

# **GLOBAL COUNTERFEIT TRADE**

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## INTRODUCTION

Chinese organized crime operates in all areas around the world. It is highly decentralized compared to Italian and Japanese criminal groups, which has allowed it to flourish in different circumstances and given it the flexibility to quickly take advantage of new profitable opportunities. One area in which Chinese criminals have become dominant players is counterfeiting and piracy.

The global trade in counterfeit goods has arisen alongside the rise of international trade over the last several decades. Organized crime has taken advantage of the desire of legitimate business to move money and goods freely across borders in a minimum amount of time by moving illegal goods through the same channel as legal goods. Both developed and developing countries are unable to sufficiently monitor their borders to combat counterfeit trade.

Counterfeiting of consumer goods has global economic effects. Health and safety are also compromised by counterfeiting. Fake auto parts and electrical equipment put their users in dangerous situations. Global trade in counterfeit cigarettes has significant health and economic effects. Finally, the rise of counterfeit pharmaceuticals, and the shift of these counterfeits from lifestyle drugs to disease prevention and life-saving medicines, produces the most direct hazards to public health and safety throughout the developing and developed worlds.

The policies to combat counterfeiting are largely in place through international organizations such as the World Trade Organization and World Health Organization. However, China has not effectively curbed the counterfeit production within its borders. Other countries

and industries lack the political will to enforce existing policies. Counterfeiting is seen as a trade issue rather than a law enforcement issue. Businesses fear cutting off their own profits by losing access to the significant Chinese market or scaring consumers afraid of fakes from buying legitimate goods. Consumers typically view purchasing counterfeit goods as a victimless crime.

This largely indifferent attitude towards counterfeiting by both consumers and authorities has created a low-risk, high-reward system for organized crime. They are able to create counterfeits which often have higher markups than other criminal enterprises with little fear of being apprehended and little punishment if they are caught. If global counterfeiting is to be fought effectively, these profit margins must be reduced. Public awareness of the dangers of counterfeiting needs to be combined with improved efforts to enforce trade policies. Business and industry need to lead the way in exposing and informing the public of counterfeits, particularly pharmaceuticals, rather than obfuscating the problem to protect their stock prices.

Even these solutions point to the underlying problem that needs to be resolved to reduce counterfeiting. Counterfeiting is not viewed as a serious problem on its own; it is only when public health and safety are endangered that the threats of counterfeiting are taken seriously. This could be an effective tool for fighting some counterfeit merchandise, such as automotive or aircraft parts, electrical equipment, or particularly pharmaceuticals. But it will not be effective in fighting other forms of counterfeiting. Consumers are too sophisticated to believe a campaign that equates fake handbags or DVDs with public health issues.

## OVERVIEW OF CHINESE ORGANIZED CRIME

Chinese organized crime groups are structurally different from their Italian or Japanese counterparts. The Japanese *yakuza* are divided into three main groups with a total of around 80,000 members.<sup>1</sup> The Italian mafia has five major groups. Chinese organized crime is much more decentralized than this. There are many groups, most of which have multiple subgroups. The largest single Triad is the Sun Yee On group, with 56,000 members. Another large group, the 14K, has 20,000 members in over 30 subgroups. Triads have a hierarchical structure but remain decentralized. The higher levels in the organization do not direct the operations of the subgroups. Their main purpose is to settle disputes within the organization.<sup>2</sup>

The term “Triad” has become synonymous with Chinese organized crime, however that is not entirely accurate. Triads originated as secret societies that operated against the rule of the Qing dynasty in the 17<sup>th</sup> century. Some groups turned to crime in the 20<sup>th</sup> century after the Cultural Revolution left no dynasties to operate against. Not all Triads turned to crime at this time. Some of them remained as nothing more than social clubs. Of over fifty Triads in Hong Kong, fifteen to twenty of them are involved in criminal activity.<sup>3</sup>

Just as not all Triads are criminal organizations, not all Chinese organized crime groups are triads. Another type of criminal organization is the *tong*. The word *tong* means “meeting

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<sup>1</sup> Lal, Rollie. "Japanese Trafficking and Smuggling." *Transnational Threats Smuggling and Trafficking in Arms, Drugs, and Human Life*. Ed. Kimberley L. Thachuk. New York: Praeger Security International General Interest-Cloth, 2007.

