is any adverse effect the proposed new GATT dispute settlement procedures may have on Special 301, and the conduct of Special 301 negotiations.

The draft GATT Understanding on Rules and Procedures Governing the Settlement of Disputes would change the current rules considerably. Under the Understanding, if a GATT plaintiff requested the establishment of a GATT panel, it would be established promptly and would render a report virtually certain to be adopted by the GATT Council. If the report were regarded as aberrant, an appeal could be taken.

Any government found to have violated GATT rules or nullified and impaired GATT benefits would be called upon to provide the GATT written reports of its progress in implementing the GATT panel's recommendations within the reasonable time period established by agreement or arbitration. If it failed to implement the panel's recommendations or provide adequate compensation within the reasonable period of time for compliance, it would be virtually certain to obtain GATT authorization to reciprocally suspend concession.

If a satisfactory TRIPs agreement were fully implemented by all GATT members, PMA would expect to benefit from these procedures to settle, effectively and expeditiously, any disputes over the application of those rules. However, to the extent that the TRIPs agreement were unsatisfactory, or its implementation were delayed significantly for developing countries, PMA would be seriously concerned.

Currently, in the absence of adequate international rules on intellectual property protection, the United States unilaterally may determine whether or not a foreign government's protection of intellectual property is adequate, without breaching international rules. The United States also may take actions in response to (that is, retaliate against) inadequate intellectual property protection, provided such action does not violate GATT rules or nullify and impair GATT benefits.

Action that involves increasing duties or imposing quotas on products can be in violation of current GATT rules that bind certain tariffs and generally prohibit quantitative restrictions. However, action in other respects—such as limitations on the provision of services—is not precluded by current GATT rules. Moreover, so long as the GATT fails to provide adequate rules on trade in services, investment and intellectual property, inter alia, there may be some tolerance by the international community of U.S. unilateral action responding to unfair trade practices not addressed by the GATT.

However, the post-Uruguay Round GATT presumably will address these areas of trade. Under a far more comprehensive GATT,. the ability of the United States to employ unilateral measures with respect to GATT members to address remaining unfair practices will be reduced. *First,* once GATT rules are developed for intellectual 'property, services and investment and improved for trade in goods, there simply will be less tolerance in the international community for any country's unilateralism. *Second,* the GATT will cover more trade, requiring resort to the GATT dispute settlement procedures for more disputes. *Third,* any unilateral action

that violates GATT rules or nullifies and impairs GATT benefits will be subject to swifter and surer GATT-authorized sanctions.

The engine that drives Special 301 is the threat of retaliation by the United States if another government refuses to protect intellectual property adequately. If implemented, the GATT Understanding on dispute settlement would undermine the credibility of this threat, since U.S. retaliation itself likely would be found to be a violation of the GATT. Diminished credibility means less leverage in Special 301 negotiations, and probably fewer breakthroughs as a result.

The bottom line, then, is that if the GATT is to include the new Understanding on dispute settlement, it also must include *satisfactory* rules in the TRIPs agreement implemented on a timely basis. If the TRIPs agreement continues to fail to protect existing patented subject matter, and to permit developing countries to pirate our drugs for five, ten or more years into the future, then the new Understanding would reduce our leverage to seek pipeline protection and a quicker termination of patent piracy through Special 301 negotiations.

CONCLUSION

For all of the reasons articulated here today, PMA companies continue to be concerned that, in efforts to compromise on an overall agreement, GATT signatories could be pressed into accepting a sub-standard TRIPs accord. The submitted text raises the possibility that such a compromise could be struck and thus presents a clear and present danger to our industry.

These weaknesses in the current TRIPs text send exactly the wrong message to developing countries which must either create or improve their systems of intellectual property protection if they are to create opportunities for foreign investment and economic growth. Furthermore, the TRIPs accord as currently written could weaken the political position of such close allies as Mexico, where the Government recently enacted a world-class law far superior to that of the current TRIPs proposal. The long transition period would encourage India, Brazil Thailand and other developing countries to resist further concessions in bilateral discussions, in effect making the TRIPs accord a "ceiling" for intellectual property protection rather than a "floor" from which to construct higher standards.

With the pending Uruguay Round draft "Dunkel Text," we could be approaching a crossroads in deciding upon a continued multilateral or bilateral approach to trade policy.

Frankly, our trade partners have had Special 301 and Section 301 in their sights for many years. They have denounced U.S. "unilateralism" as undermining the GATT process. This view is patently wrong; but we worry that in the rush to save the GATT Uruguay Round, we may succumb to our trade partners wishes to "neutralize" Section and Special 301. Too much conventional wisdom surrounding the GATT argues that a failure of the GATT Round will allow trade blocs and trade wars will only grow.

A failure of the Uruguay Round will not result in such cataclysmic occurrences. Not at all. The greater danger is that a new Multilateral Trade Organization (MTO) will take over for U.S. leadership and lead to a catastrophic loss in leadership by the United State on trade issues. Such a development would have disastrous consequences for the trading system.

On the other hand, we can and must, continue to use bilateral pressure to open markets abroad, and this includes improving intellectual property protection abroad. We must do this until such time as GATT or MTO is prepared to provide the same multilateral framework as is contained in our bilateral objectives. Until then, we would argue, a weak GATT or MTO agreement is more likely to lead to American disillusionment with the trading rules and this lead to greater future trade conflict.

Thus, PMA urges the Congress to do two things related to the issue of Special 301:

First, be very wary of any package that is brought back on GATT that only marginally improves the global environment for IP protection while simultaneously effectively undermines Special 301.

Second, coordinate closely with the USTR on ongoing efforts to respond to the challenges of using this very effective bilateral tool.

PREPARED STATEMENT OF SENATOR MAX BAUCUS

When we think about international trade, goods, like automobiles, steel, and semiconductors, most often come to mind.

But America's most successful export industries don't produce steel or automobiles. They produce intellectual property, such as books, films, recordings, pharmaceuticals, and computer software.

With the exception of agriculture, intellectual property producers make a larger positive contribution to the U.S. trade balance than any other U.S. industry. The American motion picture industry logs an annual trade surplus of $3.5 billion, pharmaceuticals produce an annual surplus in excess of $1 billion, and the list goes on.

Unfortunately, American intellectual property industries are often deprived of the fruits of their labor. In foreign markets, piracy of U.S. intellectual property is rampant.

Pirated copies of first-run American films sometimes appear in Asian markets before the films are released in the U.S. Pirated copies of American computer software can be purchased in Guatemala, Poland, the United Arab Emirates, and many other countries.

All told, the International Trade Commission has estimated that foreign piracy of U.S. intellectual property cost the U.S. as much as $40 to $60 billion annually. If this piracy could be eliminated, the lion's share of the U.S. trade deficit would disappear.

SPECIAL 301

In order to combat this piracy, the Congress included a provision in the 1988 Trade Act that has become known as Special 301.

Specia 301 is a close relative of Section 301. It directs the Administration to identify the nations that allow the most egregious piracy of U.S. intellectual property as "priority countries." The Administration is directed to initiate negotiations with the priority countries to end piracy. If negotiations are not successful within six. to nine months, the Administration is directed to retaliate against the exports of the pirate country.

In addition to identifying priority countries, the Administration has also developed "watch lists." Placement of a country on a watch list indicates that the U.S. will closely scrutinize protection of intellectual property in that country and possibly initiate a Special 301 case in the future.

Special 301 determinations are made annually on or before April 30th.

RECORD OF SPECIAL 301

I have not always been pleased with the Bush Administration's implementation of Special 301. In 1989 and 1990, for example, the Administration published warning lists, but declined to initiate any Special 301 cases.

Finally, in 1991, the Administration initiated Special 301 cases against three countries—China, Thailand, and India.

But even with a spotty record of implementation, Special 301 has been one of the most successful provisions from the 1988 Trade Act. The threat of Special 301 action has spurred reform in a number of countries, including Mexico and Argentina. Progress has also been made with Thailand on copyright protection.

CHINA

In the most important Special 301 victory to date, on January 16th, China agreed to protect U.S. intellectual property from piracy.

I have the highest praise for our trade negotiators handling of the Special 301 case against China. They combined hard negotiations, solid deadlines, and the credible threat of retaliation to reach this agreement.

In the end, they were able to convince China to agree to a regime of intellectual property protection that is in some ways superior to what we were able to win in the draft GATT Agreement.

Of course, we must see to it that this agreement is faithfully implemented. But all major U.S. intellectual property vendors have enthusiastically endorsed the new agreement with China.

INDIA

Unfortunately, the Administration has not always used Special 301 as deftly as it did with China.

I am very disappointed with the Administration's decision last week, not to retaliate against India for its piracy of intellectual property.

India has distinguished itself as perhaps the most notorious pirate of U.S. intellectual property. India has been one of the chief opponents of a strong GATT agreement to protect intellectual property. In addition to pirating U.S. intellectual prop-

erty for its home market, India takes the more galling step of actually exporting pirated drugs to other countries. India has reportedly turned piracy of U.S. pharmaceuticals into a $200 million per year export industry.

To the credit of our trade negotiators, some progress has recently been made on convincing India to reform its copyright and trademark laws and to provide access for U.S. motion pictures. But piracy of U.S. pharmaceuticals continues without apology.

In light of this, I fully expected the Administration to retaliate against India's exports to the U.S. when the final Special 301 deadline for India was reached last week. But I was disappointed. The Administration took no action against India.

The U.S. has initiated cases against India under both Super 301 and Special 301. In both cases, India refused to end its protectionism. And in both cases, the U.S. declined to retaliate.

Our failure to take action against India is particularly disturbing because the U.S. could retaliate against India without in any way violating its GATT commitments.

Last year, the U.S. imported more than $524 million worth of goods were imported from India under a voluntary concessionary tariff program known as the Generalized System of Preferences or GSP. The U.S. is in no way obligated to continue to provide India with special, preferential tariff treatment. In fact, U.S. law contains a specific provision to end GSP for countries that do not protect intellectual property.

But the Administration continues to provide India with special tariff breaks even though it annually pirates several hundred million dollars worth of U.S. pharmaceuticals.

I fear that our failure to retaliate against India despite its intransigence greatly undermines the credibility of Special 301 and U.S. trade law generally.

I cannot help but think that the leaders of other countries under pressure to end piracy of intellectual property will take note of our failure to act against India and conclude that Special 301 is a paper tiger.

The Administration left the door open to take action against India in the future. Unless progress is made, I call upon the Administration to restore the credibility of Special 301 and retaliate.

1992 SPECIAL 301 DETERMINATIONS

The Administration is due to make another Round of Special 301 determinations by April 30th. With piracy still rampant and the prospect of a GATT agreement on intellectual property still some distance off, I call upon the Administration to make aggressive use of Special 301.

The U.S. intellectual property industry has urged action against Indonesia, Brazil, Hungary, Turkey, Poland, Taiwan, Venezuela, and the Philippines.

I was particularly disturbed to see Indonesia once again appear on this list. Last year, Indonesia narrowly avoided action under Special 301 by agreeing to a series of sweeping reforms regarding protection and distribution of U.S. films. Apparently, Indonesia has failed to fulfill some of these commitments.

In addition, the European Community has now implemented its outright quota on U.S. television programs. This makes the EC a strong candidate for action under Special 301.

CONCLUSION

In a better world, the U.S. would not be forced to win intellectual property protection on a country-by-country basis.

