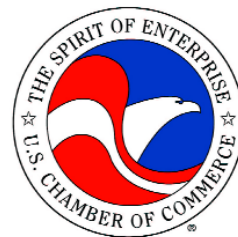


# COUNTERFEITING AND PIRACY IN BRAZIL:

THE ECONOMIC IMPACT



BRAZIL-U.S. BUSINESS COUNCIL



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# EXECUTIVE SUMMARY

This report, commissioned by the Brazil-U.S. Business Council, reviews the economic costs of counterfeit and pirated goods for the Brazilian economy. Copies of software, compact discs, medicines, mobile phones, food and drink, car parts, tobacco products, and imitation designer fashions are sold every day in the huge Brazilian market of nearly 180 million consumers. New technology means that more goods than ever are vulnerable to copying.

Counterfeiting and piracy hurt not only companies doing business in Brazil, but in turn, all Brazilians. Major industries, such as software and music, lose more than half of their sales to these illegal activities. Consequently, there are fewer jobs for Brazilians, the government collects less tax revenue, Brazilian consumers must pay higher prices for inferior products, and counterfeited products endanger the health and safety of consumers.

Measuring the full economic impact of counterfeiting and piracy is hard because these activities are clandestine. Even the Brazilian government lacks official data on the economic damages caused by the sales of counterfeit or pirated goods.

Despite these limitations, a review of the best available industry estimates indicates that at least \$1.6 billion in sales are lost every year to counterfeiting and piracy. The copyright industry alone estimates yearly losses of nearly \$800 million. Industry estimates also show that Brazil would net \$500 million a year in lost cigarette tax revenue if counterfeiting or piracy were reduced or eliminated.

The data developed for this report are based on a survey of major industry sectors, interviews with trade association representatives, and a review of existing reports and literature.

## KEY FINDINGS

In a typical year, millions of counterfeit cigarettes, medicines, t-shirts, toys, Ray Ban look-alikes, fake Nike sneakers, pirated DVDs, and software flood the Brazilian market. The costs of intellectual property rights infringements reverberate throughout the Brazilian economy. Thousands of jobs and billions of dollars in sales are lost every year.

Equally important, millions of dollars in annual tax revenue are lost that support Brazil's public services and social programs like education and health care. This harms Brazilian consumers, entrepreneurs, workers, and ultimately, the Brazilian economy.

It is difficult to obtain a single value for all the losses associated with counterfeiting and piracy because of the differing methodologies used to calculate the impact by each industry sector. However, an industry-by-industry review shows the enormous economic losses for the Brazilian economy and its people due to violations of intellectual property rights.

# COUNTERFEITING AND PIRACY HARM THE BRAZILIAN ECONOMY

## **Decrease in Sales and Jobs**

### **Counterfeiting and piracy cost hundreds of millions of dollars in sales.**

The losses in sales extend from an estimated loss of \$14 million from book piracy to nearly \$350 million in lost recording industry sales to almost \$520 million in software piracy losses in 2003.

**Counterfeiting and piracy cost thousands of jobs.** Estimates of job loss vary by industry. The toy industry reports that it has lost 80,000 jobs to piracy in recent years, the recording industry estimates a loss of some 55,000 jobs over three years, and the optics and lenses industry lost 8,000 jobs in 2003.

Also, Brazilian consumers are harmed when they buy pirated goods or counterfeits because they end up paying an excessive price for an inferior product. Further, the manufacturer of the genuine product is blamed when the consumer believes that he has bought a genuine article, creating a loss of goodwill for the company if the product fails.

## **Decline in Tax Revenue**

**Counterfeiting and piracy result in lost tax revenue.** If software piracy were reduced by 10 percentage points, an additional \$335 million in tax revenue would be generated between 2002 and 2006. The cigarette industry reports that the government loses \$500 million a year in cigarette tax revenue.

## **Reduction in Foreign Investment and Innovation**

**Counterfeiting and piracy cost foreign investment and foreign know-how.** Foreign investors are reluctant to invest in Brazil if new products can be copied easily, especially pharmaceuticals and software.

