

The Impact of Intellectual Property Theft on the Economy

Innovation drives economic growth and job creation. Protection of intellectual property (IP), through patents, trademarks and copyrights, is critical to ensuring that firms pursue innovation. Counterfeiting and piracy erode the returns on innovation and slow economic growth because of the negative impacts on companies, consumers and governments. While the problem is worldwide, China accounts for the vast majority of pirated goods seized at the U.S. border.

IP-intensive industries accounted for nearly 20 percent of all jobs in 2010 and contributed over a third of GDP.¹ IP-intensive industries have higher wages with a better-educated workforce and contribute more to trade. Additionally, workers in IP-intensive industries generate sales per employee twice as large as their counterparts in non-IP-intensive industries.²

IP infringement harms companies through lost revenue, the costs of IP protection, damage to brand, and decreased incentives to innovate because of potential theft.³ Consumers are harmed when they purchase counterfeit goods of lower quality, some of which, such as counterfeit medicines, may pose health or safety risks. Governments lose tax revenue and bear enforcement costs. Decreased incentives to innovate resulting from IP infringement reduce economic growth, weaken the nation's competitiveness, and decrease job creation.

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Increase in IP theft

IP theft has increased in recent years. Investigations of foreign infringement of domestic intellectual property rights have risen in eight of the last ten years, from 17 cases in 2002 to 69 cases in 2011.⁴ Moreover, there has been a dramatic rise in the number of cases in recent years, with the number of cases investigated by the United States International Trade Commission (U.S. ITC) rising by 80.6 percent and 23.2 percent in 2010 and 2011, respectively (see **Figure 1**).

U.S. Customs and Border Protection reports that consumer electronics (22.0 percent), footwear (14.0 percent) pharmaceuticals (9.0 percent) and optical media (9.0 percent) made up more than half of the total domestic value of counterfeit goods entering the United States in 2011.⁵ Goods from China accounted for more than three-fourths of the value of counterfeit products seized in the United States from 2004-2009.⁶ But the problem is not limited to the United States. Counterfeiting and piracy

have become increasingly pervasive in international trade. Estimates show that trade in counterfeit and pirated products as a share of all globally-traded commodities increased by 7.6 percent between 2000 and 2007.⁷ These figures underestimate the full extent of the problem since electronic piracy is excluded.

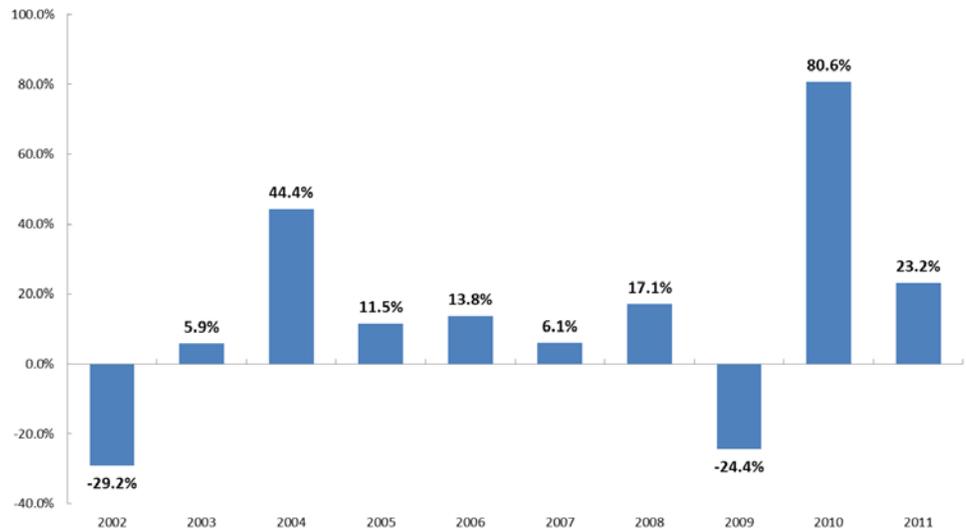
Infringement of intellectual property rights

Businesses often experience lost revenue and ultimately lower profits when sales are diverted from authentic goods to counterfeit ones. In addition to lower sales, profits are also adversely affected by the additional costs required to protect the firm from future episodes of intellectual property infringement.⁸ One estimate found that the average company lost \$101.9 million in revenues and incurred costs of \$1.4 million in identification and enforcement of intellectual property rights, leading to an average decline in profits of \$46.3 million.⁹

Recent government data help to shed light on the magnitude of foreign infringement. In 2011, the U.S. Customs and Border Protection seized 24,792 counterfeit or pirated goods, a 24.2 percent increase over the amount of goods seized in 2010.¹⁰ These seized goods represented more than \$1.1 billion in lost sales.¹¹

Figure 1. Foreign Infringement Investigations by the U.S. ITC

Annual percent change in number of Section 337 investigations instituted by calendar year



Source: JEC Chairman's staff calculations based on data from the U.S. International Trade Commission.

