

Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors

Executive Summary

Invisible enemy!



Foreword



Consumers are today at grave risk due to the menace of counterfeiting. Consumers of fake products face perilous risk to life and property. Consumers need to know the extent of the problem. This report is an important step towards empowering the consumers with knowledge of the pervasive nature of this problem.

FICCI has been at the forefront of advocating policy framework on various aspects affecting the industry. Scattered anecdotal accounts on the extent of the problem of counterfeiting and smuggling can be found in media reports and government documents. However a systematic treatment of the subject was missing. FICCI's initiative in the form of the 'Committee Against Smuggling and Counterfeiting Activities Destroying the Economy' (CASCADE) has not only initiated research to assess the extent of the menace but has also gone one step further to outline its impact on our society. I am delighted to see this comprehensive report. This report is the first ever compilation of its kind in seven key industry sectors in India. This report demonstrates that India is serious about adequately protecting its knowledge based economy. Indian industry urges the government to make this a priority.

I would like to congratulate all the committee members and stakeholders who have contributed towards this project particularly Thought Arbitrage Research Institute (TARI) and it is hoped that this study would lead to further sector specific researches to pierce the veil shrouding the extent of this problem.

I wish FICCI-CASCADE success in its future initiatives.



Dr. A. Didar Singh
Secretary General
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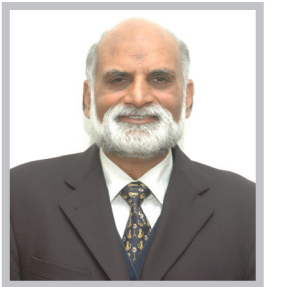
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Chair's Message



FICCI-CASCADE is a unique forum which has been campaigning not only for the cause of the Industry but also in favour of consumer rights, against smuggling and counterfeiting since its inception. FICCI-CASCADE is also at the forefront to commission research and propose law and policy reforms to the Government and other relevant stakeholders through knowledge papers, report, and studies on issues related to counterfeiting and smuggling. For example, it has presented recommendations to the Government to inform the IP enforcement agenda specific to counterfeiting issues in the future National IP Policy.

It is my pleasure to present the fruit of independent research on the problem of counterfeit and contraband goods in India. This research focused on seven key industry sectors of India. I hope that the government will take further, the initiative to commission research for a better understanding of the problem and the means to tackle it in many other sectors of the industry. The report reconfirms with methodological rigour that there is a problem of counterfeit and contraband goods that is hurting our economy. This problem has become so enormous that the legitimate industries have become "victims" of counterfeit and contraband products.

We as a nation have given to ourselves the laws that are not only compliant with our international obligations on IPRs but also ahead of those obligations in many ways. So, in principle, we do not subscribe to anything that might be dubbed as enabling production and distribution of counterfeit and contraband goods. This report enables the nation to take a step further by recognizing the problem, resolving to confront it and collaborating to diffuse this socio-economic menace.

One of the most important things that this report does is to bring to the foreground the social impact of trade in counterfeit and contraband goods. We need to understand this better if we are to make any headway in our campaign against this menace. For instance, we need for all concerned to understand that a counterfeit product steals revenue from the government. This increases the deficit which in turn causes inflation. This in turn reduces the purchasing power of the consumer. Also, buying a 'counterfeit and contraband product' knowingly means strengthening the distribution network of all products that are illegal. It entails letting people take one step forward in the quicksand of "living in illegality". Additionally, these steps may aid in funding organized crime, or allow provision of guns and drugs in the hands of our children. These are of course, simplistic portrayals of the ripples that this menace brings about. This however, enables us to focus on the starkness of the reality confronting us. I am sure more messages of the self-defeating nature of the demand for counterfeit and contraband goods products will be available for you in the report.

To sum up, I would say that we are faced with a deadly menace. We are not in denial about that menace. We will not tolerate it either. We are investing heavily to fight it and the report that we are unveiling today will give us a benchmark to judge the return on investments that we are making to transform ourselves from "victims of counterfeiting and smuggling" to "victors over counterfeiting and smuggling". But in order to succeed we must stand up to the social and economic wrong that is being perpetrated upon us.

Travelling on this arduous path of finding facts is not easy and the whole team within FICCI and the independent research team of Thought Arbitrage Research Institute (TARI) – deserve to be congratulated for their effort, dedication and commitment.

