

Testimony of Mitch Bainwol

Chairman and CEO

Recording Industry Association of America

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Mr. Chairman and Members of the Subcommittee, on behalf of the Recording Industry Association of America, I appreciate the opportunity to testify today about international intellectual property piracy.

I am Chairman and CEO of the Recording Industry Association of America (RIAA), the trade group that represents the U.S. recording industry. RIAA's mission is to foster a business and legal climate that supports and promotes our members' creative and financial vitality. Our members are the record companies that comprise the most vibrant national music industry in the world. RIAA members create, manufacture and/or distribute approximately 90% of all legitimate sound recordings produced and sold in the United States.

Music is the world's universal form of communication. It touches every person of every culture on the globe to the tune of \$32 billion annually, and the U.S. recording industry accounts for more than one-third of that world market. Our members create employment for thousands of people, including singers, musicians, producers, sound engineers, record promoters and retail salespersons, to name only a few.

The importance of the U.S. recording industry, and intellectual property protection, to the U.S. economy

International markets are vital to our companies and our creative talent. Exports and other foreign sales account for over fifty percent of the revenues of the US record industry. This strong export base sustains American jobs.

The protection of our intellectual property rights abroad is vital to promoting America's competitive advantages in world commerce. As our trade deficit has soared, we call upon Congress to consider more closely the relationship between our widening trade and current account deficits and copyright piracy and to take steps to enable us to more effectively protect our intellectual property rights at home and abroad.

An important part of our nation's competitive strength lies in the creation of knowledge-intensive intellectual property-based goods and services. This is one of those economic activities that Americans do better than the people of any other nation. The "core" U.S. copyright industries account for more than five per cent of US GDP. Employment in our industries has doubled over the past 20 years, growing three times as fast as the annual growth rate of the US economy as whole. The foreign sales and exports of U.S. copyright industries were nearly \$90 billion in 2001, an amount greater than almost any other industry sector, including automobiles and auto parts, agriculture and aircraft.

The intellectual property of the United States is like a warehouse of ideas and creativity. For people to walk in and steal them is no more tolerable than theft of physical goods. And the sale of our recordings abroad makes a major contribution to America's current account balances. Each and every sale of a pirated product abroad that substitutes for the sale of a legitimate American product increases our current account deficit. As a result, Americans employed in competitive industries like ours are denied financial benefits that should have occurred but did not.

The Effect of Music Piracy

The piracy of music is almost as old as the music industry itself, but historically it was difficult for the criminal to reproduce copies as good as the real thing. Now with the advent of digital recordings, criminals can reproduce near perfect copies of any recording. There is massive manufacture and traffic of illegal CDs, both in the form of molded CDs that are produced in large plants, and CD-R's produced with blank optical discs and readily available computer CD-R burners

Annual world-wide pirate sales approach 2 billion units; worth an estimated \$4 - \$5 billion. Globally, 2 in 5 recordings are pirate copies. Total optical disc manufacturing capacity (video / audio CDs, CD-ROMs and DVD) – stands at 45 billion units, having quadrupled in the past five years and greatly exceeds legitimate demand. This creates a business environment ripe for exploitation by criminal syndicates and even international terrorist groups, at times shielded by governments hostile to our interests. Given that the pirate producer has few or none of the overheads associated with genuine production, the profit margin is substantial.

The battle against intellectual property theft must be unrelenting. Digital technology and internet piracy have greatly exacerbated our problems. High levels of piracy, in conjunction with market access barriers in certain countries plague our industry. Our country must employ every tool at its disposal, including the critically important leverage provided by international trade agreements. This is why your hearing today is so critical to us.

RIAA belongs, along with MPAA, BSA and ESA, to a copyright-based umbrella organization called the International Intellectual Property Alliance. In its recent Special 301 recommendations to USTR, IIPA identified serious copyright protection and/or enforcement problems in 56 countries. We face major piracy problems in such countries as Mexico, Paraguay, Thailand, Malaysia, Taiwan and Ukraine. But four countries—Russia, China, Brazil and Pakistan—stand out. My testimony today focuses on these nations.

Russia

Russia's copyright piracy problem is enormous. The performance of the Russian government over the past decade can be summed up as representing a legacy of failed

commitments of obligations to the United States and the broader international community.