## **Rise in Organized Crime Activities**

**Counterfeiting and piracy support criminal activities.** Criminals derive huge profits from counterfeiting and piracy, as do organized criminal activities that involve piracy as just part – and frequently the most lucrative part – of a diversified criminal portfolio including trade in narcotics, money laundering, prostitution, and terrorism.

## **Increase in Health and Safety Concerns**

**Counterfeiting and piracy produce health and safety concerns.** It is no longer rare to find counterfeit pharmaceuticals in hospitals or counterfeit parts in aircraft and autos. These fake products can cause injuries and death.

# ECONOMIC IMPACT OF COUNTERFEITING AND PIRACY ON BRAZIL BY MAJOR INDUSTRY SECTORS

## MOTION PICTURE PIRACY

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- ◆ 30 percent of all audiovisual sales are pirated
  - ◆ \$120 million a year in lost revenue due to piracy
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## RECORDING INDUSTRY PIRACY

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- ◆ 52 percent of all records and music are pirated
  - ◆ 55,000 jobs lost over three years due to piracy
  - ◆ \$82 million in unpaid taxes
- 

## BUSINESS SOFTWARE PIRACY

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- ◆ 55 percent of all business software applications are pirated
  - ◆ \$187 million a year in lost revenue due to piracy
- 

**COUNTERFEITING AND PIRACY COST THE BRAZILIAN ECONOMY THOUSANDS OF JOBS, BILLIONS IN SALES, AND HUNDREDS OF MILLIONS IN TAX REVENUE**

## TOBACCO COUNTERFEITING

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- ◆ 34 percent of all cigarettes sold are counterfeit
  - ◆ 51 billion illegal cigarettes
  - ◆ \$500 million a year in lost cigarette tax revenue
- 

## TOY COUNTERFEITING

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- ◆ 12 percent of all toys are counterfeit
  - ◆ 80,000 jobs lost due to toy counterfeiting
  - ◆ \$31 million a year in lost sales
- 

## OTHER COUNTERFEITING AND PIRACY

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- ◆ 48 percent of all eyeglasses are lost to piracy
  - ◆ 10 percent of all auto parts sold in Brazil are counterfeit
  - ◆ 5-7 percent of all medicines in Brazil are counterfeit
-

# ECONOMIC COSTS BY INDUSTRY

This report compiles the best available economic data on intellectual property infringements for major industry sectors. Counterfeiting and piracy in Brazil are focused mainly on the domestic market. In fact, it is estimated that three out of five counterfeit or pirated products are imported into Brazil from such countries as Paraguay, China, Singapore, Korea, and Malaysia due to the large numbers of consumers and to the difficulties that the Brazilian authorities have in securing their frontiers.

## COUNTERFEIT CIGARETTES

Brazil is flooded with counterfeit cigarettes. Tobacco companies lose hundreds of millions of dollars annually to smuggled or fake cigarettes. These illegal cigarettes now represent 34 percent of the volume of cigarettes sold per year, jumping from 5 percent of the market in 1991 and 20 percent in 1995. Approximately 51 billion cigarettes are sold illegally every year in the Brazilian market out of a total of 150 billion cigarettes sold per year, mainly originating in Paraguay.

### Economic Impact

Brazil would net \$500 million a year in lost cigarette tax revenue if counterfeiting were eliminated. The billions of counterfeit tobacco products available in Brazil are also beyond the reach of Brazil's National Agency of Health Control. Thus, these products are outside the health agency's scope, posing additional risks to Brazilian consumers.

## U.S. COPYRIGHT-BASED INDUSTRY PIRACY

The combined total losses to the U.S. copyright-based industries in Brazil, including software, records and music, entertainment software, and motion pictures, totaled \$785 million in 2003, according to the International Intellectual Property Alliance.

### Software Piracy in Brazil

More than 60 percent of all software, covering PC software, operating systems, consumer-oriented software, and local language software was pirated in Brazil in 2003, according to the Business Software Alliance (BSA). Software piracy losses totaled \$519 million last year, making Brazil the 11th country worldwide by losses from piracy.

