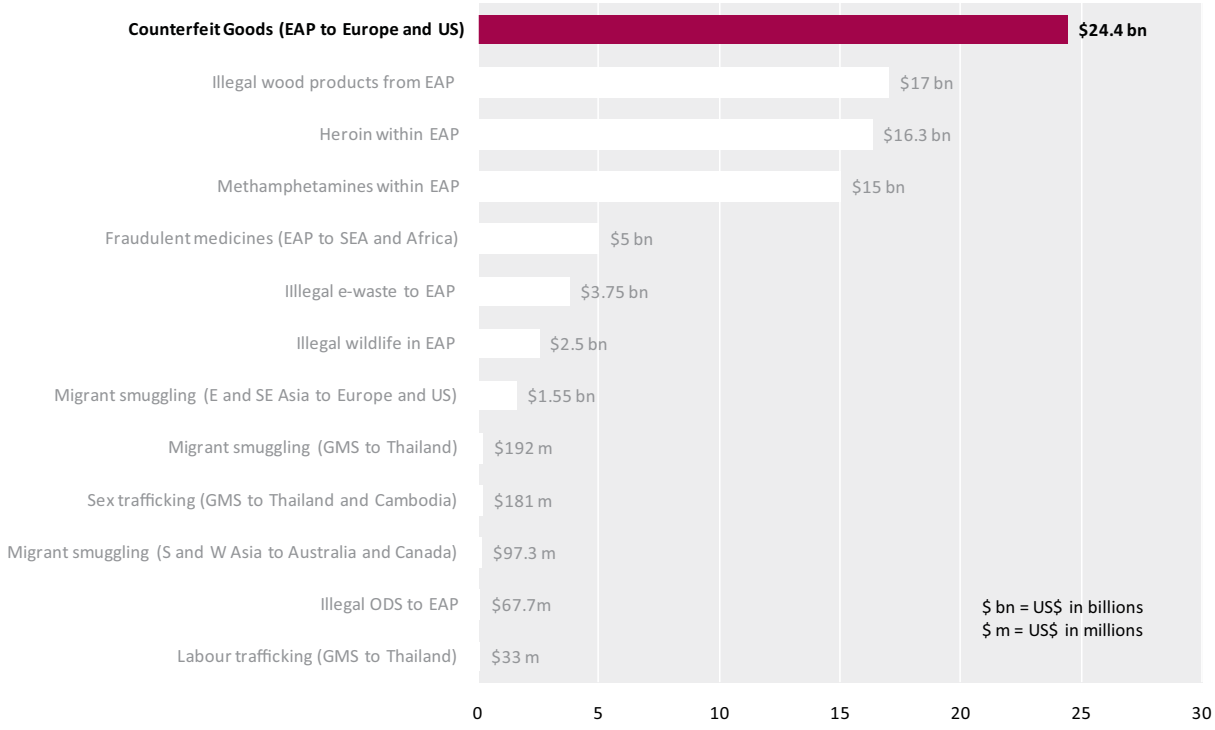
Chapter 11

Counterfeit consumer goods from East Asia to the United States and the European Union



NATURE OF THE THREAT

1. **Dangerous goods for sale:** no – or poor-quality – controls (e.g., fake baby food; dangerous toys; tainted milk).	2. **Exploitative working conditions:** dangerous unregulated sweatshops.
3. **Linkages to other TOC:** TOC groups distributing counterfeits are often associated with other crime types, e.g., prostitution, money laundering, human trafficking.	4. **Lost government revenues:** loss of import duties; loss of sales tax; lower revenues overall.
5. **Facilitates corruption:** undermines rule of law and accountability.	

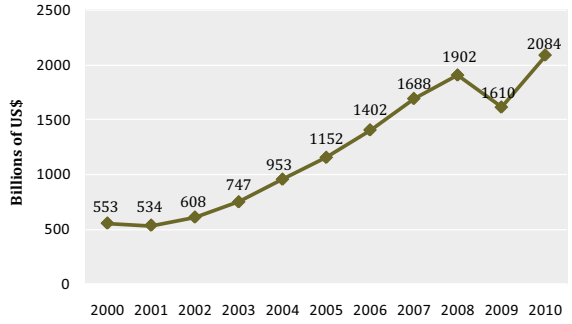
1. What is the nature of this market?