<sup>2</sup> United States Library of Congress. Federal Research Division. *Transnational Activities of Chinese Crime Organizations*. By Glenn E. Curtis, Seth L. Elan, Rexford A. Hudson, and Nina A. Kollars. Washington. Apr. 2003.

<sup>3</sup> United States Library of Congress.

hall.” These are social clubs within Chinese communities that often provide cover for the activities of youth gangs. Other organizations can be referred to as simply gangs. Among the most dangerous of these is the Fuk Ching, which is the largest Chinese gang in New York City. A single organized crime group can contain both Triad and non-Triad members, and even members from multiple Triads. The largest non-Triad group is United Bamboo, operated out of Taiwan, with 20,000 members.<sup>4</sup>

Chinese Triads are engaged in all manner of criminal activity. Some groups get by on protection rackets against the immigrant Chinese population. Human trafficking by operatives known as “snakeheads” not only provides its own funding, but also creates a larger immigrant population to be exploited. Chinese organized crime dominates the heroin trade in Southeast Asia and Oceania. China White, as the drug is called, is responsible for 80% of the heroin trade in Australia. Extremely sophisticated document and credit card fraud uses state-of-the-art technology to create fakes which can even include supposedly counterfeit-proof holographic images on documents. Money laundering in North America and Europe is often done through cash-heavy businesses like shops and restaurants. Money is moved back to China through off-book transactions known as *fei qian* (“flying money”).<sup>5</sup>

Chinese organized crime groups are active all over the world. A single group like the Big Circle gang operates in the United States, Canada, South America, Western Europe, Russia and Southeast Asia. The 14K operates all over Asia, Europe and Oceania. The Wo Shing Wo, a Triad

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<sup>4</sup> United States Library of Congress.

<sup>5</sup> United States Library of Congress.

umbrella organization, has subgroups in the U.S., Canada, Europe, Russia, Southeast Asia, Japan and Oceania. The groups are very adaptable, often working alongside or avoiding conflict with indigenous groups. In Italy, for example, Chinese groups limit their activity to human smuggling in deference to the mafia.<sup>6</sup>

This combination of globalization, decentralization and adaptability has allowed Chinese organized crime to adapt its activities across regions. Chinese snakeheads in Australia increased human trafficking to meet the demands of the Sydney Olympics in 2000. Triads also traffic in black market lobster and abalone in Australia. In Russia, Triads are involved in running illegal casinos and trafficking Russian women for prostitution rings. They supplement this activity with trade in counterfeit vodka and the smuggling of Russia's natural resources such as metals, timber and agricultural products. Chinese groups work with Russian organized crime to poach sea cucumbers, a delicacy in China, from coastal areas.<sup>7</sup>

One area in which Chinese organized crime has come to dominate the international market is the production and trade of counterfeit goods. Chinese criminals have perfected the production, transport and sale of all kinds of goods, from benign fake consumer goods like electronics and apparel, to deadly trade of counterfeit drugs.

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<sup>6</sup> United States Library of Congress.

<sup>7</sup> United States Library of Congress.

## COUNTERFEIT TRANSACTIONS

In an interview, Don deKieffer, an attorney for deKieffer and Horgan who specializes in helping companies defend against counterfeits, explains how a typical counterfeit transaction in the United States would work. It begins with a party in the U.S. tracking “what’s hot.” They buy a handful of legitimate copies. For a small-time operation, the counterfeiter may be able to handle the rest of the transaction themselves. However, for major operations they need to be able to work through existing supply chains. For consumer goods, with a particular emphasis on apparel and accessories, that means Triads. The Triad, likely working out of New York City, puts an order through their counterparts in Taiwan or Hong Kong. Those counterparts take the original copy to a factory in an area of southern China such as Guangzhou or Shanghai.

The factory reverse-engineers the products and creates a handful of sample products which it sends back to the Triad in New York. If the counterfeits are satisfactory, a full order is placed. The orders are shipped through shell companies from the factory to intermediate consignees in Los Angeles or New York. The shipments are usually in full containers, are often declared to Customs exactly as they are, and duties are paid to minimize the likelihood of getting the shipments searched. Sometimes the products and logos may be shipped separately to further reduce the chance of getting caught by Customs. Once through the ports, the goods are sent to public warehouses, which are acres-large warehouses that are divided up by chain-link fences and rented out to anyone who needs space. If further work on the product is needed, such as sewing logos onto the products, they are done here at the public warehouse.

