

# **BOOTLEG BILLIONS**

## **THE IMPACT OF THE COUNTERFEIT GOODS TRADE ON NEW YORK CITY**

**City of New York  
Office of the Comptroller**

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**November 2004**

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## Executive Summary

The Comptroller's Office estimates that \$23 billion was spent on counterfeit goods in New York City during 2003. This illegal trade deprived the City and its residents of about \$1 billion in tax revenue. The loss of this revenue significantly affects the City's ability to deliver essential services such as education, public safety and sanitation, and creates a higher tax burden for all City residents. Counterfeiting also displaces New York City payroll jobs and poses significant health and safety risks to the City's residents.

The dollar exchange of counterfeit goods in New York State during 2003 was estimated to be \$34 billion and deprived the State of approximately \$1.6 billion in tax revenue.

New York State and New York City lost a combined total of approximately \$2.6 billion in tax revenue in 2003 as a result of the sale of counterfeit goods.

- The estimated dollar exchange associated with counterfeiting throughout the United States during 2003 was \$287 billion, which is 63 percent of the total \$456 billion annual worldwide trade in counterfeit goods.<sup>1</sup>
- Counterfeiting activity also poses significant safety risks to the population including risks associated with counterfeit drugs and other dangerous, unregulated products.
- New York City suffers a high share of counterfeiting (8% of the nation)<sup>2</sup> for several reasons:
  - The high shipping volume at the City's Port includes 13.4 percent of total U.S. container traffic.
  - The City is a lucrative market for counterfeit sales because New York City's per capita income is 22 percent higher than the U.S. average.
  - New York City's high sales tax increases the cost of legitimate retail goods. The large differential between legitimate goods, and untaxed counterfeit goods creates a further demand for lower-priced counterfeit goods. The City's sales tax revenue per resident totaled \$440 in 2000; the highest in the U.S.
  - The large City population and the significant number of visitors to New York City generates high demand for both legal and counterfeit goods.<sup>3</sup>

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<sup>1</sup> See Summary Table.

<sup>2</sup> Large-scale production of counterfeit goods occurs within New York City as evidenced by the fact that 42 percent of all counterfeit compact discs seized in the U.S. are made within the New York metropolitan area.

<sup>3</sup> In 2003, New York City had 37.8 million visitors; 4.8 million of them from abroad.

## **Recommendations:**

- Create an industry task force including representatives from New York State, New York City and the Federal government.
- Seek dedicated funding from the Federal and State governments to support enforcement. Recycle a portion of revenues generated by fines and enforcement actions to further strengthen enforcement.
- Encourage the creation of an intellectual property research and training center that would be associated with a public or private institution.
- Increase public awareness and education regarding counterfeit trade and implement regulations to make it easier for consumers to know when they are buying from legitimate street vendors.
- Extend the advanced techniques and benefits of industry-wide anti-counterfeiting intelligence-- such as the type developed by the music industry--to industries that do not yet use such techniques.
- Increase enforcement of existing laws against the counterfeiting industry, such as enforcing safety regulations applicable to retail stores.

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## Introduction

The alarming rise of global trade in counterfeit goods continues to threaten New York City's economy in very significant ways. The fiscal implications of this illegal activity are most perceptible in lost tax revenues to the City, which based upon the analyses that follow, annually exceed \$1 billion.

- Unpaid New York City Sales Taxes: \$380 million;
- Unpaid New York City Business Income Taxes: \$290 million; and
- Unpaid New York City Personal Income Taxes: \$360 million

The resulting revenue loss to the City of New York deprives City residents of critical services--such as education--and opportunities to fund salaries for additional police and fire personnel. The counterfeit goods trade also presents significant safety risks to the residents of our City.

The sale of counterfeit goods continues to escalate and undermines the fiscal strength of the national, state and local economies.