### Economic Impact

If Brazil lowered its piracy rate by 10 percentage points, its software services sector could grow to nearly \$17 billion by 2006, according to an economic impact study conducted for BSA by the International Data Corporation (IDC) in April 2003.

## ESTIMATED TRADE LOSSES DUE TO COPYRIGHT PIRACY

2003

(in U.S. dollars)

Industry	Losses	Piracy Level
Records and Music	\$339M	52%
Business Software Applications	\$187M	55%
Entertainment Software	\$126M	56%
Motion Pictures	\$120M	30%
Books	\$14M	n/a
<b>TOTAL LOSSES</b>	<b>\$785M</b>	

Note: Data are rounded.

Source: International Intellectual Property Alliance

A 10 percentage point reduction in Brazil's software piracy rate to 46 percent could add \$3.2 billion to the economy, create more than 13,000 high-wage, high-tech jobs, and increase local industry revenue by more than \$2.4 billion, according to the BSA/IDC study. The cumulative effect of all of this growth could mean an additional \$335 million in tax revenue for the Brazilian government.

### Recording Industry Piracy

Modern technology has enabled an unprecedented level of production in recording piracy, decreased the costs of piracy, and improved the quality of pirated copies. Sound recording piracy, in both compact disc and audiotape format, amounted to an estimated \$339 million in Brazil in 2003.

Recording piracy in Brazil has grown exponentially since 1997, from 5 percent of the CD market in 1997 to 52 percent in 2003. This translates into a volume of 94 million pirated units in 2003. Record sales revenue in Brazil dropped some 55 percent, over a five-year period ending in 2002, and have continued to slide since then.

#### Economic Impact

More than 2,000 stores were closed due to recording industry piracy, resulting in the loss of some 55,000 jobs over three years. Other effects included a reduction of sales of recorded music by 55 percent between 1997 and 2002 due to piracy. Also, recording industry piracy costs Brazil an estimated \$82 million in unpaid taxes. The audiocassette market in Brazil remains entirely dominated by piracy, as it has been for the past several years.

While recording piracy often is seen as a victimless crime, the impact is felt throughout the entire music value chain. The victims include artists whose creativity gets no reward; the loss in hundreds of millions in tax revenue; economies that are deprived of new investment; consumers who get less diversity and choice; and record producers who are forced to reduce their artistic rosters because it is impossible to compete against theft.

### Entertainment Software Piracy

The predominant form of entertainment software piracy in Brazil continues to be CD burning, which accounts for about 80 to 90 percent of pirated product in the market. Factory produced pirated console discs are usually produced in Asia (e.g., Malaysia) and exported to Brazil through Paraguay, or increasingly through other trans-shipping countries. Similarly, pirated entertainment software in cartridge formats continues to be shipped from Asia (primarily China) through Paraguay. It is sometimes assembled there before being transported across the border to Brazil.

## ECONOMIC BENEFITS OF LOWERING SOFTWARE PIRACY 2002 - 2006

*Impact of lowering piracy by 10 percentage points (in U.S. dollars)*

Contribution to GDP	+\$3.2 Billion
Local Industry Revenue	+\$2.4 Billion
Additional Tax Revenue	+\$335 Million
New Jobs	+13,400

Source: Business Software Alliance

## IMPACT OF RECORDING INDUSTRY PIRACY

*(over five years)*

Store Closures	2,000
Job Losses	55,000
Drop in Artists Signed	30%
Reduction in New Record Releases	7%

Source: Association for the Protection of Intellectual Rights

## Economic Impact

Estimated trade losses due to entertainment software piracy in 2003 reached \$126 million, with an overall estimated piracy rate of 56 percent. Piracy in the audiocassette market is estimated at between 80 and 90 percent of all sound recordings in Brazil.