The U.S. has worked for years to negotiate a multilateral agreement on intellectual property protection under the GATT.

I strongly support Administration efforts to conclude a GATT agreement. But thus far, those efforts have not borne fruit. In fact, the current draft GATT agreement prepared by GATT Director Dunkel has some serious deficiencies.

The reality is that we may have no alternative but to win intellectual property protection country-by-country.

Therefore, we must continue to vigorously employ and enforce Special 301. It is now our only defense against intellectual property piracy.

PREPARED STATEMENT OF JOSHUA BOLTEN

It is a pleasure to appear before the Subcommittee to discuss the Administration's Special 301 program. My testimony will describe why obtaining improved intellectual property protection is important to the Administration; review what we believe

has been our highly effective use of the Special 301 statute in the three years it has been in place—focusing in particular on our most recent efforts with China, India, and Thailand; and finally say a few words about our upcoming Special 301 review.

THE IMPORTANCE OF INTELLECTUAL PROPERTY PROTECTION

The damage from piracy to U.S. companies relying on patents, copyrights, trademarks, and trade secrets is staggering. According to one estimate several years ago, U.S. industries lose as much as $60 billion in revenues each year from theft of their intellectual property.

The list of victims who fall prey to the international crime of piracy reads like a *Who's Who* of innovative and creative individuals, companies, and industries. They cover a broad spectrum, including: automakers and moviemakers; chemical companies and aviation companies; songwriters and software writers; inventors of cellular telephones and authors of textbooks on cellular biology.

There are many reasons for the current enormity of piracy. Technological change has had a profound effect on trade. The application of computers, laser printers, and other new technologies make it easier and faster to appropriate and reproduce products incorporating intellectual property. At the same time, thanks to faster and better communications, the world is shrinking, trade is increasing, and ideas are disseminated faster and more freely. This too has led to increased piracy.

Pirates, counterfeiters, and infringers do not limit their damage to individual inventors and creators, they present a threat to our economies—industrial as well as developing nations. Pirates rob us not only of sales, but of a part of our future. Each act of piracy produces a chilling effect on innovation: fewer new medicines, fewer new machines, fewer new books, and fewer new symphonies make us all poorer.

In short, intellectual property pirates slow the pace of progress. They put people out of work. They lower standards of living. They hurt us individually and collectively.

That is why improving the protection of intellectual property at home and around the world has for some time been a shared priority of the Congress and the Executive. The Special 301 statute and its implementation have been the clearest expression of that shared undertaking, but our efforts of course predate the 1988 enactment of Special 301, and have taken place at both the bilateral and multilateral levels.

For example, in 1984 the Executive Branch and Congress worked together to make adequate intellectual property protection a key criterion in granting bilateral trade benefits under the Generalized System of Preferences. In addition, we have made strong intellectual property protection an essential element in our bilateral trade and investment agreements.

These efforts are complemented at the multilateral level by the Uruguay Round of GATT negotiations. At the outset of the negotiations in 1986, the United States put the world on notice that we expected high standards for trade-related intellectual property rights (TRIPS) to emerge in this Round. And, in the negotiating objectives laid out in the first section of the 1988 trade act, the Congress underscored the priority the United States attaches to strong GATT rules on intellectual property.

The importance of achieving strong intellectual property rules multilaterally has been reinforced through our bilateral negotiations. We have noted, for instance, that when adequate intellectual property protection is finally established in one country, the pirates do not disappear—they simply relocate. Asian pirates have subsequently moved to the Middle East, Latin pirates have moved from one country to another.

The best way to eliminate this shell game is to raise *global* intellectual property standards and enforcement. That is what TRIPS can do, and that is one reason why the Administration has placed so much emphasis on the multilateral process, even as we proceed with bilateral negotiations. And, indeed, the framers of Special 301 noted in the statute itself the complementary nature of the bilateral and multilateral processes. Thus, we have used Special 301 to reinforce our multilateral efforts in the Uruguay Round, and *vice versa.*

IMPLEMENTATION OF SPECIAL 301

When Congress enacted the Special 301 provisions in 1988, it established a process of examining the intellectual property practices of all of our trading partners. It set up strict statutory criteria for addressing the "most onerous and egregious acts, policies, or practices that . . . have the greatest adverse impact" on U.S. products. Those countries whose practices meet these criteria—and that are not entering into good faith negotiations or making significant progress in bilateral or multilat-

eral negotiations—are to be named as "priority foreign countries." Priority foreign countries are then subject to initiation of a Section 301 investigation, which must be completed within an expedited time period.

When we began the annual review process under Special 301 in 1989, the Administration built upon the blueprint set out in the statute and created the "priority watch list" and "watch list." The "priority watch list" consists of those countries whose acts, policies, or practices meet some—but not all—of the criteria for identification as a priority foreign country. Such a country may, for example, have serious deficiencies in its intellectual property regime, but still be making significant progress in bilateral or multilateral negotiations.

The "watch list" consists of those trading partners that maintain other intellectual property practices or barriers to market access that are of particular concern to the United States. The process of identifying "priority foreign countries," "priority watch list" and "watch list" countries has provided additional leverage to achieve our goals. Korea, Japan, Malaysia, Portugal, and Chile are all examples of countries that have taken significant steps to improve the level of protection of intellectual property in their countries in large measure as a result of Administration efforts under Special 301. In addition, progress has been made with countries outside the 301 rubric. Included in this list are trade agreements containing key intellectual property provisions with Poland, Czechoslovakia, the former Soviet Union, Bulgaria, Mongolia, Sri Lanka, and Mexico. [Attached to this testimony is a 1991 fact sheet that describes in detail progress made under Special 301 since the first annual review in 1989.]

In determining which countries should be identified as priority foreign countries and which should be placed on watch lists, the Administration has consulted widely. In addition to fulfilling the statutory requirement of consulting with the Commissioner of Patents and Trademarks and the Register of Copyrights, each year the Administration seeks comments from the public on particular problems they experience in the area and the effect of these problems on U.S. commerce. This process has proved a fruitful source of information.

NEGOTIATIONS WITH PRIORITY FOREIGN COUNTRIES

Let me review now our negotiations with trading partners identified as priority foreign countries. On April 26, 1991, the Administration identified the People's Republic of China—India, and Thailand as "priority foreign countries" under Special 301. On May 26, we initiated investigations of the relevant acts, policies, and practices of China and India, and noted that two Section 301 investigations undertaken pursuant to petitions filed by the copyright industries and the Pharmaceutical Manufacturers' Association were already ongoing with Thailand. As specified in the statute, this made unnecessary the initiation of a separate, "Special 301" investigation of Thailand.

On November 26, 1991, pursuant to the statute, the Administration extended the Special 301 investigations of China and India because the complex issues involved required additional time to resolve. Since November, we have: (1) successfully resolved the intellectual property investigation with China, which has committed to put in place a world class regime; (2) obtained improvements in market access for motion pictures from India as well as improvements in that country's copyright and trademark laws and commitments to improve enforcement; and (3) seen significant steps in Thailand to improve copyright enforcement. While we have achieved improvements with each of these countries, especially China, several problems remain to be resolved. The Administration is committed to resolving those problems and will take whatever action is most likely to achieve our intellectual property objectives.

Let me now provide some additional details on each of these priority negotiations.

CHINA

The Administration identified China as a priority foreign country because of its failure to provide product patent protection for pharmaceuticals and other chemicals, too short a patent term, and overly broad patent compulsory licensing provisions. There also has been a lack of copyright protection for U.S. works, particularly computer programs. China has also not provided statutory protection for trade secrets, making it difficult to obtain remedies against third parties who receive and use misappropriated trade secrets. Enforcement of intellectual property rights, trademarks in particular, was also a serious problem. As a result, piracy of all forms of intellectual property was widespread in China, accounting for major losses to U.S. industry.

After several rounds of difficult and intensive negotiations, on January 17, 1992, we concluded a Memorandum of Understanding with China concerning the protec-

tion of intellectual property. When China implements this agreement, it will provide world class patent protection. China will also join the international copyright community. U.S. authors and sound recording producers will, for the first time, be able to protect their rights in China and receive protection consistent with international standards. China has also agreed to submit trade secret legislation and provide effective enforcement procedures and remedies against infringement of intellectual property rights.

Specific Provisions of the Agreement with China

Patents. By January 1, 1993, the Chinese government will submit legislation and use its best efforts to implement the following revisions to its patent law:

—product patent protection for pharmaceuticals and agricultural chemicals;
—extend the term of protection to 20 years from the date of application for the patent; and
—place stringent limits on grants of compulsory licenses, including elimination of local working requirements.

China has also agreed to provide so-called "pipeline" protection to U.S. pharmaceutical and agricultural chemical inventions that have not been marketed yet in China. This protection will last for seven and one-half years after an application for protection is granted.

Copyright. China has agreed to join the Berne Convention for the Protection of Literary and Artistic Works by October 15, 1992. Moreover, the United States and China will establish bilateral copyright relations by March 17, 1992, through a presidential Proclamation under section 104 of U.S. copyright law. Thus, U.S. authors and producers of sound recordings will be able to obtain protection in China without first publishing in that country. In addition, China has agreed to:

—join the Geneva Phonograms Convention by June 1, 1993;
—protect computer programs as literary works under the Berne Convention; and
—protect U.S. works, including sound recordings, that are not in the public domain in this country.

Trade Secrets. China will submit legislation and use its best efforts to implement trade secret protection by January 1, 1994. This undertaking should provide basic protection against misappropriation of trade secrets and prevent the use or disclosure of trade secrets by third parties.

Enforcement. The agreement also obligates China to provide effective procedures and remedies to prevent or stop infringement of intellectual property rights, including trademarks, and to deter further infringement.

Overall, we believe that our agreement with China is an excellent one. It demonstrates that diligent negotiating and carefully targeted use of our trade authorities can produce major improvements in China's domestic regime and major benefits for U.S. exporters.

INDIA

India was identified as a priority foreign country because it has provided an inadequate level of patent protection, including failure to provide product patent protection for pharmaceuticals, too short a term for protection and overly broad compulsory licensing provisions. Copyright enforcement has also been a major problem and U.S. copyrighted works, such as books, videos, sound recordings, and computer software, are widely pirated in India. In addition, market access for motion pictures was severely restricted through quotas, fees, and other barriers. Concerns with India's trademark regime were also a reason for the priority foreign country identification.

On February 26, 1992, following a nine-month investigation, the Administration determined that India's denial of adequate and effective patent protection is unreasonable and burdens or restricts U.S. commerce. Ambassador Hills directed an interagency committee to prepare options for trade action. These options are now being evaluated.

At the same time, Ambassador Hills noted and welcomed progress made on other issues under investigation. For example, the Indian government has decided to submit, at its parliament's next budget session, legislation to provide rental rights for videos, improve protection for sound recordings, and improve enforcement of copyrights. The Indian government is also working to increase public awareness of copyright issues, and is providing additional information and training to enforcement officials.

In the area of trademarks, foreign owners of trademarks have been guaranteed national treatment—treatment as good as Indian citizens—with respect to use of

their marks in India. Trademark legislation will also be submitted to the Indian parliament to provide statutory protection for service marks and make other improvements in the law.

