

Testimony

of Franklin J. Vargo

Vice President for International Economic Affairs

on behalf of the National Association of Manufacturers

*before the Subcommittee on Government Management, Organization
and Procurement, Committee on Oversight and Government Reform*

The U.S. House of Representatives

*Hearing on “Protecting Intellectual Property Rights in a Global
Economy: Current Trends and Future Challenges”*

December 9, 2009

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Introduction

Chairwoman Watson, Ranking Member Bilbray, and distinguished members of the Committee on Oversight and Government Reform’s Subcommittee on Government Management, Organization and Procurement: thank you for inviting me to testify on “Protecting Intellectual Property in a Global Economy: Current Trends and Future Challenges.”

I am the Vice President of International Economic Affairs for the National Association of Manufacturers (NAM), the nation’s largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Our membership includes a broad swath of companies, such as medical device manufacturers EXEL International and Moldex Healthcare Products, both in Culver City, California, consumer skin care products producers such as CA Botana and consumer electronics companies like Sony Electronics, both of whom are in San Diego. I am pleased to testify today on behalf of these companies, as well as the rest of our nation’s manufacturers, on a critical issue – that of protecting American consumers from counterfeit and pirated products. The trade in fake products – whether it is medical devices, skin care products, consumer electronics, auto parts, pharmaceuticals, aircraft parts, consumer goods, or machine tools – has had a devastating impact on our economy, manufacturers, workers, and consumers.

My colleagues on today’s panel will agree with me when I say that we all have been in the forefront of pushing for strong U.S. government policies, for aggressive enforcement, for adequate personnel and financial resources, and for strong international cooperation to fight the scourge of piracy and counterfeiting. Hopefully, my colleagues and I can shed some light on how Congress, the Administration and private industry can work together in stopping the trade of counterfeit and pirated products.

IP theft is a job-killer that is stalking the road to economic recovery. While the situation is dire, we are not undone. If our nation is to regain its place of strength in the world economy, we must take affirmative steps now to end this nefarious practice. Remedies are at hand, and if Congress, the Administration and industry can work together, not only can we reverse much of the damage, but we can ground on counterfeiters and pirates both here and abroad. The enactment of the “Prioritizing Resources and Organization for Intellectual Property (PRO-IP) Act” last year, which the NAM supported, is only the beginning. Domestically, the NAM makes the following recommendations:

- Congress and the Administration must continue to establish, empower and fund high-level leadership on IP issues throughout the government – from the recently created Intellectual Property Enforcement Coordinator position within the White House, to every federal agency tasked with the protection of intellectual property. These high-level leaders can then develop an integrated strategic plan to fight counterfeiting and piracy, replete with deliverables, timetables and performance measures.
- To support the strategic IPR plan, Congress and the Administration need to give the Bureau of Customs & Border Protection (CBP) and the Immigration & Customs Enforcement (ICE) Bureau agents at our ports the tools to do their jobs effectively, including increased training, the ability to enforce exclusion orders to stop certain IP-infringing goods from entering the country, and the clear authority to seek meaningful help from rights holders when faced with a suspected counterfeit or pirated product.
- Further, we need to provide dedicated resources to the FBI and Justice Department to empower investigators and prosecutors tasked solely to the job of tackling IP theft. Federal prosecutions for IP-related offenses have increased dramatically in recent years; if we are to continue this trend, we must give them the authority, the tools and the resources to get the job done.

Internationally, the NAM makes the following recommendations:

- Congress and the Administration must continue to support a proactive, aggressive IPR agenda with our important international trading partners from China, India, and Russia to the European Union, Korea, Mexico, and Canada.
- Additionally, Congress and the Administration must ensure that U.S. intellectual property is not arbitrarily traded away at the international negotiating table through compulsory licensing regimes. Under these ‘agreements,’ large industrializing nations can take for a pittance what American companies have toiled to create – all in the name of promoting ‘green technologies’.

- Finally, Congress and the Administration need to work with the Chinese government for meaningful reforms to their IPR enforcement regime. These reforms include lowering the threshold for criminal proceedings in counterfeiting cases, ensuring the destruction of equipment used to produce counterfeit goods after a successful conviction, and ensuring provincial and municipal leaders in China are responsible for IP protection in their own jurisdiction.

Consumers Harmed by Counterfeit Products

Beyond all the economic costs and lost jobs, when counterfeit products – products such as medicines, medical equipment, pet foods, cosmetics, auto and aircraft parts, industrial fasteners, or household appliances – get into the marketplace, the lives of consumers are put at risk.