From the public warehouse, some of the goods are sent to regional distribution centers (RDC) around the country. For Washington, DC, the RDC is in Baltimore. Each morning, vendors from Washington (usually Korean) drive up to the RDC to pick up their supply for the day. They usually pay in cash unless they are particularly well trusted, in which case they may be extended some credit. The products are brought back to Washington where they are sold on the streets to tourists, businesspeople and government servants at what are extremely low prices with very large markups. A purse that sells for \$50 on the street may have cost only \$6-\$7 to produce.

The goods that do not get sold by street vendors will be stored in secondary warehouses, where they get sold on online sites like eBay. Still more are sold wholesale to flea market vendors who peddle them at markets around the country. For pharmaceuticals (which are not usually handled by Triads), most will be sold through online pharmacies. Scheduled controlled substances get sold online as well as distributed through traditional drug dealers. The money flows up to the Triads in New York, with a small amount going back to China. The Triads involved with this trade usually keep violence to a minimum so as to avoid attracting the attention of law enforcement.

If this seems like a typical, unremarkable business transaction just like any other, that is the entire point. Trade in counterfeit goods is not like drug running. As Mr. deKieffer says, "A big-time counterfeiter has to know how a legitimate transaction operates to avoid trouble." There can be legitimate records for most of the transaction. The purpose is to minimize the risk of apprehension on such a lucrative and already low-risk business.



## EFFECTS OF COUNTERFEIT TRADE

### ECONOMIC EFFECTS

Estimates of the global economic scale of counterfeiting are, by definition, difficult to specify. Estimates vary widely according to different governments, organizations or industry groups. The OECD estimates the international trade in counterfeit goods at \$200 billion dollars per year as of 2005, or about 2% of global goods trade. OECD acknowledges that this estimate is hindered by a lack of data on counterfeit seizures. It also does not count counterfeit goods produced and consumed domestically, or digital distribution of pirated IPR material.<sup>8</sup> This estimate is below the International Chamber of Commerce estimate from 1997 which put the total costs of counterfeiting at 5-7% of world trade.<sup>9</sup> The International Anticounterfeiting Coalition (IACC) estimates losses just to U.S. businesses of \$200 - \$250 billion per year and job losses in the U.S. of 750,000.<sup>10</sup>

In 2008, U.S. Customs and Border Protection (CBP) made nearly 15 thousand seizures related to Intellectual Property Rights violations, with a domestic value of \$273 million. Over 80% (\$222 million) were goods from China. Adding Hong Kong and Taiwan to China increases

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<sup>8</sup> Organisation for Economic Co-operation and Development. The Economic Impact of Counterfeiting and Piracy. France: OECD Publications, 2008.

<sup>9</sup> Presentation for the Third Global Congress on Combating Counterfeiting and Piracy, 30-31 January 2007, International Conference Center, Geneva, Switzerland. <http://www.oecd.org/dataoecd/12/7/38015608.pdf>

<sup>10</sup> GET REAL - The Truth About Counterfeiting. International Anticounterfeiting Coalition. 05 May 2009 <<http://www.iacc.org/counterfeiting/counterfeiting.php>>.

the total to 87% (\$238 million). The next highest country was India at \$16 million. The commodity most frequently seized was footwear, with 96% of the \$102 million in seizures coming from China. Safety and Security Commodities - a category which includes items such as pharmaceuticals, personal care products, cigarettes, electrical/technological/transportation articles, and others – accounted for almost 2,000 seizures with a domestic value of \$63 million.

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Compared to overall trade levels, these are very small amounts. While CBP did not specify the number of seizures by country, applying the same proportion of value from China, Hong Kong and Taiwan would result in 13 thousand IPR seizures from these areas. In contrast, according to U.S. Census Bureau statistics, there were over 13 million import transactions from these countries, meaning that roughly one-tenth of one percent of import shipments from China were seized as counterfeits. A comparison of values reveals a similar ratio: \$238 million in seizures out of a total import value of \$381 billion, or about three-fifths of one-tenth of one percent (0.06%). Using the OECD's estimate of counterfeit transactions accounting for 2% of global trade, this would mean that CBP is catching about 1/32 of counterfeit shipments from China entering the U.S.

