



# Southern China International MUN

## *Official Background Guide*

*Ecofin Committee: Addressing the economic impacts of counterfeiting in China in relation to the global industry*

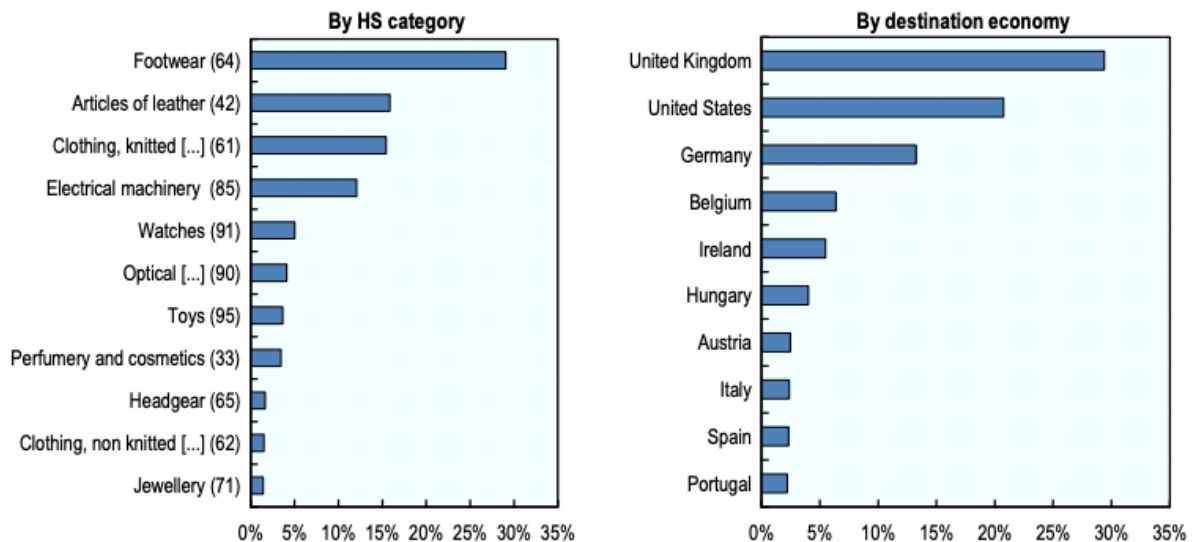
*Agenda overseen by: Eva Zhong*

\*Note: All mention of *China* within this report will pertain to information and statistics regarding Mainland China. Hongkong, Macau, and Taiwan will be named separately.

## **1. Description of the Issue**

### **1.1 History of the Issue**

Counterfeiting is the criminal practice of producing and distributing unauthorized goods that resemble (but is not) a trademarked commodity. Counterfeited products, though oftentimes visually similar to their authentic counterparts, are usually manufactured using low-quality materials in sub-par environments. According to estimates from the Organization for Economic Cooperation and Development (OECD) over 500 billion US dollars (or 3.3%) of world trade can be attributed to counterfeit and pirated goods in 2016.<sup>13</sup> “*Counterfeit trade takes away revenues from firms and governments and feed other criminal activities. It can also jeopardise consumers’ health and safety,*” stated Public Governance Director Marcos Bonturi of OECD.<sup>15</sup> The People’s Republic of China has been long-recognized as the number one source of counterfeit commodities within the international trade scene, surpassing all other nations compounded. China is involved in the production of a wide variety of counterfeit commodities, ranging from electronics to clothing to cosmetics and pharmaceuticals. Though China is the greatest exporter of counterfeit goods, it is also a victim of its own crimes. Furthermore, it is crucial to understand that the pirating of intellectual ideas is essentially what drives the industry as a whole. Over 70% of counterfeit Chinese goods traded globally are produced within China. In that sense, the Chinese counterfeiting industry impacts international economies and its own.<sup>10</sup> Counterfeiting threatens businesses, consumer rights, government legislation, and more. Therefore, it is highly essential to addressing the economic impacts of counterfeiting in China in relation to the global industry.



There are two main types of counterfeiting: **deceptive and non-deceptive**. Deceptive counterfeiting has the aim to deceive consumers into believing that the fake products they are purchasing are originals. Deceptive counterfeit commodities utilize brand names and logos to confuse unsuspecting customers. This method of counterfeiting results in diminished economic welfare for the consumers and the original suppliers. In contrast, non-deceptive counterfeiting refers to the situation where consumers are knowing and willing to purchase a counterfeit item due to a want for lower prices. In these cases, the suppliers are the greatest victims. Non-deceptive counterfeiting creates competition for original brands who manufacture their products at higher costs. Both types of counterfeiting, however, ultimately damage the legitimate global trade of goods, negatively impacting consumers and suppliers respectively.<sup>4</sup> China, at the forefront of global commercial counterfeiting, participates in both.

