

Statement Prepared For Delivery By

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Before a hearing of the

Subcommittee on Federal Financial Management,  
Government Information, and International Security  
of the  
Senate Committee on Homeland Security and  
Governmental Affairs

*"Ensuring Protection of American Intellectual Property Rights  
For American Industries in China"*

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John H. Mitchell Theater  
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465 North Beverly Drive  
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CHAIRMAN COBURN AND MEMBERS OF THE SUBCOMMITTEE: One of the most important actions you and your colleagues can take to help us protect our intellectual property rights in China is to continue to call attention to the Chinese authorities that you consider the theft of US intellectual property a high priority.

Adequate laws and resources, effective enforcement, and private sector initiatives and cooperation with the US government and Chinese government are all important tools in this fight. However, unless the Chinese government exercises the political will to address the rampant theft of US intellectual property rights (IPR), those tools are meaningless. This hearing keeps IPR high on the on the US-China agenda, demonstrating, yet again in a yet another forum, to the Chinese government the priority you and your colleagues attach to seeing satisfactory results.

The source of this problem is twofold: First, China imposes strict limits on the number of foreign films that can be exhibited in its theaters on a revenue-sharing basis, and applies burdensome regulations and confiscatory taxes on foreign home video and television content. This creates a marketplace vacuum that pirates are only too happy to fill. Second, China has not asserted the political will necessary to reduce the level of piracy. Yes, it has conducted some raids and even put a few

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<sup>1</sup> The Motion Picture Association of America (MPAA) represents the major producers and distributors of motion picture and television programs in the United States; its members are Metro-Goldwyn-Mayer Studios; NBC Universal City Studios, Paramount Pictures Corporation, Sony Pictures Entertainment, The Walt Disney Company, Twentieth Century Fox Film Corporation, and Warner Brothers Entertainment.

pirates in jail, but it has not materially reduced the level of piracy and the ready availability of pirated products in the shops and in the streets.

As I will elaborate, fighting piracy, especially in a restricted market such as China, means more than simply enforcing laws and going after the counterfeiters – the traditional anti-piracy tools. Getting better access to the Chinese market is a critically important tool in the fight against piracy. The controls the Chinese government imposes upon legitimate film producers and distributors have no effect whatsoever on the pirates. Until we have the same unrestricted access to that market, we will not be able to compete effectively and stop the theft of our content.

On behalf of the member studios and the hundreds of thousands of Americans who earn their livelihoods in this industry, thank you for your interest and the opportunity to address the Subcommittee.

### **SCOPE OF THE PROBLEM**

Regrettably, to coin a phrase, if you did not see a counterfeit DVD, you were not in China. Unfortunately, I fear our collective perception of China has become so ingrained with the notion that China is overflowing with pirate DVDs we frequently fail to appreciate the magnitude of the problem.

The problem is ubiquitous – on virtually every street corner, packed on to the shelves of audio-visual shops in every neighborhood. We estimate that the piracy rate exceeds ninety percent – more than nine of every ten DVDs in the Chinese market is a fake, stolen product. That would be like, Mr. Chairman, going to Northcutt Chevrolet in Enid and learning that nineteen out of every twenty of the cars and trucks on the lot are fakes. Counterfeit, stolen motion pictures cost our members nearly \$300 million annually, in China alone.

Too many, especially some around the world who should be allies in the fight against piracy in China, view this as an American problem. While we certainly bear the disproportionate share of the burden of this problem, movie piracy in China affects film makers all around the world. Our research indicates that almost half the pirated product is actually Chinese product. We also find stolen copies of Japanese, Korean, French, and Indian movies in China.

A few weeks ago, a young Chinese film producer visited my office. When asked to define his number one problem, he did not mention financing, distribution, or any of the other obstacles film producers must overcome: He said piracy is his biggest problem -- the theft of his movies, in his home country.

It is clearly more than an American problem, it is a problem afflicting film makers no matter where they live and make movies, in more than one way. Not only are the pirates sapping legitimate movie makers in the China market, they are encroaching on legitimate markets all around the world. Our analysis of pirated DVDs seized from around the world traced their production back to over fifty plants in China.

As we dig deeper into this problem, particularly the global spread of China-sourced pirated product, we are coming to a disturbing conclusion: There is a growing link between piracy of motion pictures and organized crime. Our Asia-Pacific Regional

Office just completed a new study on these connections. With your permission, Mr. Chairman, I have included a copy of that study with my statement and would like to have it included in the record. Let me cite a few of its findings:

Criminal theft of IPR dwarfs criminal revenues from narcotics trade: US government and international law enforcement records peg the illegal narcotics trade at \$322 billion last year; criminal revenues from all IPR theft were significantly higher, \$512 billion.

