

GAO

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on Courts, the Internet, and Intellectual
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**INTELLECTUAL
PROPERTY**

**Risk and Enforcement
Challenges**

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Highlights of [GAO-08-177T](#), a report to House Judiciary, Subcommittee on Courts, the Internet, and Intellectual Property.

Why GAO Did This Study

Intellectual property plays a significant role in the U.S. economy, and the United States is an acknowledged leader in its creation. Industries that relied on IP protection were estimated to account for over half of all U.S. exports and employed about 18 million Americans in 2006. However, legal protection of IP varies greatly around the world, and several countries are havens for the production of counterfeit and pirated goods. Counterfeit products raise serious public health and safety concerns, and the annual losses that companies face from IP violations are substantial. Eight federal agencies undertake a wide range of activities in support of protecting IP rights, and two mechanisms coordinate protection efforts: the National Intellectual Property Law Enforcement Coordination Council (NIPLECC) and the Strategy for Targeting Organized Piracy (STOP). GAO was asked to address: (1) the nature of the risks that U.S. corporations face in protecting IP, particularly in countries such as China, and (2) U.S. methods for implementing and coordinating domestic IP enforcement activities. This testimony is based on issued GAO reports that focused on IP protection and related trade matters.

What GAO Recommends

In prior reports, GAO made a number of recommendations to various agencies to strengthen their management of their IP enforcement efforts.

To view the full product, including the scope and methodology, click on [GAO-08-177T](#). For more information, contact Loren Yager at (202) 512-4128 or yagerl@gao.gov.

INTELLECTUAL PROPERTY

Risk and Enforcement Challenges

What GAO Found

U.S. intellectual property is increasingly at risk of theft as U.S. firms become more integrated into the world economy and the production of more sophisticated processes and investments move overseas. High profits and technological advances have also increased the risk of IP infringements by making counterfeiting and piracy more attractive and easy to conduct. At the same time, deterrents such as penalties and other measures have failed to keep pace. The seriousness of these risks has been exacerbated by weak enforcement in some countries, particularly China.

While the U.S. faces significant obstacles when trying to ensure effective IP protection abroad, it also faces serious challenges in coordinating domestic efforts and ensuring that IP protection remains a priority. The large number of federal agencies involved, due to the cross-cutting nature of IP protection, makes coordination particularly important. However, GAO's recent report on coordinating mechanisms for federal IP protection, we found that the effectiveness and long-term viability of the coordinating structure is uncertain. In addition, each of the agencies involved in IP has multiple missions, and it is a challenge to ensure that IP enforcement is a sufficiently high priority. GAO's report on the efforts of the Customs and Border Patrol (CBP) to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been generated by pockets of activity within certain modes of transport and product types as well as among a limited number of port locations. While the number of seizure actions has increased, this growth can be attributed to a growing number of small-value seizures made from air-based modes. CBP lacks an approach to further improve border enforcement outcomes; it has been focused on efforts that have produced limited results, while not taking the initiative to understand and address the variations among ports.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to report on our work on intellectual property (IP) protection before the subcommittee of the U.S. Congress that has identified this topic as one of its primary areas of focus. I appreciate the opportunity to provide some insights from GAO's wide range of work on this issue. As you know, intellectual property is an important component of the U.S. economy. Prior hearings of this subcommittee have focused on the patent reform act, trying to create the right formula for stimulating creative and inventive activity in the United States. Ultimately, however, patents will only be meaningful if there is real protection of IP in the United States as well as other countries. Today, I will discuss the increasing risk and enforcement challenges to IP protection as advances in technology and changes in global manufacturing make counterfeiting and piracy a greater threat.

This hearing is particularly timely, as during the last year a number of news stories have raised severe doubts among the American people about the quality and safety of products imported from China and the ability of the Chinese government to regulate its manufacturers. While some of the goods that posed risks in recent months were legitimate goods associated with U.S. firms (Mattel), it is well known that counterfeit goods from China pose risks to U.S. consumers, and unlike the situation with legitimate goods, there is little recourse to go back to the importer or manufacturer and demand that the risks be eliminated.

I know that many of these issues are familiar to members of this subcommittee, particularly as this panel held back-to-back hearings on China and Russia IP theft in May 2005. As requested, today I will summarize the work that GAO has performed in two areas: (1) the nature of the risks that U.S. corporations face in protecting IP, particularly in countries such as China, and (2) U.S. methods for implementing and coordinating U.S. IP enforcement activities.