Note: Section 337 of U.S. trade law allows U.S. companies to receive exclusion orders on U.S. imported goods that violate U.S. intellectual property rights. This statute covers a broad range of intellectual property including design and utility patents, trademarks, copyrights, trade secrets and false advertising.

Availability of a counterfeit good can also put downward pressure on the price of the authentic product, causing a further decline in a firm's revenue. Additionally, a company's brand may be damaged when consumers who are unaware they have purchased a counterfeit good blame the maker of the genuine product for the poor-quality counterfeit they have bought.

Few small businesses bring foreign infringement complaints

Small businesses are unlikely to have the financial resources to protect themselves from IP theft or pursue enforcement actions when facing losses. Data on investigations initiated and completed by the U.S. ITC show that while small businesses represent 79.0 percent of all businesses in the U.S., they comprise only 10.5 percent of firms filing complaints regarding intellectual property infringement.¹² The vast majority of firms, 78.9 percent, that request an investigation into the infringement of intellectual property are large and often public firms.¹³ This could be because small firms do not have the resources to pursue enforcement actions but could also reflect a bigger impact of infringement on larger firms.

Resolution of foreign infringement cases is a lengthy process

Resolution of foreign infringement complaints often take substantial time to resolve. Nearly one-third (30.1 percent) of cases submitted to the U.S. ITC took at least a year to complete (see **Figure 2**). And 7 out of 10 cases (69.9 percent) took 6 months or longer. The large costs associated with intellectual property infringement may mean that some firms are forced out of business before the infringement investigation is completed.

Figure 2. Time Taken to Resolve Foreign Infringement Cases

Section 337 Investigations instituted after December 31, 2009 and completed.



Source: JEC Chairman's staff calculations based on data from the U.S. International Trade Commission.

Additionally, protecting intellectual property from the start can be time-consuming. For example, even with recent improvements in the patent review procedure, new applications take approximately three years to fully process.

Conclusion

Intellectual property is at the core of U.S. competitiveness, productivity gains and economic growth. While creating precise estimates of the magnitude of counterfeiting and piracy is difficult because of the complexities associated with measuring a secret, illegal activity, there is broad agreement that IP theft has increased in recent years. The consequences are many. Foreign infringement of intellectual property harms businesses by raising their costs, lowering revenue, and eroding profits. Consumers can face health or safety hazards from counterfeit pharmaceuticals and automotive products, and pirated software presents a range of threats to computer security and personal privacy. As a result of counterfeiting and piracy, governments have to make do with less tax revenue.

Strengthening IP enforcement and providing more timely resolution of foreign infringement complaints can help combat IP theft. The Office of the U.S. Intellectual Property Enforcement Coordinator is developing a new Joint Strategic Plan on Intellectual Property Enforcement. This plan presents an opportunity to improve the protection of intellectual property in the United States, reduce the costs of IP infringement and provide individuals and firms with greater confidence that their ideas and innovations will be protected.

Sources:

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- ⁴ U.S. International Trade Commission. "Number of Investigations Instituted by Calendar Year." http://www.usitc.gov/intellectual_property/documents/cy_337_institutions.pdf. Washington D.C.
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- ⁹ Feinberg, Robert M. and Donald J. Rousslang. "The Economic Effects of Intellectual Property Right Infringements." *The Journal of Business*, Vol. 63, No. 1, Part 1. p. 79-90. January 1990.
- ¹⁰ U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement. "Intellectual Property Rights: Fiscal Year 2011 Seizure Statistics." Washington D.C. p. 6. 2012.
- ¹¹ *Ibid*. The total value of lost sales resulting from foreign infringement was likely greater than that since the electronic transfer of goods and services was excluded.
- ¹² Joint Economic Committee of the U.S. Congress. "Tax Incentives for Small Business Hiring and Investment: Strengthening the Backbone of the Economy." Washington D.C. p. 2. July 2012.
- ¹³ Chairman's staff calculations based on data from the U.S. International Trade Commission (accessed July 3, 2012), U.S. Securities and Exchange Commission, and Dun and Bradstreet. Employment data comprised 76 of the 83 Section 337 disputes begun and completed after December 31, 2009.