Part of the allure for organized crime to move into DVD piracy is the incredible profit margins, exponentially higher than for drugs: The mark-up on pirated DVDs made in Asia and sold in Europe, for example, averages an astounding 1150%, three times the mark-up of heroin sourced in Asia and sold on the same street corners, and the criminal risk is far lower.

The report cites two recent cases linked back to China, with tentacles around the world, including into the US. In September 2005, a federal grand jury in New York indicted thirty-nine individuals tied to the Yi Ging Syndicate, based in New York but which funneled much of its one million dollars plus a year earnings back to China. Next January, an American, Randolph Guthrie, will stand trial in the US for his role in leading a criminal syndicate, based in Shanghai, that made and distributed hundreds of thousands of pirate DVDs around the world; when he was arrested last summer, Chinese authorities seized more than 210,000 counterfeit DVDs.

I think it goes without saying that many of these revenues finance other illegal activities in which these criminal organizations are involved, making the reach of piracy even more pernicious: This is not just an American problem, and it is not just a motion picture industry problem, it is now underwriting activities that threaten all of us, in all walks of life.

Of course, it affects some of us more directly than others. As I said at the outset, our members employ nearly one million American men and women, at all job levels. We employ thousands of laborers, electricians, technicians, truck drivers, as well as professionals in finance, legal positions, and specialized support services.

There seems to be a view – a myth – that buying a stolen DVD only means a movie star earns a few dollars less on that movie. Let me be clear: That notion is just that, a myth. Every dollar the pirates earn is one less dollar going to an American worker, a worker employed in an industry that is one of the few in this country bringing more money back to the US in export earnings than it sends overseas.

Chinese piracy of US motion pictures also hits some of us very personally. I was in China the last time in May. I strolled the neighborhood near my hotel, and looked into one of the audio-visual stores I came across. I admit I was not surprised to see shelves of pirated DVDs, disappointed, but not surprised. I was, however, taken aback when one title caught my eye: *"The Hitchhikers Guide to the Galaxy."* At the time, the movie was not available on DVD in the US, so I knew it was a fake, taking the money out of a US film maker's pocket. That film maker: my son. He is a producer and that was his most recent film. I relayed the story to him, and he replied: "And what Dad, Mr. Chairman of the MPAA, are you going to do about this?"

## WHAT THE MPAA IS DOING TO PROTECT ITS CONTENT

MPAA invests millions every year in fighting piracy, in China, and around the world. We go after the pirates, we work with governments to enact and then enforce adequate laws, we work to educate the public about the consequences of piracy, and the legal alternatives to piracy, and we are constantly seeking new ways to prevent the problem through technology, education, and changing business practices.

As I have indicated previously, piracy in China is indeed a China problem, but it is also a problem with global reach. A pirated disc made in China can, in a day or two, be in the street markets of Los Angeles. Someone can illegally camcord a movie in Moscow, send the file by way of the internet to someone in Guangzhou who then dubs and subtitles the Russian dialogue, and then illegal presses thousands of DVDs.

We approach the problem fully cognizant of its global reach, with a seamless strategy of going after the producers, distributors, and sellers of DVDs and the machinery they use to make the fakes. We have aggressively pursued a strategy to stop the illegal camcording of movies, which is still the largest source of pirated product. We are very appreciative of the action Congress took to make illegal camcording a federal crime and that the President signed the bill earlier this year.

We seek to track the production of optical discs, to make sure the plants that make them are legal, registered, and their product produced with internationally recognized identifying codes. Increasingly, we are beefing up our internet strategy to go after the thieves who think they can anonymously download and send stolen movies over the internet.

We are also on the ground in China. Our representatives survey the market for information about the incidence of piracy and pass on this information to the Chinese authorities. In many cases, this information helps Chinese authorities formulate cases for raids on sellers and distributors, and often, those authorities invite our representatives to accompany them on such raids.

We operate and participate in training sessions for Chinese authorities and jurists on IPR laws and enforcement, in the US and in China. We also work closely with US officials in elevating the importance of IPR enforcement; for example, our representatives participated in the IPR Roundtable our Embassy conducted in Beijing at the first of this month.

One of the most significant initiatives we have been able to launch with the Chinese government was the joint anti-piracy memorandum of understanding (MOU) we executed with three entities of the Chinese government: Ministry of Culture (MOC), State Administration of Radio, Film and Television (SARFT), and National Copyright Administration (NCA).

