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**Hearing on
"Will China Protect Intellectual Property? New Developments in Counterfeiting,
Piracy, and Forced Technology Transfer"**

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We applaud the Commission for holding this very important hearing on IP protection in China. This is a critical issue for BSA and our members.

BSA is an association of the world's leading software companies and their hardware partners around the world.¹ BSA members create approximately 90% of the office productivity software in use in the United States and around the world.

The software industry has proven to be a remarkable engine for jobs and economic growth. The software and related services sector employed almost 2 million people in the US in 2007 in jobs that paid 195% of the national average wage. This sector contributed more than \$261 billion to US GDP in 2007, making it the largest of the US copyright industries.

The packaged software industry's overseas earnings contributed a \$37 billion surplus to our nation's balance of trade in 2009. As much as 60 percent of revenues for the leading US software companies are generated from sales outside US borders.

A few months ago the Chief Executive Officers of twelve BSA member companies came to Washington, DC to meet with Congressional leaders and the President's senior economic

¹ *The Business Software Alliance (www.bsa.org) is the world's foremost advocate for the software industry, working in 80 countries to expand software markets and create conditions for innovation and growth. Governments and industry partners look to BSA for thoughtful approaches to key policy and legal issues, recognizing that software plays a critical role in driving economic and social progress in all nations. BSA's member companies invest billions of dollars a year in local economies, good jobs, and next-generation solutions that will help people around the world be more productive, connected, and secure. BSA members include Adobe, Altium, Apple, Autodesk, AVEVA, AVG, Bentley Systems, CA Technologies, Cadence, Cisco Systems, CNC/Mastercam, Corel, Dassault Systèmes SolidWorks Corporation, Dell, HP, IBM, Intel, Intuit, Kaspersky Lab, McAfee, Microsoft, Minitab, PTC, Progress Software, Quark, Quest Software, Rosetta Stone, Siemens, Sybase, Symantec, Synopsys, and The MathWorks.*

team. Their message was simple – the US software industry is key to the US economy and China is a critical market for our future growth.

Two Chinese practices stand in the way of American software companies' ability to compete in China: massive illegal use of software (nearly 4 out of every 5 computer programs installed on personal computers (PCs) in China last year were being used illegally) and the development of "indigenous innovation" policies that limit our access to a broad swath of the Chinese market.

The indigenous innovation issue has received high-level attention from the US government over the past year and BSA applauds this. Progress, however, has been slow in getting China to rethink and suspend its problematic indigenous innovation policies – from government procurement, to standard-setting, to certification requirements – that pose significant market access restrictions for US software and other technology companies. These policies are characterized by significant preferences for domestic firms and requirements seeking to compel transfers of technology as a precondition for market access. More action is needed.

Given its broad-based impact on the US economy, we believe the pervasive use of illegal software in China needs intensified attention from the US government as well.

It is now an established fact that software and computers have changed the world in which we live. Information technology has made us more efficient, more productive and more creative. Software and computers deliver results on national priorities such as health care, energy, infrastructure, education, and e-government.

Software has been at the heart of this technology revolution. It is also a big part of the US industrial base, whether it is the software used by steel companies, the autos we drive, or the energy saving appliances we use in our daily lives. Software drives productivity and innovation in almost every economic sector, helping businesses of all sizes perform better in good times and bad.

We believe our country's ability to create jobs depends in large part on our ability to export. We support the President's ambitious National Export Initiative (NEI) goal of doubling US exports of goods and services over five years. We stand ready to do our part, but cannot do so if a market as critical as China is out of reach because of high levels of software piracy.

Here are the facts. Our annual Global Software Piracy Study undertaken by market research firm IDC estimates that nearly 4 out of every 5 software programs installed on PCs in China widely used in the government, enterprises and by consumers in 2009 were unlicensed. The Study conservatively estimates that the commercial value of those programs is \$7.6 billion. That is double what it was just 4 years ago. In stark contrast, the estimated revenues from sales of PC software from US producers in China were around \$1 billion.

But these numbers, large as they are, understate the problem.