In today's fast-paced, globalized world, a significant share of manufactured goods are produced though a decentralized process, making use of a variety of specialized subcontractors. As a result, any given product can be produced by a series of collaborators, and a large number of people can access technical specifications, either directly or through reverse engineering.

Gone are the days when manufacturers could shutter their plants and guard trade secrets. Today, those who hold intellectual property rights are often situated half a world away from those who make their ideas come to life. When unauthorized copies of their products appear on the market, it is unclear where to place blame and how to enforce rights. In effect, counterfeit goods are an untallied cost of the growth in offshore manufacturing.

Today's "knock offs" may be made on the same machines by the same technicians who made the originals. Some are simply over-runs, unauthorized production in excess of what is delivered to the rights holder. The products may even be improved, although more often the copies employ cheaper materials, aiming for the lower end of the market. Factory seconds may be re-sold rather than discarded. In most parts of the world, few can tell a copy from an original, so there is very little market for goods bearing the higher price.

Figure 1: Value of exports of Chinese manufactured merchandise (in billions of US$)

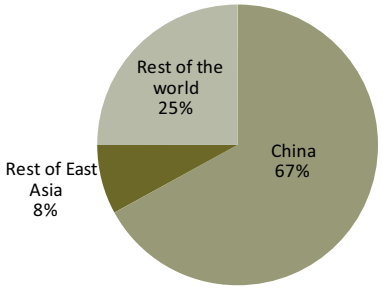


Source: WTO 2012

In a very short period of time, China has become the world's workshop (see Figure 1), producing a significant share of the world's manufactured goods. Just as China is the source of a large share of global manufactured goods, it is also the source of a large share of counterfeits. Based on seizure data, it appears that at least two-thirds of the world's counterfeits depart directly from China, while an unknown share may be transshipped though other countries, concealing the origin. Most customs seizure statistics refer to the origin of the shipment (provenance), not the origin of the goods.

According to the World Customs Organisation (WCO), around 75% of counterfeit products seized worldwide between 2008 and 2010 were manufactured in East Asia, primarily China.[1] In that three-year period, China was the departure point for roughly 67% of worldwide seizures, although the number of items seized declined during that period. Other significant East Asian departure points for counterfeit goods include Malaysia, Thailand, Indonesia, Japan, the Philippines, the Republic of Korea, Singapore, and Viet Nam.

Figure 2: Source of counterfeit items seized by customs agencies globally, 2008-2010



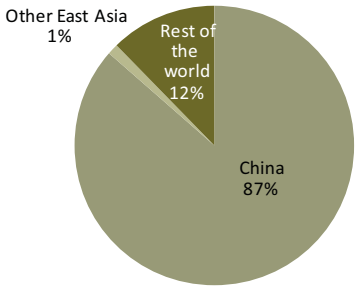
Source: WCO 2008; WCO 2009; WCO 2010

Customs seizure statistics from the United States reflect the same trends as WCO statistics, highlighting the prominence of China as a major source of counterfeit products.[2] According to US Customs, China accounted for 87% of the value of the counterfeits they seized between 2008 and 2010 (see Figure 3). Although European seizures are measured in volumes rather than value, the situation

[1] WCO 2008; WCO 2009; WCO 2010. Specifically, WCO data indicates that China was the departure country for 596,419,033 of 816,497,720 (73%) seized items between 2008 and 2010. WCO data on 'country of origin' was not available for this time period. However, it is believed that for most seizures involving China, that that nation is both the 'country of origin' and the 'country of departure.' The extent to which this the case for other nations is not clear. Note that these WCO statistics include counterfeit medicines.

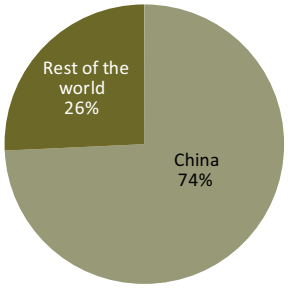
[2] USCBP 2008; USCBP 2009; USCBP 2010. A source country refers to the country of last known departure. Note that these US Customs statistics include counterfeit medicines.

