

Commentary

High price of shoddy goods

By Alfred Tella
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The selling of counterfeit products is big business, accounting for more than 5 percent of merchandise trade worldwide, according to U.S. government estimates. And it is on the rise, in America and globally.

U.S. Customs and Border Protection reported in 2002 that counterfeit goods brought into this country in one year cost American businesses an estimated \$200 billion in revenue and the loss of some 750,000 jobs. Customs counterfeit-related seizures rose 125 percent between 2000 and 2005, and with new enforcement tools they rose an impressive 80 percent in fiscal 2006. Since the early 1990s counterfeit trade is estimated to have grown 8 times faster than legitimate trade.

Knowledgeable people say that seizures represent only a tiny fraction of the fakes that get through, so one can only guess at the volume of counterfeit merchandise entering the United States. Such products, which use unauthorized trademarks or trade names, get through when sellers use forged or invalid documents, or when the goods are smuggled in.

Counterfeit products hurt American business across the board -- small businesses probably the most -- cheat consumers, unemploy workers, cost the government revenue, and can be dangerous to public health and safety. It's part of the downside to globalization.

Counterfeit goods are generally lower in quality than the products they imitate, and are generally hard to distinguish from the original. Often they sell for prices equal to legitimate goods, and even when sold at lower prices, consumers frequently don't know they are fake and overpay for what they get. They are sold in stores and on Web sites, are known to be involved in the laundering of drug money and, according to Interpol, are used as a funding method by terrorists.

The largest source of counterfeit goods by far is China, though the business is becoming more widespread and sophisticated. Components of counterfeit products are shipped from country to country throughout the world for assembly and distribution, lessening the risk of seizure. Besides China, counterfeit exports have been traced to Russia, countries in the former Soviet bloc, India, the Philippines, the Middle East, Africa and Latin America.

Counterfeit products include baby food, toys, automobile and aircraft parts, electronics, tools, sporting goods, cosmetics, soap, medicines, footwear, cigarettes, clothing, batteries, jewelry, sunglasses, video discs, purses, shampoo, perfume, credit cards, pacemakers and software, among many others.

Automobile brakes made of compressed grass and wood have shown up in American stores, and other counterfeit auto parts look so good that even trained mechanics can't tell they are fake. According to Loss Prevention Concepts Ltd., a Michigan consulting and intelligence-gathering organization, fraudulent parts have caused deaths from airline and auto accidents. LPC further reported: "Counterfeit shampoo has caused hair loss, counterfeit stomach medicine has caused ulcers, and counterfeit toys and baby foods have caused serious problems for children. Counterfeit clothing is generally quite shoddy and replica kids clothing usually is not flame retardant and can present a fire hazard. Likewise, counterfeit sunglasses are generally not shatterproof and often have no ultraviolet protection."

The importation of adulterated products from China has been highlighted recently by front-page news reports of melamine apparently knowingly put into wheat flour by Chinese firms that falsely labeled the mixture. It was then shipped to America where it was mixed into more than 100 brands of American pet food. Many pets died, and some of the contaminated pet food was fed to chickens and hogs sold for human consumption. Meal manufactured with melamine-contaminated Chinese flour has also been fed to fish. Melamine is an industrial chemical that in tests gives false high readings of protein content, thus allowing the adulterated flour to be passed on as a higher-value product.

Earlier this year the Humane Society of the United States (HSUS) reported that a large number of imported jackets being sold as faux fur in America were in fact made of dog fur. Most of the jackets HSUS tested came from China and were either falsely labeled or not labeled at all. They were sold by department

stores nationwide and included high-end designer brands. The sale or importation of dog and cat fur products is outlawed in the U.S. However, animal fur is often cut and dyed, making it difficult to identify.

Economic adulteration also occurs domestically. The U.S. Food and Drug Administration has won convictions against companies making and selling phony orange and apple juice, maple syrup, honey, cream, olive oil and seafood, among other food products.

An increasing number of fake products that cheat consumers and go undiscovered could be biasing our consumer price data.

The quality of goods helps determines their prices. However, in the case of fakes the poor quality often cannot be detected or recognized as such, and the prices paid for these goods are higher than they would be if consumers knew what they were actually getting. To the extent that fakes represent a growing share of the consumer market, this translates into hidden price inflation that eludes official data.

In constructing its price indexes, the Department of Labor attempts to adjust prices for quality change. Sophisticated adjustment methodologies have enabled the department to capture quality improvements, such as from technological change, resulting in lower rates of measured inflation. The effect of quality deterioration resulting from a proliferation of fake imports works in the opposite direction -- inflation is understated. Unfortunately, it's hard to get a handle on the extent of the potential bias, like trying to draw a bead on something you can't clearly see.

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