Disposable medical care product manufacturer EXEL International recounts news stories from earlier this year where over two million counterfeit insulin pens had been introduced into the regular European distribution channels. While it should be noted that these were not EXEL products, it is still a cause of concern for them as every reported incident of counterfeit medical products creates fear and uncertainty over the integrity of *all* medical products, legitimate ones included. Interestingly, these counterfeit insulin pens were distributed from a wholesaler in Malaysia, who in turn claims they derived from Iran, beyond which the supply chain could not be traced.

Our drug-manufacturing members tell us about the threats posed by the aggressive distribution of fake medicines, and the incredible effort being made by the U.S. pharmaceutical industry and its customers, suppliers and other partners to ensure the counterfeit medicines not seep into supply chains in the U.S. or around the world. The World Health Organization (WHO) has estimated that up to 1 percent of medicines available in the developed world are likely to be counterfeit.¹ The figure rises to 10 percent globally and can be as high as 33 percent in some developing countries. Despite the major efforts of the industry, hospitals, pharmacies and other partners, counterfeit medicines are penetrating the legitimate supply chain here in the U.S. And we're not just talking about aspirin and bandages here. These counterfeit products often target very sensitive product areas including cardiovascular and central nervous system medications, chemotherapy medicines, and high-tech medical devices such as endoscopes and defibrillators.

¹ World Health Organization Fact Sheet on Counterfeit Drugs, July 2009, <http://www.who.int/medicines/services/counterfeit/CfeitsFactSheetJuly09.pdf>.

Other examples include counterfeit batteries that look so much like legitimate batteries the only way to tell the difference is with an X-ray machine where you would see that the fake battery is lacking in thermal vents. It may seem like a small oversight, but it is a critical one as thermal vents are integral in avoiding a catastrophic failure of the battery, which could lead to a catastrophic loss of life and property from fire or chemical burn. In the automotive aftermarket for parts and accessories, among the most commonly counterfeited items are brakes, rotors, headlamps, tail lights, oil pumps, windshields, and steering arms, many of which seem to trace their roots back to China.

Manufacturing Jobs Harmed by Counterfeit Products

Not only do counterfeit products steal our nation's most innovative ideas, but they steal high-paying American manufacturing jobs as those fake products displace legitimate ones in the marketplace.

According to the U.S. Department of Commerce, America's IP-intensive industries employ nearly 18 million workers, and account for more than 50 percent of all U.S. exports, representing 40 percent of the country's growth.² U.S. intellectual property is worth between \$5 trillion and \$5.5 trillion – more than the nominal gross domestic product (GDP) of any other country;³ yet the continuing trade in counterfeit products results in the loss of hundreds of thousands of jobs annually.

Counterfeiting is a world-wide problem. In 2008, the Organization for Economic Co-operation and Development (OECD) estimated that the amount of counterfeit goods smuggled across borders amounts to at least \$200 billion per year world-wide.⁴ This number, however, only represent *cross-border* counterfeits, not those produced and sold within the same country, nor does it account for upstream and downstream losses borne by suppliers to and customers of the companies whose legitimate sales are displaced. In total, it is reasonable to estimate that the amount of economic harm inflicted by IP theft easily surpasses a *half-trillion dollars* every year.

² *Engines of Growth: Contributions of the U.S. Intellectual Property Industries*, Stephen Siwek, Economists Incorporated, 2005, at http://www.nbcuni.com/About_NBC_Universal/Intellectual_Property/pdf/Engines_of_Growth.pdf.

³ Robert Shapiro and Kevin Hassett, "The Economic Value of Intellectual Property," USA For Innovation Report, October 2005; available at http://www.usaforinnovation.org/news/ip_master.pdf

⁴ The Economic Impact of Counterfeiting and Piracy, OECD, June 2008, <http://www.oecd.org/dataoecd/21/20/40896133.pdf>.

Despite the world-wide impact of counterfeiting and piracy, U.S. manufacturers bear the brunt of the burden. Statistics released by CBP this year show that from FY07 to FY08 the number of IPR seizures increased by 9.7 percent, from 13,657 to 14,992, and the domestic value of the goods CBP seized for IPR violations increased by 38.6 percent to \$272.7 million from \$196.7M in FY 2007.⁵ This is no doubt to some extent attributable to CBP doing a better job identifying and seizing counterfeit goods. But from the reports of our member companies, it primarily reflects the fact that the economic assault on the worldwide marketplace in every sector is simply out of control.