My remarks are based on a variety of assignments that GAO has conducted on IP protection over the past 4 years. Some of this work was focused on the challenges that U.S. firms face in securing IP protection abroad, and some has focused on the extent to which U.S. firms rely on nations like China and India as part of their production chain. We have also done extensive work on the international and domestic efforts undertaken by U.S. agencies to coordinate their efforts to address IP theft and piracy issues. Finally, we have drawn from some of our ongoing work for the Senate regarding federal efforts to enforce IP rights at the border. We

made several recommendations during the course of this work, with which the recipient agencies generally agreed. Our work was conducted in accordance with generally accepted government auditing standards.

Summary

U.S. intellectual property faces increasing risk of theft as U.S. firms integrate into the world economy and the production of more sophisticated processes and investments move overseas. For example, as the technological and manufacturing capability in Asia increases, such as in the semiconductor industry, more complex parts of the production process are being carried out in countries like China. High profits and technological advances have also raised the risk of IP infringements by encouraging and facilitating counterfeiting and piracy, while the deterrents, such as penalties and other measures, fall short. Economic incentives for counterfeiting and piracy include low barriers to entry, high profits, and limited or low legal sanctions if caught. At the same time, technology has allowed accessible reproduction and distribution in some industries. The severity of these risks has been intensified by weak enforcement in some countries, particularly China, whose enforcement challenges have persisted despite U.S. efforts.

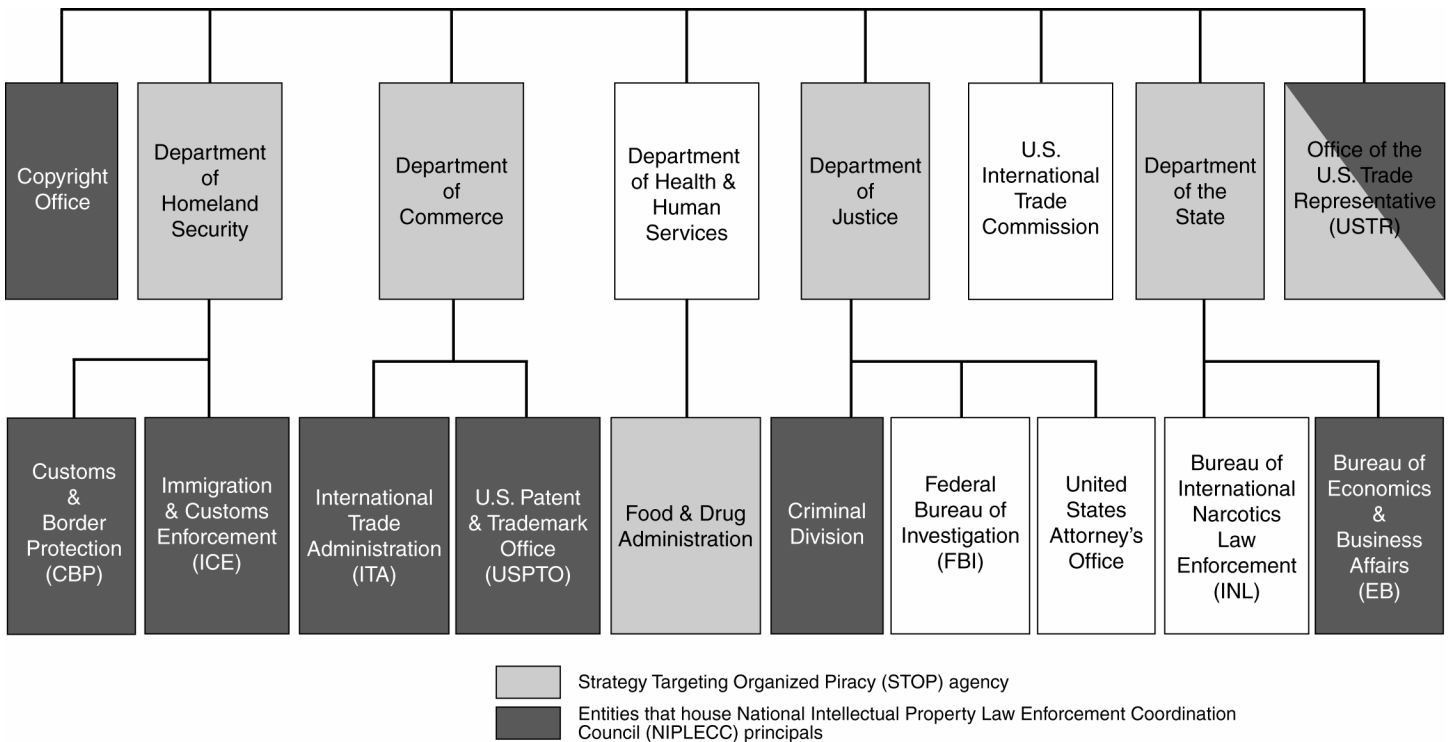
The United States faces significant obstacles to both providing effective IP protection abroad while coordinating domestic efforts and ensuring that strong intellectual property protection remains a priority. The cross-cutting nature of the issue and the necessity for coordination is evident given the large number of agencies involved in IP protection. However, we recently reported on the law enforcement coordinating council and found that the effectiveness and the long-term viability of the current IP enforcement coordinating structure is uncertain and made particularly challenging by agencies' multiple missions. Our report on the efforts of the Customs and Border Patrol (CBP) to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been accomplished within certain modes of transport and product types and have been restricted to a limited number of ports. For example, 10 ports are responsible for three fourths of the value of the goods seized. Despite recent increases in seizure outcomes, CBP lacks an approach to make further improvements in its level of seizures. We found that CBP has focused on efforts that have had limited results and has not taken the initiative to understand and address the variations in seizure outcomes among ports. For instance, CBP lacks data with which to analyze IP enforcement trends across transport modes and has not tried to determine whether certain ports have been relatively more successful in capturing IP-infringing goods.