This MOU was signed last July 13, in connection with the most recent discussions held under the auspices of the Joint Committee on Commerce and Trade (JCCT). Under its terms, every three months MPAA will submit to the MOC and SARFT a list of motion pictures scheduled to be screened in China by its member companies. All home video products that are available in the marketplace prior to the legitimate

home video release date in China will be deemed illegal audio and visual products and forfeited, and when a criminal copyright infringement offense has been committed, the case will be prosecuted.

On October 25, we met with the Chinese side to review the results of the MOU. For our part, we surveyed a small selection of shops in four key cities: Beijing, Shanghai, Guangzhou, and Shenzhen. The surveys were by no means intended to provide a comprehensive assessment of anti-piracy enforcement progress across China; merely an indication as to whether the needle had moved at all:

Specifically, during October, the surveys of target outlets in Shanghai showed that of the films covered under the agreement, no pirate versions were available at all, at the time the shops were surveyed.

In Guangzhou, the availability of pirated versions of the identified titles was down quite sharply from September, when almost all titles were available.

In Shenzhen, availability of pirated titles fell fifty percent from September.

In Beijing, in August, with the exception of one shop that carried only fifty percent of the protected titles, pirate versions of the six films ran from seventy to ninety percent. In September, the original shops continued to offer pirated versions of the protected titles. In October, the original ten shops had cleaned up remarkably; however, an additional ten shops surveyed showed piracy rates averaging around eighty percent.

The MOU only covers a handful of movies, and though it applies to the entire country, we have only been able to survey a limited number of cities and only a selection of retailers in each. We are disappointed with the results.

In spite of their formal commitment to protect specific US movies, the Chinese authorities failed to demonstrate meaningful progress even within the limited review we conducted. Our next review of the MOU will occur in January and we would be pleased to keep the Subcommittee apprised of our progress.

In addition to the work we are doing with the Chinese government and industry, and with other US copyright industries, I might add, most notably the sound recording industry, our key partner is the US government. I commend this Administration for the priority it has given this problem, and its willingness to work with us. I want to mention some of those key officials:

Secretary Guterrez has been an incredibly forceful advocate during his travel in China. In Washington, a few months ago he appointed Chris Israel to take on the job of coordinating US government efforts. Also, the Undersecretary for Patents and Trademarks has been deeply involved.

Attorney General Gonzales just last week announced a series of initiatives to strengthen IPR enforcement, including a new IPR task force; while aimed at the US, piracy is a global problem demanding a seamless, global response.

The State Department has been a key ally, particularly the work of Undersecretary Shiner. Our Ambassador gives this high priority, as evidenced by the IPR roundtable I mentioned, and we have an extraordinarily capable IPR attaché in Beijing.

The US Trade Representative (USTR), Ambassador Portman, personally has been extremely helpful, raising IPR as a top priority during his visit to China immediately preceding the President's trip. USTR's general counsel's office, intellectual property office, and China office have all been invaluable. They are on the front lines and we deeply appreciate their work and support.

In addition, USTR's analysis of trade barriers around the world ensures that this problem in China stays a top US agenda item. Just last week, we filed our comprehensive submission of the barriers to trade in US motion pictures and it includes an extensive discussion of the details of the problems we have in the China market. Mr. Chairman, with your permission, I would ask that the China portion of that report be included in the record of this hearing and I have attached a copy of it to my statement.

Finally, credit goes right to the top, too. President Bush made IPR a top agenda item during his summit with President Hu. Having our views and concerns addressed at this level is invaluable in elevating the priority of IPR on the bilateral agenda and in motivating that crucial ingredient I noted: political will, the political will of the Chinese government to act.

Our work with the US government goes on virtually every day on this problem, and we are currently working very closely with the USTR on our next steps to secure adequate protection of our product in China.

#### **HOW CAN YOU HELP?**

Mr. Chairman, having surveyed the scope of the China problem, the steps the US motion picture industry is taking, I want to bring my statement to conclusion with some points for you and your colleagues to consider for ways you can help protect American IPR in China.

First, help make sure our government has the resources it needs. Not only do we need tough laws in the US, such as the package from Attorney General Gonzales I mentioned, the agencies who enforce those laws, inspect imports, train foreign officials in IPR, and enforce international trade agreements need resources.

I know full well the difficulties the Congress has been dealing with on controlling the deficit, I also know that it ought to be in our national interest to promote and protect winning industries, and this industry is a winner. As I have said, we employ nearly one million Americans, in good, well paying jobs, and we have a positive balance of trade in every market where our countries do business, except one: China.

Why do we run a movie trade deficit with China? Piracy is certainly a key reason, though another is the onerous, burdensome restrictions we have on doing business in China, and even in getting into that market.

