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BSA
BUSINESS SOFTWARE ALLIANCE

TESTIMONY OF ROBERT HOLLEYMAN
PRESIDENT AND CEO
BUSINESS SOFTWARE ALLIANCE
BEFORE THE
HOUSE COMMITTEE ON GOVERNMENT REFORM

MAY 13, 2005

The Business Software Alliance (BSA)[1] is pleased to participate in today's hearing on the threat that domestic source restrictions pose to free trade in the global economy. The U.S. software industry derives more than half of its revenues from exports; thus, free trade and open markets are critical to the industry's continued growth. Due to strong global demand for our products and services, the U.S. software industry has for many years remained a leading driver of economic growth in the United States, and a major contributor of tax revenues and skilled, highly-paid jobs. In 2002 alone, software developers and other computer services industries employed nearly 2.6 million workers and contributed $400 billion to the national economy.

At this moment U.S. software firms are faced with the imminent prospect of being denied or severely restricted in their access to the government procurement market in China. This is a result of onerous domestic source

[1] The Business Software Alliance (www.bsa.org) is the foremost organization dedicated to promoting a safe and legal digital world. BSA is the voice of the world's commercial software industry and its hardware partners before governments and in the international marketplace. Its members represent one of the fastest growing industries in the world. BSA programs foster technology innovation through education and policy initiatives that promote copyright protection, cyber security, trade and e-commerce. BSA members include Adobe, Apple, Autodesk, Avid, Bentley Systems, Borland, Cadence Design Systems, Cisco Systems, CNC Software/Mastercam, Dell, Entrust, HP, IBM, Intel, Internet Security Systems, Macromedia, McAfee, Microsoft, PTC, RSA Security, SAP, SolidWorks, Sybase, Symantec, UGS and VERITAS Software.

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restrictions that have been proposed by the Chinese government as part of regulations implementing a 2002 law on government procurement. This is an issue of paramount concern to the software industry, and my testimony this morning will focus on this serious development.

I will note at the outset that BSA member companies strongly advocated for China's WTO accession in December 2001. As a condition of WTO membership, China committed to a program of extensive and far-reaching reforms that, among other things, require it to extend national treatment and improved market access to U.S. exports, protect intellectual property rights and initiate negotiations for accession to the WTO Government Procurement Agreement (GPA).

Discriminatory policies like China's proposed software procurement regulations violate the spirit of openness that China embraced in joining the WTO. Shielding the domestic software industry from U.S. competition is also inconsistent with Premier Wen Jiabao's commitment to facilitate the increase of U.S. exports to China. The true test of China's commitments is whether China agrees to abandon protectionist policies like these proposed regulations.

Once implemented, the procurement regulations will have an immediate, negative economic impact on the U.S. software industry. Much of the Chinese market for business software is already lost to rampant piracy that results in billions of dollars in lost export revenue. A large part of what remains of the software market after subtracting the 92 percent that is lost to piracy, consists of government purchases. The Chinese government's policy of walling off access to the country's largest purchaser of IT products thus has an outsized impact in this environment.

Moreover, we believe that severely restricting access of U.S. software makers to China's government procurement market will retard, rather than advance China's broader development goals. This policy will not only deny China's government the ability to use some of the world's most advanced software, it will undermine China's own efforts to encourage the active participation of U.S. software companies in developing a vibrant software economy in China.

BSA applauds the Administration's efforts to engage China's senior leaders in an attempt to resolve these and other trade issues. With Congress' support, we hope these efforts will lead to a result that benefits both countries.

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China's Discriminatory Software Procurement Regulation Would Severely Limit U.S. Exports of Software Products and Services and Set a Dangerous Precedent for other U.S. Industries

The Chinese government procurement market represents one of the most significant growth opportunities for the U.S. software industry and the global IT industry as a whole. The Chinese government is the primary purchaser of software in the world's largest emerging market for IT products. According to a recent study conducted by IDC, a leading IT research firm, the market for packaged software in China grew 19.5 percent in 2002 to reach $1.62 billion. IDC predicts that the market will continue to grow at a compound annual rate of 25.8 percent, making it a $5.1 billion market by 2007. This explosive demand for software and other IT products will be fueled in significant part by government IT procurements, including China's proposed multi-billion dollar E-government initiative. In 2003, for example, government procurement of software products and services totalled $608.4 million.

BSA is thus deeply concerned about China's plan to close its government procurement market to U.S. software and other products and services. In 2002 China enacted a law requiring with limited exceptions that its government purchase only domestic goods, services and public works. This law is applicable to every services and goods industry from which the Chinese government procures and has very significant ramifications for all U.S. industries seeking access to China's government procurement market.

