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**Counting the Cost: The Economic Impacts of  
Counterfeiting and Piracy**

*Preliminary Findings of the OECD Study<sup>1</sup>*

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<sup>1</sup> Presentation for the Third Global Congress on Combating Counterfeiting and Piracy, 30-31 January 2007, International Conference Center, Geneva, Switzerland. Text shortened for delivery. It will be available on the OECD web site at [www.oecd.org/sti/counterfeiting](http://www.oecd.org/sti/counterfeiting).

# **Counting the Cost: The Economic Impacts of Counterfeiting and Piracy**

## ***Preliminary Findings of the OECD Study***

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### ***Why this study?***

Counterfeiting and piracy are longstanding problems which appear to be growing in scope, magnitude and economic and social impact. They have negative effects on affected firms and their employees while raising economic, health, safety and security concerns for governments and consumers. The emergence of the Internet and the growing number of free trade zones have opened new distribution channels for counterfeit and pirated goods, and raised jurisdictional problems. So, the OECD member countries, with strong support from industry, asked for this study.

### ***Why the OECD?***

This isn't the first time the OECD had looked at the question.

The OECD put out a report in 1998 on the Economic Impacts of Counterfeiting – the author was a consultant who was working for the ICC at the time -- that was still widely cited. So, no problem, do a quick update, there are sure to be a few new data sources and lots of experts out in our member countries to draw upon. Our governments and the business sector seem to be, for once united in their desire to do a new study and provide the OECD Secretariat with the means to produce it. What could be simpler?

- We underestimated the difficulty that our member governments would have in agreeing the scope.
- We underestimated the complexity of the job once they had agreed on it.
- We overestimated the input we would get from the very governments and industry organizations that were most keen on seeing the outcome.
- And, not least, we underestimated the budget needed to do the job and the time it would take.

Our report – still not finished and not ready for release – will be examined by our advisory group of national experts in February and March and, even if all goes well, won't be out in the public domain before May.

## ***What were we asked to do?***

Taking the TRIPS definitions of intellectual property rights, we were to embark on a three part project. The first part, which I am speaking about today, covers counterfeit and pirated goods. A second part (covering digital piracy) and a third part (covering other IPR infringements) are to be produced later. We were to cover:

- an analysis of trends and developments;
- an assessment of the effects on rights holders, consumers and society at large (including governments);
- an assessment of the magnitude of the phenomenon;
- a description and an assessment of the polices and measures being used;
- in addition to these four main issues the report examines various other aspects such as the markets for counterfeit and pirated goods, demand and supply drivers, etc., and includes studies of various specific sectors<sup>2</sup>.

## ***What are the main findings?***

### ***I. Analysis of trends and developments:***

The *scope* of products being counterfeited and pirated is broad and expanding, according to surveys we conducted with industry and public authorities and related research. There is a notable expansion from luxury to everyday products and household goods and the health and safety risks of substandard counterfeit products, including pharmaceuticals, are a growing concern. Evidence is available from a variety of sources, including customs and other enforcement activities, investigations by industry and research organisations and legal proceedings.

Customs data indicate infringements throughout the product groupings that together define the full range of goods commercially traded world wide. Seizures occurred in 744 out of the 5200 or so six–digit categories of the Harmonised System<sup>3</sup>.

Textile products were the most common (30 per cent of the total), followed by machinery and equipment (17 per cent). What is striking in a closer examination of the data is the number of products that could pose health and safety risks.

Customs data also suggest that ***counterfeiting and piracy are taking place in virtually all economies***. Reporting economies identified some 149 sources of counterfeit and pirated

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<sup>2</sup> Including audiovisual, automotive, food and drink, electrical components, pharmaceuticals, etc.

<sup>3</sup> The Harmonized Commodity Description and Coding System, known as the Harmonized System or the HS, developed by the World Customs Organization (WCO), is the goods nomenclature used as the basis for compiling Customs tariffs and international trade statistics.

products, including 27 of the OECD's 30 member economies<sup>4</sup>. The 149 sources include economies that served as intermediate shipping points.