Congress and the Administration's Role

The President's Innovation Strategy explicitly recognizes the importance of IP protection, stating that the U.S. "must ensure that intellectual property is protected in foreign markets and promote greater cooperation on international standards that allow our technologies to compete."⁶ Last year, the PRO-IP Act was signed into law, expanding government's ability to respond to this national crisis with stronger laws, better leadership and dedicated resources. This was an important first step, but the battle is not over. First, we must strengthen law enforcement's ability to identify, detain, prosecute and punish those who would bring illegal counterfeit products onto U.S. shores via our ports. At the same time, we must work with our foreign partners abroad to help them stop the trade in fake products.

In the United States, there are a number of things that Congress can do to help manufacturers. First, effective high-level leadership on IP protection must be established, both at the Agency level and on a government-wide level. To that end, President Obama has named an Intellectual Property Enforcement Coordinator (IPEC), as directed to by the PRO-IP Act. Victoria Espinel, who was the first Assistant United States Trade Representative for Intellectual Property and Innovation, now awaits confirmation by the full Senate. As part of her responsibility as the IPEC, Ms. Espinel will be responsible for creating our nation's anti-counterfeiting policy with the help and coordination of the eight different federal agencies responsible for interdicting and prosecuting these criminals. We are pleased that the Administration has taken this step in selecting Ms. Espinel, and we are looking forward to the benefits of a more coordinated approach to IP enforcement.

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http://www.cbp.gov/linkhandler/cgov/trade/priority_trade/ipr/seizure/fy08_final_stat.ctt/fy08_final_stat.pdf

⁶ A Strategy For American Innovation: Driving Towards Sustainable Growth and Quality Jobs (page 15), http://www.whitehouse.gov/assets/documents/sept_20_innovation_whitepaper_final.pdf

Congress' role in IP protection is as equally important in combating counterfeit products. Specifically, effective enforcement requires dedicated resources. The PRO-IP Act authorized new IP-dedicated FBI agents and prosecutors, so as to have the undivided attention of key federal law enforcement officers focused not only on the problem, but the solution. To aid in that effort the House this June passed the Commerce, Justice and Science (CJS) Appropriations bill, H.R. 2847, that would increase funding to critical programs authorized by the PRO-IP Act, including an additional \$8 million for new FBI agents to investigate intellectual property (IP) cases, an additional \$2 million for new U.S. Attorneys to prosecute IP crimes, and \$20 million for economic, high-tech and Internet crime prevention grants to state and local law enforcement agencies. In the Senate, however, this critical funding has been stricken from the CJS Appropriations bill. The NAM would like to see this funding restored.

In June, the House passed the Foreign Relations Authorization Act, H.R. 2410, which would create 10 new Intellectual Property Attaches in key embassies around the world, plus the resources to support their efforts. These IP Attaches would aid enforcement efforts abroad, as well as work with their host governments to help reform applicable laws, regulations, practices and agencies to enable them to fulfill their international and bilateral obligations with regards to IP rights. The NAM is supportive of this aspect of the bill, which is now pending in the Senate Foreign Affairs Committee.

Also currently pending in the Senate Finance Committee is the "Customs Facilitation and Trade Act of 2009," S. 1631, which will create a stronger role for the CBP and ICE in protecting U.S. consumers from counterfeit products. This legislation is particularly critical, as CBP and ICE are our nation's first barrier against the flood of counterfeit and pirated product coming in through our nation's ports. Unfortunately, they are overburdened and do not have the rights tools to fight the rising tide of pirated products. S. 1631 will go a long way in strengthening CBP and ICE by establishing leadership with the responsibility to make IP enforcement a priority, increasing IP resources with better training for those in the field, and making statutory changes that will enable more effective enforcement for CBP inspectors and ICE investigators. Overall, the Customs Facilitation and Trade Act is a solid bill. The NAM will continue working with stakeholders in the Senate to strengthen the bill before it goes to the House.

The International Side

The NAM has long supported an aggressive U.S. program to raise international rules and national laws around the world protecting intellectual property rights. But strong international and national laws and regulations are only part of the battle. Strong enforcement is absolutely essential. The NAM strongly supports a proactive, aggressive international approach by the U.S. Government agencies. We also have supported putting intellectual property rights (IPR) issues, including enforcement, high up on the agenda for US government dialogues with a wide range of important international trading partners from China, India, and Russia to the European Union, Korea, Mexico, and Canada.