Figure 3: Value of counterfeit items seized in the US, 2008-2010



Source: USCBP 2008; USCBP 2009; USCBP 2010

Figure 4: Source of counterfeit items seized by European Customs, 2008-2010



Source: EC 2009; EC 2010; EC 2011

in the EU is similar (see Figure 4). Seizures from China also dominate in Australia and New Zealand. WCO seizures are dominated by four categories of products: CDs and DVDs; accessories, watches, and footwear; tobacco products; and textiles.

Although statistics are not recorded for many East Asian countries, most casual observers remark on the ubiquity of counterfeits. There are several well-known markets for counterfeit goods in the region, including Chaosan in Guangdong Province of China; the Ziyuangang market in Guangzhou, north of Hong Kong (China); Mae Sot in Thailand; Mong La and Myawady in eastern Myanmar; and the Ben Thanh market in Viet Nam.

The authorities in the region are well aware of the problem, and some have undertaken aggressive campaigns to combat it.

In July 2011, China concluded a nine-month enforcement drive, leading to the arrests of more than 9,000 suspects in connection with the seizure of US$530 million of counterfeit products, and the closure of almost 13,000 illegal factories. To bolster its campaign efforts, Chinese authorities instructed all central government agencies to use only legally-purchased computer software, and remains in the process of ensuring that sub-national governments and state-owned enterprises set aside budgetary finances to follow suit.[5] While software piracy rates in China have declined in recent years, a 79% piracy rate for software purchased in China has been estimated. The use of counterfeit software by Chinese government institutions is considered by some to remain problematic despite ongoing initiatives by China to curb this practice.[6] Another recent example of official Chinese crackdown in counterfeit goods operations are the series of raids which took place on in July 2012 on a truly nationwide scale – involving 18,000 officers across 190 cities. The resulting seizures were valued at a total estimated value of US$182 million (equivalent to 1.16 billion yuan). Over 2,000 people were arrested and 1,100 facilities were destroyed.[7]

Box: Counterfeit Seizures in the Pacific Islands

Between 2006 and 2010, Customs authorities in the Pacific Islands reported seizing nearly 100,000 counterfeit items, excluding cigarettes and related items. Data from the Oceania Customs Organization (OCO) for the year 2010 shows that counterfeits were more than twice as likely to enter Pacific Islands nations on the persons and in the luggage of international travellers than through all other transport methods combined, including air and sea freight. This is despite the fact that the average seizure value for sea freight counterfeit shipments was nearly three times what was entering the Pacific Islands via personal travel.[3] Like the US and EU, the Pacific Islands have seen an increase in reported cases of counterfeits arriving by mail over the past five years, from just four such cases in 2006 to 21 cases in 2010.[4]

[3] OCO 2011: p. 7.
[4] UNODC communication with OCO, 2011
[5] IPPC 2011; Martina 2011; PDO 2011; Xinhua News Agency 2011c, "China police raid over 13,000 dens for IPR violations", *Xinhua News Network*, 26 July 2011.
[6] China Daily 2010, "China persists in fight against software piracy", *China Daily*, 14 December 2010.
[7] See the following Reuters story based on information from the Ministry of Public Security. Accessed at: http://www.reuters.com/article/2012/08/05/us-china-drugs-idUSBRE87401D20120805

Thailand has also had some success in suppressing counterfeit consumer goods. For example, in 2011, the Royal Thai Police and Department of Special Investigation conducted 9,872 raids and seized 4,561,272 items. In the same year, the Customs Department conducted 581 raids and seized 308,458 items. Also in 2011, the government organized two ceremonies during which 2.1 million counterfeit items - worth approximately US$ 40 million - were destroyed.[8]

2. How is the trafficking conducted?

Because those involved in counterfeiting may also be involved in producing the genuine product, the production processes are similar. Although dedicated counterfeit factories have been detected in large numbers, production is often decentralised, making use of networks of specialists. Sometimes production processes cross borders. Counterfeit logos may be attached to generic garments and items produced elsewhere. The misbranding of merchandise can even occur in transit countries. As a result, many of those involved in manufacturing counterfeits may have no notion that they are doing anything illegal.

At the level of marketing, of course, there is active collusion, or at least willing blindness. As with any market, there are both push and pull factors at work. Those who organize the production of counterfeits may actively seek distributors, making contacts through the Internet or social networks. At the same time, regional distributors may travel to China or contact Chinese firms with specific production requests. A flurry of activity on both sides may accompany major market events, such as sports competitions and the release of new product lines.