Consider some facts about our access to the China market: The good news is that the money our movies made in China in 2004 doubled the amount they made in 2003. The sobering side is that that amount was only \$10 million. One American movie on an opening weekend makes more, as we saw this past weekend with *"Walk The Line," "Harry Potter and the Goblet of Fire,"* and with *"Chicken Little"* a couple of weeks ago, and we will see every weekend for the rest of the year.

In recent years, in fact, two Chinese movies *"Kung Fu Hustle"* and *"House of Flying Daggers"* both, individually, made more in the US than all US movies made in China for the years they were released, and, ironically, both were distributed in the US by one of our member companies.

The primary barrier is the quota the Chinese impose on the number of foreign films they permit into their market under normal business terms, what we call revenue-sharing whereby the US producer shares the box office with the Chinese distributor. The Chinese allow only twenty such films into China a year, from all countries, not just the US. That means film makers from France, Japan, the UK, Korea, and the US together can only hope to get a part of that twenty-film quota.

Once into the market, the government controls the distribution of the movies. A state agency, through two divisions, distributes all the films in China, and dictates the terms of the revenue sharing with US film makers.

There are many other restrictions, detailed in the attachment to my statement, but the net effect is critical. When fighting piracy and protecting IPR, most are familiar with what I call the traditional methods – effective laws, enforcement, raids, and the like. In China, getting better access is just as critical and intertwined closely with our strategy towards that market.

My second recommendation is that we want the same access to the Chinese market as the pirates have. The barriers I outlined and that are enumerated in the attachment do not, at all, restrict the number of movies in China. Virtually any movie Chinese consumers might want is available, not necessarily through legitimate channels, controlled by the restrictions applied to us, but from pirates who have no such restrictions and who operate largely without deterrent sanctions applied to offenders. Not only are our movies being stolen, we face an enormously unbalanced playing field, at distinct competitive disadvantage.

We are convinced access to the Chinese market on fair terms, the same terms as the pirates, is central to fighting piracy in China and protecting our rights there. We want to be able to compete, not bound by quotas, government restrictions on distribution rights, black-out periods when only Chinese movies are screened, nor onerous taxes, and we want transparent clearance procedures.

Third, let me come back to where I started: political will. Just as the US government needs adequate resources and strong laws, so do the Chinese. However, for the most part, that is not the main problem. With a few notable exceptions, the Chinese IPR statutory regime is adequate and with changes, can easily be brought into compliance with World Trade Organization (WTO) standards.

The problem is political will, and keeping the pressure on is a key way to bolster that will. For example, we know the Chinese can stop pirates. When the Chinese open a film the government wants to promote and protect, pirated copies of it are non-existent; the word goes out that piracy will not be tolerated. Even when we surveyed results of the MOU, we saw some modest improvements in some places – evidence that the Chinese can crack down on the pirates if they want.

The Chinese frequently recite this rationale for the IPR problems: The US, they say, has over 200 years experience with IPR; China has only twenty. China needs time to grow and develop. True. I acknowledge the problems with developing an adequate and effective IPR system, and culture. On the other hand, I have seen what China can accomplish when it makes something a priority. My first trip to China was about twenty years ago. The changes I saw between then and my last visit last May are breath taking. The lesson here is that when the Chinese have the will and desire to change and reform, they can, a lesson I am convinced can be applied to making changes to protect better American IPR.

I saw another personal example of how the authorities can act when properly motivated. Last May, the day after I discovered the pirated copy of my son's movie, *"The Hitchhikers Guide to the Galaxy,"* I met with the mayor of Beijing and told him. The next day, the shop where I got the movie was raided and closed: political will in action. Unfortunately, it was short-lived; our China representative informed me the other day that the shop is back in business.

A couple of weeks ago, *The Wall Street Journal* carried a telling story, about the paucity of counterfeit Olympics-logo goods in China. The production, distribution, and sale of those goods is tightly regulated and policed, and fakes are not tolerated. It is virtually impossible to find counterfeit Olympics goods in China. Why? As one of the Chinese officials said, it is because fakes dilute the value of the logo, the intellectual property upon which the Chinese have invested to finance the games.

The lesson: When the Chinese want to stop piracy, they can be enormously effective. They do not need twenty more years experience with IPR, they have the resources, they have the basic statutes, and they can make the changes needed to improve them. They need the political will to protect our goods as effectively as they are protecting the Olympic logo.

Please keep the pressure on; this hearing is one way to do so. Make sure you mention this when meeting with Chinese authorities. Above all else, unless the Chinese know this is a priority for all of us, we fear they will fail to exercise the political will to protect our IPR.

Mr. Chairman, members of the Subcommittee, I appreciate again your attention to the acute problems we are facing in China and the chance to share with you the perspective of the US motion picture industry.

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