It is not an overstatement to say that America's international economic competitiveness – and thus our ability to create viable good jobs here at home – depends on strong IPR rules and laws, aggressive enforcement and deterrent penalties, and in-depth international cooperation. Our competitiveness is based on developing and producing top-quality, cutting-edge technologies. And that strategy is all based on IPR, such as patents, copyrights, trademarks, and industrial designs.

One key new area of IPR concern which has emerged over the last year goes to the heart of our Green Technologies manufacturing strategies. In the international negotiations leading up to the Copenhagen Conference on Climate change, a cabal of large rapidly industrializing nations has insisted that “green technologies” must be exempt from IPR rules and laws. Those nations, led by India and China, have been insisting throughout the preliminary negotiations that green technologies must be subject to a “compulsory licensing” regime so that developing nations can immediately access the latest environmentally friendly industrial technologies without having to comply with standard IPR rules or indeed the rule-of-law more generally.

We at the NAM and others in U.S. industry are well aware of how “compulsory licensing” regimes are often gamed, as evidenced by the abuses against U.S. and other international pharmaceutical manufacturers. We've seen U.S. companies, workers, and regions suffer when countries abuse the compulsory licensing regime. The NAM will continue to urge U.S. negotiators in the Copenhagen process fight aggressively to oppose any compulsory licensing provisions in a Copenhagen agreement or anywhere else. Manufacturers in the United States have invested billions of dollars (and will invest much more) to develop cutting-edge, environmentally-friendly technologies and to create good jobs here at home. We will not sit by idly and let anyone, anywhere steal that technology in the market place, in the back alleys, or at the negotiating table.

As U.S. manufactures lead the way in the research, development and production of cutting edge “green technologies” we must ensure that these innovations are protected internationally. Achieving the kind of breakthroughs that the Administration, Congress and U.S. industry seeks will require billions in investment and will consumer the best minds of our generation. We simply must ensure that a strong and robust IP regime supports these investments.

In the international negotiations leading up to the Copenhagen Conference on Climate change, a group of large rapidly industrializing nations has insisted that “green technologies” should somehow be exempt from well-established rules protecting IP. Those nations, led by India and China have been falsely claimed the patents on “green technologies” are putting key tools out of the reach of developing nations. This is a dangerous proposition because it distracts us from two key issues. First, it distracts us from the true challenges to deploying clean technologies in most developing countries which are related to infrastructure and adoption of basic improvements. Most of the technologies that would have the biggest impact on developing nations aren't protected by patents and/or have gone off-patent. Second, probably the single biggest deterrent to deploying clean technologies in most nations are large tariffs put in place as protectionist barriers. When Brazil has a total tariff and non-tariff barrier of 160 percent and China has a 40 percent barrier on clean-coal technologies, our conversation should start there.

Insisting that green technologies must be subject to a “compulsory licensing” regime so that developing nations can simply take the latest environmentally friendly industrial technologies is a short-sighted attempt to take advancements made by U.S. companies that will chill investment and cost jobs.

We applaud statements made by Congress and the Obama Administration regarding the importance of protecting IP in the context of climate change talks. Earlier this year the House adopted by a vote of 432-0 an amendment to the Foreign Relations Authorization Act that emphasizes the importance of intellectual property in the Copenhagen Climate negotiations, and a bipartisan group of 60 Members recently sent a letter to Secretary Clinton reaffirming this point. Likewise, the President’s top negotiator to Copenhagen has testified to Congress about the importance that the Administration places on IP protection.

I want to highlight growing concern about the spread of blatantly unlawful anti-IP attitudes into new countries of concern. The NAM has been a strong supporter of the annual “Special 301” process lead by the Office of the USTR to identify priority IPR problems around the world. We commend USTR and all the other agencies of the U.S. Government which have worked so hard to make the Special 301 process a useful tool that can deliver real results. We look forward to working with USTR, the Administration, the Congress, and other stakeholders to strengthen and sharpen the Special 301 process and make it an even more useful tool for fighting counterfeiting and piracy and protecting U.S. manufacturing, technologies, and jobs.

Today, I also want to highlight one of our latest concerns regarding the virulently anti-IPR policies and politics, most vividly in the diatribes from President Correa himself, in Ecuador. Rapidly deteriorating IPR conditions are far from our only concerns about Ecuador. IPR takes its place in the list along with counter-narcotics cooperation, human rights, democracy, rule-of-law and treatment of international investors in a growing list of concerns about conditions in Ecuador. President Correa’s public threat to revoke well-established IPR protections for local and international companies in the pharmaceutical, agricultural and chemical sectors seem to signal that Ecuador prefers to deal with pirates and counterfeiters, rather than legitimate businesses.