Anil Rajput,
Chair CASCADE
Senior Vice President Corporate Affairs, ITC Ltd

Editor's Note



We are pleased to present a comprehensive report on the problem of counterfeiting, smuggling and tax evasion in India entitled "Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors." This report is a groundbreaking compilation of the extent of the problem in India that offers the building blocks for key policy makers and decision makers. The report has been prepared by Thought Arbitrage Research Institute (TARI) on behalf of FICCI Committee Against Smuggling and Counterfeiting Activities Destroying Economy (CASCADE).

This report is a first ever compilation of facts and figures on counterfeiting, smuggling and tax evasion in seven key industry sectors in India. This research has deployed a methodology which is by far the most comprehensive till date, at least in India. Lakhs of data points have been analyzed and 129 existing sources have been referred and relied upon. The data crunching was followed by a robust validation exercise with relevant stake holders. This qualitative element is the most significant part of the research that needs to be emphasized before this audience and all those who read and make use of it.

Our industry and government is very concerned about weak intellectual property protection and enforcement in India. The exponential growth of intellectual property (IP) crime has been illustrated very clearly by various studies and information from a variety of sources as well as the media. While counterfeiting used to consist primarily of apparel and other such items, the high profitability and low risk involved has allowed criminals, including organized crime rings, to become very active, counterfeiting virtually everything including, for instance, pharmaceutical products, electrical products, software, movies, food, wine, personal care products, automobile parts and luxury goods. While IP crime can lack, for some, the social stigma of many other criminal offences, this illegal activity is a drain on the economy and is responsible for loss of employment, a reduction in tax revenues for governments, and poses serious consumer health and safety risks due to the poor quality of products and sometimes hazardous nature of the fakes. Virtually no industry escapes this illegal activity.

We hope that this report would be a stepping stone towards empowering the consumer with his "RIGHT TO KNOW RIGHT NOW". We also hope that proactive strategy built on the basis of the 'Way forward' as outlined in the report on "Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors." will demonstrate that India is serious about adequately protecting its knowledge based economy. Indian industry urges the government to make this a priority.

We would like to thank all the committee members and stakeholders who have contributed towards this project particularly Thought Arbitrage Research Institute (TARI) and it is hoped that this research will be useful for consumers; industry, policy makers, researchers and other stake holders in order to begin to comprehend the problem that the nation is faced with and would face if efforts are not made sooner than later to curb this menace.

Meenu Chandra
Joint Director, Team Lead
FICCI- CASCADE

Executive Summary

Grey Market or Illicit Market comprises of transactions which are done outside the authorised channels of trade and mainly includes counterfeiting, smuggling and tax evaded goods.

Existence and operation of illicit markets is an enduring problem that escalates each day in scope and magnitude and impacts industries, consumers, government and economies as a whole. The market for fake or counterfeit or smuggled products is one of the biggest challenges faced by Indian industry, impacting 'Brand India' globally.

Counterfeiting is commonly understood as any process of fraudulently manufacturing, altering, or distributing a product that is of lesser value than the genuine product with the intention of misleading the buyer about the genuineness of product. Smuggling refers to import or export of goods secretly contrary to the law and especially without paying duties imposed by law. Tax evaded goods are those which are produced/ imported without paying legally required taxes. The taxes evaded may include excise duty (value added tax), sales tax, customs duty, service tax etc.

Some of the factors responsible for existence and operation of the grey market are: high unit profitability, large potential market size, tax arbitrage, rise of genuine brand power (that may be replicated), moderate investment and technology requirements, easy access to distribution channels, ease of concealing operations coupled with poor enforcement. Changing consumer preferences such as high value/price consciousness, low prices of fakes coupled with acceptable perceived quality, low health and safety awareness, low respect for Intellectual Property also play a significant role.

In 2005, the Organisation for Economic Co-operation and Development (OECD) estimated that international trade in counterfeit and pirated products could have been up to USD 200 billion.¹ Business Action to Stop Counterfeiting and Piracy (BASCAP), 2008 study estimated the impact of counterfeited products on the G20 economies to be US\$ 455 to US\$ 650 billion and projected that by 2015, this impact would rise any-where between US\$ 1,220 to US\$ 1,770 billion.²

There are study reports, research papers and other publications available from international bodies on extent of counterfeiting/ smuggling impacting American, European, G20 and other economies. However, almost no work has been done in India to assess the magnitude of challenge posed to multiple sectors of the economy. Unless this assessment is done, it becomes difficult for industry and government to initiate remedial, enforcement and policy responses.