Background

Intellectual property, for which the U.S. government provides broad protection through means such as copyrights, patents, and trademarks, plays a significant role in the U.S. economy, and the United States is an acknowledged leader in its creation. According to the U.S. Intellectual Property Rights Coordinator, industries that relied on IP protection were estimated to account for over half of all U.S. exports, represented 40 percent of U.S. economic growth, and employed about 18 million Americans in 2006. However, the economic benefits that copyrights, trademarks, and patents bring are threatened by the fact that legal protection of IP varies greatly around the world, and several countries are havens for the production of counterfeit and pirated goods. The global illicit market competes with genuine products and it is difficult to detect and take actions against violations. Although the public is often not aware of the issues and consequences surrounding IP theft, counterfeit products raise serious public health and safety concerns, and the annual losses that companies face from IP violations are substantial. The Organization for Economic Cooperation and Development recently estimated that international trade in counterfeit and pirated products in 2005 could have been up to \$200 billion.

Eight federal agencies as well as entities within them undertake a wide range of activities in support of protecting IP rights, as shown in figure 1. These are the Departments of Commerce, State, Justice, Health and Human Services, and Homeland Security; the U.S. Trade Representative (USTR); the Copyright Office; the U.S. International Trade Commission; within Justice, the Federal Bureau of Investigation (FBI); and within Commerce, the U.S. Patent and Trademark Office (USPTO). In addition, two entities coordinate IP protection efforts: the National Intellectual Property Law Enforcement Coordination Council (NIPLECC), created by Congress in 1999, and the Strategy for Targeting Organized Piracy (STOP), initiated by the White House in 2004. (These are discussed later in this testimony.)

Figure 1: Primary U.S. Agencies and Entities Supporting U.S. IP Rights



Source: GAO.

Note: NIPLECC is required to consult with the Register of Copyrights on copyright law enforcement matters. Immigration and Customs Enforcement, while not an original member, was reported as a member of NIPLECC in the council's fifth annual report issued in September 2006.

U.S. agencies use policy initiatives and enforcement activities to improve IP protection in the United States and abroad. Policy initiatives include reviewing IP protection undertaken by foreign governments and negotiating agreements that address intellectual property. Trade policy initiatives to increase IP protection and enforcement are primarily led by USTR, in coordination with the Departments of State, Commerce, USPTO, and the Copyright Office, among other agencies. Enforcement activity in the United States includes detecting and seizing IP-infringing goods at the U.S. border and investigating and prosecuting those who engage in IP-infringing activities. The Department of Justice, including the FBI, and the Department of Homeland Security's Customs and Border Protection (CBP) and Immigration and Customs Enforcement take actions such as engaging in multicountry investigations involving intellectual property violations and seizing goods that violate IP rights at U.S. ports of entry. The Food and Drug Administration (FDA) also investigates intellectual property

violations for FDA-regulated products as part of its mission to assure consumer safety.