**The following summary table highlights the dollars exchanged for counterfeit goods.**

Summary Table, *Counterfeit Trade, U.S., NYS, NYC, 2003*

Row	Region/Country	Value	Basis for Estimate
1	World	<b>\$456 billion</b>	6% of \$7.6 trillion world trade
2	U.S.	<b>\$286.8 billion</b>	62.9% of \$456 billion world trade
3	New York State	<b>\$34.4 billion</b>	12.0% of \$286.8 billion U.S. trade
4	New York City	<b>\$22.9 billion</b>	8% of \$286.8 billion U.S. trade

### 1. The Global Supply Chain for Counterfeit Goods<sup>4</sup>

The volume of counterfeit goods in New York City is substantial. This is due in part to the highly organized global supply chain for counterfeit goods and the attraction of New York City as a gateway to U.S. markets. Counterfeit goods follow the typical trade pattern of legitimate goods and a large percentage of these items originate in Asia. Unfortunately, Asia (with the exception of Japan) remains the area with the lowest enforcement rate of intellectual property rights in the world.

#### **The World-Wide Counterfeit Trade: \$456 billion**

Anti-counterfeiting organizations at the local, national and international level have estimated the size of counterfeit sales in the world as a ratio of counterfeit goods to all trade. The International Chamber of Commerce (ICC) estimated in 1996 that a range of 5 to 7 percent of world trade was in counterfeit goods.<sup>5</sup> World trade grew from \$3.6 trillion in 1990 to \$5.3 trillion in 1996 to \$6.2 trillion in 2000<sup>6</sup> and

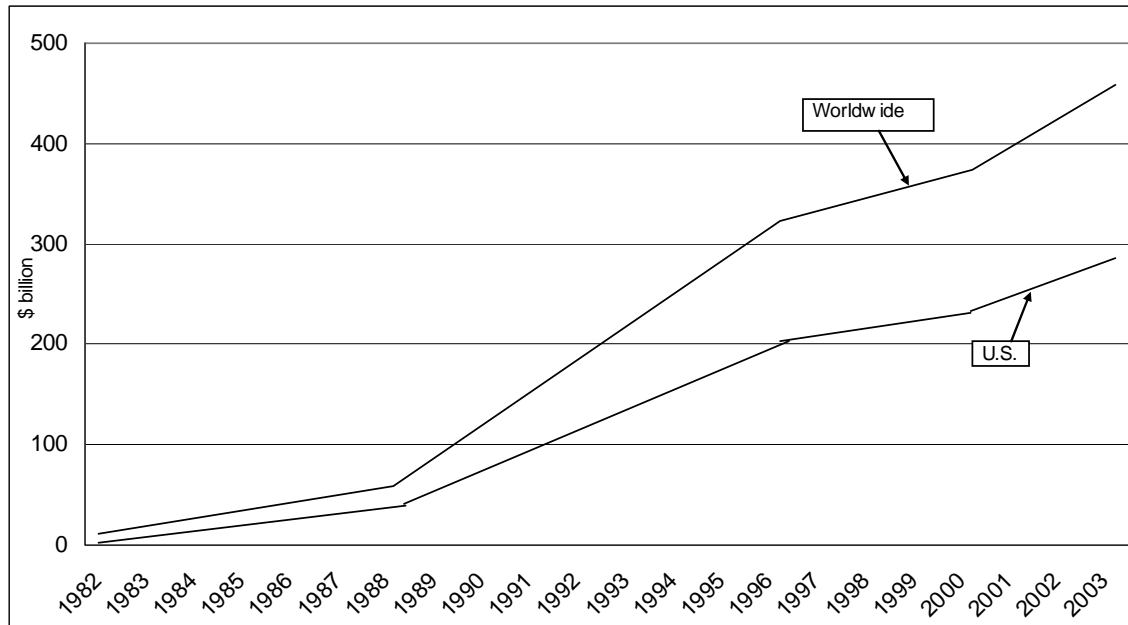
<sup>4</sup> Counterfeiting is the term applied to the sale of goods that are not authentic but are manufactured, packaged or labeled (or all three) to look like the authentic product. Authentic products are manufactured under copyright, trademark or patent protections that are collectively called "intellectual property" rights.

<sup>5</sup> International Chamber of Commerce, ICC Commercial Crime Services, "A Brief Overview of Counterfeiting," [www.iccwbo.org/ccs/cib\\_bureau/overview.asp](http://www.iccwbo.org/ccs/cib_bureau/overview.asp).