China has indicated that it will issue implementing regulations on a sector-by-sector basis and has decided that software will be the first area subject to the new law. The draft software procurement regulations that were released in March would severely restrict the ability of American (and other non-Chinese) software companies to sell to the Chinese government. They establish a two-tiered preference system - the first tier for "domestic" software and the second for qualifying "foreign" software, with domestic software heavily favored in the procurement process. To qualify as "domestic" software, a product must be made and primarily developed in China, and the copyright must be owned by a Chinese entity. Open source software distributed by a domestic Chinese distributor will also be treated as domestic software. To qualify as eligible foreign software, the software provider must satisfy as-yet unspecified levels of investments in China, R&D expenditures, outsourcing of jobs, technology transfer, and tax payments. Every procurement of foreign software must be

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justified in writing and approved in advance by the Ministry of Finance (or the local equivalent, for purchases by local government). Procurement of foreign software that is not on the list of eligible foreign software will be permitted only in "special circumstances."

If enacted, these onerous requirements would impose far greater barriers to the procurement of U.S. software by Chinese government agencies than U.S. law imposes on government procurement of Chinese software and services. In a market where over 90 percent of software is pirated, costing the industry more than $3.8 billion per year, and where the Chinese government is by far the largest purchaser of legitimate software, such a discriminatory procurement regime would effectively close the door to many, if not all, U.S. software companies – or for that matter, any non-Chinese company.

Because U.S. software companies derive more than half of their income from exports, the Chinese procurement preference will have an immediate and significant economic impact on the United States in the form of decreased exports to China. These are not theoretical concerns; we are already seeing the effects of China's restrictive procurement policy in the marketplace, even though the regulations haven't been promulgated. Last November, after the Chinese government released a description of the draft regulations, a number local and provincial governments either cancelled orders for American software or awarded substantial purchases exclusively to Chinese suppliers. Thus, China's decision to close or greatly restrict its government procurement market to much of the world's best software products is already translating into lost jobs and tax revenues for the United States economy.

BSA is also concerned that such a regulation would set a dangerous precedent for other U.S. industry sectors. Given the broad scope of China's 2002 public procurement law, there is every reason to believe that the proposed software regulation is merely the first of a series of measures that will ultimately close to foreign competition all sectors of procurement that China considers strategic to its economic development. A discriminatory procurement regime of this type would deny U.S. industry a vital export market and exacerbate the U.S. trade deficit with China.

China's Procurement Regulation Violates the Spirit of its WTO Commitments and Serves to Protect its Domestic Industry at the Expense of U.S. Economic Interests

China's plan to close its government procurement market to software and other U.S. products and services would clearly violate the spirit of China's WTO

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commitments. In its WTO accession agreement, China committed to initiate negotiations for accession to the WTO GPA "as soon as possible." Not only has it failed to honor this commitment, its proposed procurement regime rejects each of the fundamental tenets of the GPA, namely openness, transparency, fair competition based on merit, equality, and accountability. It would also violate Premier Wen's commitment to increase U.S. exports to China.

BSA and other industry groups have urged the Chinese government not to adopt these domestic software preferences or, alternatively, to define eligible "domestic" or "foreign" software in a way that permits unlimited competition by U.S. software companies. We have also urged the Chinese government to adopt merit-based procurement rules that do not favour one type of technology or licensing model of software over another. Senior U.S. trade officials have also expressed concerns about the proposed regulation repeatedly with the relevant Chinese authorities. It remains unclear, however, whether these messages have been heard by China's political leadership. The Chinese government appears determined to promote its domestic software industry through discriminatory government procurement policies. Software developers worldwide are concerned that China will maintain this protectionist course, unless the United States and its major trading partners take specific action.

BSA has joined with a broad cross-section of IT and other U.S. industry leaders to urge that immediate steps be taken to delay implementation of the software procurement regulation pending mutual agreement of a software procurement framework that is open, inclusive and non-discriminatory and that allows U.S. and other foreign software makers to compete without restriction in China's government procurement market. We request that the U.S. government – in cooperation with the European Union and other governments around the world – take all necessary steps, including continued work to promote China's accession to the GPA, to preserve market access for all non-Chinese companies to China's very important government procurement market. Time is of the essence, as China may move ahead to implement final regulations at any time.

* * *

BSA appreciates the opportunity to participate in today's hearing, and we look forward to working with the Congress on these important issues. I would be happy to answer any questions you may have.