U.S. Intellectual Property Increasingly at Risk As Firms Operate Globally and Economic Incentives and Technology Facilitate IP Theft, Which is Exacerbated by Weak Enforcement

U.S. intellectual property is increasingly at risk of theft as U.S. firms become more integrated into the world economy and the production of more sophisticated processes and investments move overseas. High profits and technological advances have also increased the risk of IP infringements by making counterfeiting and piracy progressively attractive and easy, while the deterrents, such as penalties and other measures, fail to keep pace. The seriousness of these risks has been exacerbated by weak enforcement in some countries, particularly China, whose enforcement problems has persisted despite U.S. efforts.

Global Operations Increase the Risk of IP Theft

The risk of IP theft increases as U.S. companies operate more globally and locate their production facilities in other countries. Our report on the U.S. semiconductor industry illustrates this movement of production to other countries and increasing concerns about IP theft.¹ Initially, U.S. firms invested in overseas manufacturing facilities such as India and China, to perform the labor-intensive assembly of semiconductors for export to the United States. However, as the technological and manufacturing capability in Asia increased, more sophisticated parts of the process have been sourced in India and China. This shift where more advanced technology is being used abroad creates a greater risk for those firms involved by making advanced technologies protected by IP laws more readily available to those who might want to copy them illegally.

The shift of operations to overseas facilities is also evident in the U.S. investment statistics. For example, we reported in December 2005 that U.S. investment in China has been growing, and the value of U.S. affiliate sales in China began to exceed the value of U.S. exports to China in 2002.²

¹See GAO, *Offshoring: U.S. Semiconductor and Software Industries Increasingly Produce in China and India*, GAO-06-423; Sept. 7, 2006.

²See GAO, *China Trade: U.S. Exports, Investment, Affiliate Sales Rising, but Export Share Falling*, GAO-06-162, Dec.12, 2005.

U.S. companies have generally concentrated their investments in China in the manufacturing sector, in industries such as transportation equipment, chemicals, and computers and electronic products. U.S. investment in China funds the creation of U.S. affiliates, who then sell in China and to other countries, including the United States. U.S. affiliate sales of goods and services have become an important avenue for accessing the Chinese market. Factors such as the growing Chinese market, lower labor costs, and China's accession to the World Trade Organization (WTO) have drawn U.S. companies to increase their investment and sales in China.

Economic Incentives and Technological Advances Also Raise the Risk of IP Violations

Economic incentives to commit counterfeiting and piracy activities contributed to the growth in IP rights violations in recent years. Economic incentives include low barriers to entering the counterfeiting and piracy business, potentially high profits, and limited or low legal sanctions, including penalties, if caught. For example, one industry pointed out that it is much more profitable to buy and resell software than to traffic in cocaine. In addition, the low prices of fake products are attractive to consumers. The economic incentives can be especially acute in countries where people have limited income. Economic incentives have also attracted organized crime in the production and distribution of pirated products. Federal and foreign law enforcement officials have linked intellectual property crime to national and transnational organized criminal operations. The involvement of organized crime increases the sophistication of counterfeiting operations, as well as the challenges and threats to law enforcement officials confronting the violations.³

Technological advances have lowered the barriers to counterfeiting and piracy by allowing for high-quality, inexpensive, and accessible reproduction and distribution in some industries. The mobility of the equipment makes it easy to transport it from one location to another, further complicating enforcement efforts. Industry and government officials described this as the “whack-a-mole” problem — when progress is made in one location, piracy operations often simply move. Likewise, the Internet provides a means to transmit and sell illegal software or music on a global scale and provides a sales venue for counterfeit goods. According to an industry representative, the ability of Internet pirates to hide their

³See GAO, *Intellectual Property: U.S. Efforts Have Contributed to Strengthened Laws Overseas but Challenges Remain*, [GAO-04-912](#) (Washington D.C.; September 8, 2004).

identities or operate from remote jurisdictions often makes it difficult for IP rights holders to find them and hold them accountable.

