

**TESTIMONY  
OF JACK VALENTI  
PRESIDENT AND CEO  
MOTION PICTURE ASSOCIATION OF  
AMERICA**

**BEFORE THE  
COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE**

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## **THE ECONOMIC WORTH OF THE COPYRIGHT INDUSTRIES**

The copyright industries are responsible for over five percent of the GDP of the nation. Over the past quarter century, these industries' share of GDP grew more than twice as fast as the remainder of the economy. They earn more international revenues than automobiles and auto parts, more than aircraft, more than agriculture. The copyright industries have been creating new jobs at three times the rate of the rest of the economy. The movie industry alone has a surplus balance of trade with every single country in the world. No other American industry can make that statement. And all this comes at a time when the US is suffering from some \$400 billion in trade deficits.

## **THE SCOPE OF THE PROBLEM**

The spread of theft of America's creative works flows like a swiftly running river in every nook and cranny of this planet. Today I'd like to focus on China and Russia, where the problems are large and growing at an alarming rate. In both countries, organized criminal groups play a large role in the replication and distribution of pirated DVD. And, in both countries, the piracy problems are spilling out beyond their borders to infect markets all around the world.

We also have serious piracy problems in Brazil, Pakistan, Malaysia, Taiwan and Thailand, as well as many other countries. Without a coordinated national effort to tackle the unbridled theft of American creative works, and lacking effective prosecutions and deterrent sentencing, Brazil's serious piracy problems show no signs of improving. Illegal production and export of pirated optical discs also plague Pakistan and Thailand. Malaysia, too, has a very significant production and export problem, but enforcement authorities there have been working very hard to tackle the problems, conducting impressive raids against pirate factories and pirate retail markets. Laudable efforts of Taiwan's enforcement authorities are being undermined by the lack of progress in Taiwan's Legislative Yuan in adopting urgently needed legislative reform. For a full list of our concerns, I commend to you the 2004 Special 301 Report on Global Copyright Protection and Enforcement submitted by the

International Intellectual Property Alliance on February 13, 2004.<sup>1</sup> Nevertheless, if we were to make progress in the two countries I will highlight today, that would put a significant dent in global piracy.

Stolen films, usually captured by sophisticated camcorders in theaters, or in special preview screenings, are uploaded to the Internet and are available for individuals to download in any country around the world. At last month's Cannes Film Festival, representatives of cinema studios, production houses, infrastructure providers and film directors from the United States, Europe, India, China, and Russia gathered under the auspices of French Minister of Culture and Communication Renaud Donnedieu de Vabres and President of the Cannes Film Festival Gilles Jacob to call for the launch of strong, urgent and coordinated action to fight the scourge of piracy. The participants underlined in particular the threat that the free downloading of protected works through Internet peer-to-peer systems represents to the world's creators. Taiwan and Korea are two countries with high levels of internet access and rapidly growing internet piracy; neither have fully updated their legal infrastructure to address the growing problems.

Camcordered copies of our films also find their way to the pirate DVD production centers, including China, Russia, Malaysia, Thailand and Pakistan, where they are used as the master copies in the illegal replication plants.

In the international arena, international trade in pirated optical discs is in the hands of enterprising criminal organizations. According to Ron Noble, the international police network's secretary general at the first Global Congress on Combating Counterfeiting in Brussels last month, "Interpol believes there is a significant link between counterfeiting and terrorism in locations where there are entrenched terrorist groups." How much of the revenues flow to terrorists is hard to measure, but doubtless it is there.

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<sup>1</sup> (An electronic version of IIPA's Special 301 report is available at [http://www.iipa.com/special301\\_TOCS/2004\\_SPEC301\\_TOC.html](http://www.iipa.com/special301_TOCS/2004_SPEC301_TOC.html).)

## CHINA

For a decade, American film companies have engaged in a concerted effort to penetrate the Chinese entertainment market. Despite a pair of trade agreements, strong support from the US Government, steady investments in relationships and projects, and a continual dialogue with Chinese authorities, the predicament of American filmed entertainment industry in China is grim. Piracy has reached a level not seen since 1995, and market access barriers continue to thwart efforts to deliver legitimate film and home entertainment programming to Chinese audiences.