China

We have special concern with regard to China, which has for a number of years been the epicenter of global counterfeiting. China, the number one source country in FY 2008 for counterfeit goods seized, accounted for \$221.6 million or 81 percent of the total domestic value of IPR seizures.⁷ Despite extensive engagement between the U.S. and Chinese governments, and a range of commitments on the part of the Chinese government, there still remains a thriving counterfeit industry in China.

⁷ CBP, ICE Release Annual Report on Counterfeit Goods Seized, January 08, 2009, http://www.cbp.gov/xp/cgov/newsroom/news_releases/january_2009/01082009.xml.

Another member company, CA Botana, gives an example of how counterfeiting in China is aided by its one-sided import laws and their impact on even small U.S. businesses. Any company looking to obtain an export license for personal care products into China must provide a 100 percent formulation of the product – essentially a list of the secret ingredients and their amounts – as well as comply with further requirements that these imported products have 75 percent Chinese content in them. Because of these requirements, companies such as CA Botana are forced to work with Chinese companies who are producing both authorized and unauthorized products (which are also considered as counterfeit). Due to this practice, U.S. businesses are seeing over 20 percent of their sales – both here and in the U.S. – supplanted by counterfeits. When a full fifth of a manufacturer’s sales disappear, so does their ability to maintain their worker base.

The theft of their intellectual property is a big problem for large companies; it is an insurmountable one for small companies that do not have the resources to track down and prosecute counterfeiters. Many small companies choose not to sell their goods to Chinese buyers for fear of having them illegally copied and sold in China and third markets.

Foreign companies are not alone in suffering losses in profits and reputation as a result of product counterfeiting. The NAM believes that there are several things that must be addressed in order for China to bring the problem under control:

- Currently 99 percent of copyright and trademark counterfeiting cases in China are enforced administratively, rather than criminally. In these circumstances, counterfeiters, if convicted, receive fines that represent just a cost of doing business, not a real deterrent. A greater number of cases must be referred for criminal prosecution.
- In addition, in cases when there is a counterfeiting conviction, the equipment used to produce the goods must be destroyed. Under current Chinese practice and law, it is too easy to leave the courtroom and resume business as usual.
- The Chinese central government has made great strides in recognizing the importance of IPR protection and in raising awareness of the issue. However, until provincial and municipal leaders in China are measured and held accountable both by the Government of China and internationally on the degree of IP protection afforded within their jurisdictions, there will continue to be greater emphasis on job creation without regard to enforcement of IP law, and U.S. manufacturers and workers will suffer.

Conclusion

If we are to allow counterfeiting and piracy to run unabated, the risks to the American economy are obviously very serious. However, if we are to invest in protecting our nation's consumers, workers and businesses from IP thieves, the rewards will come back to us six-fold. According to a report commissioned by the Coalition Against Counterfeiting and Piracy (CACP) – which the NAM helped found – investing in stopping counterfeiting is sound economic policy. Authored by Laura Tyson, former Chair of the National Economic Council, the report entitled “An Economic Analysis of the Proposed CACP Anti-Counterfeiting and Piracy Initiative” concluded that:

- For every dollar invested, federal tax revenues would increase significantly with an intermediate range of \$4.9 to \$5.7;
- Each dollar would increase U.S. economic output approximately between \$64 and \$75;
- The increase in output would result in the creation of between 174,000 and 348,000 new jobs during the third year of the program; and
- State and local governments can expect to receive incremental revenues between \$1.25 billion and \$1.50 billion, in present value terms over three years.

The Report also concludes that by aggressively going after counterfeiters and pirates as laid out by the PRO-IP Act and recommendations included in S. 1631, Congress' efforts could reasonably be expected to reduce losses attributable to piracy and counterfeiting somewhere between five and ten percent over three years.

We are looking forward to working with Congress and the Administration to ensure that all possible efforts, avenues and opportunities to stop counterfeiting and piracy are explored and exhausted, whether it be within our borders, at our ports-of-entry, or with our trading partners abroad. The health and well-being of our consumers, our workers and our manufacturers demand we do it.

The NAM appreciates the opportunity to work with the Committee in developing any plan to combat IP theft and we hope for a continued dialogue regarding ways to strengthen our nation's efforts.