Close to 60 per cent of seizures originated from only 5 countries – China, Thailand, Hong Kong (China) Korea and Malaysia.<sup>5</sup> The products intercepted differ quite significantly between countries but most of them include clothing and apparel, electrical equipment, leather articles, toys, games and clocks and watches.

Distribution, formerly largely through informal markets, are increasingly infiltrating legitimate supply chains, including established retail shops. The Internet has provided new and powerful *distribution channels* -- auction sites, stand-alone e-commerce sites and email solicitations. Free-ports<sup>6</sup> are also used to process as well as trans-ship counterfeit and pirated products.

*Counterfeit and pirated products are being sold in virtually all economies*, but consumption patterns vary. For example, the Middle East is an important market for automotive parts, while Africa is a major destination for counterfeit pharmaceuticals. Counterfeit cigarettes, on the other hand, are appearing almost everywhere. Piracy of music, movies and software appears to be significant in all economies, especially developing countries.

Over a third of the respondents to the OECD survey indicate a link with criminal networks and *organised crime*, a result consistent with Industry surveys. Profitability can be high, while the risk of prosecution and jail is low in most economies, as is the level of fines. The risks are sometimes even further diminished through the bribery and corruption of public officials. Large amounts of money are apparently being made, with some proceeds reinvested in more sophisticated counterfeiting/piracy operations.

## *II. Assessment of the effects of counterfeiting and piracy*

The effects of counterfeiting and piracy on rights holders, consumers, governments and the economy as a whole are considerable. The sales volume, prices and costs of rights holders suffer, as do investment, royalties and brand value. For consumers, there are often significant health and safety risks that undermine any gains from lower prices. For governments, tax revenues are lost, with consequences for government expenditure. Finally, there are the broader economy-wide effects on trade, foreign investment, employment, innovation, criminality and the environment. Some effects are immediate, while others are more indirect and long term. It is hard to get data on these impacts in

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<sup>4</sup> Of the OECD countries, only Iceland, Ireland and Sweden were not mentioned

<sup>5</sup> More than 80 per cent of seizures originated from only ten countries: China 32 per cent, Thailand 13 per cent, Korea 9 per cent, Hong Kong (China) 8 per cent, Chinese Taipei 4 per cent, then Turkey, Malaysia, Vietnam, Philippines and Pakistan.

<sup>6</sup> A *free port* or *free zone* is a port or area with relaxed jurisdiction usually free of customs or with favorable customs regulations. Some international airports have free ports.

cost terms, however, it is clear that the economic impact of counterfeiting goes well beyond estimates of the value of counterfeited products.

### ***III. Magnitude of Counterfeiting and Piracy***

The overall degree to which products are being counterfeited and pirated is unknown and unknowable. Counterfeiters aren't good at filling out statistical questionnaires. One assessment that has become very well known is that published by the Counterfeiting Intelligence Bureau of the International Chamber of Commerce in 1997 that indicated that the overall cost of counterfeiting in the world was about 5-7 per cent of world trade, up from 2-4 per cent at the end of the 1980s.

This found its way into the 1998 OECD report and ever since we have been, unfortunately, faced with this so-called "OECD figure". Why "unfortunately"? The answer is quite simple. The methodology is not clear and the ICC report quite openly indicates that the estimates reflect judgments not supported by hard data. Some interpret the figure to mean that counterfeit products traded internationally account for 5-7 per cent of total traded goods; others assume that the figure relates total counterfeit production (to include production for domestic consumption as well as export) to world trade. Is world trade "total" or "goods" or "manufactures"? Are the counterfeited goods valued at the border, at the prices to final purchasers in the market, or at the price charged for the equivalent genuine product? Nor is it clear what types of IPR infringements are included. Is it limited to trademark violations or does it include patent, copyright, etc.?

Data are developed using various methods and sources, each of which can contribute to an overall understanding of the situation, albeit from different perspectives. Combining and confronting methods and results is a potentially sound but difficult approach in estimating the magnitude of the activity and can also be of value for estimating impacts.

Customs data on interceptions/seizures was a key input to the OECD analysis. Unfortunately, the number of governments providing information was limited, and the completeness of the responses patchy, so we can only have an extremely crude indicator of the role of counterfeit and pirated products in international trade.