To understand China's current large involvement in counterfeiting on a global scale, China's past economic and financial standings must be examined. Though counterfeiting itself is an illicit activity, the industry grew as a result of economic growth. During the late 1970s, Chinese politician Deng Xiaoping spurred progress to reform China's economy. During this period, international companies were welcomed to place their investments within Chinese borders. Due to China's minimal wages and looser production regulations, many foreign businesses were interested in offshoring their manufacturing to this country. As new industrial influences appeared in China, locals found the opportunity to re-create these branded products as cheaper counterfeits.<sup>1</sup> Throughout the decade between 1990 and 2000, the trend of rapid growth in counterfeiting can be observed in mainland China. This can be attributed to the presence of more luxury fashion brands from Western countries within Chinese borders. Due to its experience collaborating with international brands, Chinese factories have developed the skills to counterfeit all of the most popular products being sold globally. Thus, China was able to disrupt the global economy with its large counterfeit industry. In the late 2000s, an estimated 230 million US dollars of counterfeit products from China were identified in the United States alone, which is close to 90% of counterfeit

commodities intercepted cumulatively. In Europe, officials believe that over 60% of counterfeit items intercepted originated in China.<sup>5</sup>

Despite its huge participation in the counterfeit industry, China does, in fact, exercise laws and regulations regarding intellectual property rights (IPRs), which has been recognized back in 1980. However, though trademarks, copyrights, and patents are addressed in Chinese Criminal Law, the enforcement of these regulations are lacking.<sup>10</sup> Additionally, there exists a loophole within the Chinese Criminal Code that serves as an appealing incentive for suppliers to participate in counterfeiting. Even though the sale of counterfeit goods within China may be a risky endeavor, it becomes difficult for governments to trace such illicit activities once they exit the Chinese borders. Therefore, Chinese authorities are less interested in the economic damages caused by counterfeit products that are traded abroad.<sup>5</sup>

The act of counterfeiting brings about numerous negative implications: it primarily decreases revenue generated by legitimate businesses, destroys the integrity of brands, incurs high costs in order to enforce intellectual property rights, diminishes consumer satisfaction, and causes job losses.<sup>18</sup> To start, legitimate businesses are directly harmed. The original business will be required to compete with counterfeiters, which means they are losing more and more revenue from sales. Furthermore, the involvement of counterfeit products will make it increasingly difficult for legitimate producers to enter the market due to their competitive disadvantage of higher material costs. Not to mention the fact that if customers are deceived into believing they have purchased the real product when it is actually a counterfeit, they will most likely condemn legitimate manufacturers if the forged product's quality is sub-par. Next, filing lawsuits and starting investigations to protect intellectual property rights against counterfeiting is a long and costly process. If counterfeiting continues, a business will have to delegate a large portion of their budget into anti-counterfeiting when it could be used more effectively elsewhere.<sup>18\</sup>

However, the businesses are not the only ones suffering financially, countries that export and import counterfeits are harmed as well. China, the number one exporter of counterfeit products, might find itself in a challenging predicament.<sup>18</sup> First of all, overseas businesses might become disinclined to manufacture their goods in a nation that is infamous for producing counterfeits - foreign companies fear that China will infringe upon their intellectual property rights. Furthermore, even if legitimate manufacturers in China are producing for a respected brand, the products may have an inferior reputation of being low quality, simply because the manufacturing is completed in a country known for counterfeiting. If products from manufacturers cannot be sold, businesses will be forced to lay off a substantial amount of employees - this creates extreme job losses. Countries that import counterfeit goods also become victims in this sadly large and scarily powerful industry. Developed countries that are victims of counterfeit products from China will have to allocate government funds into enforcing intellectual property rights and spending more time to legally punish counterfeiters.<sup>15</sup>

