

Chapter 1. Counterfeiting – The current landscape

Introduction

Globalisation, progressing trade facilitation and the rising economic importance of intellectual assets are important drivers of economic growth. This economic importance of intangible assets in the global context has in turn shifted industry and policymakers' attention onto intellectual property (IP). For modern industries, IP is one of the key value generators and enablers of success in competitive markets and, for policymakers, it plays a crucial role in promoting innovation and driving sustained economic growth.

However, in the globalised world, the rising importance of IP has also created new opportunities for criminal networks to free-ride on others' intellectual assets and pollute trade routes with counterfeits. The recently observed broadening scope and magnitude of counterfeiting and piracy, in particular in the trade context, is seen as a significant economic threat that undermines innovation and hampers economic growth.

In order to provide policymakers with reliable empirical evidence about this threat, the Organisation for Economic Co-operation and Development (OECD) and the European Union Intellectual Property Office (EUIPO) joined forces to develop an understanding of the scale and magnitude of the problem of IP infringement in the trade context. The results are published in a series of reports, such as: *Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact* (OECD-EUIPO, 2016); *Mapping the Real Routes of Trade in Fake Goods* (OECD-EUIPO, 2017); *Trade in Counterfeit Goods and Free Trade Zones: Evidence from Recent Trends* (OECD-EUIPO, 2018b); *Why Do Countries Export Fakes?* (OECD-EUIPO, 2018c); and *Misuse of Small Parcels for Trade in Counterfeit Goods* (OECD-EUIPO, 2018a).

Altogether these reports provide robust evidence of the significant volume of trade counterfeiting and piracy. They also document the large scope of this threat to efficient business and the well-being of consumers worldwide, and point at the damages it causes by reducing firms' revenues and undermining their incentives to innovate.

The existing studies triggered great policy attention on combating counterfeit and pirated trade. This has been paralleled by increased efforts by the private sector to raise awareness of this threat. However, the existing dataset is becoming dated, which could hamper understanding of the recent trends linked to trade in counterfeit goods.

In addition, several recent developments could also contribute to the overall picture that affects the state of the art of counterfeit trade. These include the boom in trade in small parcels and the recently reported a slowdown in world trade. All interrelated, they should have a joint impact on the illicit trade in counterfeits, calling for new analysis.

This report refreshes the picture of trade in counterfeit and pirated goods, and provides policymakers with an updated set of information about this threat. To do this, this report employs the methodology to measure the scale and counterfeiting developed in the OECD (2008) report and updated in OECD-EUIPO (2016). This methodology is used with a new

set of world data on seizures of counterfeit and pirated goods, and results in a set of objectives, a robust illustration of economy- and industry-specific patterns in trade in counterfeiters. Such information is crucially needed, not only for better understanding this threat but also for developing effective governance responses.

This study largely relies on statistical data on counterfeiting and piracy that, just like data on any other clandestine activity, are largely incomplete and limited. Consequently, the quantitative results presented in this study illustrate only certain parts of the phenomenon of counterfeiting and piracy. However, in order to make sure that this picture is factual, clear and unbiased, and to maximise its potential, the methodological apparatus was tailored to the available dataset.

Scope of the study

Counterfeiting and piracy are terms used to describe a range of illicit activities related to intellectual property rights (IPR) infringement. Following the OECD (2008) and OECD-EUIPO (2016) studies, this study refers to the definitions as described in the World Trade Organisation Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). Consequently, this report focuses primarily on the infringement of copyright, trademarks, design rights and patents; the term “counterfeit” used in this report refers to tangible goods that infringe trademarks, design rights or patents; and the term “pirated” to describe tangible goods that infringe copyright.

Such use of terms “counterfeit” and “pirated” implies that substandard, adulterated or mislabelled pharmaceutical products that do not violate a trademark, patent or design right are thus beyond the scope of the study, as are, for example, replacement automotive oil filters and headlamps that are made by firms other than the original equipment manufacturer (provided the replacement parts do not violate a patent, trademark or design right).

Two important things should be kept in mind in this context. First, this wording is used for the purpose of this report only and does not constitute any definition outside its scope. Second, this study does not include intangible infringements, such as online piracy or infringements of other intellectual property rights.

Trade in counterfeits: What we know so far?

The updated analysis based on available data provided a detailed set of pictures about the volume of trade in fakes, its scope and trade routes. They also provide additional information about drivers of trade in fakes and some of its damaging effects.

Volumes and industry scope of trade in fakes are significant.