*Piracy lowers job offers and damages the country's economy and image.*

## Motion Picture Industry Piracy

The piracy of foreign and Brazilian films is ubiquitous and continues to worsen. Clandestine duplication and distribution organizations sell high quality illegal copies that include counterfeit packaging. One out of every three home video entertainment products in Brazil last year was pirated, according to the Motion Picture Association of America (MPAA).

Adriana Hack Velho  
*Wired*, May 11, 2001

Optical disc piracy, which includes Laser Discs and DVDs, is increasing in Brazil and is a major threat to the audiovisual sector. It has a piracy rate approaching 15 percent of the market and accounts for approximately 25 percent of total seizures of pirated product.

## Economic Impact

The U.S. motion picture industry loses \$120 million annually due to piracy in the Brazilian market, according to the MPAA. It estimated an overall audiovisual piracy rate of 30 percent in 2003.

## Publishing Industry Piracy

The publishing industry reports that unauthorized photocopying of English language study materials and individual lessons and chapters from textbooks, as well as entire books, continues to be a major form of book piracy in Brazil.

## Economic Impact

Estimated trade losses due to book piracy in Brazil reached \$14 million in 2003.

## Pharmaceutical Industry Counterfeiting

Brazil is known for its counterfeit pharmaceuticals and chemicals. Pharmaceuticals are particularly susceptible to counterfeiting because they are a high profit and low bulk product. Brazil is the 10th largest market in the world for pharmaceutical products, with revenue of over \$5 billion in 2001, according to Interfarma, the Brazilian association for research-based pharmaceutical companies.



While it is difficult to find exact statistics, Interfarma notes that the situation in Brazil remains challenging in terms of intellectual property, pricing, and industry image. Official sources indicate that one-fifth of all branded medications currently sold in Brazil are counterfeit.

#### Economic Impact

The National Secretariat of Health estimates that five to seven percent of all medicines in Brazil are counterfeit. Such examples include:

- ◆ Anti-epileptic pills containing 25 percent of the labeled amount;
- ◆ Fake penicillin and tetracycline products containing only a small portion of the labeled amount of the antibiotic, or none at all;
- ◆ Birth control pills made with wheat, resulting in over 200 reported unwanted pregnancies;
- ◆ Prostate cancer drugs distributed without the active ingredient;
- ◆ Diet pills containing anything and everything from laxatives and diuretics to thyroid hormones and tranquilizers.

#### Video Game Piracy

The Brazilian video game industry sales totaled almost \$100 million in 2003, a substantial increase from just \$33 million in 2001, according to ABRAGAMES, Brazil's association of video game manufacturers.

#### Economic Impact

The losses in the video game industry are substantial, with illegal sales accounting for nine out of every ten games sold in Brazil. According to the chief executive of Vivendi Universal Games Brasil, sales volumes would be three or four times higher if the piracy problem were taken more seriously.

#### Toy Industry Counterfeiting

Counterfeit toys make up 12 percent of the entire toy market sales in Brazil, which means losses for this industry in the amount of \$31 million a year.

#### Economic Impact

Toy piracy also resulted in the loss of some 80,000 jobs in this industry in recent years – a large number in a country with 11 million unemployed, according to a report by Dannemann, Siemsen.

#### EXAMPLES OF COUNTERFEITING AND PIRACY IN BRAZIL

- 
- ◆ Nearly 70 percent of all sunglasses and eyeglasses sold in Brazil are imitations
- 
- ◆ 40 percent of all compact discs sold in Brazil are fakes
- 
- ◆ 1.5 million fake Barbie dolls and 1 million pairs of fake Nike athletic shoes are sold in a typical year
- 
- ◆ 9 out of every 10 video games sold in Brazil are illegal
-

## Optics and Lenses Industry Piracy

The optics and lenses industry in Brazil also is affected by high rates of piracy. The Brazilian Association of Industries of Optics Products reports that 47.5 percent of the domestic optics and lenses market is lost to piracy. In some cases, bogus eyeglasses cause health problems. Brazilian authorities report that falsified reading glasses have done serious harm to consumers.