The record industry lost \$405 million and suffered a 64% piracy rate in 2003. Russia is the world's largest exporter of pirate CD's. This production has devastated the domestic Russian market, and exports of pirated Russian CDs are causing serious damage to the legitimate market for recorded music worldwide. Russian pirated CDs have been found in more than 26 countries. Russia's criminal enforcement system has failed to stem persistent commercial piracy. Overall copyright industry losses have well exceeded \$6 billion for the past seven years.

The number of CD plants in Russia has more than doubled in the last three years to 34 known to us. Production capacity has nearly tripled as criminal operations have encountered little hindrance in expanding their activities. Even more troubling, eight production plants are located on the facilities of Russian military-industrial enterprises. Russia's annual manufacturing capacity now stands at 342 million CDs and 28 million DVDs, despite the fact that only 30 million legitimate music CDs were sold in Russia in 2003.

Russia's anti-piracy efforts are severely hampered by flawed legislation, ineffective enforcement by the Russian authorities and insufficient deterrent penalties in the courts.

In order to address these problems effectively and in a timely manner, we propose a series of benchmarks for Russian Government to meet. We advocate that failure by Russia to show substantial progress on these issues by July 1, 2004 should result in the immediate suspension of Russia's preferential duty-free "GSP" benefits on their products imported into the United States. The Administration's July 1 decisions on Russia and other GSP cases are fast approaching. In addition, we commend the U.S. Administration for conditioning Russia's accession to the World Trade Organization on full compliance of its copyright regime, both from a legislative and enforcement standpoint, with the WTO TRIPS obligations. It is imperative that the Administration continue to do so.

We propose the following benchmarks. Russia should:

1. Immediately commence inspections, on a regular, unannounced and continuous basis, each of the 34 known optical disc plants, and immediately close down any plant and seize any machinery found to be used to produce pirate product or operating without a license;
2. Adopt a decree setting forth sentencing guidelines for judges-advising the Courts to impose penal sanctions as provided under the penal code as amended (Article 146);
3. Pledge to investigate all complaints from copyright owners in respect of the commercial replication, distribution or export of pirate optical discs;

4. Introduce, either via executive order or legislation, the necessary modifications of the optical disc licensing regime so that it provides for more effective control over the operations of the plants, including stricter controls on the importation of polycarbonate and machinery, mandatory seizure and destruction of machinery used to produce pirate materials, and the introduction of criminal penalties for the owners of such plants;
5. Announce, from the Office of the President, that fighting copyright piracy is a top priority for the country and particularly for Russia's law enforcement agencies and the General Procurator's Office, which fighting piracy must be priority task. The Office of the President should also instruct the Inter-Ministerial Commission, headed by the Prime Minister, to deliver reports every three months to the President on what steps have been taken to address the problem; and
6. Sign into law the copyright law amendments that have already had their third reading in the Duma.

These steps, if taken, should provide a sufficient basis for maintaining Russian participation in the GSP program. They will not, however, resolve the situation, and progress towards more completely addressing the range of continuing problems--both legal and enforcement related, must be closely monitored. Russia's anti-piracy efforts remain severely hampered by flawed legislation, ineffective enforcement by the Russian authorities and insufficient deterrent penalties in the courts. We are hopeful that Russia will meet the benchmarks set forth above. In the longer term, the Russian government will need to address legal reforms in the copyright law (even after the adoption of the current amendments), the criminal code, the criminal procedure code, and the administrative code, as well as to press for stronger and more effective enforcement compatible with WTO TRIPS and the WIPO digital treaties.

China

RIAA has a long history of active involvement in intellectual property negotiations between the United States and China. We participated in negotiations led by the Office of the U.S. Trade Representative in 1995 and 1996 undertaken pursuant to Section 301 investigations, resulting in exchanges of letters obligating China to close factories producing and exporting pirate CDs that were causing catastrophic disruption of our global markets. While the Chinese government did indeed successfully disrupt the exportation of pirate products, it has not yet seriously tackled the problem of piracy within its borders, an obligation that was undertaken in these bilateral agreements, as well as in their World Trade Organization (WTO) commitments.

Last year, despite China's various bilateral and multilateral commitments to the United States, the record industry lost \$286 million and suffered a 90% piracy rate in China. We face three significant and related problems there:

1. The Chinese internal market remains almost entirely pirate (at over 90%) despite many raids, seizures and administrative fines that clearly have been inadequate to deter continued piracy.
2. Internet piracy is growing rapidly in China. Many websites offer downloading of pirated music files, some for a financial charge, others for free. At any moment in time, approximately 70 million Chinese citizens are online—a huge number.
3. A series of market access and investment barriers prevent our members from serving the Chinese market in a timely manner, which perversely only increases consumer demand for pirated product.