Finally, in a significant policy move, the Indian government has decided to lift its restrictions on the importation and distribution of U.S. motion pictures, granting access to its huge cinema and video market. Effective April 1 of this year, India will eliminate import quotas on motion pictures and will not require U.S. motion picture companies to enter into agreements with an Indian government corporation in order to import and distribute motion pictures and videos.

Despite this significant progress, the Indian government has refused to change its position on providing adequate and effective patent protection. The Administration is continuing to consult with the Indian government on this matter, and we are fully prepared to act in the near term if progress is not forthcoming.

THAILAND

Thailand was identified as a priority foreign country in the 1991 Special 301 review because of its government's failure to enforce copyright laws and because of deficient patent protection, in particular lack of product patent protection for pharmaceuticals. In response to a Section 301 petition filed by U.S. copyright interests, the Administration had previously initiated (in December 1990) an investigation of Thailand's copyright enforcement practices. In March 1991, in response to a petition from the Pharmaceutical Manufacturer's Association (PMA), the Administration had also initiated an investigation of Thailand's patent practices. Consistent with the Special 301 statute, at the time of the 1991 identification of Thailand as a priority country, the Administration continued those earlier investigations rather than initiate new ones of the same issues.

With respect to copyright enforcement issues, the Thai government last year increased enforcement efforts. It conducted raids and seized infringing videos and sound recordings, as well as the machinery used to produce these goods. In addition, the Thai government agreed to accelerate the prosecution of alleged copyright infringers, seek imposition of penalties sufficient to deter current and future infringers, and reduce the burdensome documentation that copyright owners must submit for a raid to be conducted. However, none of the copyright infringement cases being prepared by prosecutors or pending before the courts had been adjudicated by December 21, 1991, the time of the statutory deadline for a determination in the investigation. In these circumstances, USTR determined that Thailand's acts, policies, and practices with respect to copyright enforcement are unreasonable. The appropriate action in response was to monitor enforcement actions and note that we intend to assess the situation during this year's Special 301 review. If the Thai government does not effectively implement its commitments, including concluding successful prosecutions of pirates, the Administration is prepared to act expeditiously.

With respect to Thailand's patent law, Thailand's National Legislative Assembly last week enacted amendments to the existing law that we are currently reviewing. The Administration will evaluate the new legislation and the results of consultations being held this week in Bangkok, before making its determination by March 13. We are continuing to meet with the Thai government and seek improvements through implementing regulations and other administrative provisions prior to the mid-March deadline.

THIS YEAR'S SPECIAL 301 REVIEW

In preparation for this year's Special 301 review, the results of which will be announced by April 30, we requested submissions from the public on acts, policies, and practices that should be considered with respect to designation of foreign countries under the statute.

We received a total of nine submissions from three companies and four industry associations. Several of the submissions suggested elevating countries that are presently on the priority watch list or watch list to a higher level. Seven countries—Poland, Ecuador, El Salvador, Guatemala, Paraguay, the Commonwealth of Independent States (CIS), and Peru—have been suggested for addition to the lists.

With respect to which trading partners should be identified as priority foreign countries, public submissions suggested that the following countries be identified: Brazil, Hungary, Indonesia, Philippines, Poland, Taiwan, Turkey, and Venezuela. Submissions argued that the following countries should be placed on the priority watch list: Argentina, Australia, Colombia, Egypt, the European Community, Germany, Greece, Italy, Indonesia, Korea, Paraguay, Turkey, and the United Arab Emirates.

Finally, submissions suggested the following countries for inclusion on the watch list: Brazil, Canada, Chile, Cyprus, China, CIS, Ecuador, El Salvador, Guatemala, Mexico, New Zealand, Peru, Saudi Arabia, Taiwan, and Venezuela. (The suggestion that some countries appear on different lists is due to differences among the submissions in the perceived gravity of the problem with that country and thus the priority that should be assigned to resolving that problem.)

In the weeks ahead, we will be following up with our embassies in the countries for which we have received submissions, and with the foreign governments themselves, in an effort to resolve as many problems as possible before the completion of this year's review.

CONCLUSION

The Administration and Congress have made the improvement of intellectual property protection around the world one of the United States' top trade objectives. We have pursued consistent rules to achieve this objective in a variety of fora. Special 301, administered with the flexibility contemplated in the statute, has allowed us to achieve major improvements in intellectual property protection in a number of countries. Our major complimentary objective, a strong TRIPS agreement in the GATT—is within reach.

We believe that our efforts, multilateral and bilateral, have been both complementary and reinforcing. The Administration remains committed to using all the tools at our disposal to achieve effective intellectual property protection around the world for U.S. creators and producers.

PROGRESS ON INTELLECTUAL PROPERTY ISSUES

1991

- Chile enacted a revised patent law, including product patent protection for pharmaceuticals but implementing regulations have not yet been issued. (January).
- The United States and The People's Republic of Mongolia signed a trade agreement including strong protection for intellectual property rights (January).
- The United States and Bulgaria signed a trade agreement including strong protection for intellectual property rights (April).
- Japan sent a revised copyright law to the Diet for consideration which would extend the term of protection from 30 to 50 years, and provide better protection for foreign phonograms (March).
- Japan introduced a bill in the Diet amending the Trademark Law to provide protection for service marks (March).
- Venezuela has decided to modernize its industrial property legislation and intends to submit legislation to Congress by mid-1991.
- Egypt forwarded a new audio-visual law to its Parliament (April), and long-awaited copyright amendments are expected shortly.
- Greece is near completion of draft copyright amendments to extend protection to sound recordings and computer software.

1990

- Mexico published its "Industry and Trade Sectoral Plan" outlining the government's program to modernize protection and enforcement of patents, trademarks and trade secrets (January).
- The Federal Republic of Germany increased penalties for infringement of intellectual property rights (January).
- Yugoslavia amended its patent law to extend the term of protection to 20 years from filing, among other improvements (March).
- The United States signed a trade agreement with Poland which includes strong terms of protection for intellectual property rights (March).
- Chile clarified its copyright protection for computer software, thus ensuring that it is a literary work (June).
- The European Community, Japan, Switzerland, and fourteen LDC's tabled legal texts in the Uruguay Round negotiations on the Trade Related Aspects of Intellectual Property Rights (April).
- The United States signed a trade agreement with Czechoslovakia which includes strong terms of protection for intellectual property rights (April).
- In Spain, several defendants were found guilty of computer software piracy by a district court judge in the first case to test the 1987 intellectual property law (May).

- The United States and the Union of Soviet Socialist Republics signed a trade agreement which includes Soviet commitments to pursue strengthened IPR protection (June).
- The People's Republic of China passed a copyright law with protection effective in June, 1991. However, the law does not protect foreign authors' works first published outside of China. (September).
- Malaysia amended its copyright law and acceded to the Berne Convention for the Protection of Literary and Artistic Works (October).
- Japan enacted a law protecting trade secrets (October).
- The European Community took a "common position" on protection for computer software, including a 50-year term of copyright protection (December).

1989

- Agreement was reached to establish bilateral copyright relations with Taiwan (January).
- Korea created a task force to coordinate intellectual property responsibilities between ministries and designated enforcement teams (January).
- A Bilateral Agreement on Copyright was signed with Indonesia (March).
- A Uruguay Round mid-term review decision on intellectual property was reached (April).
- The People's Republic of China committed to provide copyright protection for computer software (May).
- Colombia resolved royalty remission problem concerning motion pictures (May).
- Taiwan agreed to expeditiously resolve copyright problems concerning motion pictures (May).
- Saudi Arabia adopted a patent law (May).
- Colombia passed a law defining computer software as copyrightable material (June).
- Spain extended patent protection to U.S. plant varieties on a reciprocal basis (June).
- Taiwan initialed a bilateral copyright agreement, and submitted legislation which better protects films from unauthorized public performance (July).
- Argentina agreed to modify its pharmaceutical product registration procedures, and to address the issue of patent protection for pharmaceutical products (September).
- Indonesia enacted its first patent law including product protection for pharmaceuticals, effective August 1991 (October).
- Portugal increased penalties for audio piracy (November).
- Italy introduced legislation to prevent computer software piracy (November).
- Saudi Arabia enacted a new copyright law (December).

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, thank you for the opportunity to address the subcommittee this morning. I will make my comments brief. I am personally pleased with the agreement that the Administration has reached with China on intellectual property protection. As we all know, China-U.S. trade relations have been a topic of heated debate in recent weeks and months, and I don't think anyone on this subcommittee or in the entire Senate would disagree that there are still many areas in which we can and must improve our trade relationship with China. However, coming from a state where some of the world's leaders in software products are headquartered, including WordPerfect Corporation and Novell, Inc., I can assure you that the agreement with China on intellectual property protection is a significant and positive step.

I would like to also commend Ambassador Hills and her staff at this time for the way in which they conducted the Special 301 investigation of China's intellectual property protection practices and for their ability to reach an agreement that will, in my opinion, be a great benefit to U.S.-China trade relations. I think it is worth noting that USTR proved its willingness to take action, when necessary, at times during the negotiations with China when it looked as if China was not going to improve its intellectual property protection practices.

However, as pleased as I am with the China agreement, we must not forget that reaching an agreement is only the first step. Upholding the agreement and enforcing the provisions of the agreement will determine its true value. The fact is, we still have a long way to go not only in China but in other countries where intellectual property protection remains a large problem.

Just to give you an idea of the magnitude of this problem in the area of software, I spoke with officials of WordPerfect, in Orem, Utah, and they estimate total losses for the U.S. software publishers, due to copyright pirating in Taiwan, Korea, and Thailand alone, to be in the neighborhood of almost $1 billion. This does not include literature, motion pictures, videos, and pharmaceuticals. I am greatly concerned by this, and it must not go on.

In closing, Mr. Chairman, I want to strongly encourage the Administration to continue using the Special 301 provision of the 1988 Trade Act. It is an effective tool, as we have seen in the case of China, and we cannot afford not to use it to enforce fair and equitable treatment for U.S. patents and copyrights around the world. Thank you, Mr. Chairman.

PREPARED STATEMENT OF ROBERT W. HOLLEYMAN II

Mr. Chairman and Members of the Subcommittee: On behalf of the members of the Business Software Alliance (BSA) I am pleased to have the opportunity to testify as part of today's hearing on intellectual property rights protection and the Special 301 provisions of the 1988 Trade Act. The BSA was formed in 1988 with the specific purpose of representing leading business software publishers on one of the most critical issues affecting the international competitiveness of the software industry: the copyright protection of software products in overseas markets. Our members include Aldus, Apple Computer, Autodesk, Borland International, Lotus Development, Microsoft, Novell, and WordPerfect. Since its founding in 1988, the BSA has undertaken public policy, public awareness and enforcement campaigns in more than 20 countries around the world.

This statement is also presented on behalf of the Software publishers Association (SPA), the leading trade association of the personal computer software industry. The SPA, with offices in Washington and Paris, represents 900 business, education, and entertainment software publishing companies.

In its very short history, the U.S. computer programming and software industry has grown to be a strong force in the U.S. economy. The industry comprised 1.18 percent of the U.S. GNP in 1989 and posted the highest annual real growth rate—15.5 percent—of all copyright industries during the period of 1977–89.[1] Higher rates of growth have been experienced by many companies since that time.