The economic impacts of counterfeiting go beyond simply losses of sales by the legitimate rights holders. Companies face downward price pressure by competing with counterfeiters which do not incur development and advertising costs needed to grow brand

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<sup>11</sup> U.S. Customs and Border Protection. U.S. Immigration and Customs Enforcement. Intellectual Property Rights Seizure Statistics: FY 2008. 15 Jan. 2009. 17 Apr. 2009 <[http://cbp.gov/xp/cgov/trade/priority\\_trade/ipr/seizure/](http://cbp.gov/xp/cgov/trade/priority_trade/ipr/seizure/)>.

recognition. A firm's reputation can be damaged and goodwill lost due to customer dissatisfaction with counterfeit products. Finally, firms are forced to spend their own resources combating piracy to protect their copyrights and trademarks.<sup>12</sup>

There are macroeconomic effects as well. Labor is damaged as production shifts to lower-paying jobs creating counterfeits. Higher rates of counterfeiting in a country are correlated with losses of Foreign Direct Investment. Substandard counterfeit products made with cheaper materials and processes lead to increased environmental damage, as does the destruction of counterfeit goods after their seizure. Governments lose both sales tax revenue on the trade of counterfeit merchandise and payroll tax revenue on their production. And the overall costs of public health and safety increase when they are threatened by dangerous counterfeit goods.<sup>13</sup>

## HEALTH AND SAFETY EFFECTS

### DANGEROUS PRODUCTS

Public safety is endangered when people rely on the safety and integrity of legitimate products to perform otherwise dangerous tasks. This integrity is compromised with the introduction of counterfeit products. One example is the market for automotive spare parts and accessories. The Motor & Equipment Manufacturers Association produced a special report in 2009, warning its members that counterfeit automotive parts may enter the marketplace at a

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<sup>12</sup> Organisation for Economic Co-operation and Development.

<sup>13</sup> Organisation for Economic Co-operation and Development.

number of points along the supply chain. The increasing globalization of supply chains and speed of transportation mean counterfeit parts can originate anywhere in the world, and can be “pinballed” to mask their original origin.<sup>14</sup>

The U.S. military has suffered the effects of counterfeit materials. Because many military systems, such as flight computers, have remained unchanged for twenty years or more, they require computer chips no longer created by their original manufacturer. This fact, along with a desire to trim costs through less-restrictive third-party purchasing, has led to many of these replacement parts being bought on informal Chinese markets. It is estimated that as much as 15% of the Pentagon’s replacement parts purchased may be counterfeit, although officials have been unable to identify counterfeit parts as the reason for any accidents.<sup>15</sup>

Counterfeit cigarettes pose another public health problem. In the first half of 2007 alone, Chinese authorities seized over 4 billion counterfeit cigarettes being manufactured in their country.<sup>16</sup> In April 2007, 243 thousand cartons of fake Marlboros and Newports from China were taken in a single seizure in New York City. The counterfeits sell for about half the price of legitimate cigarettes, and no tax revenues are collected on sales of fakes.<sup>17</sup> Since they do not face the same regulation as legitimate cigarettes, they are more likely to contain toxic

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<sup>14</sup> "Understanding the Flow of Counterfeit and Gray Market Goods through the U.S. Automotive and Commercial Vehicle Parts Marketplace." Jan. 2009. MEMA Brand Protection Council. <<http://www.mema.org/pdf/SRFlow.pdf>>.

<sup>15</sup> Grow, Brian, Chi-Chu Tschang, Cliff Edwards, Brian Bumsed, and Keith Epstein. "Dangerous Fakes." *Business Week* 13 Oct. 2008: 34. ABI/INFORM Global. ProQuest.

<sup>16</sup> "China seizes 4.12bn counterfeit brand cigarettes in first half of 2007." *Xinhua* [Beijing] 12 July 2007.