China's Recent Commitments

On April 21, China made a series of commitments to the United States via a meeting of the U.S.-China Joint Commission on Commerce and Trade. China promised to:

- Significantly reduce IPR infringement levels.
- Increase penalties for IPR violations by taking the following actions by the end of 2004:
 - Subject a greater range of IPR violations to criminal investigation and criminal penalties.
 - Apply criminal sanctions to the import, export, storage and distribution of pirated and counterfeited products.
 - Apply criminal sanctions to on-line piracy.
- Crack down on violators by:
 - Conducting nation-wide enforcement actions, city-by-city, against piracy and counterfeiting, stopping the production, sale and trade of infringing products, and punishing violators.
 - Increasing customs enforcement action against the import and export of infringing products and making it easier for rights-holders to secure effective enforcement at the border.
- Improve protection of electronic data by ratifying and implementing the World Intellectual Property Organization (WIPO) Internet Treaties as soon as possible.
- Launch a national campaign to educate its citizens about the importance of IPR protection. The campaign will include press events, seminars and outreach through television and print media.

- Establish an intellectual property rights working group under the JCCT. Under this working group, U.S. and Chinese trade, judicial and law enforcement authorities will consult and cooperate on the full range of issues described in China's IPR action plan.

China has committed to tangible, specific steps to address the rampant piracy of copyrighted works. If fully implemented, this will be a landmark announcement and a real victory for composers, record companies, artists and other copyright owners in China. The U.S. Trade Representative and Commerce Department deserve enormous credit.

This announcement may be an important first step, but we look to the Chinese Government to ensure that future deeds match present words and commitments. Immediate action by the Chinese authorities to address these problems is critical. Chinese commitments in prior years have not been fully implemented. We will closely monitor implementation of these new commitments. We call upon China to ensure that this program reduces piracy by 50 percent from its current levels by the end of the year, with further verifiable and significant reductions in the following years so that the legitimate business can expand and TRIPS level enforcement be achieved.

We have also advocated that China remove existing barriers to market access for legitimate sound recordings. Thus far, China has not done so. The vacuum in the marketplace caused by China's market barriers will always be filled by pirates who, by the nature of their illegal activities, do not adhere to legitimate rules. We strongly urge that China immediately begin to remove practices that limit market entry and the distribution of legitimate materials. For example, shortening the time for censorship approvals and permitting wholly-owned foreign investments in all aspects of sound recording activity would be welcome steps to ensure that China reaches its potential for generating legitimate commerce in copyrighted materials.

Brazil

In past years, Brazilian pirates stole the entire music cassette market. They are now doing the same to the CD market, destroying what was once a vibrant and profitable market for our members. Our industry lost an estimated \$340 million from piracy in Brazil in 2003, a 52% piracy rate.

Organized criminal elements, from within and outside Brazil, exercise control over the production and distribution of infringing copyrighted products. Brazilian pirates produce much pirated product on blank CD-R, which is imported or smuggled from abroad, and enters the Brazilian market through Brazil's weak border controls.

The most serious deficiency in Brazil involves ineffective, non-deterrent criminal enforcement. While good laws are in place, enforcing these laws has met with abysmal results. Although a few Brazilian police units have conducted a substantial number of

raids, these raids have resulted in very few criminal prosecutions. Over the last six years, the ratio of convictions to the number of raids run each year is less than one percent. In those few cases that reach judgment, the sentences are not deterrent.

A GSP decision with respect to Brazil is due on July 1. We believe it is time for the U.S. Administration to conclude that which has been evident for quite some time; that Brazil fails to provide adequate and effective intellectual property protection as required under the U.S. GSP statute.

While there has been some welcome cooperation between certain Brazilian authorities and our industry, consistent and systematic anti-piracy results from the Brazilian government have been thus far quite inadequate. We are very pleased that the Brazilian Congress has established a Brazilian Parliamentary Inquiry on Piracy. Representatives from this Inquiry recently visited Washington and signed a joint declaration with Members of the U.S. Congress' International Anti-Piracy Caucus committing themselves to improving copyright protection in Brazil. This Inquiry is due to expire at the end of this month. We strongly support its re-chartering and continuation. We praise the positive, effective actions this Inquiry has already taken against piracy in Brazil and will do all we can to help them in their continuing efforts.