American companies have proven to be world leaders in the software industry. In 1989, according to a study prepared by Economists, Inc. and released by the International Intellectual Property Alliance, the U.S. software industry attained sales of $36.3 billion, $12 billion of which were in foreign markets.[2] Yet, the most critical statistic for the U.S. software industry is the amount of revenue that is lost each year—not due to poor product quality or inefficient production—but due to the outright theft of our products. Software piracy, as this theft is often called, remains rampant and pervasive through the world, costing the worldwide software industry between $8–10 billion in annual losses due to piracy outside the U.S. For every dollar of sales abroad, the industry loses between fifty cents (50¢) and seventy-five cents (75¢) due to piracy. As world leaders, U.S. companies bear the brunt of this problem.

Software theft—through illegal copying of software for internal use or retail sale—is the largest single threat to the U.S. software industry's international growth. While the estimates vary, some examples of countries which experience high levels of software theft include Taiwan, where 90% of the software in use is illegally copied; Thailand, where 98% of the software in use is illegally copied; South Korea, where 86% of the software in use is illegally copied; Germany, where 76% of the software in use is illegally copied; and Italy, where 82% of the software in use is illegally copied. Of utmost importance is the fact that software theft is rampant in markets with high economic growth rates and increasing demand for software products and in these places, the pervasive spread of illegal copies has achieved deeper market penetration than the original products and is close to wiping out the legitimate industry.

This overwhelming worldwide trend of illegal software use can only be stopped through the enactment and vigilant enforcement of software copyright laws and efforts to increase public awareness of these laws. The BSA, SPA and their members have worked to increase awareness of software copyright laws among software users and retailers, foreign governments, the media, and the public-at-large. While we

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[1] Stephen E. Siwek and Harold W. Furchtgott-Roff, *Copyright Industries in the U.S. Economy* (Washington, D.C.: Economists Incorporated, 1990), p. 19.

[2] *Copyright Industries in the U.S. Economy*, p. D–6, Table D–11.

have experienced some progress, we have also learned that recognition of the law is not an automatic deterrent to the illegal act. There are two principal reasons for this: first, copying software is as easy as pressing a button on a personal computer and takes less than a few seconds; second, copying software costs nothing except the price of a blank disk, which is only a few dollars compared to the average U.S. price of several hundred dollars for a software application package.

Therefore, the enactment and enforcement of copyright laws by foreign governments is an absolute necessity in order to stem the tide of software theft. Our industry believes foreign governments should have many reasons for enacting software copyright laws—namely, they create a good environment for investment, they encourage innovation and the growth of indigenous industry, and they spur employment. However, in reality, we have found that the deciding factor which compels many foreign governments to provide strong protection for intellectual property is their desire to create a favorable environment for trade with the United States.

In the software industry's view, the Special 301 provisions of the 1988 Trade Act constitute the single most effective mechanism the U.S. now holds to secure strong copyright protection for software, and open markets for U.S. companies. Let me cite the proof—the Memorandum of Understanding reached between the U.S. and the Peoples' Republic of China in January of this year.

Little more than seven weeks ago, the software industry considered its prospects for doing business in China to be dim at best. Rampant piracy was directly costing U.S. publishers in excess of $225 million annually, while China's purportedly "new" software regulations adopted in 1991 offered little, if any, protection to American publishers.

Cognizant of the enormous rate of piracy and the lack of protection under Chinese law, most U.S. publishers simply wrote off China as a viable market. Publishers preparing products for distribution in the P.R.C. recognized that they did so in the face of significant risks since no effective copyright protection existed for U.S. works. What a difference Special 301 can make.

On January 16 of this year—with China facing within hours the very real threat of trade sanctions under Special 301—Ambassador Hills was able to announce that a Memorandum of Understanding on intellectual property protection had been reached between the U.S. and the P.R.C. Pursuant to the agreement, China committed to accede to the Berne Convention, to recognize and protect computer programs as literary works under Berne for a term of 50 years, to provide protection for computer programs of U.S. nationals first published outside of China, to issue regulations that ensure a copyright owner's right to control the unauthorized rental of computer programs, and to provide for protection of existing U.S. copyright works, including computer programs. Of equal importance was China's agreement to provide effective procedures and remedies to prevent or stop infringement of intellectual property rights and to deter further infringement.

While questions remain—particularly with respect to enforcement—the extent to which China was willing to make significant concessions under the deadline of Special 301 cannot be underestimated. The commitments that China made in January greatly exceeded any assurances that had been offered in our prior bilateral negotiations.

For software publishers, Special 301 opened the door to the P.R.C.—the world's most populous nation and potentially one of the largest markets for legitimate software—which was at risk of being overrun by pirated software. For software publishers, Special 301 represents the strongest trade mechanism our government can now utilize to open up markets in which our companies can compete. We are absolutely convinced that when given the opportunity to compete, programs developed by U.S. publishers will receive the widespread market acceptance that they have traditionally gained both here and in open markets abroad.

One wishes it were possible to say, Mr. Chairman, that all of our industry's trade problems were solved as a result of the U.S.–P.R.C. agreement. Unfortunately, that is not the case. In China, we must await implementation and enforcement of the agreement reached in January. In other countries, fundamental work remains to be done.

For the software industry, Germany leads the list as the foreign country producing the single greatest revenue loss as a result of rampant piracy. Publishers and distributors collectively suffered an estimated loss of $1.86 billion in Germany in 1990—$721 million of which was borne by U.S. software publishers. Piracy of this magnitude is pervasive throughout Germany because there is absolutely no enforcement against individuals and companies that make and use copied software. This is coupled with rapid growth of the market demand in Germany that is being met by illegal software that is fast achieving a deeper market penetration than legitimate products. Illegal practices of this scale are inexcusable in a country such as

Germany where the economy and business culture are among the most advanced in the world.

The problem our industry faces in Germany is rooted in the fact that the German judicial system has imposed upon publishers an unprecedented burden of proof of originality—of copyright-ability—that renders our industry's ability to initiate enforcement actions virtually impossible. The Office of the United States Trade Representative placed Germany on the Special 301 "Watch List" last year because of this specific problem. Unfortunately, in the intervening year, we have yet to see any concrete steps taken by Germany to rectify this problem. While repeated verbal assurances have come from German government officials that legislation would be forthcoming to remedy this problem, we have not seen any real progress, not even a draft of remedial legislation. What is needed is legislation to bring Germany into compliance with the terms of the European Community's software directive which was specifically drafted to restrict the ability of German courts to establish copyright originality requirements, as they have, which effectively prevent publishers from seeking infringement relief.

Practices such as this, by one of our country's strongest trading partners, can no longer be tolerated. It is simply unacceptable for U.S. publishers to have to bear at least $721 million in annual losses in one country without any means of effective recourse. Losses of this magnitude have made stopping piracy in Germany the highest trade priority for the U.S. software industry. For this reason we have petitioned USTR to elevate Germany to the "Priority Watch List" for 1992. We ask for the help of this Committee, the Congress, and the Office of the U.S. Trade Representative in elevating this problem with Germany to make it one of our nation's top trade priorities in the year ahead.

I would like briefly to highlight just a few of the other priority countries for the software industry, as identified in BSA's Special 301 filing made through the International Intellectual Property Alliance. These countries include:

- Italy, whose government has yet to provide explicit protection for software and where the industry lost approximately $754 million in 1990 due to an 82 percent piracy rate ($237 million borne by the U.S. software publishing industry);
- Taiwan, where additional enforcement is needed and where losses to the software industry in 1990 amounted to approximately $753 million due to a ninety percent piracy rate ($290 million borne by the U.S. software publishing industry);
- Thailand, which does not provide explicit copyright protection for software, where there has been no enforcement against flourishing pirate markets, and where the software industry lost approximately $50 million in revenues in 1990 due to a 98 percent piracy rate ($25 million borne by the U.S. software publishing industry);
- Poland, where piracy is growing more rapidly than in any other country in Europe, amounting to losses of approximately $100 million in 1990 due to a piracy rate of 90 percent and whose government has yet to honor a bilateral treaty with the U.S. requiring an improvement to its copyright law; and
- The Republic of Korea, where the industry lost approximately $320 million in 1990 due to a piracy rate of 86 percent ($123 million borne by the U.S. software publishing industry) and where additional legal remedies and significant increases in penalties are necessary to combat widespread piracy.

Before closing, I would like to raise one additional problem area that our industry thought had been solved but which has recently reappeared.

When the BSA was first organized in 1988, one of its first areas of activity was in Hong Kong, where a significant retail piracy market existed, coupled with an export piracy trade, and high levels of end user piracy in the business community. Working closely with support from the Hong Kong Customs and Excise Department, we made significant inroads in stopping the export piracy trade and in closing retail piracy markets. Unfortunately, recent developments in Hong Kong have shown that foreign government commitments to fighting piracy can fade and that the industry and the U.S. government must remain vigilant to prevent retrenchment and a return to runaway piracy.

On Tuesday of this week, March 3, two of three defendants in a major retail piracy case were sentenced in Hong Kong. The case was intended to set a precedent for nearly 100 others that remain pending and involved the seizure of some 71,000 pirated manuals and 30,000 diskettes. The defendants were charged in relation to approximately 15,000 manuals and 3,000 diskettes, whose copyright owners cooperated actively in the prosecution. Under the existing Hong Kong law, each defendant was potentially subject to a year in prison and approximately US $2,300,000 (HK $18,000,000) in fines on the basis of the charges filed. The difference between the

potential and the actual sentences imposed shows the risk that copyright owners face when enforcement wanes.

When sentences were meted out in the above case on Tuesday, charges were dropped against one defendant, a repeat offender, in exchange for guilty pleas to lesser charges by the two first-time offenders. These two defendants then received a six-month suspended sentence and a joint fine of HK $300,000, which works out to less than US $20,000 each. Conspiracy to defraud charges were dropped entirely. To most observers, the impact of this case will be quite clear and widespread. Weak sentences, such as those imposed in this case, will have absolutely no deterrent effect and, in fact, could have the perverse effect of encouraging piracy where the risk of minimal punishment in Hong Kong may be considered by some to be outweighed by the enormous returns from copying high-value software by low or no-cost means.

Unfortunately, the weak penalties imposed in this case follow a suspended sentence of three months and a fine of approximately $4,400 in another retail piracy case, and the return of a highly visible software piracy market in the Golden Shopping Arcade—where late last year I personally witnessed programs costing upwards of several hundred and even thousands of dollars U.S. being copied in the open for sale at prices that simply cover the cost of the diskette and a small profit for the pirate. Piracy problems such as these are compounded by a proposal that is now on the table by the Hong Kong Law Reform Commission to eliminate existing criminal penalties for end user copying.

The software industry is under assault from all sides in Hong Kong—through reduced enforcement and proposed statutory changes that could signal to Hong Kong citizens and the rest of Asia that some forms of piracy are to be tolerated. The BSA and the SPA urge the U.S. government to make it clear through Special 301 and in bilateral negotiations with Hong Kong that this is simply unacceptable and that U.S. software publishers should not be asked to pay the price for the outright theft of our products.

In conclusion, Mr. Chairman, the BSA and the SPA would like to thank this Committee for the attention that is being devoted to the interests of the U.S. software and intellectual property industries through the scheduling of this hearing, the passage of Special 301 and monitoring of its progress, in other bilateral and multilateral negotiations, and in face-to-face meetings with representatives of foreign governments. We feel fortunate to have such support from the Congress and its staff.