How economic incentives and technological advances can contribute to IP piracy can be seen in the optical media industry (CD's, DVD's). The cost of reproduction technology and copying digital media is low, making piracy an attractive employment opportunity, especially in a country where formal employment is hard to obtain. According to the Business Software Alliance, a CD recorder is relatively inexpensive. The sometimes large price differentials between pirated and legitimate CDs also create incentives for consumers to purchase pirated CDs – even those who might have been willing to pay a limited amount extra to purchase the legitimate product. Low-cost, high-quality reproduction and distribution in some industries are creating increasingly strong incentives for piracy. Private sector representatives have identified Russia as a prominent source of pirated software and optical media, which include music, movies, and games. For instance, USTR reports that the U.S. copyright industries estimate that they lost in excess of \$2.1 billion in 2006 due to copyright piracy in Russia. The U.S. copyright industries also reported that in 2006 Russia's optical disc production capacity continued to be far in excess of domestic demand, with pirated products apparently intended for export as well as domestic consumption.

While a number of factors increase the risk of IP theft, the deterrent effect of IP enforcement efforts has not kept pace. A number of industry officials believe that the chance of getting caught for counterfeiting and piracy, along with the penalties, when caught, are too low. CBP only inspects a small percentage of containers entering the country each day even for counterfeit goods seized at the border. CBP officials said that the enforcement penalties are not an effective deterrent. In reviewing CBP penalty data for fiscal years 2001 through 2006, we found that less than 1 percent of the penalty amounts were collected. Federal officials we interviewed remarked that the penalties or even the loss of goods through seizures are viewed by counterfeiters as the cost of doing business. In work we did several years ago on small business efforts to patent abroad, we reported that patent attorney experts viewed the potential for unauthorized production as well as the level of IP infringement and enforcement in other countries as highly important factors that needed to be considered in developing a foreign patent strategy.⁴ They also advised

⁴See GAO, *International Trade: Experts' Advice for Small Businesses Seeking Foreign Patents*, [GAO-03-910](#), (Washington D.C.: June 26, 2003).

that firms need to understand the practical—or enforcement—value of the patent, and China and Russia were both mentioned as countries where the patents were of limited value but the situation was improving.

Weak Enforcement Exacerbates the Risk of IP Theft, Particularly in China

China's track record for enforcing IP laws has been historically weak. We reported in October 2002 that when China joined the WTO in 2001, some WTO members noted concerns about enforcement of IP regulations in China, and the majority of China's commitments in its WTO accession agreement were intended to address these concerns.⁵ For example, members raised concerns about filing civil judicial actions relating to IP violations in China, and they noted that the way in which damages resulting from IP violations were calculated often resulted in inadequate compensation. We identified 32 IP rights related commitments made by China in its WTO accession agreement, about half of which were related specifically to IP enforcement.

Based on our 2002 survey, U.S. companies with a presence in China considered China's commitments in the area of IP rights to be the most important of those made in its WTO accession agreement. However, they also recognized that they were going to be among the most difficult for China to implement, particularly those related to rule of law and reforming state owned enterprises. Indeed, in our 2003 follow-up interviews, respondents reported that China had implemented its IP rights commitments only to some extent or to a little extent.⁶ Our ongoing work on federal IP law enforcement actions reiterates this concern about IP infringement in China. Sixteen of the thirty companies and industry associations we interviewed cited China as the primary country producing and distributing IP-infringing goods. They went on to note that these are

⁵See GAO, *World Trade Organization: Analysis of China's Commitments to Other Members*, [GAO-03-4](#), (Washington D.C.; October 3, 2002).

⁶See GAO, *World Trade Organization: Selected U.S. Company Views about China's Membership* [GAO-02-1056](#) which was released on September 23, 2002; *World Trade Organization: U.S. Companies' Views on China's Implementation of Its Commitments* [GAO-04-508](#) March 24, 2004.

often substandard products that are sold in grey markets⁷ or through the Internet.

USTR put China on its Special 301 Priority Watch List⁸ in 2005 on the basis of serious concerns about China's compliance with its WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)⁹ obligations as well as with commitments it made in a subsequent bilateral forum in 2004. In addition, China remains subject to Section 306 monitoring.¹⁰ USTR also identified IP rights protection in its February 2006 Top-to-Bottom review¹¹ of U.S.-China trade relations as one of China's greatest shortcomings and greatly enhancing China's IP rights protection became a priority goal for the United States. The review outlined a number of action items for the United States to undertake to achieve this goal, which included increasing U.S. enforcement staff levels, enhancing cooperation with the private sector, and promoting technical exchanges between U.S. and Chinese agency officials.