The remainder of the Brazilian Government should follow this example and undertake an effective national anti-piracy plan to reduce copyright piracy. The Brazilian Government should:

General Enforcement

- Conduct a vigorous national anti-piracy campaign.
- Significantly improve and implement deterrent criminal enforcement, including persistent raiding, effectively prosecuting in a speedy manner and convicting copyright pirates in all industry sectors.
- Establish federal task forces across the country, creating an anti-piracy coordinator in each State office, which would include formal and specific operational coordination with industry sectors.
- Create a centralized unit of police officers to work on important copyright cases, and provide them with specific guidelines to conduct their cases.
- Direct the Federal Police and Customs to intensify inspections along country borders, and adopt more efficient norms to intercept contraband, blank CD-R's and pirate recorded CD imports. Require Customs authorities to keep statistical records of seizures of products.
- Expedite issuance of search warrants, especially in criminal cases where sometimes it has taken up to six months to obtain such warrants.
- Support the various enforcement agencies working with copyright industries in anti-piracy actions, use organized crime units in intellectual property actions, and increase resources and training for these agencies.

Prosecution

- Speed up criminal copyright infringement prosecutions and expedite judicial orders to destroy confiscated piratical and counterfeit products.
- Assign dedicated prosecutors in each State to lead anti-piracy campaigns that include major investigations of organized crime groups as well as keeping major commercial areas free of pirate product street vendors.
- Secure convictions against businesses that are replicating and distributing optical discs illegally.

Criminal Convictions / Civil Judgments

- Apply the new criminal code amendments in copyright infringement cases.
- Assign piracy cases to judges trained and experienced in intellectual property cases with a view to establishing specialized IP courts.
- Reduce bonds and increase timely decisions in civil copyright infringement cases.
- Create a specialized court which adjudicates copyright infringement cases.

Politically

- The recommendations of the CPI should be issued this summer and promptly acted upon.
- The CPI itself or a comparable body should be made permanent and continue acting aggressively against piracy.

Pakistan

Eight known facilities in Pakistan produced upwards of 180 million discs in 2003, nearly all illegal, about 160 million of which were exported to at least 46 countries. Our industry lost \$70 million to piracy in Pakistan in 2003, and suffered a 100% piracy rate.

The Pakistan government to date has taken only cosmetic steps to curtail production or export of pirated product. In 2001, the IIPA filed a petition with USTR to remove Pakistan's preferential tariff benefits under the U.S. "GSP" program because of the frightening growth of production of pirated optical discs in Pakistan. Acceptance of this petition and initiate an investigation remains "pending" before the U.S. Executive Branch. We urge that an investigation be promptly commenced and vigorously pursued.

It is crucial in the context of our larger bilateral relationship that Pakistan live up to its obligations to provide adequate and effective copyright protection and take immediate steps to eradicate piracy in all forms, including optical disc piracy. Its failure to address this large and growing organized criminal activity will have far reaching implications for the rule of law in general, and will undermine Pakistan's ability to provide a stable democratic regime. Pakistan's inadequate enforcement system fails to "prevent infringements" and fails to provide "remedies that constitute a deterrent to further infringements," as required by the WTO's "TRIPS" agreement. Despite skyrocketing production, distribution and export of pirate optical discs, Pakistan has not initiated

meaningful actions—criminal, civil or administrative—against its fast-growing pirate optical disc producers.

The Government of Pakistan should:

1. Shut down known production facilities (if necessary, by temporary order). Permit production only upon demonstration of licenses to produce legitimate materials (whereupon supervised access to the plant should be granted to permit the legitimate production).
2. Stop all pirate exports of optical discs from Pakistan.
3. Issue a directive to courts on the seriousness of copyright crime and the need to impose deterrent penalties in cases of commercial piracy. Train police, prosecutors and judges on these issues. Strengthen and impose maximum criminal fines.
4. Pass and implement an effective optical disc law to control production, including monitoring and control on imports of production equipment and raw materials (including polycarbonate), and require use of unique source identifiers (SID Codes) to track the location of production.
5. Pass a law to implement the WIPO “Internet” treaties, and join the treaties.