We also wish to express our support for the Administration's efforts, where Ambassador Hills and her quite able staff have engaged in countless hours of negotiations to protect the interests of American software publishers. It is remarkable what has been done with the very limited staff resources that have been available and we join with our colleagues in the copyright community in advocating that additional personnel be dedicated to this effort. Quite literally, in this year and next, fundamental ground rules are being adopted around the world that will directly affect the U.S. software industry's ability to compete in foreign markets in the decades to come. We urge that the maximum resources possible be devoted to the U.S. government's efforts.

As the members of the Committee can see, remarkable progress has been made in some of the areas mentioned in today's testimony, but much more remains to be done, and we must remain vigilant to U.S. interests even in those areas we feel that initial progress has been achieved. Special 301 provides a unique, effective mechanism that can open doors and markets for U.S. industry where we are now effectively shut out because of high rates of piracy or other market barriers.

We urge the members of this Committee to continue to ensure that Special 301 is used as it was intended. In the absence of a strong multilateral agreement to protect intellectual property in the GATT, Special 301 is the strongest tool we have and the software industry urges that it be fully utilized.

When travelling abroad, our members and I are sometimes asked how the U.S. and our industry justify support for Special 301 and the sanctions that may be imposed under the provisions of the 1988 Trade Act. For us the answer is simple. The purpose of Special 301 is not to impose sanctions, rather it is to use the threat of sanctions to encourage our trading partners to open their doors and to provide protection for U.S. intellectual property. Given the opportunity to compete, the U.S. software industry has not failed in a single market.

Special 301 provides the best available mechanism to ensure that the strong positive balance of trade the U.S. now holds in the field of computer software continues to grow and flourish. We urge the retention of Special 301 and its full utilization.

Thank you.

PREPARED STATEMENT OF SENATOR DONALD W. RIEGLE, JR.

I commend the Chairman for holding this hearing on the protection of U.S. intellectual property and "the special 301" provision of the Omnibus Trade and Competitiveness Act of 1988. Adequate protection for intellectual property rights is a vital goal of U.S. trade policy and "special 301" is an important provision of U.S. trade law which helps achieve this end. Both are necessary for ensuring that American ingenuity and intellectual achievements are not exposed to outright piracy by our trading partners.

In recent months, the "special 301" provision has seen a lot of action. The fact that USTR appears to be aggressively utilizing this trade tool is encouraging. I hope that USTR's notice to the Congress of two decisions under "special 301" regarding China and India is evidence of the Administration's commitment to reducing the occurrence of violations of the intellectual property rights of U.S. interests.

I realize that it is too soon for a progress report on the agreement with China. Beyond notification of the negotiation of this agreement, I look forward to periodic reports by the Administration, as to the actual elimination of Chinese violations of U.S. intellectual property rights. Here again, I hope that we do not proceed down the road of status quo according to U.S. trade policy history.

We need to aggressively monitor the success of such an accord. Anything less than full implementation and enforcement by the Chinese government of international standards and conventions on patents, copyrights, and trade-secret protections is unacceptable.

With regard to India's inadequate level of intellectual property rights protection and restrictions on market access, the remaining issues of disagreement, though small in number, are great in the amount of damage that they continue to inflict on U.S. industry. I would encourage the administration's interagency group to develop viable options for dealing with India's continued denial of adequate and effective patent protection in a timely manner. In addition, I would hope that the interagency group seriously considers the option of trade action as provided for under "special 301," so that such practices and their adverse effects on U.S. interests can be quickly stemmed.

Ambassador Hills has the tools necessary to promote proper recognition of intellectual property rights and improve market access. Congress did its part in providing these more-than-adequate tools. Now, it's time for USTR to get more-than-adequate results for the U.S. economy by using them.

PREPARED STATEMENT OF HILARY ROSEN

Good morning. I am Hilary Rosen, executive vice-president of the RIAA. RIAA members have a 50% share of the world's 22 billion dollar retail market of sound recordings, and directly employ over 75 thousand people, not counting the hundreds of thousands employed in derivative industries—from trucking and shipping to record retailers and radio station personnel and from manufacturing and packaging plants to arena and vending staff. We do business in nearly every country around the world, some profitably and some not so profitably.

I am very pleased to appear before you today to discuss strategies for improving the environment for copyright works around the world. You may simply refer to this as rock n' roll and the balance of trade. U.S. record companies lose approximately $1.5 billion a year to piracy. According to numbers produced by the department of commerce and frequently cited by USTR, elimination of this problem should result in the creation of at least 30,000 new export related jobs in the record industry alone. The music industry in particular, and the copyright industries generally, are without doubt among the most productive and competitive sectors of the U.S. economy, and at the same time, are its most fragile.

The special 301 provision of the Omnibus Trade and Competitiveness Act of 1988 that you had the wisdom to craft some years ago has proven to be a most effective tool to fight for improved copyright protection around the world. We have made significant headway, notably the recent agreement with the PRC, but much remains to be done. We must continue our struggle for the development of adequate standards, and thereafter remain vigilant to ensure that these laws are vigorously enforced. This will require the active participation of this committee, and your continued involvement in the difficult issues of enforcement once the more tangible legislative issues are resolved.

In this regard, Mr. Chairman, I note with great appreciation your recent statement on the Senate floor concerning the need for the administration to move aggressively under special 301. I concur, and hope that the 301 filing of the international

intellectual property alliance will serve as a blueprint for special 301 negotiations over the course of this year. I also want to add RIAA's strong endorsement of the proposal made by Jack Valenti to find a means to institutionalize within the administration an inter-agency team dedicated to the protection of intellectual property around the world. Carla Hills and the administration have done a superlative job in proceeding with relatively few resources, but it is time to establish a permanent and well-manned office for intellectual property—an investment in human resource with a huge payoff for the U.S. economy.

I have asked for a copy of the IIPA submission to be included as a part of the record. Rather than recite information contained therein, I wanted to use this time to paint a picture of technology and the record business that will permit you to place the information in a proper context.

American music has been both a catalyst for change, and a beneficiary of such change. It is a tribute to American composers, musicians, performers, and record companies that the words and music created, performed, produced and manufactured by them have touched the hearts and minds of those far from our shores, and have helped to create an atmosphere for democratic changes. American music has truly expanded the world's horizons. American recorded music is also a vital export, producing a highly favorable balance of trade. These days that is particularly significant, as cheap labor and lower manufacturing costs have led to a realignment in the world economy.

Unfortunately, the demand for American music in every market around the globe has led, in far too many instances, to the misappropriation of the work of American musical creators. American music is too often copied, sold, rented and broadcast without authorization, control or compensation. Inadequate, ineffective or even nonexistent copyright legislation, coupled in many cases with government indifference concerning enforcement, has led to a massive worldwide trade in illicit recordings. This ends up costing American composers, musicians, performers and record companies nearly one and a half billions of dollars in lost revenues.

RIAA member companies rely completely upon the adequate and effective protection of their copyrights, both in the U.S. and in foreign markets. Adequate and effective protection may properly be viewed as having two elements—adequate standards and effective protection. The provision of both of these elements is critical to the livelihood and growth of the entire U.S. recording industry.

Adequate standards of protection with respect to sound recordings entail a term of protection of at least fifty years and rights of reproduction, distribution and public performance or communication. Exclusive reproduction, distribution and performance rights must be viewed in the context of emerging technologies and today's marketplace. Market forces and emerging technologies threaten the reproduction right, as they erode the copyright owner's practical ability to authorize the reproduction of his or her works. The wide availability of home duplicating equipment and the existence of pre-recorded music in digital format has threatened to render traditional means of enforcing rights obsolete. The ability to authorize or prevent the rental of recordings and the transmission of digital audio signals have become indispensable elements of adequate protection. The ease of international transportation has also necessitated legislation providing the copyright owner with the ability to prevent the importation of articles from one territory into another—such importation leading to severe disruption in marketing and distribution practices.

The emergence of digital technology has had and will continue to have a profound influence on the record business, but hangs like the sword of Damocles over the individual and collective heads of sound recording owners, performers and musicians. The thread preserving the viability of our existence is copyright, but the sword grows heavier each day at the same time that new daggers appear in every corner, suspended by even finer filament. The strain placed on a copyright system when the means to enforce rights are taken away from the copyright owner's control are enormous, and it is truly a test of a legislator's will and vision to ensure that incentives to create and distribute original works is maintained.

Congress has done a remarkable job in viewing copyright not in a vacuum, but within the context of emerging technologies and business practices. You have ensured that sound recording copyright owners have a sufficient period in which to recoup investment and hopefully generate a profit, as well as to invest in the distribution of catalog recordings. Digital technology has permitted record companies, at significant expense, to take existing recordings back to the studio where they can be remastered and perfected, eliminating distortions created by earlier recording technologies. Consumers are provided with the world's greatest recordings in digital format, and I am happy to say have responded. The only thing that prompted record companies to take the risk and invest in the creation of new recordings was the ability to protect their works from unauthorized exploitation.

In recognition of the prejudice to the copyright owner's reproduction and distribution right associated with unauthorized copying, Congress also provided a sound recording copyright owner with the ability to prohibit rental. You determined that rental of recordings, and more recently computer software, was little more than an invitation to copy, thus making the right to prevent it a necessary adjunct to the reproduction right. Law was keeping pace with technology, and ensuring that technology which, as one member of Congress noted, "brought the concert into the living room but not the box office", did not erode the incentives under the copyright law.

I do need to emphasize, however, one area in which U.S. law has fallen far behind technology to the great detriment of the U.S. record industry, both domestically and internationally. I speak in this regard of the lack of a performance right in a sound recording at a time when digital transmissions promise to transform the manner in which visual and audio entertainment are delivered to the home.

Delivery of prerecorded music to consumers via the sale of a tangible good could become a historical antiquity as consumers have direct access to digital audio signals via satellite, interactive cable, telephones, and other delivery systems. These new delivery systems will provide unmatched access to prerecorded music, the question is whether copyright will be extended to fulfill the constitutional mandate to promote the progress of the arts and sciences. Present U.S. law leaves transmission of audio signals outside of the control of the sound recording copyright owner—indeed such owner is not even entitled to compensation under existing provisions.

The Senate report on the record rental amendment act notes that "commercial record rentals, to the extent that they displace sales, offend the precepts of the constitution because they deny creators a fair return from the exploitation of their works. But the ultimate loser is the American public, which is denied access to the quantity and quality of new creations that the copyright system would otherwise afford."

The "offensive" aspect of rental—the negative impact on sales due to unauthorized copying that rental produces, appears insignificant when viewed against the dangers of unrestricted and uncompensated delivery of digital audio signals to the home. The U.S., as the leading producer of sound recordings in the world, should join the more than sixty countries that already provide public performance and broadcasting rights to sound recordings, and seek the inclusion of such a right as a mandatory provision in the trips agreement, as well as to ensure its inclusion in our bilateral trade agenda. Not only is the provision of such a right essential to preserve the integrity of the system of incentives under our copyright law, but it will also enable U.S. sound recording copyright owners and performers to share in foreign revenue pools from which they are now denied access on the basis of reciprocity. If the United States wishes to maintain its position as the primary creator of prerecorded music, it is legislation that must be established, and established quickly before we lose the opportunity to create a new international norm enforceable within the GATT—a norm that I repeat is already established among our major trading partners.