Chinese policy has continued to lag far behind what has been promised by authorities. Earnings by MPAA member companies in China from theatrical distribution have fallen; in 1998, the average US film distributed to Chinese cinemas on a revenue-sharing basis earned \$1.9 million for the member company, but by 2002 that amount had fallen to \$500,000, and per company earnings for American filmmakers fell by 20% during the period.

Formal market access barriers remain in place, including a government monopoly on film importation, quantitative limits on imports, a slow and cumbersome censorship process, a theatrical distribution duopoly, limits on the retail sale of legal home entertainment, and restrictions on foreign investment, foreign channel carriage, and programming content in the television sector. Ironically, these restrictions further tilt the market environment in favor of pirates, who obey none of the government's regulations, while reaping at least 95% of the market's sales.

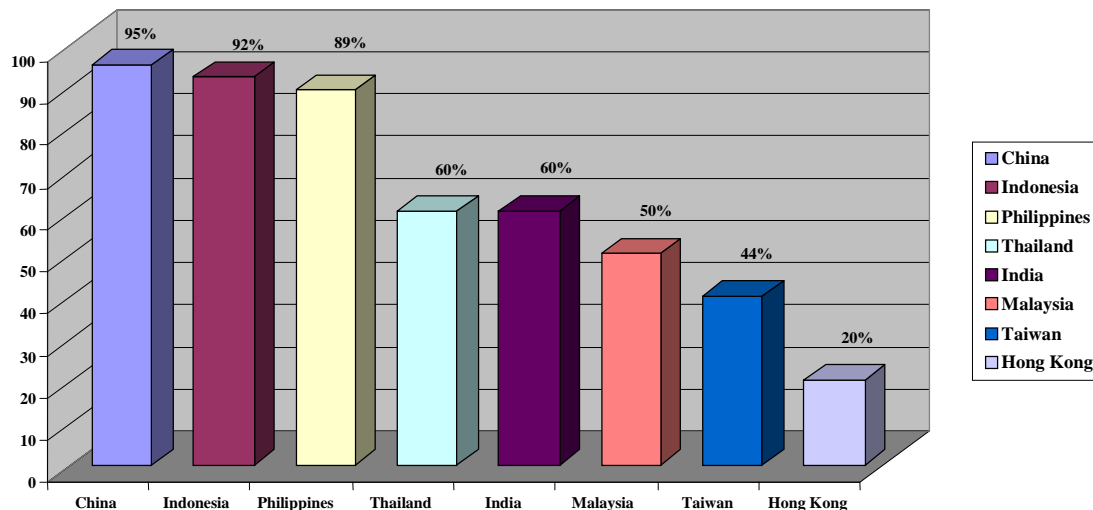
Making a bad situation even worse, word leaked in late May that major US blockbusters would not be given screen time in China during a key period when MPA member companies release their summer blockbusters to cinemas in the United States and the world. Several of our member companies had been working diligently to ensure that Chinese consumers were able to enjoy these films in cinemas at the same time as the rest of the global audience.

If audiences do not have the option of going to see a legitimate film in the cinemas, illegal home video product will flow in

to fill the demand. By discouraging consumers from seeking their entertainment at the cinema, this decision damages the revenue streams of China's cinemas and diminishes the value of the both local and US investments in new multiplexes in China. Only the criminal elements behind piracy will benefit from this decision while legitimate businesses are deprived of success.

Meanwhile, piracy problems are only becoming more severe. In 2002, the piracy rate in China for American films, home video and television) was about 91%. In 2003, the pirates captured at least 95% of that market. The current level of piracy is worse than it has been at any time since 1995, when the rate was 100%. In fact, China leads the Asian region in piracy; the rate of piracy in China is higher than that of other countries that traditionally have been plagued by piracy, including Malaysia, Indonesia, India, and the Philippines, as illustrated on the following chart.