FICCI Committee Against Smuggling and Counterfeiting Activities Destroying the Economy (CASCADE) has commissioned this study and made a pioneering attempt to estimate the size of "grey market" for selected industry sectors in India and to project the economic loss to industry, government and consequent social impact. The sectors commissioned for this study are identified on the basis of the CASCADE Committee's industry member business experience and feedback from their customers, where counterfeiting is perceived to be prevalent and where public welfare, safety issues become a key concern. The sectors are:

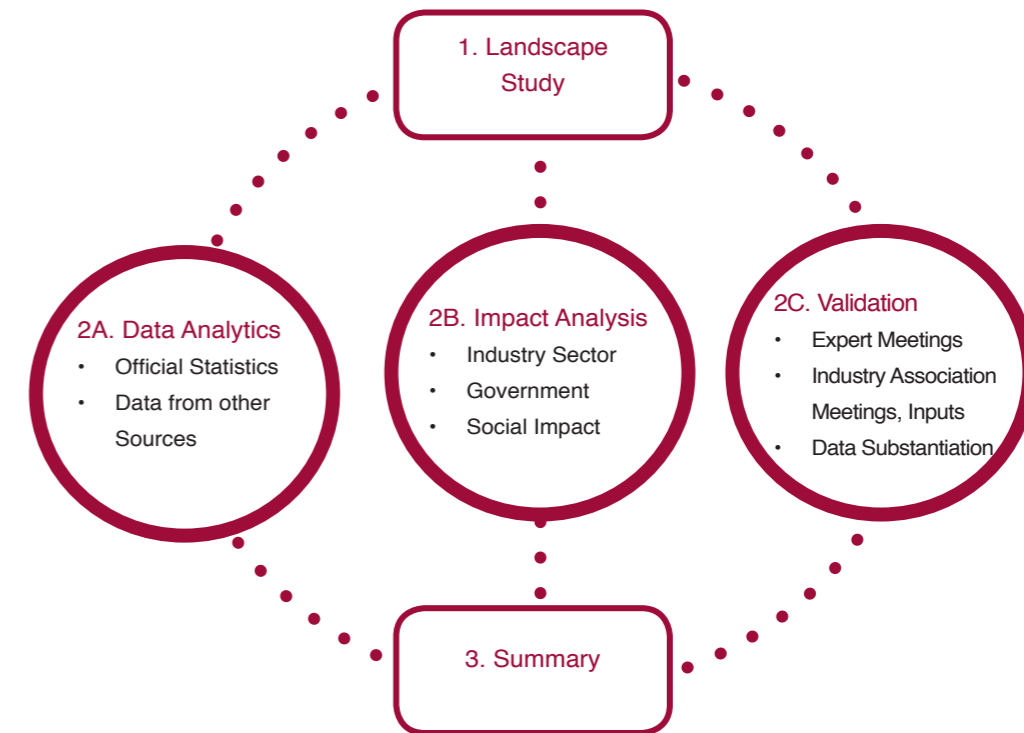
- Auto Components
- Alcohol
- Computer Hardware
- Fast Moving Consumer Goods (Personal Goods)
- Fast Moving Consumer Goods (Packaged Foods)
- Mobiles Phones
- Tobacco

The study began with the literature survey of various estimation methods used by international research reports and concluded that each method of estimation has limitations on account of data availability and underlying assumptions and no single method can be

¹ Economic Impact of Counterfeiting and Piracy, OECD, 2008

² Estimating the global economic and social impacts of counterfeiting and piracy, BASCAP, 2011

used across all the industry sectors. Therefore the study used the following approach:



This study used a combination of data analytics on Government of India statistics and industry validations to estimate the extent and level of grey market operations across industry sectors. Key data sources have been drawn from Government of India, Ministry of Statistics and Programme Implementation Annual Survey of Industries (ASI) and National Sample Survey (NSS), supplemented by data from Directorate General of Commercial Intelligence (DGCIS) under Ministry of Commerce and Industries and Ministry of Micro, Small and Medium Enterprises (MSME).

The study calculates the "difference" arising between consumption expenditure (from NSS data) and value of supply captured from sum of production from factories for domestic consumption (from ASI data), registered micro-enterprises (from MSME data) and imports (from DGCIS data).

The "difference" is attributed to the following items:

- Goods produced or imported and sold in the country by evading taxes.
- Sale of domestically produced counterfeited (either deceptive or non-deceptive) goods.

This "difference" is termed as Grey Market in this study and has been expressed as a percentage of the total consumption expenditure for the sector.