<sup>17</sup> Medaglia, Angelica. "Cigarettes are costly, but often less so in Chinatown." *The New York Times* 18 Sept. 2007, sec. B: 2.

ingredients. Production is not limited to China; Chinese immigrants are trafficked into the United Kingdom where they produce fake cigarettes to be sold throughout Western Europe.<sup>18</sup>

In Operation Smoking Dragon, U.S. FBI agents broke up a massive counterfeit cigarette smuggling ring in 2005. Based in San Gabriel, CA, the Chinese smugglers had brought more than a billion fake name-brand cigarettes into the United States, along with other counterfeit goods, such as Viagra.<sup>19</sup> A single shipping container of cigarettes (10 million individual sticks) that cost \$125,000 to produce could be sold for \$2 million.<sup>20</sup> Despite the massive financial stakes in the counterfeit trade, Smoking Dragon also hints at the lack of priority given to counterfeit cigarettes by U.S. law enforcement. Agents followed the illegal cigarette trade for several years, but would not move on the counterfeiting ring until after undercover agents has persuaded the smugglers to bring in shipments of illegal weapons and counterfeit \$100 bills from North Korea.

## PHARMACEUTICALS

Counterfeit pharmaceuticals are a growing problem globally, with China leading among suppliers. There are several methods of counterfeiting medications which can lead varying degrees of effectiveness or danger. The active ingredient itself may be counterfeited and sold to unknowing manufacturers. The finished product can be counterfeited in several different ways. Legitimately manufactured drugs can have the expiration date modified to extend shelf life. The drugs and packaging may be counterfeited, with sophisticated holograms intended to

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<sup>18</sup> "Terrorism links to city's deadly cig trade." Liverpool Daily Echo 20 June 2008: 10.

<sup>19</sup> deKieffer.

<sup>20</sup> Chen, Te-Ping. "Smoking Dragon, Royal Charm." The Center for Public Integrity. 19 Oct. 2008. <<http://www.publicintegrity.org/investigations/tobacco/articles/entry/762/>>.

denote authenticity expertly forged.<sup>21</sup> The pills may be completely fake, made of compressed chalk, dust and dirt. They may be produced off-hours by employees at the same plant that creates the legitimate drug, or they may be created in a cement mixer in a slum neighborhood.<sup>22</sup>

For some counterfeit life-style drugs, such as medications to treat erectile dysfunction, the health effects on patients can best be described as “inconvenient.” However, more serious health effects of counterfeit pharmaceuticals can be both direct and indirect. Patients who take counterfeit disease prevention drugs, such as anti-malarial medicines, may end up getting sick when they believed they were protected. Patients who take counterfeits may not recover from illness as quickly as they would have with legitimate drugs, or may not recover at all. Toxic ingredients in counterfeits can lead directly to deaths. Three-hundred and fifty deaths were reported in the 1990’s due to counterfeit pharmaceuticals containing anti-freeze as a replacement for glycerin or propylene glycol. In 2001, China reported almost 200,000 deaths due to counterfeit medicines. Estimates put the total loss of life to counterfeit pharmaceuticals between 500,000 and one million people per year.<sup>23</sup>

The story of deaths from counterfeit heparin illustrate the vulnerability even heavily-regulated developed nations can have in preventing counterfeit drugs from reaching patients. From January 2007 to mid-2008, over one hundred deaths in the United States were linked to

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<sup>21</sup> Organisation for Economic Co-operation and Development.

<sup>22</sup> Bate, Roger. "The Deadly World of Fake Drugs." *Foreign Policy* 168 (September/October 2008): 56-62.

<sup>23</sup> Cockburn, Robert. "Death By Dilution." *The American Prospect* 20 Nov. 2005.

counterfeit heparin, an anti-coagulant mostly used to prevent blood clots in surgery patients.<sup>24</sup> The heparin was distributed by the drug's legitimate manufacturer, Baxter International, with chondroitin sulfate chemically modified to mimic heparin and substituted for fifty-percent of the active ingredient. The modified chondroitin was able to pass as heparin using standard chemical tests. The counterfeit ingredient was traced to Baxter's supplier in China, who purchased heparin from several consolidators, which in turn had purchased heparin from many small shops which extract the heparin from pig intestines.<sup>25</sup> This counterfeiting occurred in China despite the execution of its former head of the Food and Drug Administration in 2007 for approving untested medicines.<sup>26</sup> Clearly, the execution of a public official did not have a deterrent affect on organized crime.