<sup>6</sup> *Statistical Abstract of the United States 2002*, Table 1307, 823, based on data from the U.N. *Monthly Bulletin of Statistics*.

\$7.6 trillion in 2003.<sup>7</sup> Using a conservative, 6 percent estimate (the mid-range of the ICC's 5-7 percent estimate) translates to world-wide counterfeiting totaling \$456 billion during 2003. (See Chart 1.)

Chart 1. *Estimates of Counterfeiting, Worldwide and U.S., Trend, 1982-2003, \$billion*



Source: Worldwide counterfeiting data are based on 6% of world trade as follows:

**1982:** \$5.5 billion. International Trade Commission, cited in Abbott and Sporn, 2002.

**1988:** \$60 billion. International Trade Commission, cited in Abbott and Sporn, 2002.

**1996:** .06 x \$5,300 billion = \$318 billion. International Chamber of Commerce and U.N.

**2000:** .06 x \$6,200 billion = \$372 billion. International Chamber of Commerce and U.N.

**2003:** .06 x \$7,600 billion = \$456 billion. World Trade Organization.

A number of observers have argued that counterfeiting is growing faster than legitimate trade. In 1998, the Organization for Economic Cooperation and Development estimated that trade in counterfeit goods had grown to 9 percent of world trade.<sup>8</sup> Customs seizures in the United States, Japan and Europe have rapidly increased--nearly doubling in the United States between 2001 and 2003 and increasing five-fold in Japan over roughly the same period.<sup>9</sup>

<sup>7</sup> Merchandise trade – commercial services were another \$1.8 trillion. World Trade Organization, April 5, 2004.

<sup>8</sup> OECD, *The Economic Impact of Counterfeiting*, 1998 and [http://bmhk.com/hkjpg/documents/WEF\\_counterfeiting.doc](http://bmhk.com/hkjpg/documents/WEF_counterfeiting.doc).

<sup>9</sup> Arai Hisimitsu, Secretary-General, Intellectual Property Strategies, "Protection is the Mother of Invention," *The Japan Journal*, October 2004, 18-19. The number of shipments of goods stopped and seized at Japanese Customs increased nearly five-fold between 2000 and 2003, from 1,600 to 7,400.

## **2. The Cost of Counterfeiting to the United States**

### **U.S. Counterfeit Trade: \$287 billion**

The U.S. remains the preferred destination for counterfeit goods because:

- The price of goods in the U.S. is typically higher than in the rest of the world.
- The U.S. imports a large quantity of legitimate goods that in 2003 were shipped primarily in more than 8 million 40-foot containers.<sup>10</sup> This high-volume import flow provides unique opportunities for integrating counterfeit goods into containers housing legitimate goods. The U.S. is not yet equipped to monitor adequately this high volume of container traffic. This weakness in U.S. security is of deep concern to officials combating terrorism, who are taking action by strengthening requirements regarding the contents of container ships before these shipments are unloaded in U.S. ports. The U.S. has devoted significant resources to monitoring this container traffic but additional efforts are essential to reduce this problem.
- The population density and transportation networks in U.S. cities provide many alternatives for anonymously distributing counterfeit goods.

The Office of the U.S. Attorney General announced on October 6, 2004 that a Justice Department intellectual-property task force would seek “new investigative resources” and “new prosecutorial tools” to address intellectual property theft. This initiative may provide an opportunity for New York City to leverage Homeland Security involvement in anti-counterfeiting efforts and the potential for enforcement resources for localities such as the City of New York.