In conclusion, I would like to point out that the American recording industry is one of the most energetic, creative, and exciting industries in the world. Through the talent of thousands of artists and musicians, it entertains millions of people at home and abroad—and it does so with recordings of remarkable diversity and depth. The entire industry is wholly dependent upon the twin pillars of adequate and effective copyright protection.

We must maintain the pressure on foreign governments to provide adequate legal protection and to vigorously enforce those protections. Bilateral initiatives have so far been very successful in this endeavor, and we support the continuation of these initiatives. At the same time, we encourage the U.S. to fully participate and to continue to drive the debate in multilateral fora, both in the WIPO and the GATT. In the GATT, we must fight the temptation to enter into an agreement at any cost. The price of an agreement which undercuts existing standards, or a services agreement which exempts the cultural industries, is too high, particularly insofar as the *quid pro quo* for such an agreement may be a limitation on the ability of the U.S. to pursue its objectives in a bilateral or regional manner.

The task ahead of us will be tough not only because we must increasingly focus our attention on the enforcement of adequate standards as well as the articulation and adoption of such standards where they are lacking, but also because new technologies are making the protection of intellectual property rights more difficult. Technologies that permit unauthorized access, collection and storage are expanding more rapidly than the ability of copyright owners to protect their properties, and are quickly outdistancing existing legal parameters. It is our responsibility to ensure that it remains, at the very least, a close race. with your help and support we will

continue to be in the competition, providing America with a vital and unique export that people around the world find artistic and exciting.

Attachment.

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE,
Washington, DC, February 25, 1992.

Ms. DOROTHY BALABAN,
Section 301 Committee,
Office of the United States Trade Representative,
600 17th Street, N.W.,
Room 222,
Washington, DC.

Re: Request for Written Submissions: Section 182 of the Omnibus Trade and Competitiveness Act of 1988 ("Special 301"), 57 Fed. Reg. 2795 (January 11, 1992)

Dear Ms. Balaban: This is in response to the Request for Written Submissions appearing in 57 Fed. Reg. 2795 (January 23, 1992). The request invites submissions from the public on policies and practices that should be considered in connection with designating countries as "priority foreign countries" pursuant to Section 182 of the Omnibus Trade and Competitiveness Act of 1988 ("Special 301"). The Special 301 provisions call upon the United States Trade Representative to identify countries which, *inter alia,* "deny adequate and effective protection" to U.S. intellectual property or deny "fair and equitable market access" to U.S. persons who rely on intellectual property protection.

The International Intellectual Property Alliance (the "IIPA" or "Alliance") is an umbrella organization formed in 1984 and consisting of eight trade associations, each of which in turn represents a significant segment of the copyright industry in the United States. The IIPA consists of the American Film Marketing Association (AFMA), the Association of American Publishers (AAP), the Business Software Alliance (BSA), the Computer and Business Equipment Manufacturers Association (CBEMA), the Information Technology Association of America (ITAA), the Motion Picture Association of America (MPAA), the National Music Publishers' Association (NMPA) and the Recording Industry Association of America (RIAA).

The IIPA represents over 1500 companies producing and distributing throughout the world computers and computer software, motion pictures, television programs and home videocassettes, music, records, CDs and audiocassettes, textbooks, tradebooks, reference and professional publications and journals. According to a 1990 report prepared for the IIPA by Economists', Inc. entitled "The Copyright Industries in the U.S. Economy," the core copyright-based industries represented by the IIPA, consisting of the publishing, software, motion picture, and music and recording industries, accounted in 1989 for over $173 billion in revenues solely from their copyright-related activities, or 3.3% of U.S. GNP. These industries grew at more than twice the rate of the economy as a whole between 1977 and 1989 (6.9% v. 2.9%), and employed new workers at a greater rate—5% between 1977–1989—than any other comparably-sized sector of the U.S. economy. These industries delivered over $22 billion in export earnings to this country in 1989. It is essential to the continued growth and future competitiveness of these industries that our trading partners provide free and open markets and higher levels of protection to the copyrights on which this trade depends.

In this Submission, IIPA provides information on twenty-three countries which deny "adequate and effective protection" to U.S. copyright owners or deny "fair and equitable market access" to U.S. persons who rely on intellectual property protection within the meaning of the "Special 301" provisions of the Omnibus Trade and Competitiveness Act of 1988. As a result of these deficiencies, U.S. copyright-based companies suffered massive losses in these countries estimated to be close to *$4 billion* in 1991.

SUMMARY OF THE IIPA'S "PROBLEM" COUNTRIES

The IIPA urges that the countries listed below either (a) be identified as *Priority Foreign Countries* pursuant to the Special 301 mechanism for their failure to provide adequate and effective protection to U.S. copyrighted works or "fair and equitable market access" to U.S. persons that rely upon intellectual property protection, or (b) be placed on, or maintained on, the *Priority Watch List* or (c) be placed on, or maintained on, the *Watch List.*

In April 1991, USTR identified three countries as *Priority Foreign Countries:* India, the People's Republic of China, and Thailand. India and China were given

until November 26, 1991 to enter into an agreement with the United States to end the practices which gave rise to the designation. Thailand's case followed a different, one-year timetable as a result of the filing of a petition on November 15, 1990 by the IIPA, MPEAA and RIAA, though Thailand remained as a *Priority Foreign Country* under Special 301.

On January 16, 1992, the PRC case was successfully terminated with an agreement to provide internationally-acceptable levels of protection to U.S. copyrights, as well as to other intellectual property. While the Thailand case was terminated on December 20, 1991, Thailand remains subject to retaliation under Section 301 following a finding by USTR that its practices violated that Section. India's case was extended to February 26, 1992 and at this writing remains subject to Section 301.

Because India and Thailand are already subject to a 301 action and are already *Priority Foreign Countries* within the meaning of the statute, IIPA listed them separately below as "Countries Already under Current 301 Action and/or Scrutiny."

IIPA recommendations are as follows:

Countries Already Under Current 301 Action and/or Scrutiny
- India
- Thailand

Priority Foreign Countries
- Philippines
- Poland
- Taiwan

Priority Watch List
- Australia
- Egypt
- Germany
- Greece
- Italy
- Korea
- Paraguay
- Turkey
- U.A.E.

Watch List
- Brazil
- Cyprus
- El Salvador
- Guatemala
- Mexico
- People's Republic of China
- Russia and the C.I.S.
- Saudi Arabia
- Venezuela

Appendix A presents a table quantifying trade losses due to piracy in each country for each of the four copyright-based industries: the motion picture, music and recordings, computer software and book publishing industries. By industries these losses break down as follows:

Motion Pictures	$1,020,700,000
Records and Music	679,200,000
Computer Software	1,991,000,000
Books:	276,000,000
Total	$3,966,900,000

Appendix B contains a survey of each country recommended. As new information is obtained, updates will be provided.

DISCUSSION

Nineteen of the countries named this year by IIPA have been the subject of a previous IIPA recommendation either in its April 1989 major report "Trade Losses Due to Piracy and Other Market Access Barriers Affecting the U.S. Copyright Industries," or in its April 1990 or April 1991 submissions under Special 301.

Four of the countries recommended for special attention this year—Australia, Paraguay, Guatemala and Venezuela—have not appeared on prior IIPA lists, though both Australia and Venezuela already appear on USTR's *Priority Watch* and *Watch List*, respectively. However, copyright problems in all these countries are well-known to USTR, and all have been dealt with extensively over the last year.

Thailand remains for many IIPA members the number one priority country. IIPA and its members remain greatly concerned that the overall credibility of U.S. trade policy will be undermined if Thailand should be permitted to delay further cracking down on piracy. It is our firm belief that only the threat of significant pain to important Thai export industries through the realistic potential of immediate retaliation will ultimately succeed in turning the situation in Thailand around. As detailed in the Thailand country survey, we believe this "credible threat" does not now exist

in the view of the Thai government and we urge USTR to ensure that Thailand is aware at the highest levels that failure to prosecute convict and punish pirates will not be tolerated.

This year, IIPA recommends that the Philippines, Poland and Taiwan be named *Priority Foreign Countries*. Both the Philippines and Taiwan have been identified for copyright problems by the IIPA since 1985. As detailed in the surveys, progress in the Philippines has been negligible over seven years and in Taiwan piracy levels continue to be high and penalties levied against pirates abysmally low.

We have named Poland because it is the bellwether state for intellectual property protection in Eastern Europe, because piracy levels have been escalating out of control and, finally, because Poland continues to find reasons to delay adoption of an acceptable copyright law.

IIPA urges USTR to maintain persistent pressure on these and the other countries named. Without constant vigilance, trade losses will grow and the overall situation worsen.

The stalemate in the Uruguay Round means that bilateral pressure must still play an essential role in opening up foreign markets closed by piracy or other market access barriers. We continue to believe that a successful Uruguay Round result remains dependent on a credible and aggressive bilateral trade strategy.

We note in particular that the so-called "Dunkel text" in TRIPS now provides an unacceptable grace period of five additional years before less developed countries must bring their copyright laws into compliance with TRIPS rules. Our industries depend critically upon bilateral efforts to speed up this process; they cannot sustain the over $2 billion in annual losses resulting from inadequate protection in those less developed countries named this year.

In addition to the significant losses resulting from inadequate copyright protection in these countries, other market access barriers stifle investment and trade in many territories as noted in the various Country Surveys. In a separate filing, MPEAA has focused its attention primarily on Indonesia, where a new draft film law threatens to undo progress made last year, and on the European Community, which was named to the *Priority Watch List* last year as a result of its trade-distorting and dangerous broadcast quotas.

CONCLUSION

IIPA applauds the successful agreement with the People's Republic of China. It is a clear demonstration of U.S. trade policy functioning at its best. We urge USTR to apply the same energies particularly to the countries, including Thailand, recommended for identification as *Priority Foreign Countries* and to the *Priority Watch List* and *Watch list* countries this year.

Respectfully submitted,

ERIC H. SMITH, *Executive Director and General Counsel.*

[NOTE: Appendix A and Appendix B were not printed in the hearing record because of their large volume, but have been retained in the Committee files.]

PREPARED STATEMENT OF JACK VALENTI

This Committee asks: What is the worth of the 301 and the Special 301? The answer: Plenty.

THE GLOBAL SCENE TODAY

The Cold War is over. But whether we know it or not another war has begun: A new World War of Trade. It is a clash between exports and imports, where the troops deployed are products, services and manufactured goods.

In the far East, Japan, Korea, Taiwan, Singapore, Hong Kong are fastening their hold on exports and relentlessly appropriating market share from what in years past were American preserves.

In Europe, twelve nation states have bound themselves in a seamless web of unity, with seven other European countries connected to their periphery. The European Community's combined marketplace economic weight is mightier than anyone a decade ago would have dreamed, larger in population and GNP than the USA.

Almost in every domestic economic arena where we once were both superior and dominant, we are stretched to the snapping edge, our malls and stores invaded by foreign goods and services. Beyond our shores what we make and market collides with an ever rising avalanche of competition, in quality, cost, and design.

THE USA'S MOST WANTED EXPORT

Yet there is one American product which is supreme on every continent in the world. It is the USA's most wanted export. Though it is not protected by patent nor secret formula nor subsidy, its popularity grows. It is greeted in every country with affection and patronage. Up to now, it has not been cloned nor duplicated by any of the Asian and European Goliaths of electronics, communications, manufacturing or services.

