The challenge of counterfeiting and piracy

Counterfeiting and piracy\(^1\) are probably as old as markets themselves. But today the extent and complexity of the problem have increased due to globalization and the spread of information and communications technology. Counterfeit and pirated goods now exact a heavy cost on industry, governments and consumers, requiring strong public action. The question is how to make progress?

Understanding the nature of counterfeiting and piracy, the economic mechanisms that drive it, its scale and the areas it affects help in designing appropriate policies to address the problem. Two recent OECD reports have analyzed the counterfeiting and piracy of tangible products (OECD, 2008) and piracy of digital content (OECD, 2009) and provide some answers.

Markets for counterfeit and pirated products

Markets for counterfeit and pirated products are not homogeneous and are driven by a range of factors that differ across market segments. The fundamental distinction in the markets for counterfeit and pirated products is between tangible and digital goods. The term tangible products refers to physical products such as clothes, cosmetics, cars, optical discs, audio equipment, spare parts, food, pharmaceuticals, and many more. A growing number of these products tend to be protected by intellectual property rights such as trademarks, patents, copyrights or design rights.

Even though the scope of tangible goods that are sensitive to counterfeiting and piracy is undoubtedly broad, the intensity of infringement differs significantly across different types of products. The analysis presented in OECD (2008) shows that the customs interceptions of infringing products are concentrated in a small number of product categories. This is illustrated in Table 1 that presents the seizure frequencies across goods covered by sensitive product categories. Tradable product categories that are the most prone to counterfeiting include clothing, electric equipment, leather goods, footwear and tobacco products.

The market for fake tangible goods is not homogeneous either and can be divided into two sub-markets. In the primary market, consumers purchase counterfeit and pirated products believing they have purchased genuine articles. The products are often sub-standard and carry health and safety risks that range from mild to life-threatening. In the secondary market, consumers are looking for what they believe to be bargains, and knowingly buy counterfeit and pirated products.

### Table 1. Seizure percentages of goods by product categories

<table>
<thead>
<tr>
<th>No.</th>
<th>Category of products (HS Code)</th>
<th>Seizure (%)</th>
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<tbody>
<tr>
<td>1</td>
<td>Articles of apparel and clothing accessories (61, 62)</td>
<td>30.6</td>
</tr>
<tr>
<td>2</td>
<td>Electrical machinery and equipment, telecom. equipment, sound and TV recorders (85)</td>
<td>26.8</td>
</tr>
<tr>
<td>3</td>
<td>Articles of leather, saddlery and harness, handbags, articles of gut (42)</td>
<td>7.9</td>
</tr>
<tr>
<td>4</td>
<td>Footwear, gaiters etc (64)</td>
<td>5.4</td>
</tr>
<tr>
<td>5</td>
<td>Tobacco and manufactured tobacco substitutes (24)</td>
<td>5.4</td>
</tr>
<tr>
<td></td>
<td>Total, Top 5 product headings</td>
<td>76.1</td>
</tr>
</tbody>
</table>

Source: OECD (2008)

Transactions in pirated intangible or digital products (i.e. a music song, a movie, a computer program etc.) form the other key market for counterfeit and pirated products. In contrast to physical goods, the digital good is intangible and one person’s consumption of the good’s content does not exclude simultaneous consumption by others. While these properties greatly facilitate the distribution and sharing of digital content they also facilitate its unauthorised use. This market even includes a large group of suppliers of pirated content that are willing to provide content at zero prices. Non-price factors (such as legality, availability and quality) are particularly important in understanding the operation of markets for pirated digital products.

### Demand and supply drivers

A number of factors affect the demand and supply of counterfeit and pirated products in the tangible and digital segments of the market.

A significant factor in the demand for counterfeit products that is common for both types of counterfeiting and piracy (tangible and digital) concerns the attitude of consumers towards counterfeiting and piracy and their awareness of the potential risks it might involve. Even though most consumers of counterfeit and pirated products are aware that they are engaged in an illegal activity, they rarely perceive it as unethical. This perception is particularly strong in the case of digital piracy, especially when no monetary profits are generated by the parties engaged in piracy.

Security problems are also not fully taken into account by consumers of counterfeit and pirated products. Producers of fakes bypass rigorous testing procedures and safety standards, which can present serious health and safety risks, eg. when sub-standard batteries for toys leak or explode, or when fake baby formula causes illness or death. On the digital market, many users of pirated digital goods seem unaware of potential security risks associated with their file exchanging activities, which could leave them exposed to malicious software which is designed to infiltrate or damage a computer system.