On the basis of the grey market percentage so derived the study calculated the loss to the industry on the basis of industry size estimates. The loss to government has been quantified to the extent of revenue loss to the exchequer which comprises of direct and indirect taxes and has been calculated on the basis of total sales loss estimate to the industry. Indirect Tax Loss to Government is computed on the assumption that the gap in demand and supply would be met through domestic production and imports and existence of the grey market results in loss of excise duty/ value added tax, sales tax and import duties.

The direct tax loss to government is computed on the basis of loss of incremental profit to industry that could have accrued because of additional sales and estimates that such incremental profits would have been taxed at 33% under Income Tax Act.

The estimated sales loss to the industry in the seven selected sectors amounts to Rs. 72,969 crores.

Estimated Sales Loss* to Industry (seven sectors)

Industry Sector	Grey Market (percentage)	Sales Loss to Industry (Rs Crores)
Auto Components	29.6	9,198
Alcohol	10.2	5,626
Computer Hardware	26.4	4,725
FMCG (Personal Goods)	25.9	15,035
FMCG (Packaged Food)	23.4	20,378
Mobile Phones	20.8	9,042
Tobacco	15.7	8,965
Total Sales Loss		72,969

*The loss has been calculated for the year 2012

Besides studying the above seven sectors in detail, this research takes a panoramic view of pharmaceutical and other FMCG sectors to arrive at a basic estimate of the possible grey market. We have deduced 5% as the grey market for these sectors and estimated the sales loss to pharmaceutical at Rs 4,274 crores and other FMCG sectors at Rs 25,033 crores.

The estimate of tax loss to the central and state exchequers for each of the seven selected sectors is summarised in the underneath table.

Estimated Tax Loss** to the Government

Industry Sector	Direct Tax Loss (Rs crores)	Indirect Tax Loss (Rs crores)	Tax Loss to the Exchequer (Rs. Crores)
Auto Components	421	2,305	2,726
Alcohol	260	2,250	2,510
Computer Hardware	47	1,187	1,234
FMCG (Personal Goods)	867	3,779	4,646
FMCG (Packaged Food)	552	5,108	5,660
Mobile Phones	496	2,678	3,174
Tobacco	861	5,379	6,240
Estimated Annual Loss	3,504	22,686	26,190

**The loss is calculated for the year 2012

However, the impact of grey market goes beyond loss of sales to industry or revenue loss to the government.

Loss of revenue to the government has a direct impact on spending on welfare measures such as on health care, education and public transport. Police and other enforcement infrastructure are also hit by this resource crunch which exacerbates the problem of grey market operations.

Additionally, the grey market exerts a downward pull on the labour market by shrinking profitability of the organised industry which would lead to lay-offs; employment of laid-off workers by grey market operators reduces the quality of working conditions and benefits otherwise afforded under law. In the medium to long term, this tends to create severe distortion in the country's labour market.

One silent victim of the grey market is the environment and the impact of environment degradation is on the most vulnerable sections of the community. Grey market operators rarely follow safety standards or guidelines for drawing natural resources, quality of materials used or in disposing waste. There are few global facilities for safe containment or destruction of seized goods or a mechanism to hold the counterfeiter liable for costs of destruction.

This study reveals the convergence of four key factors that make the Indian market susceptible to grey market operations. These are:

- Market attractiveness
- Supply Chain inefficiency
- Enforcement challenges
- Customer unawareness

Thus customers face health and safety hazards and genuine manufacturers' have reduced incentive and motivation to invest in business. Further there have been evidences of counterfeiter-criminal nexus resulting in growth of anti-social activities, violent and organized crime.

Anti-counterfeiting solutions are of extreme significance and would help the original manufacturers to increase their sales, protect their brands, and build consumers trust and confidence and help governments to increase its tax collections. It would be unrealistic

to expect any measures to eliminate counterfeiting forever, but the aim should be to make it unattractive for fraudsters to target the company's products.¹

The study suggests these measures to combat grey market operations into areas of:

- Regulatory Environment
- Consumer Awareness
- Supply Chain Management
- Technological Solutions
- Industry Initiatives
- Role of search and seizure
- Anti-Counterfeiting Policy
- Due Diligence
- Continuous Interaction between Industry Members/Associations

Further, it is recommended that FICCI should seek a mandate from Government of India to constitute an Expert Committee to formulate an orchestrated strategy with participation from policy makers, representation from enforcement agencies, industry, civil society and organizations working towards ensuring customer welfare to comprehensively address all the four identified social factors. The implementation of such strategy needs to be sector specific as challenges of each sector and its remedial measures merits exclusive consideration.