### Asia Pacific Region: Piracy Rates and Losses



China is again becoming a source of pirate discs circulating in world markets – just as it was in 1995. For example, during the first three quarters of 2003, customs officials in the United Kingdom saw an alarming escalation in seizures of pirated DVDs originating from China. During the first quarter, UK Customs officials seized fewer than 1,300 pirated discs from China – but in the following three

quarters, seizures jumped to a combined total of over 94,000. As of April 30, 2004, UK Customs seized 78,666 pirated disc from China compared with 1,238 pirated discs seized during the same period of year 2003 (a rapid increase of 6,254%). Despite the seizure in China of 34 optical disc production lines and two mastering lines in 2003, source piracy has still received insufficient attention from Chinese authorities to deal with the rapidly increasing export problem.

Domestically, rampant piracy continues to fill the void created by slow and limited access to the legitimate market. Far less legal filmed entertainment is entering China than the market demands. Restrictions on access and bureaucratic obstacles to distribution in the theatrical, home entertainment and television marketplace provide a vacuum that is readily filled by pirates, who ignore time-consuming bureaucratic obstacles like censorship procedures and pay no taxes.

While DVD piracy has been crippling to foreign films, this rampant piracy is equally devastating for the local Chinese film industry. Many Chinese studios are on the verge of collapse. No supplier of legal films, local or foreign, can compete with pirates who pay no taxes, endure no censorship obligations, and who carry none of the costs of running a studio and paying actors and actresses.

Television piracy is also a major concern. The government runs 38 provincial broadcast television stations and 368 local stations, which commonly broadcast unauthorized content, often in reliance on counterfeit "letters of authorization" or "licenses" from companies in Hong Kong, Thailand or Taiwan, which purport to convey broadcast rights. In addition, the more than 1,500 registered cable operators in China routinely include pirated product in their program schedules.

**Actions Needed:** In order to curtail the excessive levels of piracy in China, China must take the following steps:

- Strengthen focus, coordination and effectiveness of the various Chinese enforcement agencies through strong direction from the top Chinese leadership.
- Build consumer awareness of the dangers and penalties of engaging in piracy.

- Establish credible legal deterrents to piracy to include the lowering of the criminal threshold for copyright violations.
- Create strong, well-coordinated local enforcement entities such as that in Shanghai.
- Sharp improvement in the transparency regarding enforcement raids, criminal case proceedings and court sentencing results.
- Set a fixed timetable for bringing piracy rates steadily down from current levels exceeding 95%. An immediate goal should be to bring piracy below 50% by the end of 2004.
- Take immediate action to stop the rising volume of pirate exports from China.
- Take concrete steps to improve market access and eliminate obstacles to distribution in the theatrical, home video and television markets.

China is slowly enunciating policy goals that provide some room for cautious optimism that these items may be addressed. In April 2004, at the conclusion of the US - China Joint Commission on Commerce and Trade, Chinese Vice Premier Wu Yi specifically committed to reduce rates of piracy. She also pledged to lower the criminal threshold for piracy and to increase the number of infringing acts subject to criminal penalties by the end of the year. These criminal law commitments are important in correcting some of the biggest structural impediments to criminal prosecutions and deterrent sentencing for IP crimes in China. China also indicated that they would be conducting a nationwide enforcement campaign, stepping up border enforcement and launching a public education campaign. Finally, China will adopt and implement the WIPO Internet treaties.

## **RUSSIA**

**Background:** There has been an explosion of large-scale factory production of pirate DVDs in Russia over the past few years. The export of pirate DVDs to both developed and growing markets across Europe has eviscerated any progress that had been made in Russia towards the creation of a healthy legitimate audiovisual market. The known local DVD plants have an estimated annual production capacity of over 30 million DVDs, well over ten times the

level of legitimate local demand. These discs are clearly being made for export to markets across Europe, carrying multiple language tracks and subtitles. Moreover, the local Russian market is saturated with pirate DVDs, with the level of piracy estimated at 92% in 2003. Sales of legitimate DVDs have fallen back to 1999 levels despite a significant increase in the number of households with DVD players, and despite efforts by foreign producers to move legitimate product into the Russian market much earlier than in prior years. In 2002, we reported the seizure of over 226,000 pirate DVDs in raids on warehouses and outlets across Russia. That number jumped in 2003 to over 1.4 million.