What American product, creative or manufactured, other than passenger aircraft, captures more than 40% of the Japanese marketplace? What American product is usually number one wherever it is available in western Europe? What segment of America has more recognizable figures, known and applauded, in every hamlet of the world?

Of course, it is the American movie and TV program. American-created movies and programs return to this country over $3.5 billion in SURPLUS balance of trade.

THE AMERICAN MOVIE/TV PROGRAM IS UNDER ASSAULT . . . FROM QUOTAS, RESTRICTIONS, TRADE BARRIERS

No wonder then that some foreign governments are keen to shrink the American visual presence. To achieve this aim, these countries have invented ingenious non-tariff trade barriers, all kind of hedge rows, trade spikes, restrictions in varying lethal dimensions. And if that wasn't enough, too many countries are languid in their protection of our creative material from theft by "pirates." It is one thing for a country to say, "we have no restrictions, come right on in," but quite another if when we get there we find that every movie we import is promptly stolen, illegally duplicated, flooding that territory with counterfeit copies, rendering worthless all that we own while that government stands aside, unable or unwilling to safeguard our intellectual property. It's a double whammy.

The U.S. film industry confronts the European Community in a controversy over "contract rights," whether or not contractual agreements made in the United States will be recognized in the European Community. The throat of the issue is who controls the copyright of a movie. The U.S. has one view. Europe has an opposite view. But Europe has the trumps because the European Community will deal the trade cards. What cannot be argued is that the American movie industry is the healthiest in the world. Possibly the U.S. view of contract rights might be one reason. But if the European Community exiles our concept of contract rights, we are in for painful times.

The trade barriers most fashionable in the European Community and other world areas are Screen Quotas and Television Quotas. The Quota carves out a percentage of "screen time" in movie theaters and "air time" on television stations, usually over 50% or more in television, and reserves that time for that which is the native creative product. Thus the Quota inhospitably informs us that there is an impenetrable wall beyond which American visual entertainment cannot go. Passageway through the wall is available only to those of specified origins, but not American.

PIRACY RAMPANT

In too many countries laws protecting intellectual property are either non-existent, or so loose fibered they are a national joke, or lay out penalties so mild as to make a slap on the wrist seem cruel and unusual punishment. Or, the laws are adequate but there is no government resolve to enforce the law, which is same as not having a law at all. In all instances video pirates and signal thieves run amok.

THE TRADE WAR IS IN FULL GALLOP

Which is why for the American movies program, the trade war has not only begun, it is in full thunderclap gallop.

The trade talks on the General Agreement on Trade and Tariffs (GATT) now being negotiated in Geneva, and the North American Free Trade Agreement (NAFTA) now being discussed by Meco, Canada, and the U.S. are the most visible battlefields but not the only ones.

If the final results in any of these negotiations sanctify Quotas as a way of trade life, bars us from "national treatment" and ignores our contractual rights, America's most valuable trade asset will have been wounded. In time, the wound will widen. In time, the one American-created global enchantment, so fragile it flies on gossamer wings, so alluring it is irresistible to moviegoers on every continent, will have been enfeebled—not because its creative zest decayed, not at all, but because a good many countries and a good many people in those countries discovered that the only

way to defeat the American movie's attraction is to cage it, exile it, bar it or steal it.

In the American movie we have a world winner. But we must protect it from thievery. We must preserve its ability to move unhobbled around the world. If we allow other nations to restrict us, to put us under harness, to weaken our ability to compete fairly, if we allow them to passively observe the massive theft of our intellectual property with neither parliamentary zest to bar that theft nor the national commitment to enforce the laws, then a great American export trade prize will have been crippled.

THE 301 AND THE SPECIAL 301 ARE OUR INDISPENSABLE DEFENSE WEAPONS

On April 8, 1987, I testified before this Committee on behalf of the International Intellectual Property Alliance. On that day I, and many others, urged the adoption of new ways to battle old foes. The Congress in its bi-partisan wisdom obliged.

The Trade Act of 1988 confirmed the resolve of the 301 and buckled to it the Special 301, with enlarged powers and swifter remedies, girding the U.S. Trade Representative with the weaponry it needs to go after pirates in whatever part of the world they ply their illegal trade, as well as to collapse market barriers. The American movie industry and all other U.S. enterprises which depend on the uncrackable shield of copyright for global sustenance are every day vigilant because, like virtue, we are everywhere besieged.

Attached to this testimony is a specific catalogue detailing the worth and benefit of 301 and Special 301 on an ever ascending curve.

STORMY WEATHER IN TOO MANY COUNTRIES, IN PIRACY, QUOTAS, MARKET ACCESS

Let me illuminate some areas where we are encountering heavy trade weather. We are urging the USTR to move quickly, sternly in all these places.

A 301 filed against THAILAND by the IIPA and the American movie and record industries in 1990 has been stonewalled by the Thais. At this moment, Thailand may be accurately described as the worst "piracy" arena anywhere. **This was a terrible disappointment to us. We urged USTR to order retaliation—but hold it in abeyance to see if the Thais put these pirates behind bars. The sad part is, the Thais now believe they're home free, without putting a single thief behind bars.** Either USTR takes the gloves off with Thailand, or the 301 will have been severely blunted.

ITALY's copyright laws are as porous as a wicker basket. The IIPA estimates losses of almost $600 million in that one country alone. The Walt Disney Company has been stung with the most audacious, and up to now, unpunished theft of FANTASIA and SNOW WHITE, with the government powerless to intervene. What is being visited on Disney is an outrage grazing the meaner edges of absurdity.

In POLAND and GREECE piracy is unbridled, though the Greek government has pledged an overhaul of its copyright law and tepid piracy penalties.

In what was formerly known as the SOVIET UNION, it's Dodge City deja vu. As of this writing, there is no sign saying "guns will be checked at the door." Piracy is literally 100% throughout the territory. Which is why I announced some months ago that no more films from MPAA companies would be licensed to that part of the world until there are in place copyright laws solidly linked to enforcement."

CYPRUS has been a great export center for video thieves. Prodded by being listed on the Special 301 Watch List, the Cypriot government reports it is working to eradicate this intolerable nest of pirates.

In TAIWAN and EGYPT conditions for the protection of our property are rapidly sliding downhill. In GUATEMALA, video and cable theft are without boundaries. In VENEZUELA, reform of the copyright laws cries out for swift renovative action.

In INDONESIA, our noses are pressed against the windowpane of their border. We cannot open offices there, cannot conduct our business for ourselves, and must channel all our films through government appointed monopolists.

In the EUROPEAN COMMUNITY we are challenged by television quotas which exile us from more than a majority of air time.

NEEDFUL THINGS TO MAKE 301 AND THE SPECIAL 301 MORE EFFECTIVE

301 and Special 301 truly work only when USTR makes it painfully clear to those who restrict us and have feckless attitudes about protecting our property that the U.S. is dead serious. No new legislation is required.

I cannot laud Ambassador Carla Hills too highly. In a global nest of complexities, she has been a mostly triumphant captain. She has been thoroughly supportive of MPAA's and the International Intellectual Property Alliance's objectives. Her staff

is absolutely first class, a matchless group unsurpassed in energy and ability by any in the government.

But in resources USTR is thinly clad. It has a tiny band of professionals, not enough to man all the barricades. Trade negotiations consume time, great chunks of time. These negotiations are riddled with complicated, obscure issues which resist quick solutions. Even the very best of staff professionals is hard pressed to challenge so many tangled details on so many barricades and bring them to close, on schedule.

MPAA believes USTR needs more support staff. It is my judgment that the return on this expenditure in high caliber staff would be one of the worthiest investments the Congress could make. MPAA also believes that one of the flaws in the current process is that it takes too long. Thailand is a prime example of how delay or hesitation can be devastating.

To sum up, the 301 and Special 301, used sparingly, with precision, is literally the only counter-rebuttal available to American intellectual property. It has to be admired, valued and sustained by the Congress which gave it birth. Without 301, American intellectual property is undone.

AN ADDENDUM—SOME HISTORY AND ACTIONS: 301/SPECIAL 301

ENACTMENT OF SECTION 301

- In October of 1984, Section 301 of the Tariff and Trade Act of 1984 was amended to specify that failure to provide "adequate and effective protection" for intellectual property is an "unfair trade practice." The amendment also allowed USTR to "self-initiate" a 301 action.
- The same legislation also renewed the expiring Generalized System of Preferences (GSP) program to set "adequate and effective protection" as a criterion for maintaining GSP benefits. These benefits permit less-developed countries to import certain products duty-free into the U.S.

First Actions Under Section 301

Korea

In August, 1985, the International Intellectual Property Alliance ("IIPA"), representing the motion picture, music recording, music publishing, book publishing and computer software industries, filed its first comprehensive report on "Piracy of U.S. Copyrighted Works in Ten Selected Countries." The report was filed in response to USTR request for comments under Section 301 and GSP.

Among the countries listed was *Korea,* which was cited for losses of almost $150 million due to piracy (audiovisual cassettes—$16 million; record piracy—$40 million; book piracy of $70 million and computer software piracy of $20 million.) IIPA also complained of market access barriers (direct distribution of films, for example, was prohibited) and an inadequate copyright law, under which foreign works received no protection.

In the fall of 1985, *USTR self-initiated a 301 against Korea* for failure to provide "adequate and effective" copyright and patent and trademark protection. As a result, Korea "settled" the 301 action in 1986 by agreeing to pass a new copyright law, which was effective July 1, 1987, and to join the Universal Copyright Convention effective October 1, 1987. It also promised to enforce these new rules and to apply "administrative guidance" against pirates.

Also in 1985, MPEAA filed a Section 301 complaint against Korea for its failure to allow U.S. motion picture companies to distribute their product directly in Korea. In 1986, Korea agreed to allow direct distribution. But the last barriers were not eliminated until 1988, following a second 301 complaint.

Taiwan

Because the GSP program was amended in 1985 to require beneficiary countries to provide adequate and effective protection for intellectual property, Taiwan was fearful of losing its GSP benefits because of massive piracy. (The Alliance's August 1985 report cited Taiwan for massive piracy of books, video cassettes, records and tapes and software, with losses estimated at $76 million internally and $110 million for exports. The videocassette market was estimated to be 100% pirate, audiocassettes 70%.) In July 1985, Taiwan adopted a new copyright law.

Singapore

Singapore was listed in the IIPA 1985 report as the "capital of world piracy," affecting virtually all types of U.S. copyrighted works. Losses were estimated at $358 million. Singapore, like Taiwan afraid of losing its GSP benefits, in 1987 amended its copyright law to specifically provide protection for foreign works and to toughen

penalties. Better yet, the government immediately began enforcing the new law, which has helped to eradicate much of the piracy in Singapore.

Malaysia

In response to bilateral trade talks with the U.S., Malaysia in 1987 adopted a strong new copyright law. U.S. works were not protected until 1989, however, through Special 301 leverage. In 1985, pirate sound and video cassettes dominated the Malaysian market, with up to 80% of the market pirate. Since then, record and tape piracy has been reduced significantly, and videocassette piracy is slowly being reduced.