The supply of tangible counterfeit and pirated products is primarily driven by profit motives. Counterfeiters and pirates often target products where profit margins are high, taking into account the risks of detection, the potential penalties, the size of the markets that could be exploited and the technological and logistical challenges in producing and distributing products.

Unlike in the market for tangible products, the profit motive can be absent in the digital piracy market. Digital products in high demand, especially by younger people, and the ease and very low cost of reproduction and transmission of digital products make these products very attractive to share. Furthermore, a large number of suppliers in the market are not driven by profit motives, but by other non-market factors, such as gaining recognition within a peer group, or providing free access to other users. This behaviour can be sustained because the marginal cost of reproduction and delivery of digital content is zero, or close to zero.

### Effects

The effects of counterfeiting and piracy are wide ranging and affect consumers, rights’ holders and government. IP infringements also have a broad range of general socio-economic effects, such as effects on innovation and growth, criminal activities, the environment, employment, foreign direct investment, and trade.

Consumers who knowingly buy counterfeit goods might perceive this as a good bargain but the savings that they may achieve by knowingly purchasing lower-priced counterfeit or pirated products need to be considered in a broader context. Depending on the product, consumers can be worse off and expose themselves to health and safety risks. Moreover, consumers are often not aware that the goods they buy are counterfeit. Copying, packaging and labelling have become quite sophisticated, making it difficult to tell fake and genuine products apart. In some cases, counterfeit goods have started to find their way into regular distribution systems and legitimate supply chains.

Criminal networks and organised crime thrive in counterfeiting and piracy activities. They take market share from legitimate businesses and undermine innovation, with negative implications for economic growth. Moreover, bribery associated with counterfeiting and piracy...
can weaken the effectiveness of public institutions at the expense of society at large. Governments are also affected through foregone tax revenues and the costs incurred in combating the problem. These activities also have longer-lasting effects as they reduce the incentives for firms to innovate or invest.

While the economic, social and development losses from counterfeiting and piracy are large, the precise scale of the problem in terms of lost profits, tax revenues, health and safety, etc. remains uncertain. Data on international trade together with customs data on seizures of fake goods provide some indication of how big the counterfeit and piracy business is – up to US $200 billion in 2005, according to OECD (2008). This figure does not include counterfeit and pirated goods produced and sold within domestic markets, nor the flow of pirated digital products being distributed via the internet, suggesting that the scale of the problem may be significantly larger.

**Industry and government responses**
Considering the large scale of the problem, renewed national and international efforts are needed to fight counterfeiting and piracy. There is no single remedy, and the OECD reports lists several ways to develop information and analysis, strengthen legal and regulatory frameworks, enhance enforcement and deepen the evaluation of policies programs and practices.

The global nature of counterfeiting and piracy makes it difficult to combat. This is a particularly striking problem for digital piracy that generally cannot be detected at national borders. Closer government/industry co-operation would help to identify and counter counterfeiters and pirates. Many industry groups and associations have launched activities to assist in dealing with counterfeiting.

Moreover, tackling public attitudes is important to address the problem. Although consumers that buy counterfeited and pirated goods are generally aware that it is illegal, they do not always perceive it as unethical and continued emphasis should be placed on education and consumer awareness to overcome this perception.

Finally, a better understanding of the scale of the problem would help and would benefit from more comprehensive and comparable datasets. Unfortunately, there is no commonly agreed reporting framework at this time. Further work to monitor and analyze markets for counterfeiting and piracy will be required in the future.

For more information on the OECD project on counterfeiting and piracy visit: www.oecd.org/sti/counterfeiting or contact: piotr.stryszowski@oecd.org

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**References**

OECD (2008), The Economic Impact of Counterfeiting and Piracy
OECD (2009), Piracy of Digital Content

1. This note reflects my own views, and not necessarily those of the OECD or its member countries.

2. Counterfeiting and piracy are terms that are commonly used to describe a range of illicit activities related to violation or misuse of intellectual property rights. In the context of this article they primarily concern infringements of trademarks, copyrights, patents and design rights.

3. The quantification of the impacts of counterfeiting and piracy carried out by the OECD has thus far only focused on the counterfeiting and piracy of tangible goods.