The Comptroller’s Office estimates that the total dollar exchange of counterfeit goods in the U.S. during 2003 totals \$287 billion. This estimate is based upon an update of a 1996 estimate of U.S. losses.<sup>11</sup>

## **3. The Cost of Counterfeit Goods Sold in New York State in 2003**

### **New York State Counterfeit Trade: \$34 Billion**

New York City’s gross product in 2003 was \$430 billion, approximately 4 percent of Gross Domestic Product (GDP). In 2001, the New York Gross State Product (GSP) was \$826.5 billion, or approximately 8 percent of that year’s GDP.<sup>12</sup> New York State (excluding New York City) produced approximately 4 percent of GDP. The Comptroller’s Office estimates that New York City’s share of the U.S. counterfeit goods trade is twice its share of gross product, i.e., 8 percent of \$287 billion. The Comptroller’s Office also estimates that New York State’s share of the counterfeit-goods trade--excluding New York City--is the same as its share of GDP, i.e. 4 percent. New York State and New York City together constitute 12 percent of the counterfeit goods trade or approximately \$34.4 billion.

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<sup>10</sup> Estimates of the number of containers that arrived in the United States in 2003 range as high as 20 million. The difference appears to the Comptroller’s Office to be explained by the fact that 20-foot and 45-foot containers are used as well as the most common (in U.S. trade) 40-foot containers and that shippers seeking more precise terminology speak of 20-foot-equivalent units (TEUs), so that 8 million 40-foot containers would be described as 16 million TEUs.

<sup>11</sup> David Stipp, “Farewell, My Logo,” *Fortune*, May 27, 1996.

<sup>12</sup> U.S. Department of Commerce, *Statistical Abstract of the United States*, 2003, Table 663. GDP in 2001 was \$10.1 trillion. GDP in 2003 was \$11.0 trillion.

## Unpaid Taxes – New York State Fiscal Loss – \$1.6 Billion

New York State loses an estimated \$1.6 billion in taxes (sales and income), 4.75 percent of the \$34.4 billion New York State counterfeit goods trade.

### 4. Counterfeit Goods in New York City and Related Unpaid Taxes

New York City generates about four percent of U.S. GDP (\$430 billion<sup>13</sup> out of \$11 trillion<sup>14</sup> in 2003). Yet, it is estimated that NYC's Gross City Product accounts for 8 percent of all U.S. counterfeiting on a value-added basis--double the 4% national average. The disproportionate impact of counterfeiting on NYC is illustrated by the following:

1. *The Port of New York/New Jersey accounted for 13.4 percent of all containers imported into the United States in 2003.* In 2002, the Port of New York accounted for 4.2 percent of U.S. imports and 6.8 percent of U.S. exports.<sup>15</sup> In addition, the Port's six terminals and 1,200 acres for container storage make it the largest container port on the East Coast of North America.
2. *New York City accounts for 42 percent of seized counterfeit CDs (see Appendix), suggesting that a high volume of counterfeit goods are processed through the Port of New York.* This large volume of goods displaces legitimate goods that would otherwise have been sold and taxed by New York City. During the first ten months of 2003, the State of New York accounted for 69 and 49 percent of seizures of counterfeit videocassette tapes and counterfeit DVDs, respectively. It accounted also for 52 percent of blank DVDs, 75 percent of DVD burners and 64 percent of VCRs.<sup>16</sup>
3. *New York City's average per-capita income is 22 percent above the national average.* In 2002, the average U.S. per capita personal income was \$30,804 and the average New York City per capita income was \$37,476.<sup>17</sup> High-income communities are better able to afford goods of any kind and the flow of legitimate goods simultaneously provides a well established transportation network for counterfeit goods.
4. *Sales-tax revenues per resident in 2000 was \$440; the highest of any U.S. city.* Counterfeiters, who typically do not collect sales taxes, can therefore offer a larger discount from retail prices than they otherwise could in a city with lower sales taxes. For the same year, Los Angeles' sales tax per resident was \$119; Chicago's sales tax per resident was \$63; Houston's sales tax per resident was \$160; Philadelphia's sales tax per resident was \$68; San Diego's sales tax per resident was \$305; Phoenix' sales tax per resident was \$211. These substantially lower amounts make the difference in price in New York City between legitimate and counterfeit goods greater than in these other cities.

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<sup>13</sup>Source: NYC Comptroller's Office.

<sup>14</sup> U.S. Department of Commerce, *Statistical Abstract of the United States*, 2003, Table 663. U.S. GDP in 2001 was \$10.1 trillion and in 2003 GDP was \$11.0 trillion. Source: U.S. Department of Commerce, Bureau of Economic Analysis (web site [www.bea.gov](http://www.bea.gov), November 2004), *National Income and Product Accounts*, Table 1.1.5, "Gross Domestic Product."