THE OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988: THE NEW SPECIAL 301 MECHANISM

What Did It Do

The new Special 301 mechanism added to Section 301 (see above) a specific remedy and timetable for "market access" barriers:

a. it "institutionalized" USTR's 301 authority by asking USTR to review "problem" countries on an *annual* basis, not an *ad hoc* basis as in the past. Thus it recognized the importance of intellectual property protection to U.S. industries and U.S. trade.

b. it shortened the time period for USTR action from one year to six months (with a possible, but maximum, 3-month extension), in recognition of the fragility of intellectual property products.

Has it worked

YES:

—It kept the pressure on countries to adopt good laws and enforce them, in the face of an annual U.S. review of trade problems.

—It focused the Executive Branch's attention and resources to solve this debilitating trade problem.

How Has It Worked

1. In 1989, MPAA and IIPA asked USTR to target 12 countries under Special 301. All 12 were named by USTR to Priority Watch and Watch lists, including:

Thailand—Cited for lack of protection for U.S. works under its copyright law and the resulting rampant piracy, with losses estimated at $61 million in 1988. (This includes cable piracy, videocassette piracy and unauthorized public performance.)

China—Does not have a copyright law. Book and computer software piracy, in particularly, have been enormous.

Korea—Cited for failure to enforce its new copyright law and penalties. Book piracy continued openly, as did videocassette, audiocassette and software piracy.

Taiwan—Book piracy was reduced markedly in Taiwan, but despite the new copyright law, illegal public performance of movies in so-called "MTV"s, or video parlors, continued unabated, as did videocassette, software and record piracy, because of lack of enforcement.

Saudi Arabia—Home video piracy and record and cassette piracy were estimated at 100%, while Ashton-Tate and Microsoft products were 98% pirate. Trade losses were estimated at $189 million.

Egypt—Virtually no progress was made in stemming losses from piracy between 1984 and 1989. Estimated losses increased from $23 million to $66 million, including videocassettes, audiocassettes, books and software.

What has happened from 1989 to 1992

China passed a copyright law in 1990 and in 1992, under threat of trade sanctions after being designated a Special 301 priority country by USTR, agreed to join the Berne Convention.

Saudi Arabia passed a copyright law In 1990 for the first time, and may join Berne soon. This would set a precedent for the Middle East. The Saudis must make some changes in their law and improvement enforcement.

Korea began enforcing its new copyright law in 1989–90. Video piracy has declined from virtually 100% of the market to about 28%. Despite initial local opposition, Korea also opened its market to outside distributors following the MPEAA's 301 petition.

Maiaysia joined Berne in 1989 and began enforcing its law, thus reducing piracy.

India has just agreed (1992) to adopt copyright reforms and to abolish market access restrictions on the film industry.

Indonesia signed a bilateral agreement in 1989 protecting U.S. copyrights and cracked down on audio and video piracy. They agreed in 1991 to liberalize market barriers to the motion picture industry.

Taiwan has introduced, but has delayed adopting, a new copyright law. *Major* enforcement problems remain in Taiwan.

However, major problems remain. USA must tackle them this year.

1. *Thailand:* A 301 filed against Thailand by MPEAA, IIPA and the Recording Industry Association of America in November, 1990, did not result In the problem being solved. USTR must get tough or Thailand will probably remain the "worst" pirate country. Thailand must commit to *punish* piracy if it is to be stopped.

2. Piracy levels remain high in:

Greece—Rampant TV and video piracy are destroying any legitimate market for films and TV programs. Greece's copyright law is outdated and it has failed to regulate pirate TV stations. Trade losses on film, recording and music piracy are estimated at $56 million. However, in response to complaints under Special 301, the Greek government has promised to amend its copyright law to provide greater protection for copyright and sterner penalties for Pirates.

Italy—Widespread piracy has resulted in estimated trade losses for all copyright industries of $575 million. Lack of an adequate copyright law and enforcement is the root of the problem. Software piracy is estimated at 80% of the market. The Walt Disney Company has been stung with the most audacious, and up to now, unpunished theft of FANTASIA and SNOW WHITE, with the government powerless to intervene. What is being visited on Disney is an outrage grazing the meaner edges of absurdity.

Poland—Video and audio piracy, as well as software piracy, are rampant. An estimated 70% of Poland's video market is pirate and pirate audiocassettes are exported throughout Eastern Europe and as far south as Greece. The Polish copyright law is seriously deficient. Trade losses are estimated at $140 million.

Former USSR—None of the former USSR states have adopted copyright laws to date. Piracy is virtually 100% in all categories. MPEAA members have ceased sending films to those countries because of piracy problems. Trade losses due to piracy of motion pictures have been very conservatively estimated at $40 million.

Cyprus—Cyprus has been an export center for piracy. In response to being placed on the Special 301 Watch List, it is working to reduce piracy by enacting a new copyright law and instituting enforcement mechanisms.

Egypt—Trade losses have consistently increased, to their present estimated level of $70 million. Egypt has drafted two copyright laws and one draft audiovisual law, but those drafts fail to contain adequate protection for copyrighted works.

Taiwan—The situation has deteriorated rapidly since April 1991, as the Taiwan government refuses to make a serious commitment to genuine enforcement of copyright protection. Trade losses have ballooned to an estimated $370 million. An estimated 86% of video rental shops carry pirate tapes.

Guatemala—Cable and video piracy remain unchecked without adequate copyright or cable laws or any sort of enforcement.

Venezuela—Reform of the copyright law is urgently needed. Illegal retransmission of satellite signals and pirate videocassettes are increasing, with losses estimated at more than $12 million.

3. Market access barriers persist in Indonesia. Despite promises, the Indonesian government, distribution must be channeled through government-sanctioned monopolies.

4. Broadcast quotas are still in place in the EC.

COMMUNICATIONS

STATEMENT OF NINTENDO OF AMERICA INC.

Nintendo of America Inc. ("NOA") wants to commend you for conducting this oversight hearing on the Special 301 provisions of U.S. trade laws, and for your leadership on intellectual property issues of such great importance to U.S. industry. The aggressive use of Special 301 last year by the Administration proved the efficacy of this mechanism, which Congress designed to identify, quantify, and eliminate intellectual property piracy by foreign countries.

Nintendo of America, several licensees and developers of games for the Nintendo Entertainment System, and owners of film and character properties ("film and character licensors") filed a Special 301 Comment with the United States Trade Representative ("USTR") on February 20, 1992. We believe our situation may be instructive to the Subcommittee as an example of foreign piracy of copyrighted works and how the USTR can assist in remedying this problem.

NOA has requested that Taiwan be designated a priority foreign country due to the Taiwanese video game infringement industry, which has caused irreparable injury (an estimated $1.5 billion in lost sales at the retail level in 1990) to NOA, its over 100 licensees and developers of NOA games and the film and character licensors, who license their properties for use in NOA games.

NOA sells Nintendo Entertainment System ("NES") products which consist of a computer console which displays games stored in video game cartridges on a television screen. In the United States, over 32 million NES consoles have been sold, which are in about 34% of U.S. households, and more than 200 million NES game cartridges.

NOA, which is located in Redmond, Washington, a Seattle suburb, employs 1,450 people who are involved in marketing, sales, distribution, repair, engineering, game evaluation, licensing and assembly of video game products. A 1989 study indicates that NOA benefited the Seattle metropolitan area by generating about 1% of its sales, 4,470 jobs and $75.1 million in income. In addition, NOA's developers, licensees and film and character licensors make a large contribution to the U.S. economy.

There are presently 70 NES software licensees whose combined game software exceed 450 titles. NOA has initiated a program in which licensees are granted a license to manufacture video games in the United States. Acclaim Entertainment, Inc., Oyster Bay, New York, recently began its manufacturing operations in the United States and has produced over 1,000,000 cartridges, another strong contribution to the U.S. economy from a licensee. As more licensees exercise the right to manufacture games, the benefit to the local and national economy will grow in terms of employment, income and spending, building upon the millions of dollars NOA licensees currently expend to develop, market and advertise their cartridges and accessories.

Many of the developers and licensees enter into license agreements to use in their games such as famous properties as "Indiana Jones," owned by Lucasfilm, Ltd., "Popeye," owned by King Features, "Teenage Mutant Ninja Turtles," owned by Mirage Studios, "Back to the Future," owned by Universal City Studios, Inc., and "Mickey Mouse," owned by The Walt Disney Co.

A substantial number of the games marketed and sold for use with the NES are developed and licensed by U.S. licensees and developers. The developers generally earn royalties on the sale of authentic video games developed by them. In contrast, licensees earn profits on the sale of video games. The film and character licensors earn royalties on the sale of authentic video games. Along with NOA, all of these companies have lost substantial revenues from the production and sale of counterfeit NOA video games.

The vast majority of the counterfeit NES games are made in Taiwan. The Taiwanese video game infringement industry consists of several levels of companies. A key

element in the rampant video game piracy is United Microelectronics Corp. ("UMC"), which manufactures and sells the preponderance of the Read Only Memory ("ROM") semiconductor chips containing NOA's copyrighted video games. The Taiwanese government created UMC by transferring to it a pilot semiconductor plant and engineering staff to run the plant and funding UMC's operations. The Taiwanese government owns about 30% of UMC's stock, about 23% is held by the Ministry of Economic Affairs and about 7% by the Ministry of Finance. Four officials from those Taiwanese agencies serve on UMC's Board of Directors.

Taiwanese assemblers purchase ROM chips from UMC and other components from other suppliers, and produce counterfeit video game cartridges. Some assemblers do their own exporting, while others use trading companies to do their exporting. The infringing Taiwanese video games are sold in the United States, Canada, and throughout the world.

The infringement problem is exacerbated by the fact that the infringing NES games are generally sold in multiple game-in-one cartridges containing as many as 260 different video games in one cartridge, while authentic NES games are generally sold in single game cartridges. Thus, each sale of an infringing multi-game cartridge causes NOA, its developers, licensees and their film and character licensors a much greater loss than one lost sale or the loss of royalties due to one lost sale. Moreover, the inferiority of the infringing games can harm the reputation and good will of NOA, its licensees, developers and the film and character licensors because consumers are likely to assume that the infringing games are genuine and may decline to purchase additional genuine games.

NOA has mounted a comprehensive enforcement program against the infringement problem through (1) reliance on the U.S. Customs Service ("Customs"), which has done an exemplary job, to seize imported infringing products prior to entry into the United States; (2) reliance on the criminal—authorities to prosecute infringers; and (3) civil cases in the United States against 150 defendants and in 17 foreign countries.

While NOA has sought to resolve the infringement problem through a settlement agreement with UMC, thus far, such efforts have not been successful. Accordingly, NOA has been working with the USTR to get the Taiwanese government to take responsibility for eliminating UMC's infringing activities since the Taiwanese government created UMC and has continuing ties to it. In addition, NOA is seeking to have the Taiwanese government institute effective monitoring of software exports, in order to prevent exports of infringing video games from Taiwan. Finally, NOA has sought enactment of Taiwan's draft copyright act in its current form and its effective implementation to ensure broader copyright protection for video game owners.

In sum, NOA has urged that Taiwan be designated as a priority foreign country under Special 301 because of its failure to:

(1) take steps to stop the production and sale of infringing computer chips containing NOA's copyrighted software programs by UMC, a company partially owned and controlled by the Taiwan government;

(2) enact copyright laws with provisions sufficient to protect and enforce copyright rights in software, including video games; and

(3) institute effective controls over software exports to prevent exports of infringing software from Taiwan.