The OECD-EUIPO (2016) study presented a set of quantitative pictures of trade in counterfeit and pirated products. The magnitude of the problem is very significant; in 2013, international trade in counterfeit and pirated products could be as much as USD 461 billion. This represented up to 2.5% of world trade. The magnitude of the phenomenon for a group of developed countries, such as the European Union, could be twice as high as on a world scale. In 2013, imports of counterfeit and pirated products into the EU amounted to as much as USD 116 billion (EUR 85 billion), which represented up to 5% of EU imports.

In terms of industry scope, infringed products are found in numerous industries, such as luxury items (e.g. fashion apparel or luxury watches), intermediary products (such as machines, spare parts or chemicals) and consumer goods that have an impact on personal health and safety (such as pharmaceuticals, food and drink, medical equipment or toys).

The trade routes are very complex

Regarding the economies of origin of fakes in world trade, existing studies show that trade routes of fakes are very complex. Parties that engage in the trade of counterfeit and pirated products tend to ship infringing products via complex routes, with many intermediary points. The transit points are used to facilitate falsification of documents in ways that camouflage the original point of departure, establish distribution centres for counterfeit and pirated goods, and repackage or re-label goods. In addition, while imports of counterfeit goods are, in most cases, targeted by local enforcement authorities, goods in transit are often not within their scope, which means they are less likely to be intercepted.

These trade routes were studied in a report by OECD-EUIPO (2017) that used a set of statistical filters to go further in clarifying the role of important provenance countries. It identified key producing economies and key transit points for ten main sectors that are particularly vulnerable to counterfeiting. These sectors span a wide range of IP-intensive, tradable goods, from fast-moving consumer goods, such as foodstuff or cosmetics, to business-to-business products, such as spare parts and computer chips.

The People’s Republic of China (hereafter “China”) emerges as the top producer of counterfeit goods in nine out of ten analysed categories. In addition, several Asian economies, including India, Malaysia, Pakistan, Thailand, Turkey and Viet Nam are important producers in many sectors, although their role is much less significant than China’s. Turkey appears to be an important producer in some sectors – such as leather goods, foodstuffs and cosmetics – which are conveyed by road to the EU.

The report also identifies several important transit points for trade in counterfeits, including Hong Kong (China), Singapore and the United Arab Emirates, which are handling trade in counterfeit goods in all the analysed product categories. Fake goods arrive in large quantities in containers and are sent further in small parcels by post or courier services.

In addition, there are some important regional transit points. For example, several Middle Eastern economies (e.g. Saudi Arabia, the United Arab Emirates and Yemen) are important transit points for sending fake goods to Africa. Four transit points – Albania, Egypt, Morocco and Ukraine – are of particular significance for redistributing fakes destined for the EU. Finally, Panama is an important transit point for fakes on their way to the United States.

Counterfeiters thrive in poor governance environments and misuse many good trade solutions

Regarding the question of why some economies emerge as important hubs for trade in counterfeits, there are five main drivers that determine an economy’s propensity to become an active actor in the trade in fake goods (OECD-EUIPO, 2018c):

- Governance: high levels of corruption and poor intellectual property protection are factors that greatly influence the degree of exports of fake goods from an economy.
- Free trade zones (FTZs) that offer a relatively safe environment for counterfeiters, with good infrastructure and limited oversight. The share of fake goods from

economies hosting the 20 biggest FTZs is twice as big as from economies that do not host any FTZs. The existence, number and size of FTZs in a country correlate with increases in the value of counterfeit and pirated products exported by that country's economy. An additional FTZ within an economy is associated with a 5.9% increase in the value of these problematic exports on average (OECD-EUIPO, 2018b).

- Production facilities: low labour costs and poor labour market regulations are important drivers of trade in counterfeit and pirated goods. Improving working conditions, by raising the minimum wage or increasing paid leave, would decrease the share of counterfeit and pirated products exported, especially by economies with weak governance.
- Logistics capacities and facilities: the ability to trace and track consignments is the key factor for reducing the share of counterfeit and pirated products in exports. However, other factors increase this trade, including: low shipping charges; fast, simple and predictable customs formalities; and good quality trade and transport-related infrastructure (e.g. ports, railroads, roads and information technology). These factors tend to be also much more important drivers in economies that are highly corrupt.
- Trade facilitation policies that refer to the fact that enhancing transparency is likely to reduce the likelihood that an economy will export fakes: this includes the availability of detailed information on trade flows; the degree of involvement of an economy in the trade community; transparent and regular review of fees and charges imposed on imports and exports; and sound internal co-operation between border agency and other government units. Other factors tend to encourage counterfeit trade, such as advance rulings (i.e. where the administration asks traders about the classification, origin, valuation methods, etc., applied to specific traded goods) and the possibility to appeal administrative decisions by the border agencies. Importantly, the factors that potentially encourage counterfeit trade tend to be particularly pronounced in highly corrupt economies.