## 1.2 Recent developments

Counterfeit products from China have dominated global trade economies in recent years. In spite of the many attempts to enforce legislation, global exchanges of counterfeit commodities have doubled since 2008.<sup>1</sup> In 2016, China produced 47% of global counterfeit exports, which is valued at around 240 billion US dollars.<sup>13</sup> Counterfeit products from China enter 150 economies all around the world, including that of developed countries such as Australia and Switzerland.<sup>10</sup> In 2018, counterfeiting was named the “largest criminal enterprise in the world” in 2018 by Forbes business magazine.<sup>14</sup> Though counterfeiting within the nation is nearing saturation in multiple economic sectors, exports of counterfeits from China to international economies are predicted to grow extensively in the coming years.<sup>5</sup> Current estimations predict that China is now responsible for close to 80% of fake commodities present in the global marketplace. Currently, brands in the United States, Italy, and France are most impacted by counterfeit goods from China, with their intellectual property rights infringed upon massively. For example, the Department of Homeland Security in the United States reported that nearly 90% of seized counterfeit products originated in mainland China or Hong Kong.<sup>9</sup> The recent development of e-commerce platforms have also created channels for distributors to sell counterfeit products, creating more challenges when monitoring online transactions. The sheer number of counterfeit suppliers is a huge issue to be addressed as well.

The counterfeit industry in China is still expected to grow immensely, and the issue of counterfeiting will continue to destroy global economies. The current statistics from the **Business Action to Stop Counterfeiting and Piracy (BASCAP)** and the **International Trademark Association (INTA)** values the worldwide counterfeit industry at more than 1.7 trillion US dollars and is predicted to increase close to 3 trillion US dollars and remove close to 5.5 million jobs by 2022. As quoted from the International Chamber of Commerce (ICC), the counterfeit industry “*creates an enormous drain on the global economy – crowding out Billions in legitimate economic activity and facilitating an “underground economy” that deprives governments of revenues for vital public services, forces higher burdens on taxpayers, dislocates hundreds of thousands of legitimate jobs and exposes consumers to dangerous and ineffective products.*” Action is needed immediately in addressing the economic impacts of counterfeiting in China in relation to the global industry.<sup>3</sup>

## 2. Emphasis of the Discourse

### 2.1 Right-wing approach

Right-wing ideologies regarding economics and policy-making largely focuses on reduced regulations on businesses. Though this provides businesses with more freedom, it does also diminish the supervision of counterfeiting that occurs as a criminal business enterprise. As a result, governments are more reluctant to intervene when problems arise. The Chinese

government, though aware of the issue's severity, is not strengthening regulations on counterfeiting in an effective manner. Economies are still up and running despite the issues, as right-wing beliefs trust that the problems will be resolved over time through continued free-market trading. That is not to say they are inactive in addressing the problem, they are simply more likely to strengthen legitimate trading processes to recover economic losses from counterfeiting. Additionally, right-wing nations focus on internal collaboration and modification when issues arise. Therefore, they are less likely to accept support or resources from other nations. Right-wing approaches generally focus on smaller and slower changes within the nation to stop counterfeiting from impacting the global industry.

## **2.2 Left-wing approach**

Left-wing ideologies regarding economics and policy-making center around stronger regulations on businesses to improve overall social welfare. Though the United States is a largely capitalist nation that falls under right-wing ideals when it comes to economics, their approach to resolve this issue may lean more towards the left. Left-wing nations are more likely to implement stricter policies in order to protect the rights of businesses and consumers. Their approach may be more collaborative, by interacting with other nations to develop collective strategies to combat counterfeiting. Left-wing approaches emphasize greater reforms and international participation to target counterfeiting.

## **2.3 Stance of intergovernmental organizations**

**The Organisation for Economic Co-operation and Development (OECD)** is an international organization with more than 30 member nations working towards accelerating economic progress and global trade. The organization provides an opportunity for countries to discuss, compare, coordinate, and improve financial policies both regionally and internationally. However, the organization's members are mostly higher-income countries that comprise a large percentage of the world's gross domestic product - the United States, the United Kingdom, Australia, Canada, France, Germany etc. The OECD has been closely following counterfeit trading worldwide while producing informative news reports regarding relevant statistics and trends. The OECD identifies mainland China and Hong Kong as the largest manufacturers of counterfeit goods. The organization analyzes that "*free trade zones – where economic activity is driven by reduced taxes, customs controls and lighter regulation – can unintentionally facilitate counterfeit trade*".<sup>15</sup> In 2018, OECD is collaborating with its member states to construct proper protocols to assist authorities address the issue directly. Additionally, the OECD has carried out appraisals regarding the economic frameworks used to combat counterfeiting in China specifically, concluding that Chinese authorities have been enhancing efforts to halt counterfeit production and exportation. However, China still requires continued efforts in terms of international cooperation with domestic economies.<sup>10</sup> Since China is not a member of the OECD, the organizations' evaluations are representative of other economies impacted by China's involvement in counterfeiting.