<sup>15</sup> Source: William Testa and Thomas Klier, "Estimating U.S. Metropolitan Area Export and Import Competition," *Economic Perspectives*, Fourth Quarter 2003, Federal Reserve Bank of Chicago, 13-27.

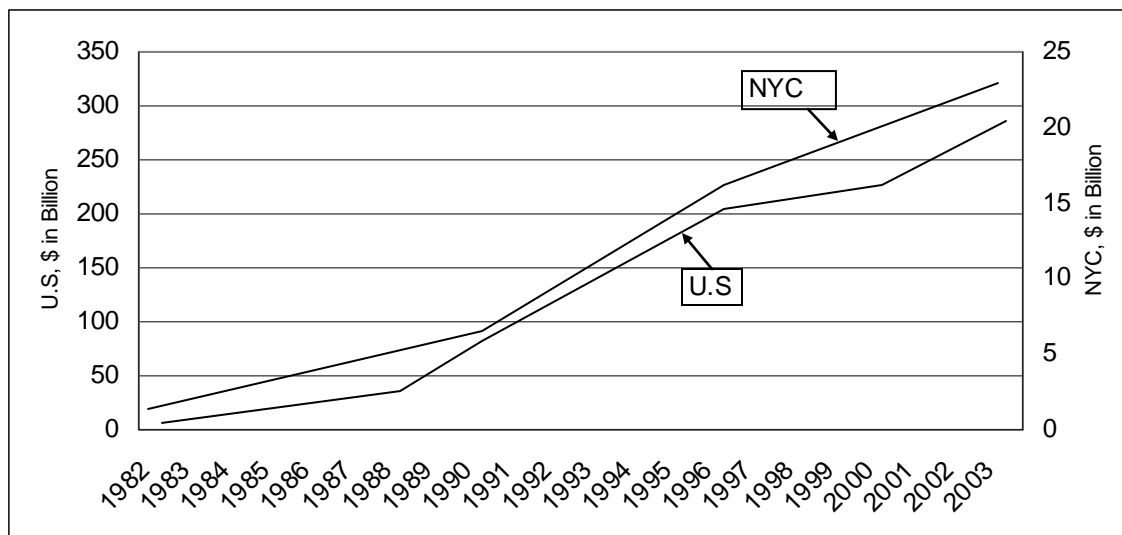
<sup>16</sup> Motion Picture Association of America, November 24, 2003.

<sup>17</sup> Source: Bureau of Economic Analysis, U.S. Department of Commerce.



5. *The City is a magnet for tourists and short-term residents*, in part because New York City is pedestrian-friendly. The City's high population density and substantial public transportation network make it easier to engage in sales of counterfeit goods.

Chart 2. *Growth of Counterfeiting in NYC, \$ billion, 1990-2003*



Source: NYC Comptroller's Office.

### **New York City Fiscal Loss: \$1.03 billion**

The estimated \$22.9 billion exchanged for counterfeit goods in New York City in 2003, cost the City \$1.03 billion in lost tax revenue. This estimate is obtained by applying the average NYC tax rate of 4.5 percent to the estimated \$22.9 billion exchanged for counterfeit goods. Combined with New York City's loss of more than \$1 billion, the State and City's loss of tax revenue exceeds \$2.5 billion.

The total fiscal loss to the City may be divided among the following major components of the City's taxes:

*Unpaid Sales Taxes: \$380 million.* Since counterfeit sales are illegal, sales taxes are not typically paid to the City or to the State. Many sales are made on the street or in offices. Further, when counterfeit goods are purchased at stores, the absence of a paper trail for these illicit goods makes it less likely that purchases can be traced for tax collection purposes. In addition, New York City is a wholesale outlet for counterfeit goods, with buyers from other parts of the U.S. or other countries traveling to the City to collect counterfeit items for retail sale elsewhere. The City also has many centers where counterfeit goods are shipped and thereafter distributed via parcel services.