Of these five drivers, gaps in governance, especially high levels of corruption and gaps in intellectual property rights enforcement, are the crucial factor for trade in fakes, multiplying the effects of FTZs, logistic facilities or trade facilitation policies. For instance, the presence of FTZs is a particularly strong driver of trade in counterfeit and pirated goods in economies with weak governance, high corruption levels and a lack of intellectual property rights (IPR) enforcement.

While all the factors identified above matter, it is important to note that none of these factors *alone* can explain the intensity of exports of fakes from a given economy – it is the combination of numerous factors that allows important nodes in counterfeit trade to emerge.

Also, important to note is that many of the factors presented above can actually be extremely beneficial for trade in general, such as good logistics facilities. It is the misuse of these facilities that can result in higher flows of trade in fake goods. The degree to which this misuse occurs greatly depends on governance issues, particularly levels of corruption and IPR enforcement. The policy challenge is to reduce the scope for misuse while keeping open the possibility of benefiting from trade.

The effects of counterfeiting are damaging

The effects of trade in counterfeit goods challenge the well-being of consumers, efficient businesses and effective governance. For consumers, counterfeiting poses dangers to health, safety and privacy (e.g. counterfeit mobile phones with pre-installed malware). It may also lower consumer satisfaction, notably when low-quality fake goods are purchased unknowingly. For right holders and their authorised vendors, rising counterfeiting increases revenue losses, while trademark infringements continuously erode brand value. For governments, counterfeiting means lost tax revenues, higher unemployment and greater expenses incurred – both to ensure compliance with anti-counterfeiting legislation and to react to public safety threats and labour market distortions.

In some cases, certain short-term damaging effects of counterfeiting can be estimated, providing an indication about the gauge of the damages it causes. For example, in Italy, at least 88 000 jobs were lost altogether due to counterfeiting and piracy. That represents 2.1% of full-time equivalent employees in sectors directly affected by counterfeiting in Italy. In 2016, in Italy, forgone tax revenues from the retail and wholesale sector amounted to EUR 4.3 billion. That same year, forgone tax revenue from Italian right holders to the Italian government amounted to EUR 6 billion. Altogether, trade in counterfeit and pirated goods resulted in a reduction in Italian public revenues equal to almost EUR 10.3 billion, the equivalent of 3.2% of the taxes were collected on value-added, personal and corporate incomes as well as social security contributions, or 0.62% of Italian gross domestic product (GDP).

A changing economic landscape

Markets for infringing products develop dynamically and have been affected by several economic developments over the past ten years. Some of these major patterns are likely to shape the overall economic background for the evolution of trade in counterfeit goods. The main patterns include:

- Reduction in volumes of manufactured trade in recent years.
- Rapid growth of trade in small parcels.
- Strengthening of the role of FTZs.