**The World Trade Organization (WTO)**, as the largest intergovernmental organization that facilitates and regulates international trades, has been working with China as of 2001. China's request for accession within the organization has been difficult, due to the lack of transparency and intellectual property policies.<sup>6</sup> *“Seventeen years after China joined the WTO (2018), China still falls considerably short of fulfilling its WTO obligations to protect intellectual property”*.<sup>2</sup> The **Trade-related Aspects of Intellectual Property Rights**, otherwise known as the TRIPS agreement, serves to reduce economic damages from counterfeiting by allowing members to extensively protect intellectual property. When dealing with the issue of counterfeit products from China to other economies within the organization, the WTO has jurisdiction over dispute settlements and enforcing regulations. Trade treaties are established between countries. The WTO recognizes the issue of Chinese businesses violating intellectual property rights and can pressure China to fulfill their obligations to the organization if other members propose such requests. The United States, for example, has utilized the WTO to scrutinize China's enforcement of intellectual property laws, and successfully so.<sup>2</sup> The WTO essentially acts as a third-party organization that monitors China's international trade activities. Nonetheless, the organization necessitates other member states to collaboratively improve China's legal system regarding intellectual property rights and counterfeiting.

**The United Nations Office on Drugs and Crime (UNODC)**, recognizes the illicit trafficking of counterfeit goods as an organized crime prevalent to both national and international economies. Counterfeit goods account for approximately 1/3 of economic losses resulting from organized crime in East Asia alone (90 billion US dollars), and China is the primary producer. *“In many parts of the world, international, regional and national law enforcement authorities have uncovered intricate links between this crime and other serious offences including illicit drugs, money laundering and corruption”*.<sup>17</sup> In general, the organization believes that continuous counterfeiting from China will prompt the expansion of other large-scale criminal activities that will have extensive economic and social costs. Therefore, the UNODC stresses operational actions to enforce legislation to prevent counterfeit products from entering the international trade scene, and emphasizes the importance of educating consumers to make informed decisions.<sup>17</sup>

## **2.4 Stance of developed countries**

More economically developed nations, such as the United States, United Kingdom, Germany Switzerland, Australia, France etc. are both more financially able to recover from the economic costs of China's counterfeiting and more involved in combating the issue as a whole. Furthermore, *“the relative impact of counterfeiting is twice as high for a group of developed countries, such as the EU, than it is for the world as a whole”*.<sup>12</sup> This statistic suggests that developed countries are greater victims of counterfeiting. First of all, developed countries with a wide range of products, businesses, and brands manufacture their commodities in China. Additionally, they are the largest retailers of common house-hold items and luxury goods. As a result, counterfeit exports from China damage the authentic

businesses present in developed countries. During a meeting with WTO members regarding counterfeit trademarks good back in 2012, representatives from developed countries considered “*counterfeiting to be one of the most serious problems to be discussed...because of the economic loss and because the products can be dangerously sub-standard*”.<sup>6</sup> Developed countries with more well-developed intellectual property rights view counterfeiting as one of greater concern. Additionally, consumers in developed countries have a higher standard of living and an increased financial ability to purchase authentic products. Consequently, developed nations are willing and able to combat counterfeiting in China to alleviate economic costs to the global industry.

## **2.5 Stance of developing countries**

Developing countries such as **China, India, Turkey**, are among the largest exporters of counterfeit goods. However, governments of these nations have not prioritized regulations protecting intellectual property rights. In fact, the economies of these nations have endured drastically in recent years that combating counterfeit trade has not been the main focus. As a result, there is a general lack of awareness regarding the economic severity of counterfeiting. It is also important to understand that, in contrast to developed nations, consumers in less economically developed countries are more inclined to purchase counterfeit products due to their lacking financial capabilities. Similarly, many individuals choose to participate in counterfeit production due to the lack of available jobs to fulfill monetary requirements for basic needs. However, the prospect for combating counterfeit goods is still positive: “*rapidly emerging economies such as Brazil, Mexico, China, and Turkey see increasing interest among growing middle classes for higher quality goods protected by recognizable brands. There is also a rapid trend among innovative local firms toward brand development, investments in product variety and quality*”.<sup>4</sup> These mindset changes will prompt greater focus towards combating counterfeit production. Certain industries in developing countries have been saturated by counterfeit products to the point where authentic products are obstructed from entering the market.<sup>18</sup> The economic damages of counterfeit products is great for local brands within developing countries, resulting in an increased willingness for China and other developing nations to start addressing the problems in collaboration with developed countries.<sup>4</sup>