*Unpaid Business Taxes on Production and Sale of Counterfeit Goods: \$290 million.* Hundreds of surveillance actions have been conducted at wholesale locations that have led to the discovery of confirmed manufacturers or suspected manufacturing locations within New York City. Much of this intelligence has resulted in arrests and seizures at these distribution and manufacturing locations. Although the New York City Police Department continues to make enormous strides in addressing this problem, the City's efforts are made more difficult because these illegal enterprises are easily established and are highly mobile. This Report's Appendix provides a detailed example of New York City's central role in the counterfeit goods supply chain.

*Unpaid Personal Income Taxes: \$360 million.* Since the manufacture, distribution and sale of counterfeit goods is illegal and is usually a cash transaction, vendor incomes are difficult to trace. The absence of a paper trail facilitates the failure of vendors to pay income taxes. The result is that the City loses personal income taxes as well as business income taxes.

*Indirect Losses to the City Economy and Revenue:* A further impact of counterfeiting is that it undermines the notion of fairness for those who pay taxes and endangers the future prosperity of the City's businesses and creative community. Businesses that pay sales taxes, companies that invest in branded products or enterprises that pay licensing fees for intellectual property will no doubt lose confidence in government if these rights are not vigorously protected. New York City has a significant stake in curtailing counterfeiting because it has many highly paid jobs that are tied to the creation and protection of *trademarks, copyrights* and *patents*. Those who prey upon the intellectual property of others may shrink the pool of investment in creative talent--designers, product developers, artists, musicians, advertising copywriters, marketing experts--and this pool of talent is one of New York City's greatest long-term assets.

## **5. Product Safety Issues**

In addition to the significant economic impact that counterfeit goods have both globally and locally, this illicit trade poses tremendous risks to the health and safety of City residents. Several examples of these risks are provided below.

### **Counterfeit Items Can Be Dangerous**

- Counterfeit electrical products are sold with fake brands or Underwriters Lab certifications. UL has seized more than 30 million counterfeit electrical products such as Christmas lights, electric fans and extension cords. Fake power strips are made with undersized wires that can cause fires.
- The World Health Organization reported that 10 percent of all pharmaceuticals in the world are counterfeit and as much as 60 percent in some developing countries.
- The Federal Aviation Administration estimates that 520,000 counterfeit airline parts are installed each year in U.S. planes.
- Each year about \$12 billion in counterfeit automobile parts are installed in U.S. cars.<sup>18</sup>

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<sup>18</sup> International Anti-Counterfeiting Coalition, "Facts on Fakes," 12-15.

## 6. Conclusions and Recommendations

Participation in a counterfeit economy is not a victimless crime. It places taxpaying businesses at a competitive disadvantage and deprives City residents of revenue for essential City services. By further reducing the distribution and sale of counterfeit goods the City could potentially lower taxes and/or provide better services to City residents.

### Responses to Counterfeiting

Cooperation between the City and industries most affected by counterfeiting is essential to reducing the impact of this activity. Several important support mechanisms exist that substantially assist private companies to detect and prevent counterfeiting:

- **International agencies** such as the Commercial Crime Services unit of the International Chamber of Commerce (ICC), which develops advanced techniques for identifying counterfeit goods and maintain databases of manufacturers and distributors of counterfeit goods.
- **Industry-wide coalitions** such as the Record Industry Association of America or the Motion Picture Association of America, which train police officers in identifying counterfeit goods and uncover sources of counterfeit goods to assist law-enforcement agencies.
- **Individual company agents** in the apparel, jewelry and other industries, which hire investigators and attorneys to work with law enforcement.

## **Recommendations:**

- Create an industry task force including representatives from New York State, New York City and the Federal government.
- Seek dedicated funding from the Federal and State governments to support enforcement. Recycle a portion of revenues generated by fines and enforcement actions to further strengthen enforcement.
- Encourage the creation of an intellectual property research and training center that would be associated with a public or private institution.
- Increase public awareness and education regarding counterfeit trade and implement regulations to make it easier for consumers to know when they are buying from legitimate street vendors.
- Extend the advanced techniques and benefits of industry-wide anti-counterfeiting intelligence-- such as the type developed by the music industry--to industries that do not yet use such techniques.
- Increase enforcement of existing laws against the counterfeiting industry, such as enforcing safety regulations applicable to retail stores.