### Economic Impact

The Brazilian optics and lenses industry has closed 102 companies, resulting in a loss of more than 8,000 jobs in the last 10 years.

## OTHER INDUSTRIES

### Auto Part Counterfeiting

It is estimated that 10 percent of all auto parts sold in Brazil are counterfeit. The most commonly counterfeited parts are axles, bearings, shock absorbers, bulbs, break pads, catalytic converters, and clutches.

### Other Counterfeiting

The legitimate clothing industry loses an estimated \$1.8 million per year due to counterfeiting.

*New technology has broadened the range of goods that are vulnerable to copying. It has dramatically increased their quality, as well as lowering their cost of production. Where once counterfeits were cheap and shoddy imitations of the real thing, today, their packaging and contents (especially for digital products such as software, music, CDs, and film DVDs) often render them almost indistinguishable from the genuine article.*

*The Economist, "Imitating Property Is Theft," May 15, 2003*

# BLACK AND GRAY MARKET FRAUD

In addition to the enormous business losses resulting from counterfeiting and piracy across many industries, the sale of products on the black and gray market is an extremely serious problem for Brazil. The Brazilian government is unable to reduce the flow of illegal goods that are sold on the black market from entering the country. It also is unable to prevent gray market fraud, which refers to companies that are engaged in legitimate activities but do not fully comply with tax and regulatory obligations.

## Black Market Fraud

Experts estimate that the Brazilian black market is worth \$20 billion and over 1.5 million jobs are lost due to these illegal activities. The most affected sectors are electronics, cigarettes, beverages, clothing, shoes, photographic equipment, and glasses. They represent 63 percent of all goods seized by Brazilian customs officials in 2001.

It is estimated that in Brazil 17 percent of cigarettes, 30 percent of audio and video equipment, 50 percent of handheld computers, 60 percent of glasses, and 63 percent of personal computers are sold on the black market. The market for PCs has been so affected by the illegal competition that IBM no longer sells PCs to retail stores. They now are selling directly to companies or through the web to consumers.

## Gray Market Fraud

The gray market consists of legitimate businesses that report lower sales figures to avoid taxes. This creates a huge problem for the Brazilian economy since more than 80 percent of all tax revenue is collected from businesses.

Recently, the McKinsey Global Institute reported that Brazil's gray market now employs 50 percent of nonagricultural workers, up from 40 percent a decade ago. Gray market fraud is found throughout the economy. For example, an estimated 80 percent of retail food sales in Brazil and a quarter of soft drinks involve companies that under report sales. Also, an estimated 60 percent of clothing stores in Brazil avoid taxes.

## SCALE OF BLACK/GRAY MARKET FRAUD IN BRAZIL (percent sold on black/gray market)

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- ◆ 17 percent of cigarettes

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  - ◆ 30 percent of audio and video equipment

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  - ◆ 50 percent of handheld computers

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  - ◆ 60 percent of glasses

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  - ◆ 63 percent of personal computers

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# RECOMMENDATIONS

Both governments should strengthen cooperative efforts aimed at combating piracy and counterfeiting. Specifically, the following measures should be taken in Brazil:

1. Full implementation of a central plan to include the authority to take active enforcement measures, bring more prosecutions, and strengthen both border patrols and customs inspections. This plan should be effected through a coordinated effort between federal, state, and municipal authorities responsible for combating piracy, counterfeiting, and the gray market and include a robust mechanism for consultation with the private sector;
2. Improve judiciary performance through training and orientation aimed at deterring copyright crimes and infringement and through speedier prosecutions. The creation of a specialized court to adjudicate copyright enforcement cases should be considered.

Both business communities should also focus on finding a common methodology for measuring the impact of piracy, counterfeiting, and the gray market across industry sectors. The patchwork of differing methodologies currently employed by affected industries makes the task of estimating the total economic impact of the problem next to impossible. A common methodology will lend additional credibility to industry's efforts to illustrate the importance of the problem and help governments to better understand the entire scope of the issue, define their enforcement strategies and measure success.

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