In addition to the direct health effects of ingesting substandard counterfeit pharmaceuticals, the prevalence of ineffective counterfeit drugs can lead to secondary effects on the society. In developing nations a distrust of Western-style medicine can be formed, as the promised benefits of medication are not achieved. Additionally, the use of antibiotics which contain the active ingredient in dosages too small to be effective is believed to contribute to the growth of antibiotic-resistant disease strains.<sup>27</sup>

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<sup>24</sup> Kaufman, Marc. "FDA Raises Estimate of Deaths Linked to Blood Thinner." The Washington Post 9 Apr. 2008, sec. A: 3. <<http://www.washingtonpost.com/wp-dyn/content/article/2008/04/08/AR2008040803032.html>>.

<sup>25</sup> Bogdanich, Walt. "Heparin Find May Point to Chinese Counterfeiting." The New York Times 20 Mar. 2008, Health sec. <[http://www.nytimes.com/2008/03/20/health/20heparin.html?\\_r=1&ref=world](http://www.nytimes.com/2008/03/20/health/20heparin.html?_r=1&ref=world)>.

<sup>26</sup> "China's drug regulator to be executed - China- msnbc.com." Msnbc.com. 29 May 2007. 08 May 2009 <<http://www.msnbc.msn.com/id/18911849/>>.

<sup>27</sup> Organisation for Economic Co-operation and Development.

# POLICIES

## GENERAL MERCHANDISE TRADE

For many countries, rules on international trade of counterfeit merchandise are governed by the World Trade Organization's (WTO) trade-related aspects of intellectual property rights (TRIPS) agreement. Negotiated as part of the Uruguay Round of multilateral trade negotiations, TRIPS attempts to provide a minimum standard of treatment of intellectual property across WTO member nations. TRIPS covers copyrights, trademarks, geographic indicators, industrial designs, patents, integrated circuit layouts and trade secrets. Nations who feel their intellectual property is being used without authorization can appeal to the WTO dispute settlement panel. If the outcome is in their favor, the offended country can impose proportional trade restrictions on the offending country.

Actions to combat counterfeiting also take place as part of bilateral trade negotiations, particularly between the United States and China. Since the mid-1990s, attempts by American trade negotiators to force China to strengthen its IPR enforcement have met resistance from both American and Chinese constituencies, including those groups who might be expected to support these efforts. American interest groups focusing on human rights or the environment were worried that the U.S. would use its political capital to combat counterfeiting rather than on issues they viewed as more important. U.S. businesses were worried that China would retaliate against American companies by restricting American access to the rapidly growing Chinese market. Eventually, U.S. negotiators won concessions from the Chinese by framing IPR



violations as a strictly trade-based issue.<sup>28</sup> Additionally, China's bid to join the WTO required them to accept TRIPS guidelines.

Since China agreed to stricter IPR enforcement rules, there has been one instance of a joint effort between U.S. and Chinese law enforcement agencies in a counterfeiting case. Operation Summer Solstice was a joint operation conducted in July 2007 between U.S. Federal Bureau of Investigation and China's Ministry of Public Security. The investigation involved a software pirating ring based in Shanghai that "had close conspiracy with criminal suspects in the United States and other countries and [had] formed transregional and transnational criminal organizations."<sup>29</sup> The items sold included software such as Microsoft Office 2007 and Windows XP, and were sold online, mostly to the United States and Europe. Microsoft estimated that the organized crime group had global sales of \$2 billion. Eleven people were convicted in Shenzhen courts in early 2009 with sentences ranging from eighteen months to 6 ½ years. Nine more people are scheduled for trial in Shanghai.<sup>30</sup>

Legally, a corporation is responsible for protecting its own copyrights. According to Don deKieffer, the current situation in the United States is that if the products being counterfeited are benign themselves, then Federal law enforcement does not put a high priority on the case. Unlike drug trafficking investigations, counterfeit investigations rarely lead to fancy cars, boats or homes that agencies can seize and sell to try to recoup costs. He says lawyers are "realistic"

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<sup>28</sup> Sebenius, James K., and Rebecca Hulse. Charlene Barshefsky. Boston, MA: Harvard Business School, 2001.

<sup>29</sup> Jingyong, Zhang, and Peng Yong. ""The Chinese Police and the US Federal Bureau of Investigation Jointly Unearth Extraordinarily Serious Transnational Disk Piracy Criminal Cases." Xinhua [Beijing] 24 July 2007.