The complexity of the networks involved in satisfying global demand for counterfeits has made enforcement difficult, but the threat of detection is sufficient that counterfeiters are taking measures to avoid it. To reduce the risk of having their products seized, counterfeiters may conduct "just in time" production, minimizing inventories. To evade detection, goods may also be stored in warehouses, located at a distance from production facilities and registered to front companies.[9]

As in many contraband markets, corruption is key. Corrupt officials may sell manufacturing licenses or falsify inspections of goods.[10] At production sites, officials may receive bribes to allow the use of irregular labour or the dumping of hazardous waste. Security officials may be paid to tip off counterfeiters about upcoming police raids. In more extreme cases, corrupt public officials may themselves be members of counterfeiting networks. In the Pacific islands, authorities report several recent cases of corrupt law enforcement officers in the Republic of the Marshall Islands and Tonga facilitating the flow of counterfeit goods in the region.[11]

After production, the next phase is concealment and shipping. Counterfeiters can falsely declare goods in order to avoid inspection at border points, or combine fake products with legitimate shipments, particularly for products sourced from 'back-door production'.[12] Alternatively, brand-name counterfeit goods can be disguised with lesser-known logos in order to avoid suspicion by authorities. For example, in one shipment of illegally manufactured boots seized by US authorities, counterfeiters had covered the fake branded boot soles with non-descript and removable soles.[13] Similarly, in 2010, Czech Republic Customs seized sports shoes from China that had nameless labels sewn over the fake brand-name labels.[14]

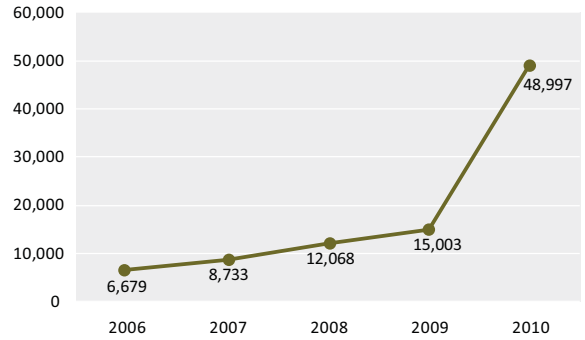
Circuitous routes used by East Asian counterfeiters to evade detection often involve free-trade zones, such as the Jebel Ali Free Zone in Dubai, United Arab Emirates. The UAE is commonly the provenance of counterfeit goods shipments, despite the fact that very little manufacturing goes on there. Free-trade zones also provide opportunities for counterfeiters to "sanitise" shipping documents in ways that disguise their original point of manufacture. A lack of enforcement in free-trade zones also allows for unbranded goods to be repackaged with counterfeit trademarks prior to being exported to destination markets.[15]

There appear to be two primary channels for transporting counterfeit goods. One is by post

[8] Official Communication with Government of Thailand, October 2012.
[9] American Chamber of Commerce in Shanghai 2010.

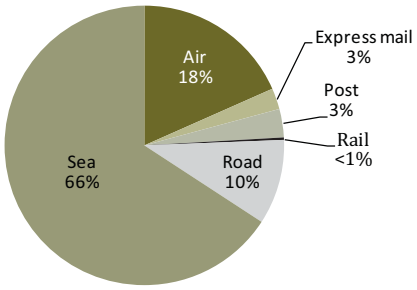
[10] Chow 2011; UNICRI 2012
[11] PCTN 2011: p.19.
[12] WCO 2011: p.11.
[13] CNBC 2011
[14] WCO 2011: p.25.
[15] NZCS 2008: p.5; Filipino Post 2011, "Nation cited as major source of fake goods", *The Filipino Post*, 22 February 2011.