**Laws and Enforcement:** Russia's laws remain TRIPs incompatible and effective anti-piracy action by law enforcement agencies is substantially deficient. Russia has yet to effectively enforce the laws it has in place at a level necessary to have any appreciable effect on piracy. On-the-ground enforcement by police and prosecutors remains lacking. As a result, Russia has some of the highest rates of copyright infringement in the world.

Russia has made progress recently in improving its intellectual property protection regime. The Government has recognized the seriousness of the piracy problem, legislative reforms have been adopted and enforcement efforts have been increased. In recent months *ex officio* enforcement actions began to be conducted almost daily and have been widely reported by local media. Three pirate DVD plants have been raided so far this year and have had their DVD lines seized. Moreover, Russian officials recognize the importance of improving IP protection in the context of accession to the WTO. However, despite the efforts to date of the Russian Government, pirate production and export continue to grow unabated. The organized criminal groups that control most of the manufacture and distribution of pirate product continue to grow in wealth, strength and influence. Piracy is acknowledged by everyone to be one of the most profitable criminal businesses in Russia. Much more needs to be done on an urgent basis to have even a nominal impact on this problem.

The criminal groups running piracy operations are well-funded and highly organized. Such groups cannot be effectively opposed by



rightsholders alone or by local organizations acting on their behalf, regardless of the dedication, bravery or expertise of their personnel. The committed help of the Russian Government is required to face down such criminal syndicates. The only way to combat the syndicates is by effective criminal enforcement. Unfortunately, Russia's criminal enforcement system is the weakest link in its intellectual property protection regime. Raids are not followed up by criminal prosecutions. Prosecutors drop cases for no reason, or cite a lack of public interest. When cases are prosecuted, the penalties imposed are not at deterrent levels. Prison sentences are usually suspended. There have been welcome exceptions, of course, but police and prosecutors are generally discouraged by their experiences from investigating and prosecuting more offenders.

Another problem that needs urgent Russian Government attention is the unacceptable return to the marketplace of confiscated pirate product. It is estimated that up to three quarters of the pirate product seized in raids finds its way back onto the market.

**Actions Needed:** To put into effect its stated commitments to tackle its piracy crisis, the Russian Government should take the following steps:

1. Inspect, on a regular, unannounced and continuous basis, each of the 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. Introduce, either via executive order or legislation, the necessary modifications of the current optical disc licensing regime so that it provides for more effective control over the operations of 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;
3. Pledge to investigate all complaints from copyright owners in respect of the commercial replication, distribution or export of pirate optical discs;

4. Act through Customs to prevent the continued export of pirate discs to other countries;
5. Pass the long-awaited amendments to the Copyright Law and ensure full consistency with international standards as set out in the WIPO Internet Treaties and the WTO TRIPs Agreement;
6. Adopt a decree setting forth sentencing guidelines for judges to advise the Courts to impose penal sanctions as provided under the penal code as amended (Article 146);

## **OTHER COUNTRIES WITH SIGNIFICANT PIRACY PROBLEMS**

**Brazil:** Brazil, our most important South American market, is beset with piracy. One out of every three tapes or DVDs is pirate. Our member companies lose an estimated \$120 million every year in Brazil to piracy. Street market sales of locally “burned” recordable DVDs (DVD-Rs) and low quality recordable CDs (CD-Rs) are ubiquitous and internet sales of pirated optical discs are also increasing rapidly. While Brazil has good copyright laws, their enforcement is abysmal. Even in those jurisdictions where police have conducted raids, criminal prosecutions are rare, and deterrent sentences even less common. Less than 1% of all raids result in convictions, and even those few sentences are so light that future crimes are not deterred.

A special Brazilian Congressional Investigation Commission on Piracy and Contraband provides one bright spot in an otherwise dismal piracy situation in Brazil. Since June of last year, this Commission made extraordinary efforts to investigate and attack piracy. They exposed a major criminal organization led by a naturalized Brazilian of Chinese nationality, Lao Kin Chong. Chong, who produces contraband optical discs for the Brazilian market and sells them in three large commercial shopping centers, was finally arrested last week after trying to bribe the head of the Congressional Commission. The Commission also investigated and arrested public agents for corruption, demonstrating that the reach that organized crime of piracy can have with official organizations. They encouraged

private authorities to carry out search-and-seizure operations against commercial outlets known for pirated material, which triggered an increase in the number of operations by police and administrative authorities. The Commission welcomed the participation of the private sector in supporting the fight against piracy.