Nearly as many PCs were sold to businesses in China in 2009 as to those in the United States. Our country's total exports to China in 2009 were \$70 billion. If Chinese

enterprises were to actually pay for just the PC software they use, we conservatively estimate that total US exports to China could grow by at least 5 percent. The impact would be higher when the broader universe of packaged software is considered. This gives you a good picture of what is at stake.

The economic harm due to the illegal use of software in China has broader consequences here at home for US jobs. Products made in China by enterprises that use illegal software hurt American competitiveness and in many cases displace US jobs. Our companies pay for their critical inputs of production, such as software, while many of their Chinese competitors do not. Chinese products made with illegal software enter our markets and undercut our goods and services. In practical terms this harms US jobs.

We need to think of the problem of illegal use of software in a different way. The problem is more pervasive, more complex, and more pernicious than it was just a few years ago. Quite frankly, the term "piracy" is outdated. It does not even begin to capture the breadth of the problem.

So what should we do?

We believe the United States should develop a comprehensive results-based trade policy with China in place of the one-off, issue-by-issue approach that guides the current relationship. Our primary measure of success should be increased US exports of goods and services.

At a recent Senate Finance Committee hearing, responding to a Senator's comment that US-China economic policy was too focused on "soothing words," Treasury Secretary Geithner said "[t]he test of these things is not what people say and it's not how many meetings you have. The test is what actually happens to the terms and conditions that US companies compete on."

We agree wholeheartedly.

For over 20 years, the United States has engaged China in round after round of discussions aimed at one-off issue resolution at periodic ministerial meetings, including improved protections for software and other forms of intellectual property. These efforts have resulted in some positive changes, but not enough. Meaningful results for our sector, as measured by increased exports of goods and services, have been lacking.

As a key element of developing and implementing a result-based trade policy, we should hold China accountable for its commitments to combat software piracy. For example, in 2004, as part of the bilateral US-China Joint Commission on Commerce and Trade (JCCT) negotiations, China committed that government entities would only use legal software. The US has an Executive Order that requires this. Soon after this commitment was made, the Chinese government self-declared that it had fulfilled this promise, though provided no means for verification. The Chinese government also committed in the JCCT that state-owned enterprises (SOEs) would use only legal software and later made assertions that this had generally been accomplished.

Since these commitments were made, software sales by US-based companies have hardly budged while illegal use of PC software in China as a whole has doubled to \$7.6 billion. At

present, SOEs and other Chinese enterprises regularly use unlicensed software to operate their businesses, safe in the knowledge that there are no consequences.

Our overall goal should be increased exports of goods and services, but there are some immediate steps that we think should be taken.

The US government should press the Chinese government to:

- Devote resources to enforcement against software piracy that are commensurate with the scope of the problem.
- Cooperate with industry's efforts to bring civil cases to enforce software license compliance, including cases against SOEs.
- Implement verification and audit systems to measure performance in fulfilling commitments on government and enterprise legalization.
- Make software piracy by enterprises subject to criminal penalties.

The United States should also undertake a full examination of available trade policy remedies to address these concerns. This would include assessing whether actions can be brought under the World Trade Organization (WTO) and whether China's practices are a form of unfair competition that can be addressed by US trade laws.

The challenges that we face due to software piracy are now being compounded by Chinese policies that restrict our access to the Chinese market. Over the past several years, the Chinese government has issued a series of "indigenous innovation" policies that erect barriers to US software and other products in a quest to promote domestic champions. These Chinese policies discriminate against foreign firms through a web of preferences for Chinese-developed technology and standards and compel American and other foreign companies to relocate their R&D to China or lose the ability to sell there.

To counteract the harm caused by these policies, the US government must press the Chinese government to suspend current policies that create market access barriers and compel IP transfers, and engage in a meaningful dialogue on non-discriminatory approaches to promote innovation.