Figure 5: Number of cases of counterfeits detected in postal shipments in the EU



Source: European Commission

Figure 6: Value of European Union seizures by shipment mode, 2010

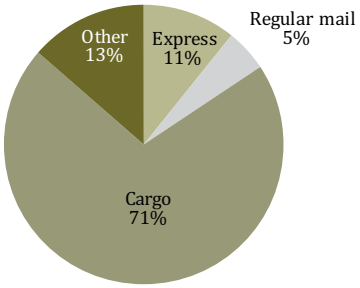


Source: EC 2011

directly to the consumer, mainly involving Internet purchases. The number of postal detections of counterfeits has increased dramatically in the European Union (see Figure 5), although the value of these small shipments constituted only 3% of the total in 2010. This has been ascribed to the increase in Internet commerce.[16] The number has also increased in the US, though much less dramatically.[17] US Customs officials have noted that with Internet-based sales, officers have to look harder to find less.[18]

The second channel generally involves containerized shipment of large volumes of merchandise to be distributed on arrival. In both the US and the EU, maritime shipments comprise the bulk of the value of counterfeits seized. The WCO does not consistently report on shipment methods in its IPR and Customs Reports, but at least some 2010 WCO data affirms the pattern seen in the US and EU. For

Figure 7: Value of US seizures by shipment mode, 2007-2010



Source: USCBP 2008-2011

example, 59% of the value of total seizures from East Asia in 2010 came from seaborne container shipments, even though there were 654 mail seizures compared to only 433 seaborne seizures.[19] Other sources also demonstrate that most counterfeit seizures are made on bulk cargo and seaborne cargo (see Figures 6 and 7).

3. Who are the traffickers?

Since so much of counterfeiting involves the same production mechanisms and the same transportation modes as legitimate manufacturing, a large, dedicated organization is not required. Anyone can contract a Chinese textile mill to produce 10,000 shirts and another to produce 10,000 brand-name patches. The shirts can be shipped by container to a free-trade zone and the patches dispatched by post to the same location. Irregular labourers can be contracted to affix the patches to the shirts, and the product can be shipped to Europe through any of the major ports, where, despite remarkable enforcement efforts, only a small share of counterfeits will be seized.

It helps, of course, to have experience in manufacturing the goods to be counterfeited and the technicalities of international shipping, but more important are connections to producers and distributors. The key players in counterfeit markets are essentially brokers and logisticians, connecting supply and demand. They invest the money, coordinate production and transport, unload the merchandise, and reap the rewards.

[16] Lomas 2011
[17] USCBP 2011: p. 12; EC 2010: p. 30.
[18] Palmer and Lee 2010

[19] WCO 2011: p. 42.

On arrival at destination, nationality-based or ethnic networks are often important for receipt and distribution. Expatriates from South Asia, East Asia, and West Africa appear to be particularly important. Wholesale distributors may offer both licit and illicit merchandise. At the distribution end, some of these goods may be sold through mainstream retail outlets, often variety stores in depressed areas, while others are sold through street vendors and at flea markets.

Street distribution often requires the consent of territorial organized crime groups in destination countries. Rather than organizing the trafficking, most often these groups license distribution, levying a "tax" on vendors. In some cases, these groups may buy bulk merchandise at a discount and arrange distribution through their own networks.

For example, in June 2010, Italian police arrested 17 Chinese nationals and seven Italian nationals in an investigation into various criminal activities, including prostitution, money laundering, tax evasion, human trafficking, and the distribution of counterfeit goods. The counterfeit goods were primarily designer clothes produced by Chinese crime groups in Tuscany. That investigation led to the seizure of 780,000 counterfeit items. Chinese criminal gangs also reportedly partnered with suspected Italian mafia associates to exploit niche markets for luxury goods in several major Italian cities. Chinese gangs reportedly forced smuggled migrants into prostitution and low-wage labour and used mafia intimidation tactics in some Chinese diaspora communities in Italian cities.[20]

In another example of Italian mafia links to counterfeiting criminal networks in East Asia, Spanish authorities arrested 64 individuals in July 2011.[21] Italian mafia associates linked to the Neapolitan Camorra group reportedly purchased thousands of counterfeit brand-name products, including tools, machinery and textiles that had been produced by 25 companies in China. The counterfeit goods were imported to Spain and Italy with plans for further distribution in Europe, North America, Latin America and South Africa.