The Parliamentary Inquiry Committee is scheduled at the end of June to submit its final report to the Lula Administration for strengthening the national system for combating piracy. In their dual role as members of the Parliamentary Front to Combat Piracy, a permanent body that enjoys the participation of the private sector, these Brazilian legislators will play a key role in pressing their Government to ensure that the proposals of the Parliamentary Inquiry Committee are effectively implemented.

We hope that the US Government will also engage the Government of Brazil in serious effort to secure more effective protection of filmed entertainment and other copyrighted works, using all appropriate trade tools, including through negotiation of high IP enforcement standards in trade agreements and by utilizing the leverage provided by preferential tariff programs such as the Generalized System of Preferences. The Administration is facing a decision shortly with regard to a petition filed by the International Intellectual Property Alliance, which proposes that the United States withdraw Brazil's GSP eligibility for failure to provide adequate and effective protection of intellectual property.

**Malaysia:** Malaysian enforcement authorities have shown remarkable courage and tenacity in actions against unlicensed optical disc factories and street markets retailing pirate DVDs. Continued vigilance, including of the licensed factories, will be necessary to reduce pirate production. Malaysia also made a significant dent in the export of pirated DVDs by means of express delivery services. Malaysia's next major challenge on the route to ridding itself of the scourge of organized, criminal optical piracy will be the successful prosecution and sentencing at deterrent levels of guilty parties.

**Pakistan:** Pakistan has become a major producer and exporter of optical discs as shown by the increasingly large seizures of pirate

product by customs services in Europe and Africa. Pakistan has at least eight active plants with 25 lines, including one DVD plant.

Pakistan is now the leading source of pirated DVDs seized by UK Customs. In the first quarter of this year, UK Customs intercepted over 94,000 pirate DVDs pirate discs that originated in Pakistan. To circumvent the Customs controls in the UK the pirates have been seeking to exploit perceived weak points in the European Union's common external border. So far this year pirate shipments from Pakistan have been detected at EU entry points in France, Netherlands, Spain, and Belgium, in addition to the UK. With the accession of 10 new countries to the EU last month, our fear is that this trend will continue. South African Customs has also intercepted several large shipments of pirated DVDs originating in Pakistan; which were transiting that country and heading for other markets in Africa.

**Taiwan:** The story in Taiwan is mixed. Large-scale factory production of pirated DVDs is largely a problem of the past in Taiwan. The organized criminal piracy organizations switched to production of blank recordable discs, a legal product, but one that provides the raw material for illegal commercial "burning" (copying) of our home entertainment in smaller, more dispersed labs in Taiwan and throughout the world. Taiwan's enforcement officials recently conducted a raid against a major "burning" lab and have also helped reduce the overt retail sales of pirated goods in street markets. Unfortunately, no progress has been made in the long awaited legislative reforms. Taiwan needs to ensure that its enforcement officials have all the legal tools necessary to continue their enforcement against hard goods piracy and to successfully tackle on-line theft. Instead of moving forward with these amendments, Taiwan is flirting with adoption of a compulsory license on internet transmission of sound recordings, a step that would be inconsistent with Taiwan's TRIPS obligations and set an unacceptable international precedent.

**Thailand:** Thailand remains one of the few major optical disc production centers in Asia that has failed to adopt effective optical disc regulations to stem the growing production problems. Unless Thailand significantly steps up its fight against the large factories that

are churning our pirated copies of DVDs, MPAA will not be able to support the Free Trade Agreement, which our countries are preparing to negotiate.

## **CONCLUSION**

What we often refer to as “piracy” is more clearly and accurately defined as “outright thievery.” It is thievery that our country cannot afford to tolerate.

I thank you, Mr. Chairman, and Members of the Committee, for your interest and your assistance in helping us illuminate this dark corner of illegal commerce.

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