We accept that we have to do our part to help ourselves. We are doing several things. Our members continue to invest on average more than 7 percent of revenues in R&D, with some investing close to 20 percent. We are determined to improve on our already world leading software products. This investment will enable us to innovate, compete and create jobs in the United States. In China, we have had a long-standing program to pursue enforcement actions against enterprises that illegally use our software and to educate users about the importance of using legal software. To date, these efforts have produced limited results. We are committed to retooling and upgrading those enforcement and education efforts and are now in the midst of implementing a new enforcement plan in China.

Software Piracy in the Chinese Market

The current rate of illegal software use in China is staggering. Recent estimates from the market research firm IDC indicate that nearly 4 out of every 5 copies (79%) of PC software installed in China in 2009 were illegal, with a total commercial value of \$7.6 billion. These

are industry averages, and understate the dire situation that piracy creates for many of our companies.

A leading source of these losses is what we describe as “end-user piracy” – the unlicensed use of software by Chinese businesses and other enterprises. Chinese authorities do not view the unlicensed use of software by enterprises as a crime. As a result, US software companies must rely on China’s civil and administrative systems to pursue these infringers. The vast scale of the problem, the generally modest civil and administrative remedies available, and the time and expense of pursuing actions against individual companies mean that, in practice, the software industry is largely powerless to deter, let alone stop, the widespread illegal use of its products in China.

End-user piracy is not limited to so-called private enterprises engaged in commercial activity in China. Far from it. Unauthorized use of software is also extremely widespread in government agencies and in China’s massive SOEs and the companies they own. China has repeatedly committed in the JCCT that all government agencies – including provincial and local government authorities – and SOEs would use only licensed software. US industry has seen little progress on these commitments.

Other forms of illegal software use are also prevalent. For example, hard-disk loading of software – where PC manufacturers and resellers install unlicensed software onto PCs before their sale – is widespread. After years of effort by the software industry and considerable pressure from the US government, China issued a Decree in 2006 stating that all PCs produced in or imported into China must have legal operating system software pre-installed. While implementation of this Decree resulted in a modest increase in software sales in the first year, progress since that time has been minimal, hindered largely by the government’s unwillingness to verify that China’s PC makers are complying with the Decree.

Physical goods piracy – including manufacture and sale of pirate CD-ROMs, each containing thousands of dollars worth of illegal business software, and counterfeiting of a virtually unlimited range of computer hardware and devices – also proceeds largely unhindered. And Internet piracy flourishes in China. China’s Internet population is now by far the largest in the world, estimated at 384 million users – a figure greater than the entire US population. The Chinese government has not effectively acted to stop Internet users and website operators from distributing unlicensed software within and outside the Chinese market.

The Impact on US Jobs

While this illegal software use takes place thousands of miles from US shores, its impact is felt right here at home, in cities and towns across America.

By refusing to pay for the software they use, Chinese businesses artificially reduce their expenses and gain a competitive advantage over US firms. This enables Chinese companies to develop and manufacture products more cheaply than their US competitors.

In short, the illegal use of software by Chinese companies not only deprives US software firms of sales and revenues, but allows these Chinese companies to undercut the sales of

goods and services by their US competitors, reducing the revenues of US companies, and depriving US workers of good jobs.

The US International Trade Commission is currently undertaking an investigation to better understand the scope of intellectual property infringement and China's indigenous innovation policies and the implications for US competitiveness and jobs. We are taking advantage of the opportunity to participate in this investigation and believe that the results, particularly the new economic models that may result from this work, should provide valuable information for policymakers.

A Results-Based Trade Policy

US industry, with the strong support of the US government, has long pressed China to protect intellectual property rights. In response, China has taken steps to improve its IP regime, such as modifications to its copyright and trademark laws, and the adoption of a regulation aimed at Internet piracy. More generally, as part of its WTO accession, China committed to following the rules-based trading system and providing adequate intellectual property protection.

But gaps remain, and enforcement of the laws is inadequate. The result is that US industry losses due to software piracy continue to grow.