<sup>30</sup> Barboza, David. "Chinese Court Convicts 11 in Microsoft Piracy Case." The New York Times 1 Jan. 2009, sec. B: 7.

about the chances of recovering damages from counterfeiters. Corporations weigh the costs of going after counterfeiters with the likelihood of recovery and may decide it is not worth pursuing the counterfeiters and chalk up the loss to costs-of-business. For a small or medium sized business, they may simply lack the resources to go after counterfeiters even if they are aware of the situation. Other companies actively and stringently enforce their trademark rights.<sup>31</sup>

## COUNTERFEIT PHARMACEUTICALS

Part of the problem with developing policies towards counterfeit drugs is that counterfeits are defined differently across countries. Pakistan's counterfeit drug definition focuses on deceptive packaging. In the United States, counterfeit drugs are any which use a patent or trademark on the drug or packaging without authorization. Nigeria includes not only patent and trademark infringement, but "any drug product whose label does not bear adequate direction for use and such adequate warning against use."<sup>32</sup> Having different definitions for counterfeits could obviously hinder cooperative efforts to combat the problem, emphasizing the need for an internationally accepted definition.

According to the World Health Organization, a counterfeit drug is "a medicine which is deliberately and fraudulently mislabeled with respect to identity and/or source. Counterfeiting can apply to both branded and generic products and counterfeit products may include products

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<sup>31</sup> deKieffer 2009.

<sup>32</sup> World Health Organization. "WHO | What are counterfeit drugs?" 08 May 2009 <<http://www.who.int/medicines/services/counterfeit/faqs/03/en/>>.

with the correct ingredients or with the wrong ingredients, without active ingredients, with insufficient active ingredients or with fake packaging.” The WHO also makes the claim that there can be no such thing as a good quality counterfeit drug.<sup>33</sup> In February 2006, they launched the International Medical Products Anti-Counterfeiting Task Force (IMPACT), a group made up of regulatory agencies, pharmaceutical trade groups, international organizations, and other groups interested in stopping the flow of counterfeit pharmaceuticals. Nevertheless, in Carolyn Nordstrom’s book, *Global Outlaws*, a WHO employee admits the complexities of the problem, saying, “It is very, very difficult to say if smuggling is good or bad when people are living in desperation.”<sup>34</sup>

There appears to be a lack of will to strengthen policies or enforce existing policies to curb the increase in counterfeit pharmaceuticals. This indifference extends from the pharmaceutical companies themselves to multinational organizations, individual governments and consumers. In *Global Outlaws*, Nordstrom explores pharmaceutical markets in Africa. She talks to a counterfeit pharmaceutical salesman named “Lucas,” who explains why his counterfeit drugs are not the dangers most would suspect they are: “If the factory sells bad drugs, we stop buying. Then what does that factory do? ...They can’t just go out and start another factory; their reputations follow them.”<sup>35</sup> This is a logical argument from a purely economic perspective. In a completely free market equilibrium, there are enough suppliers and

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<sup>33</sup> "WHO | Frequently asked questions." 08 May 2009 <<http://www.who.int/medicines/services/counterfeit/faqs/en/index.html>>.

<sup>34</sup> Nordstrom, Carolyn. *Global Outlaws Crime, Money, and Power in the Contemporary World* (California Series in Public Anthropology). New York: University of California P, 2007.

<sup>35</sup> Nordstrom.

enough consumers of each product that any supplier that falls behind in quality or price is immediately driven out of the market. But purely free markets are economic theory; in practice they rarely, if ever, exist.

Surely, one would assume that although individual governments and international organizations struggle to even define the problem, much less combat the issue, the pharmaceutical companies themselves would be at the forefront in stamping out counterfeit drugs. However, the companies are reluctant to release information on drug counterfeiting out of fear that if customers think they are in danger of receiving a fake product, they will be reluctant to buy legitimate products. They largely have the backing of regulators in this stance. After fake malaria drugs, Halfan diluted to forty-percent strength, were found in Kumasi, Ghana, GlaxoSmithKline allegedly warned local authorities away from making a public announcement.<sup>36</sup>