Other Countries Where Piracy is Severe

As noted, the U.S. recording industry also suffers major piracy losses in Mexico, Taiwan, Thailand, Malaysia, Paraguay and Ukraine.

- Mexico: Piracy of sound recordings in Mexico in 2003 resulted in \$360 million in estimated losses, with piracy levels of 61%. While the Office of the Attorney General has provided excellent support, Mexico needs to improve investigations and raids against pirates; organize actions with municipal and state authorities that will limit the distribution of pirate product through over 50,000 street vendors; encourage prosecutors to bring cases swiftly and press for maximum sentences in order to improve deterrence.
- Taiwan: Over the last 5 years, piracy rates, including on-line piracy, increased to the point of severely threatening the economic health of other local and international copyright-based businesses. Piracy of sound recordings in Taiwan resulted in \$58 million in losses in 2003, with piracy levels of 40%. Taiwan should adopt needed amendments to its copyright law including more effective and deterrent enforcement tools, establish clear liability for secondary infringements online and an effective notice and takedown system to fight all traditional, digital and Internet piracy. Taiwan must prevent adoption of negative amendments that would impose compulsory licenses on internet transmissions of

copyrighted works. Taiwan should continue a sustained copyright enforcement campaign throughout 2004 against all pirates, particularly against the organized criminal syndicates and bring effective enforcement against Internet piracy generally and make significant enforcement inroads against peer-to-peer piracy.

- Thailand: Our industry lost \$26 million to piracy in 2003, with a 41% piracy rate. Thailand is capable of significantly reducing piracy but, with rare exceptions, has not shown the political will to do so. As a potential free trade agreement partner, Thailand must provide much better copyright protection. It should take swift action against its many pirate optical disc factories; clean up street markets and malls and keep them clean, and pass an effective optical disc law and implementing regulations that make changes to the 2002 bill needed to make it effective.
- Malaysia: Piracy rates have declined markedly, from \$110 million in 2002 to \$40 million in 2003. Malaysia needs to do more to ensure the sustainability of their enforcement efforts, particularly by criminally prosecuting the more egregious pirates. We also urge Malaysia not to impose price controls on our products.
- Paraguay: The new government seems well-intentioned. Yet, enforcement efforts taken by Paraguayan authorities, however well intentioned, continue to be largely ineffective. Piracy rates remain at 99% and our losses exceed \$150 million. Paraguay must improve border enforcement by intercepting and seizing pirate goods, enacting legislation to increase criminal penalties for copyright infringement (elevating IPR violations to be “major crimes”), control the points of entry for the importation of CD-R’s, and audit for tax evasion large-scale importers of blank CD-R’s who are suspected suppliers to pirate organizations.
- Ukraine: Our industry loses \$125 million annually and the piracy level is 75%. Ukraine is a major transit country for illegal optical discs that predominantly originate in Russia and Ukrainian optical disc manufacturers are still suspected of pirate activity. Despite private sector and USG assistance and training, Ukraine continues to fail to provide adequate regulation and effective enforcement of optical media production and distribution facilities. Moreover, pirates benefit from prosecutorial delays, slow and cumbersome criminal proceedings and the absence of deterrent sentencing, as well as very ineffective border enforcement.

Conclusion

On behalf of the entire music industry, I thank you for your concern about the devastating effect of piracy on America’s composers, performers and producers and the thousands of hard working Americans whose jobs are linked to our industry. Piracy robs Americans of the fruits of their creative genius while negatively affecting our international competitiveness. We urge you to speak out about this problem to foreign leaders that you encounter in your work. Please raise piracy, particularly with leaders of the countries mentioned in my statement, at every opportunity. These governments must come to

realize that music piracy undermines our culture and their own. The leaders of these countries will only take this matter seriously if they come under pressure from every person in every branch of the American government that piracy of the magnitude they currently permit is simply unacceptable to the United States government, and that failure to address it is not without consequence.

An official from WIPO recently said that: "The correlation between the progress of the human race and its ability to invent and innovate is indisputable. Intellectual property is at the heart of the endeavor."

If intellectual property is the heart of progress, we are its soul, and our very livelihood is dependent upon our ability to protect the works that we create. Unless we are able to do something about rising piracy levels across the globe, we will no longer have the ability to invest in the creation of new recordings. That will represent a silence that is most assuredly not golden.

Thank you.