Indeed, the list of needed actions by the Chinese government identified in the US Trade Representative's "Special 301" process earlier this year is extensive. The list includes enforcement-related improvements, legislative changes and market access issues. Specifically, increases in the number of criminal prosecutions and administrative actions against copyright infringers, greater resources for, and training of, IP enforcement authorities, the assignment of judges with IP expertise to hear criminal cases, and amendments to a number of laws including the copyright law, the criminal law, and the regulations that govern Internet enforcement.

Historically, industry and the US government have measured China's progress towards improved intellectual property protection based on whether China adopted these or other specific legislative and enforcement-related measures and on commitments made by the Chinese government as part of the Strategic & Economic Dialogue (S&ED), JCCT and other bilateral negotiations. It is abundantly clear, however, that this approach is not working as all of us had expected. The Chinese government has not fulfilled many key commitments and has clearly not undertaken the more sweeping steps necessary to meaningfully reduce intellectual property theft.

In the next 12-18 months, the market for PCs sold to businesses in China is expected to become the largest in the world, and yet the outlook for software sales is dismal. On this, the past does not offer grounds for optimism. The rate of PC software piracy in China has declined only seven percentage points since 2005 – from 86 to 79 percent in five years. At this rate, it will take over 40 years for China's piracy rate to come anywhere close to the level in the United States (20%).

We urge the US government to consider moving away from measuring progress based on whether or not China amends a specific law or undertakes a discrete commitment. Instead, we need to move to a system that measures the actual results of China's actions in

terms of increased exports of US software and reductions in software piracy in the Chinese market.

Such a results-based trade policy would align well with President Obama's National Export Initiative. The President set a goal of doubling US exports in the next five years, an increase that the Administration projects will create over two million new US jobs. Increased exports of goods and services will also help to drive US economic growth more broadly; growing US exports contributed nearly 2 percentage points to US economic expansion in the last six months of 2009 alone.

This same results-based approach should be applied to China. The immediate goal should be to increase US software exports to China by 50 percent over the next two years. Given the extremely high levels of software piracy in China, this benchmark would be reasonable to achieve through a decrease in the software piracy rate. Utilizing clearly defined, concrete and measurable benchmarks to assess progress would help the United States evaluate the US-China trade relationship more accurately and encourage China to take meaningful steps to reduce illegal software use across the Chinese economy.

China Must Abide by its Trade Obligations

In parallel with the use of increased exports as the measure for progress, it is necessary to ensure that China takes seriously its international obligations and other commitments.

The Chinese government appears to have taken the view that it can turn a blind eye to widespread illegal software use with no fear of violating its obligations as a member of the WTO – and with no fear of sanctions for its actions.

The US government needs trade tools to challenge Chinese practices that have the effect of depriving the United States of benefits that it legitimately expects from China's membership in the WTO. Chief among these, in our view, is China's need to make meaningful progress in reducing illegal software use and increasing market opportunities for US software suppliers.

A WTO remedy that merits consideration is that of a non-violation "nullification or impairment" claim, under Article XXIII of the General Agreement on Tariffs and Trade. Such actions are appropriate where a WTO member's conduct, while not violating the letter of the agreement, nonetheless denies or impairs a benefit accruing to another party under the WTO.

Moreover, as discussed above, the high-levels of software piracy in China also provide an unfair competitive disadvantage for Chinese firms that use unlicensed software to produce goods and run their operations in competition with US firms. We would suggest that this practice may be a form of unfair competition subject to action under US trade laws.

Conclusion

My testimony here demonstrates the stark reality that BSA members are facing in China.

As US Trade Representative Kirk recently remarked, "[i]ntellectual property theft in overseas markets is an export killer for American businesses and a job killer for American

workers here at home.” While we believe that the United States must continue to pursue a strong economic relationship with China, China’s persistent failure to protect the intellectual property of US products and innovations and its discriminatory “indigenous innovation” policies seriously undermine this relationship. More importantly, China’s actions are costing US jobs.

We urge the members of the Commission to explore new solutions to address this challenge – including results-based trade policies and application of new trade remedies – in order to better protect US innovators, US industry and US workers. We stand ready to assist the Commission in this endeavor. Thank you.