[20] Hooper 2010; Financial Times 2010, "Chinese gangs exploit niche left by mafia," *Financial Times*, 28 June 2010; The Telegraph 2010. "Chinese Gangs Step into Gap Left by Mafia", *The Telegraph*, 10 June 2010.
[21] EuroWeekly 2011

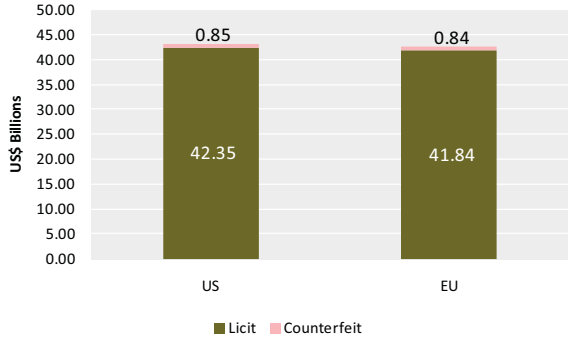
4. How big is the flow?

The poor and heterogeneous quality of data related to seizures does not allow accurate calculations of the actual size of the market for counterfeit goods. Therefore, it is important to refer to statistics related to the legitimate trade worldwide and to combine this information with other studies on crime patterns. If we limit the scope of this analysis to the flow of counterfeit goods from East Asia to EU and the US it is possible to depict a credible picture.

In 1997, the Counterfeiting Intelligence Bureau of the International Chamber of Commerce estimated global counterfeiting at approximately 5-7% of world trade.[22] This proportion is widely used in anti-counterfeiting analyses but has been criticized as an overestimate based on limited empirical data.[23] Comprehensive research by the Organization for Economic Co-operation and Development (OECD) in 2008 and 2009 concluded that counterfeiting accounts for around 2% of world trade.[24]

In 2010, the US imported about US$587 billion-worth of products from East Asia.[25] Using the OECD's 2% estimate, this amounts to roughly US$11.7 billion of counterfeit goods. In that same year, the EU imported roughly US$678 billion of products from East Asia,[26] which would yield – using the OECD's 2% estimate – approximately US$13.5

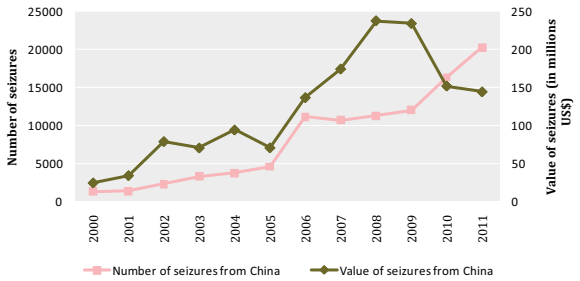
Figure 8: Value of licit imports and estimated counterfeits (2%) in 2010



Source: UNCTAD 2012

[22] ICC-CCS 2012
[23] OECD 2008: p. 71; UNODC 2010: p. 173.
[24] OECD 2008; OECD 2009. Within the region of East Asia and the Pacific, the OECD notes potential counterfeit-to-trade percentages of up to 5% for a number of countries, including China, Hong Kong, China, Malaysia and the Philippines.
[25] UNCTAD 2012
[26] UNCTAD 2012

Figure 9: Value and number of seizures of counterfeits shipped from China to the US



Source: USCBP 2008-2011

billion worth of counterfeit goods. According to this trade-based estimate then, the US and EU markets combined are estimated to have imported US$25.2 billion of counterfeit goods from East Asia in 2010. In order to avoid double counting with the following chapter which is devoted exclusively to fraudulent medicines, it is necessary to subtract the estimated value of this flow from East Asia to the U.S. and EU. Using official U.S. and EU seizure statistics for 2010, fraudulent medicines constituted only around 3% of all counterfeit products from East Asia to these jurisdictions. This would amount to approximately US$ 0.8 billion. Subtracting this figure from the total for counterfeits yields a net value of **US$24.4 billion**.

By way of triangulation, in 2010, the US seized roughly US$155 million in counterfeit goods from East Asia, while the EU seized roughly $161 million.[27] The sum of these two figures represents 1.25% of the estimated illegal trade from East Asia to EU and US. This rate of interception seems realistic and in line with previous studies by the OECD, which presented a rate of seizures equal to 0.5% of the global illegal trade.[28]

[27] USCBP 2010; EC 2010. The EU values its counterfeit seizures at the retail level. In order to make this figure comparable to US wholesale-level data, the 2010 EU retail–level seizure value was divided by a factor of 7.5. The factor of 7.5 was derived by comparing US retail and wholesale valuations of counterfeit seizures (see USCBP 2010, p. 18).
[28] OECD 2008: p. 113.