The United States has undertaken other actions with regard to IP violations in China. The United States requested WTO dispute settlement consultations with China on a number of IP rights protection and

⁷The grey market usually refers to the flow of new goods through distribution channels other than those authorized or intended by the manufacturer or producer. Grey market goods are not generally counterfeit. Instead, they are being sold outside of normal distribution channels by companies which may have no relationship with the producer of the goods.

⁸The annual Special 301 process, which refers to certain provisions of the Trade Act of 1974, as amended, requires USTR to annually identify foreign countries that deny adequate and effective protection of IP rights or fair and equitable market access for U.S. persons who rely on IP protection. According to USTR, countries or economies on the Priority Watch List do not provide an adequate level of IP rights protection or enforcement, or market access for persons relying on intellectual property protection.

⁹The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which came into force in 1995, broadly governs the multilateral protection of IP regulations. TRIPS established minimum standards of protection in various areas of IP and provides for enforcement measures for members.

¹⁰According to USTR, countries with serious IP-related problems are subject to another part of the Special 301 statute, Section 306 monitoring, because of previous bilateral agreements reached with the United States to address specific problems raised in earlier reports.

¹¹USTR's Top-to-Bottom review assessed the benefits and challenges in U.S-China trade following China's first four years of membership in the World Trade Organization, as China neared the end of its transition period as a new member. The review reflects the input of Congress, China experts, industry, public testimony and other U.S. government agencies.

enforcement issues and conducted a special provincial review over the past year to examine the adequacy and effectiveness of IP rights protection and enforcement at the provincial level. In October 2004, we recommended that the USTR and Secretaries of Commerce, State, and Agriculture (USDA) take steps to improve their performance management of their agencies' China-WTO compliance efforts. For example, we recommended that USTR set annual measurable predetermined targets related to its China compliance performance measures and assess the results in its annual performance reports, and that the Secretary of Commerce should take further steps to improve the accuracy of the data used to measure results for the agency's trade compliance related goals. We made similar recommendations to the other agencies. Not all of the recommendations have been implemented to date, but some agencies have reported looking into modifying both their performance plans and unit level plans. This month, we are sending a team to Beijing to follow up on U.S. agency activities, including their response to these recommendations.

USTR reports that China has made progress in some areas, such as completion of its accession to the World Intellectual Property Organization (WIPO)¹² Internet Treaties, and its ongoing implementation of new rules that require computers to be pre-installed with licensed operating system software. However, in other areas, the USTR reports that little progress has been made. Despite anti-piracy campaigns in China and an increasing number of IP rights cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2006. USTR reports further that the U.S. copyright industries estimate that 85 percent to 93 percent of all copyrighted material sold in China was pirated, indicating little or no improvement over 2005. Trade in pirated optical media continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music and a wide variety of counterfeit goods, and roaming vendors offering cheap pirated discs continue to be visible in major cities across China. According to USTR, piracy of books and journals and end user piracy of business software also

¹²The World Intellectual Property Organization (WIPO) is a specialized agency of the United Nations. It is dedicated to developing a balanced and accessible international intellectual property (IP) system, which rewards creativity, stimulates innovation and contributes to economic development while safeguarding the public interest. WIPO was established by the WIPO Convention in 1967 with a mandate from its Member States to promote the protection of IP throughout the world through cooperation among states and in collaboration with other international organizations. Its headquarters are in Geneva, Switzerland.

remain key concerns. In addition, Internet piracy is increasing, as is piracy over closed networks such as those of universities.

Finally, the United States has dealt with China's poor IP enforcement through efforts at the U.S. border. China accounts for by far the largest share of IP-infringing goods seized by CBP. For instance, China accounted for 81 percent of the value of goods seized in fiscal 2006, increasing from 69 percent in fiscal 2005 and nearly half in fiscal 2002. Chinese counterfeits include many products, such as pharmaceuticals, electronics, batteries, industrial equipment, toys, and many other products, some of which pose a direct threat to the health and safety of consumers.