## **POLICY RECOMMENDATIONS**

The Halfan episode exhibits what is probably the single biggest obstacle to overcome in combating global pharmaceutical counterfeiting. The public is largely unaware of the extent of the problem, with pharmaceutical companies intentionally keeping the knowledge from going public and government regulators unwilling to push for specific public details. Public warnings any time a counterfeit pharmaceutical is found should be mandatory. Pharmaceutical companies could create a lot of goodwill by being out front on this topic, rather than waiting

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<sup>36</sup> Cockburn.

until a public health disaster happens only to have it revealed that they were aware of the problem. A database of fake drugs uncovered by the world's largest pharmaceutical companies is kept at the Pharmaceutical Security Institute, yet the data are not made public. The companies claim they are trying to avoid creating a public panic.<sup>37</sup>

The fate of the people in such an important public health topic should not be in the hands of the pharmaceutical companies who may be trying to protect their own profits more than public health. As economic actors, pharmaceutical companies would need an economic incentive to be significant participants in the fight against fake pharmaceuticals. This would require a balance in which pharmaceutical companies are protected from economic losses due to disclosure of counterfeits, but also face heavy economic sanctions if they fail to disclose their knowledge.

It should be required that all fake pharmaceutical discoveries be reported to both national and international organizations, and cataloged in publicly-available databases. Any pharmaceutical company that is made aware of a counterfeit version of one of its drugs and fails to report it should face significant sanctions, including loss of market access. One could argue that the threat of major penalties for a failure-to-disclose could result in the pharmaceutical companies adopting a 'head in the sand' approach in which they willfully try to avoid discovering counterfeits. This misses two important points. The first is that the discovery of counterfeits is often not made by the companies themselves, but by officials in the countries

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<sup>37</sup> Cockburn, 2005.

where the fakes are found. Those officials could report the find to the company, in which case the company would be required to publicly disclose it. Or the official could simply report the fakes directly to the national or international organizations involved, which would in turn notify the company. The second point against the 'head in the sand' idea is that pharmaceutical companies are not disclosing the counterfeits they find now, so what difference would it make if they were to be less vigilant in searching for counterfeits in the future?

Policies to combat counterfeiting of consumer goods would be more difficult to implement. As shown, the policies are already in place in individual countries and through organizations like the WTO; it is the will to enforce these policies that is missing. On the one hand, it is legitimate to ask whether a crack-down on counterfeit consumer merchandise is really appropriate. One characteristic frequently associated with organized crime is that it seeks out the path of least resistance. It will weigh the opportunities to make profits with the likelihood of apprehension and severity of penalties. Counterfeiting offers the rare combination of extraordinarily high profits with very low likelihood of apprehension and minor penalties. And when compared with other activities typically conducted by organized crime, such as human, drug and arms trafficking; prostitution; racketeering; armed robbery and murder, the social cost of fake handbags and TVs seems relatively low. Perhaps it would be better to leave organized crime to counterfeiting if it means they will reduce their amount of activity in more destructive areas.

Huge multinational corporations have taken advantage of the increased speed and availability of trade to create multi-billion dollar organizations with larger proceeds than some

entire countries. Should governments and international organizations be spending their own limited resources to help these companies protect their profits?

Nevertheless, the counterfeit trade preys on often unsuspecting victims with deadly consequences. It would be inconsistent for authorities to aggressively pursue counterfeit health and safety products and let other counterfeit products into the market with indifference. That is essentially the approach taken by law enforcement now, and they have been unable to adjust as the global trade in counterfeit pharmaceuticals, car parts, and other dangerous products has grown in recent years. The success of Operation Summer Solstice shows the potential of bilateral efforts between countries hosting the suppliers and countries hosting the consumers. But offended countries also need to exert their rights of retaliation through the WTO if China does not show significantly more willingness to pursue the criminals on their own.

A large part of the problem lies with consumers. The Recording Industry Association of America (RIAA) attempted to combat electronic music piracy by suing those who downloaded illegal products. The backlash the industry received as RIAA lawyers took grandmothers and college students to court shows the difficulty in pursuing consumers as a tactic to combating counterfeiting. Public awareness campaigns about the often dangerously-substandard quality of counterfeits is probably the only realistic approach to reducing consumer demand.

The lackadaisical current approaches to combating counterfeiting has led to criminal enterprises making billions of dollars a year with little fear of apprehension or punishment. As the counterfeiters reach into increasingly dangerous products, awareness and enforcement must respond in kind.

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