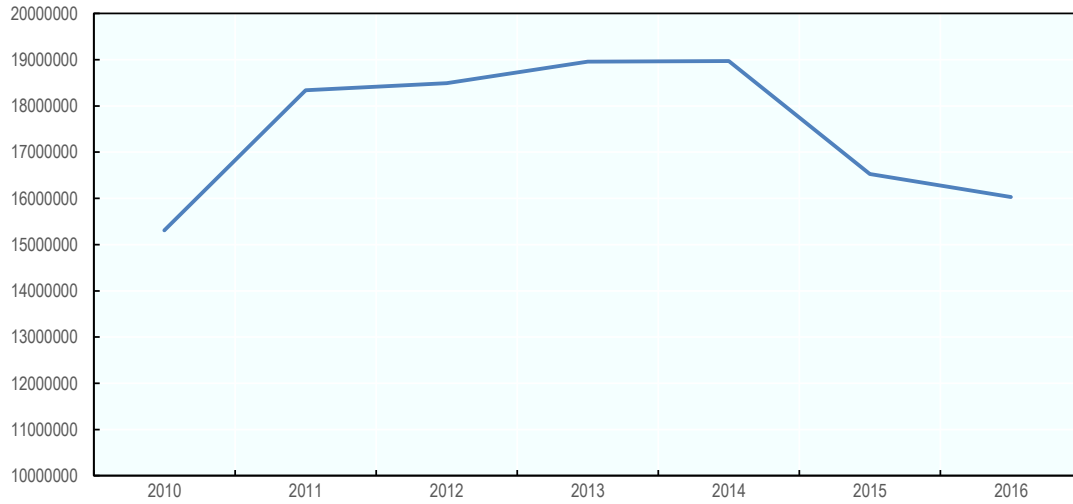
Correction in volumes of world trade

International trade has been a powerful engine of global economic growth and convergence in living standards between countries. Trade liberalisation has contributed to large economic gains of emerging market economies and to poverty decline. Following the 2008 crisis, OECD economies were faced with a major change in trade patterns. Even though the crisis hit the development of global trade hard, these patterns have resumed in recent years.

However, the general re-birth of trade stopped in 2014 when some reductions in trade volumes were reported. World merchandise trade in value terms fell sharply by 13% in 2015 and then by 3% in 2016 (see Figure 1.1).

Figure 1.1. World trade flows, merchandise trade

Annual, USD million

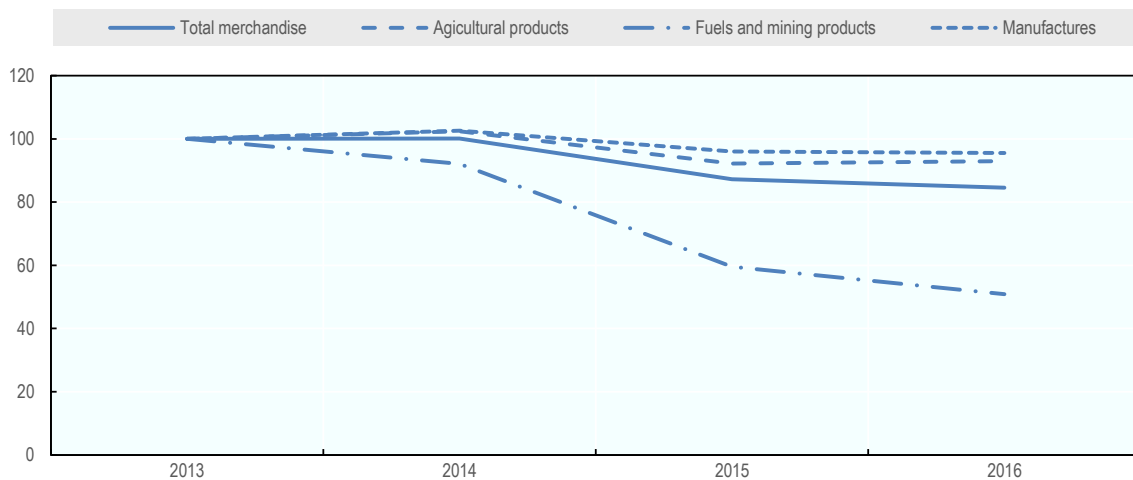


Source: WTO (2019), *Statistics on Merchandise Trade*, www.wto.org/english/res_e/statistics_e/merch_trade_statistics_e.htm.

This decrease was mostly caused by the continuing decline in exports of fuels and mining products (see Figure 1.2). However, exports of agricultural and manufactured products also declined, although to a smaller extent.

Figure 1.2. Index of world trade by sector

Annual, 2013 = 100



Source: WTO (2019), *Statistics on Merchandise Trade*, www.wto.org/english/res_e/statistics_e/merch_trade_statistics_e.htm.

Within the manufacturing sector, it is also important to note that product categories where world trade declined the most between 2013 and 2016 are not particularly sensitive to counterfeiting. Those include iron and steel, and chemicals (except pharmaceuticals).

The marked decline in commodity prices in 2015 mostly halted in 2016. However, in 2016, the volumes of trade were still lower than in 2013 across virtually all sectors that suffer from counterfeiting, for example machinery, chemicals, food, textiles and office equipment. Only pharmaceuticals and automotive products recorded slight increases in trade flows.