The study concludes that grey market poses serious challenges to the government, industries and customers. On the one hand customers face health and safety hazards and on the other hand, genuine manufacturers' incentive and motivation to invest in business growth, research and development tends to decline on account of vulnerability to counterfeits and fakes. The counterfeiter-criminal nexus results in growth of anti-social activities, violent and organized crime. The consequential price paid by society for such incidences cannot be measured only in economic terms but have far-reaching impact on national security and the country's progress.

¹ Economic Impact of Counterfeiting and Piracy, OECD, 2008

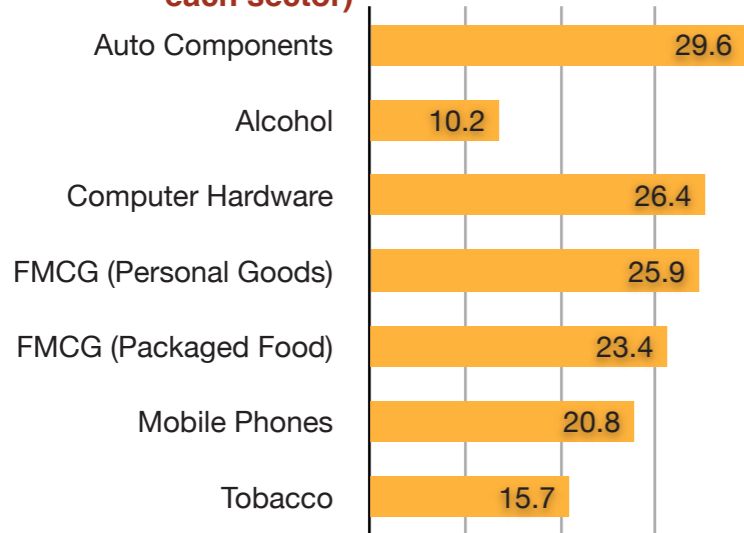
Grey Market Impact

(Calculations are for the year 2012)

Sectors studied

-  Auto Components
-  Alcohol
-  Computer Hardware
-  Fast Moving Consumer Goods (Personal Goods)
-  Fast Moving Goods (Packaged Foods)
-  Mobiles Phones
-  Tobacco

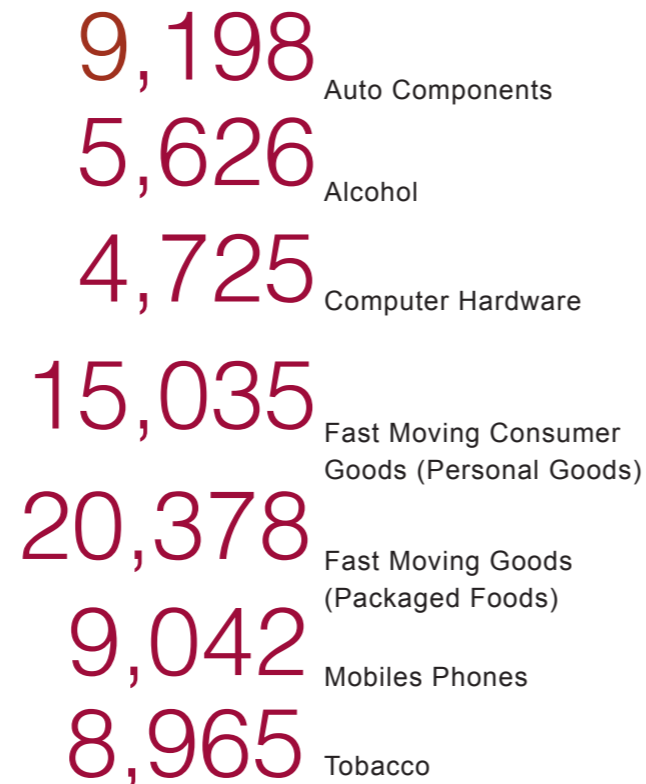
Grey Market (percentage in each sector)