## **3. Possible Solutions**

### **3.1 In favor of developed countries**

Developed nations such as the **United States, the United Kingdom, Australia, Canada, France, Germany** are often heavily involved in intergovernmental initiatives to combat counterfeiting. These governments would therefore benefit from further collaboration through multilateral organizations that address the problem - OECD or WTO as mentioned previously. Through trade agreements within countries, official clauses can be developed to enforce counterfeit regulations. In terms of stricter regulations, developed countries could

emphasize the importance of criminal proceedings regarding copyright infringement cases. The compensations that counterfeiters will have to pay to authentic producers will help alleviate part of the economic burden. Next, expanding the scope of monitoring and screening to prevent counterfeit products from entering the global trade scene should be an area of focus for developed countries. These nations have the financial capabilities to create funds especially directed towards economic losses from counterfeit products. Additionally, they are more experienced with regulating counterfeit industries as seen by their membership in related organizations. With a significant amount of imports in developed countries being counterfeits from China, they have a strong incentive to halt this situation actively. Conclusively, developed nations are more willing and able to provide assistance in diminishing counterfeit exports from China to improve the legitimacy of international trade activities. The main focus of developed countries should center around developing stricter regulations and regulatory frameworks, enforcing copyright laws in China and leading the efforts.<sup>3</sup>

### **3.2 In favor of developing countries**

Countries that are still developing economically, China included, would benefit more from solutions related to raising awareness. The concept of copyright is not as prominent in developing countries, which is the reason behind the persistent counterfeit industries in these regions.<sup>10</sup> It is crucial for all stakeholders to be fully aware and informed of the problems associated with counterfeiting. Carrying out training and education programs to producers and creating public service announcements to consumers will largely improve awareness around the problem. Once the negative economic and financial implications of counterfeiting are made aware to Chinese citizens, it may help deter the number of consumers or workers that participate in counterfeit activities. Additionally, developing countries would benefit from evaluative assessments of current regulations regarding counterfeiting. It is true that top producers of counterfeit products - **China, India, Turkey, United Arab Emirates** - do have relatively weaker policies in this area. As analyzed before, the counterfeit industry continues to thrive in areas of poor governance. Identifying areas for improvement and strengthening the overall structure of counterfeiting regulations will greatly lower activity levels. Intellectual property and copyright laws in China can be revised with input from foreign nations; this will once again encourage overseas businesses to continue manufacturing work in China. Lastly, a powerful international organization such as the United Nations can create a specialized fund for counterfeiting: financial damage already done can be compensated for and investments can be made towards further combating efforts. The main focus of developing countries should be to raise awareness of counterfeit, strengthening current laws, and introducing international collaborative efforts into China.

### **4. Keep in Mind the Following**

During your research process for your country's stance and respective solutions, remember to concentrate on their membership in intergovernmental organizations, counterfeit



inputs/exports within the global trade market, relationship with China, and how they are financially/economically impacted by counterfeit. The following questions should be considered during research:

1. To what extent counterfeiting industry in China largely impacting the normal economic activities within nations?
2. How have financial or economic costs of counterfeiting been alleviated in the past?
3. What efforts are intergovernmental organizations and international initiatives pushing to resolve counterfeiting in China? Are they successful?
4. Does the government have the authority and capability to control the growing counterfeit industry? If so, how should administrative powers be effectively utilized?
5. How does the financial and economic costs of combating counterfeiting compare with the potential benefits that will result?
6. To what extent will international cooperation to counter counterfeiting in China bring about positive change for the global trade scene and worldwide economies collectively?

## **5. Evaluation**

The Organization for Economic Cooperation and Development summarizes that “*Illicit trade in fake goods is a longstanding problem that keeps growing in scope and magnitude. These practices have negative effects on the sales and profits of affected firms while raising adverse revenue, economic, health, safety and security effects for governments and consumers*”.<sup>11</sup> As China’s counterfeit industry is expected to grow, it is crucial for us to examine the economic and financial implications for the global market. Through international cooperation between countries and organizations, counterfeit frameworks and regulations should be adopted and enforced. Increasing awareness regarding the implications of counterfeit within China and providing financial support to help the nation alleviate the problem will ultimately benefit global trade activity as a whole. For a long-standing issue in a nation with the largest established industry, innovative and strategic approaches are essential to an effective resolution. Good luck.

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