The analysis itself is based on an examination of the degree to which different fake products are detected in international trade, and the extent to which different economies are detected as sources. The data are adjusted to address a number of known biases. The resulting intensities are used to develop a set of relative counterfeiting/piracy propensities that are then used to estimate magnitude. This estimate, which, I stress once again, would benefit enormously from better interceptions/seizures data, suggests that counterfeit and pirated items which are traded internationally account for about USD 176 billion. This is about 2.4 per cent of world trade in manufactures (2 per cent of world trade in goods) – imports or exports. It does *not* include the very large volumes of fakes produced and consumed *within* economies, where in some sectors, like music, "domestic" counterfeiting and piracy appear to predominate. It does *not* include the (certainly higher) prices charged to final purchasers, nor the (higher still) prices of equivalent

genuine articles. It does not include the costs of digital piracy (to be covered in Part II of the study) or the other IPR infringements to be covered in Part III. It does not include estimates for economic costs for jobs lost or foregone, sick or injured consumers, lost tax revenues, and so forth, nor the costs of the resources expended on the struggle against the problem.

We are fully aware that 2.4 per cent or 2 per cent is significantly below the oft-quoted 5 - 7 per cent but I have already underlined my reservations about that figure. What I want to make clear is that we have *not* produced an update of that 1998 figure. We can't because we don't know what it means and we don't have the basic data required to produce estimates that we can defend on some of the "economic impacts of counterfeiting and piracy". We are certainly not saying it is less than we previously thought, nor that it has decreased -- we didn't know what it was before and, anyway, all the time series we have seen in the course of our study point to a problem getting worse not better. For those who believe that our result is somehow "too low", I would respond that it looks high to me. Higher than the entire GDP of most countries, including some OECD members, like Ireland, for example.

#### ***IV. Policies and programmes***

What about policies and programmes? Currently, the outlook is not promising. While most countries appear to have adequate legal and administrative mechanisms for combating counterfeiting and piracy, enforcement actions have not been sufficient, as resources have been devoted to higher priority areas. Moreover, penalties are generally not large enough to dissuade infringers, prison terms are rare, and the low fines, penalties and civil damages can be easily absorbed as a "cost" of doing business.

We suggest governments work with industry and move on five fronts:

- legal and administrative frameworks need to be sufficient to protect IPRs (at a minimum, consistent with TRIPs) and criminal and civil remedies and sanctions need to be strong enough to be a deterrent;
- the laws need to be adequately enforced, and meaningful remedies/sanctions need to be applied on a consistent basis;
- programmes are needed to promote public awareness of the consequences and effects on consumers, producers and society at large;
- co-operation between governments and with affected industries needs to be pursued, notably dialogue with source countries;
- a multilateral agreement on IPR enforcement which builds upon the TRIPs minimum standards and uses the other existing rules as a model could potentially become a key instrument.

#### ***Where do we go from here?***

Our work so far is just the first step. We now have some clearer ideas but we are still a long way from being able to say within reasonable confidence limits that counterfeiting

and piracy accounts for x per cent of world trade or y per cent of the total turnover of the affected industries. We are not saying that the problem is not serious. On the contrary we are saying it is extremely serious, seems to be getting more serious and needs to be dealt with by all stakeholders. According to our survey of customs officers from 50 countries, more than half of those surveyed believe that this trade will indeed increase.

The collection of data has to be improved very significantly -- customs seizure data, for example. Industry too could certainly do more in particular as regards certain aspects of trading. Self policing and a code of best practices could certainly be agreed upon. And governments have to move on five fronts I mentioned earlier.

It is certain that at the OECD there is a growing recognition of the importance of innovation for growth and of the role of intellectual property rights in that process. The struggle against the growing scourge of counterfeiting and piracy is part of that and I have no doubt we will be hearing consistent messages on that theme at the highest political level at the OECD, the G8 and elsewhere.

As for the OECD secretariat, we certainly stand ready to follow up our work, whether in developing metrics and economic impact analysis or more in the field of policy options and instruments. We also would like to build on the co-operation we established with the organizations represented here in this room and I gratefully acknowledge their contribution to our work. Finally I would like to thank the organizers for giving me the floor this Congress to present some of our interim findings.