Total Annual Sales Loss* to Industry

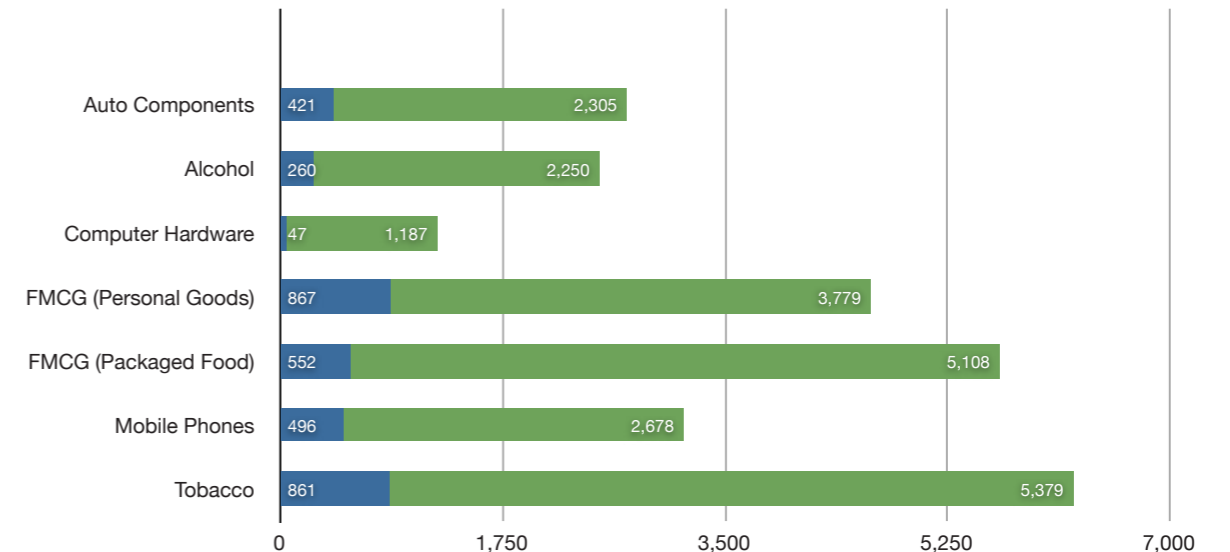


*value in Rs Crores





Study Highlights

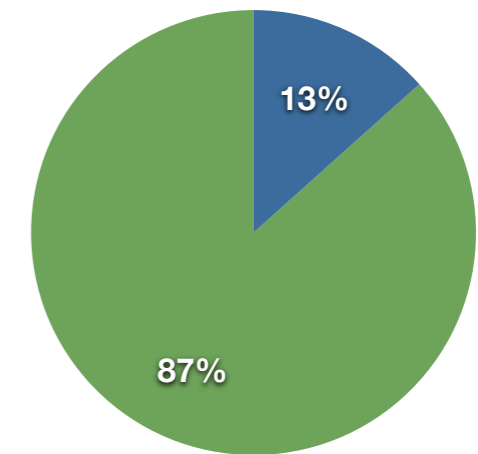
Estimated Tax Loss* in Direct and Indirect Taxes to the Government



*value in Rs Crores

Percentage Share of Direct and Indirect Tax Loss

-  Direct Tax Loss
-  Indirect Tax Loss



Estimated Annual Tax* Loss to Government



*value in Rs Crores

Overall estimate of Annual Sales Loss* to Industry



Pharmaceutical and other FMCG sectors (limited study was conducted) **29,307**

*value in Rs Crores

About this report:

This report has been prepared by Thought Arbitrage Research Institute (TARI) for FICCI Committee Against Smuggling and Counterfeiting Activities Destroying the Economy (CASCADE).

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- Corporate Governance
- Sustainability
- Economics
- Public Policy

TARI is founded by Kaushik Dutta and Kshama V Kaushik.

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About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

Federation of Indian Chambers of Commerce and Industry
www.ficci.com

About FICCI CASCADE

In the recent past India's economic growth story has attracted world's attention bringing new challenges for the domestic economy. One of the challenges currently faced is the growing illicit trade in counterfeits, pass offs and smuggled goods. These activities are also threatening brands not only in every region of the country but across the globe. Contraband and counterfeit products hurt the integrity of the brand, further diluting the brand owner's reputation. This not only results in erosion of sales of the legitimate product but further [CASACADE]s onto affect the consumers in the form of health and safety hazards.

With the above insight the Federation of Indian Chambers of Commerce and Industry (FICCI) took the initiative to dedicate a forum by establishing the Committee Against Smuggling and Counterfeiting Activities Destroying the Economy - CASCADE on 18th January, 2011 at FICCI Federation House, New Delhi.

**FICCI Committee Against Smuggling and Counterfeiting Activities
Destroying Economy (CASCADE)**
www.ficci-cascade.com