U.S. Efforts to Coordinate IP Activities and Enforce Laws at the Border Need Improvement

While the U.S. faces significant obstacles when trying to ensure effective IP protection abroad, it also faces some significant challenges in coordinating domestic efforts and ensuring that this issue remains a priority. The large number of agencies involved in IP protection issues (see figure 1) demonstrates the cross-cutting nature of the issue and the importance of coordination. However, in our recent report on the law enforcement coordinating council, we found that the effectiveness and the long-term viability of the coordinating structure is uncertain. Another challenge is that each of these agencies have multiple missions, and within the agencies it may be a challenge to ensure that IP enforcement gets sufficient priority. Our report on the efforts of CBP to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been generated by pockets of activity within certain modes of transport and product types as well as among a limited number of port locations. Despite recent increases in seizure outcomes, CBP lacks an approach to further improve border enforcement outcomes, and has been focused on efforts that have produced limited results, while not taking the initiative to understand and address the variations among ports.

Lack of Leadership and Permanence Hampers Effectiveness and Long-Term Viability of IP Enforcement Coordinating Structure

We reported in November 2006 that the current coordinating structure for U.S. protection and enforcement of intellectual property rights lacks clear leadership and permanence, hampering its effectiveness and long-term viability.¹³ Created in 1999 to coordinate domestic and international IP law enforcement among U.S, federal and foreign entities, the National Intellectual Property Law Enforcement Coordination Council (NIPLECC)¹⁴ has struggled to define its purpose, retains an image of inactivity within the private sector, and continues to have leadership problems despite the addition of a Coordinator for International Intellectual Property Enforcement as the head of NIPPLEC, made by Congress in December 2004. In addition, in July 2006, Senate appropriators expressed concern about the lack of information provided by NIPLECC on its progress.

In contrast, the presidential initiative called the Strategy for Targeting Organized Piracy (STOP), which is led by the National Security Council, has a positive image compared to NIPLECC, but lacks permanence since its authority and influence could disappear after the current administration leaves office. Many agency officials said that STOP has increased attention to IP issues within their agencies and the private sector, as well as abroad, and attribute that to the fact that STOP came out of the White House, thereby lending it more authority and influence.¹⁵ While NIPLECC adopted STOP as its strategy for protecting IP overseas, its commitment to implementing STOP as a successful strategy remains unclear, creating challenges for accountability and long-term viability. For instance, although NIPLECC's most recent annual report describes many STOP activities, it does not explain how the NIPLECC principals plan to carry out their oversight responsibilities mandated by Congress to help ensure successful implementation of the strategy.

STOP is a first step toward an integrated national strategy to protect and enforce U.S. intellectual property rights, and it has energized agency efforts. However, we previously reported that STOP's potential as a national strategy is limited because it does not fully address important characteristics of an effective national strategy. For example, its performance measures lack baselines and targets to assess how well the

¹³See GAO, *Intellectual Property: Strategy Targeting Organized Piracy (STOP) Requires Changes for Long-term Success*, GAO-07-74 (Washington D.C.; November 8, 2006).

¹⁴NIPLECC was established under Section 653 of the Treasury and General Government Appropriations Act, 2000 (Pub. L. No.106-58), 15 U.S.C. 1128.

¹⁵See figure 1 for NIPPLECC and STOP members.

activities are being implemented. In addition, the strategy lacks a risk management framework and a discussion of current or future costs – important elements to effectively balance the threats from counterfeit products with the resources available. Although STOP identifies organizational roles and responsibilities with respect to individual agencies’ STOP activities, it does not specify who will provide oversight and accountability among the agencies carrying out the strategy. While individual agency documents include some key elements of an effective national strategy, they have not been incorporated into the STOP documents. This lack of integration underscores the strategy’s limited usefulness as a management tool for effective oversight and accountability by Congress as well as the private sector and consumers who STOP aims to protect.

In our November 2006 report, we made two recommendations to clarify NIPLECC’s oversight role with regard to STOP and improve STOP’s effectiveness as a planning tool and its usefulness to Congress: First, we recommended that the head of NIPLECC, called the IP Coordinator, in consultation with the National Security Council and the six STOP agencies, clarify in the STOP strategy how NIPLECC will carry out its oversight and accountability responsibilities in implementing STOP as its strategy. Second, we recommended that the IP Coordinator, in consultation with the National Security Council and the six STOP agencies, take steps to ensure that STOP fully addresses the characteristics of an effective national strategy. In our April 2007 testimony, we reported that the IP Coordinator said that NIPLECC had taken some steps to address our recommendations, including working with OMB to understand agencies’ priorities and resources related to IP enforcement.