## APPENDIX: THE CASE OF THE RECORDED-MUSIC INDUSTRY

The recorded-music industry provides an example of the importance of New York City in the counterfeiting supply chain. The Record Industry Association of America's (RIAA) Regional Coordinator has estimated the economic losses to his industry in New York City in calendar year 2003.<sup>19</sup>

Practically all of the counterfeit and pirated music compact discs offered for sale and/or seized by law enforcement in New York City are on Compact Disc Recordable (CD-R) media. New York City has two major suppliers of CD-R media; one is located in New York City and the other in New Jersey.

Seizure statistics for 2003 indicate that nearly 2.5 million illicit sound recordings were seized in the NYC area, and that approximately 17 million illicit sound recordings made their way undiscovered to the streets of New York City for sale to the public.

The price of a counterfeit or pirate CD on the streets of New York City currently averages \$5. When that sale is consummated, sales tax is neither collected nor reported. The average wholesale price of a legitimate compact disc sold by RIAA member labels is currently \$10. The average retail price of a legitimate compact disc in the New York area is currently \$17:

- 17 million illicit sales at \$5 per CD represents \$85 million in illicit sales per year.
- 17 million in wholesale losses at \$10 per CD represents \$170 million in lost sales of legitimate product at a wholesale level.
- 17 million in retail losses at \$17 per CD represents \$289 million in lost sales of legitimate product at the retail level.

The resulting sales tax losses are as follows:

- \$ 7.3 million based on the sales price of illicit CD's (street vendor's value)
- \$14.7 million based on legitimate wholesale sales losses
- \$24.7 million based on legitimate retail sales losses

(If business and personal income taxes were included in these estimated losses, the lost taxes would be approximately three times greater.)

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<sup>19</sup> Based upon information provided by Rich, Abbott, Record Industry Association of America.

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Statistics associated with the seizure of counterfeit goods are consistent with these estimates. Approximately 2.5 million CDs were seized in the New York area in 2003; more than 42 percent of the CD seizures nationwide. They were seized as the result of 1,541 independent seizures from various manufacturers, distributors and street vendors that took place in New York City during 2003. This reflects only a fraction of the illegal activity. Many other enterprises continue to operate within New York City.

Appendix Table A. *Seizures of Counterfeit CDs, Illustrative, March 2004, New York City*

<b>Date</b>	<b>Location</b>	<b>Seizures</b>	<b>Items</b>
3/31/2004	92-21 165 <sup>th</sup> , Jamaica, NY	5,000 counterfeit CD-Rs	5,000
3/30/2004	37-15 30th Avenue, Queens, NY	1,137 counterfeit CD-Rs, 18 music DVDs, 283 counterfeit CDs, 10 music videos, 52 VCRs, 3 converters/mixers	1,503
3/19/2004	9-11 W 141 St, NY, NY	7,000 counterfeit CD-Rs	7,000
3/18/2004	33 W 31 St, #1101, NY, NY	22,000 counterfeit CD-Rs	22,000
3/4/2004	339 E 108 St, NY, NY	4,442 CD-Rs	4,442
3/4/2004	712 E 223 St, Bronx, NY	42 52x burners, 24 4x DVDR burners, 4,250 counterfeit CD-Rs, 15,000 labels, 15 boxes blank CD-Rs, 22 boxes jewel cases	19,353
3/4/2004	Bronx, NY	7850 counterfeit CD-Rs and 112 music DVDs	7,962
3/3/2004	1305 Commonwealth, Bronx, NY; 247 W 35, NY, NY	8,900 counterfeit CDs	8,900
3/2/2004	36 Ludlow Street, NY, NY	28,800 counterfeit CD-Rs	28,800
3/2/2004	36 W 31 St, NY, NY	18,200 counterfeit CD-Rs, 200 music DVDs	18,400
		<b>TOTAL</b>	<b>123,360</b>

Source: NYPD reports, March 2004.