Table 1.1. Index of world trade by main product category

Annual, 2013 = 100

Product/sector	2014	2015	2016
Agricultural products	102.42	92.15	92.98
Food	102.40	92.15	93.75
Raw materials	95.26	82.84	81.73
Fuels and mining products	92.09	59.54	50.86
Manufactures	102.57	96.02	95.49
Iron and steel	104.34	84.38	76.23
Pharmaceuticals	106.00	102.08	103.78
Other chemicals	101.37	89.68	87.20
Other semi-manufactures	102.71	94.47	92.98
Office and telecom equipment	100.95	96.75	93.41
Automotive products	104.20	99.19	101.73
Other transport equipment	103.47	101.26	99.37
Other machinery	104.20	95.73	94.35
Textiles	103.44	96.64	94.21
Clothing	106.83	100.67	99.03
Other manufactures	106.30	99.62	98.66
Total merchandise	100.07	87.17	84.57

Source: WTO (2019), *Statistics on Merchandise Trade*, www.wto.org/english/res_e/statistics_e/merch_trade_statistics_e.htm.

Boom in small parcels

The digital transformation has led to unprecedented reductions in the costs of engaging in international trade, changing both how and what we trade (López-González and Jouanjean, 2017). This has contributed to a reduction in trade costs, leading to a dramatic increase in the number of parcels crossing borders. While parcel trade has long been a common feature of international trade, the widespread adoption of digital technologies is now enabling firms to internationalise at lower cost. One feature of this evolving environment is a move from offline to online sales. Often, these take place through digital platforms which help connect supply and demand globally; provide greater convenience for shoppers; facilitate payments, whether electronic or not; and, increasingly, support the logistics of the delivery process. This has contributed to considerable reductions in the costs of engaging in international trade and led to a dramatic increase in the number of parcels crossing borders (UPU, 2016).

Small parcels can be transported cross-border via sea, road, rail and/or air. These movements can be carried out by individuals or a range of companies that handle freight. Two of the more important parties involved are national postal authorities and express and courier services, which together account for most of the movement of small shipments.

Counterfeit and pirated products tend to be shipped by virtually every means of transport, including small parcels. Between 2011 and 2013, in terms of value, counterfeits transported by container ship clearly dominated. In terms of the number of seizures, trafficking fakes by small parcels is growing, becoming a significant problem in terms of enforcement. The small parcels used by counterfeiters for trafficking are shipped either through postal or express services.

In terms of industry-specific patterns, virtually all industry sectors prone to counterfeiting are concerned, albeit to different degrees. For example, 84% of seized shipments of counterfeit footwear, 77% of fake optical, photographic and medical equipment (mostly sunglasses) and 66% of customs seizures of information and communications technology (ICT) devices involved postal parcels or express shipments. This is also the case for more than 63% of customs seizures of counterfeit watches, leather articles and handbags, and jewellery.

As noted in the UPU (2016) and OECD (2017b) reports, strong growth in trade in small parcels continued beyond 2013, which is likely to impact the patterns for trade in counterfeits in that period. Indeed, the misuse of small parcels creates significant challenges for customs authorities and has led to calls for increased attention at the international level.

Free trade zones – Important hubs of trade

Many countries have set up free trade zones (FTZs) to boost business activity and reap the benefits of free trade. These zones have been instrumental in the evolution of trade routes for the integrated supply chains of the global economy. However, FTZs may also facilitate illegal and criminal activities such as trade in counterfeit and pirated products, by providing a relatively safe environment, good infrastructure and light oversight.

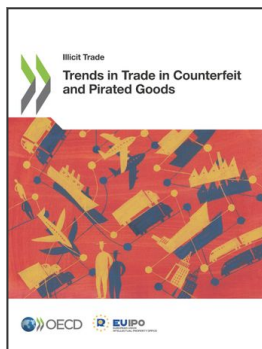
Free trade zones are perceived by governments as great tools to facilitate international trade in their ports, boosting investment and employment and enhancing welfare. Consequently, FTZs continue to grow worldwide, in all different forms. They range from large industrial areas focusing on assembly and manufacturing to specially designated storage warehouses. Their common feature is that they are geographically delimited, usually physically secured areas that offer benefits based upon physical location within the zone and represent separate, duty-free customs areas (FIAS, 2008; Siroën and Yücer, 2014).

Two studies by the OECD and EUIPO (OECD-EUIPO, 2018b and 2018c) confirm the links between FTZs and trade in counterfeit products. The existence, number and size of FTZs in a country correlate with increases in the value of counterfeit and pirated products exported by that country's economy. An additional FTZ within an economy is associated with a 5.9% increase in the value of these problematic exports on average.

Given that lightly regulated zones are attractive to parties engaged in illegal and criminal activities, the continued growth of zones makes an important context for trade in counterfeit and pirated goods. Some zones can indubitably facilitate trade in counterfeit and pirated products, especially when governments do not police zones adequately.

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