U.S. Border IP Efforts Demonstrate the Need for Improvements

In our April 2007 report, we found that the volume of goods entering the United States every year is substantial, and creates a challenge for CBP in terms of ensuring that these shipments do not carry weapons of mass destruction or illegal drugs and that appropriate duties are collected on imports.¹⁶ CBP also has the responsibility to ensure that counterfeit goods do not enter through the 300 plus U.S. ports, but detecting and seizing IP-

¹⁶*Intellectual Property: Better Data Analysis and Integration Could Help U.S. Customs and Border Protection Improve Border Enforcement Efforts*, [GAO-07-735](#) (Washington D.C.; April 26, 2007).

infringing products from among this large volume of traffic is difficult. CBP efforts in this regard include (1) targeting suspicious shipments, (2) examining goods to determine their authenticity, and (3) enforcing IP laws through seizure and penalty actions.

CBP faces challenges in targeting shipments, in part, because its primary computer-based targeting method is not equally effective in all modes of transport (that is, sea, air, truck, and rail). For example, CBP officials believe counterfeiters are increasingly using express consignment services to move commercial quantities of goods into the United States, but their computer-based targeting method is less effective in this environment. Determining during an examination whether IP infringement has occurred can be challenging because of high counterfeit quality and the complexity of U.S. IP laws. Interaction among port staff, CBP's legal and product experts, and rights holders is required to make these determinations. When violations are found, CBP is authorized to seize the goods and, if warranted, assess penalties against the violator.

Although CBP has reported increases in the number and value of IP seizures, our analysis found that the bulk of these seizures have been generated by a limited number of ports and that recent increases in seizure actions can be attributed to a growing number of small-value seizures made from air-based modes. For example, 10 ports are responsible for three fourths of the value of goods seized. In addition, nearly two-thirds of seizure value since 2001 has been concentrated in certain product types - - footwear, wearing apparel, handbags, and cigarettes. However, seizures of goods related to public health and safety have been small. Although penalties assessed for IP violations have grown steadily since 2001, CBP has collected less than 1 percent of assessed amounts. For example, CPB collected approximately 600,000 dollars of the 136.6 million dollars assessed in 2006.¹⁷

CBP has undertaken steps to improve its border enforcement efforts, but it lacks data with which to analyze IP enforcement trends across transport modes, and it has not analyzed ports' IP enforcement outcomes to determine whether certain ports have been relatively more successful in capturing IP-infringing goods. In addition, a lack of integration between

¹⁷Fiscal year 2006 is reported based on data provided in January 2007. CBP officials said that the amount collected may change because some penalty cases are still being processed, but they said that future adjustments are unlikely to significantly change the disparity between penalty amounts assessed and collected.

the ports and CBP's trade policy office hinders it from making further improvements.

Given the challenging environment in which CBP must process the vast influx of goods into the United States every day, it is particularly important that the agency utilize data to effectively focus its limited enforcement resources to those areas where they can be most effective. As a result, we have made a number of recommendations to the Commissioner of CBP. These include improvements in enforcement data as well as increased use of enforcement data to understand enforcement activities and outcomes.

Concluding Observations

This committee made a significant investment in the current legislative session in moving IP legislation to try to find the right formula for protecting and stimulating creative and inventive activity in the United States in the area of patent reform, and encountered a number of differing views on how to establish that formula. However, having the incentives for creating intellectual property is of limited value unless there is sufficient protection for the works that are created, and this hearing directly addresses that issue. There is little disagreement — at least domestically — with the need to strengthen protection, but the difficulty is in how to best achieve that goal in the face of the strong economic incentives for counterfeiting and the limited resources to prevent it. GAO has performed a large body of work for the Congress of aspects of these issues, and has put forward some specific recommendations regarding the importance of coordination as well as methods to be effective in the context of competing priorities. We appreciate the opportunity to support this subcommittee and the Congress as it continues to address these issues.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to respond to any questions you or other members of the subcommittee may have at this time.

Contacts and Acknowledgements

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