CEPS EVENT REPORT
Thinking ahead for Europe

Combating Counterfeiting and Illicit Trade - Business practices and policy direction on ICT traceability and authentication

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Illicit trade is swiftly rising and its value currently amounts to $2.3 trillion globally. According to the International Chamber of Commerce, the value of trade in counterfeit goods increased from $600 billion in 2014 to $1.7 trillion in 2015.[1] The latter value approximately corresponds to the sum of all defence budgets worldwide and represents 2.5% of goods traded globally. This trend is particularly worrying since illicit trade has negative impacts on the society as a whole: consumers buy dangerous and unhealthy products, governments collect smaller amounts of tax revenues and profits from illicit trade support crime and terrorism.

This seminar, the third of a series on combating illicit trade and counterfeiting, focuses on new information and communications technologies (ICTs) aimed at reducing fraud by enhancing traceability and authentication of products.

The role of ICT in enhancing tracking, tracing and authentication

Stakeholders and international organisations will not be able to win the fight against illicit trade without efficient tracking, tracing and authentication systems. These three terms, however, are often poorly defined or misused, as observed by Craig Stobie (Domino and founding member of the Coalition Against Illicit Trade – CAIT). **Tracking** locates products, while **tracing** determines the origins and destinations of goods. **Authentication** refers to the validation of products as genuine. How can stakeholders and international organisations enhance tracking, tracing and authentication of goods? Which ICTs are currently available to improve traceability and authentication? In this context, cooperation between public authorities, manufacturers and solution providers is crucial for the design and implementation of practical systems that are not disruptive of the supply chain while enhancing the effectiveness of controls.

Diane Taillard (GS1) highlighted two existing approaches to detect illicit trade: i) verifying identification features of products and ii) tracking products to their current location or tracing products from their previous locations.

[1] According to Carina Gommers of the Anti-Counterfeiting Committee of the European Communities Trade Mark Association (ECTA), this increase may well be explained by the highly profitable nature of illicit trade and counterfeiting, and the lower risks faced by illicit traders, as compared for example to drug trafficking.

The first approach directly refers to authentication of goods. In this regard, the World Customs Organisation (WCO), in collaboration with GS1, has developed a global anti-counterfeiting web platform that operates around three main axes: an IPM[2] tool, training to customs authorities, and operations in specific countries. According to the WCO website, the IPM tool "allows brands' operational data to be communicated directly to customs officers, facilitating the identification of counterfeit goods". IPM allows for visual inspection and authentication checks in record time. Furthermore, it prevents any human error in inputting and/or reading codes since these codes are all machine readable. As emphasised by Bob Peeters (WCO), IPM is an effective and reliable tool for combating illicit trade.

Craig Stobie (Domino) also argued that smart phone technology allows brand owners to empower consumers in the fight against illicit trade and counterfeiting. Consumers may become major actors in the fight against illicit trade by having access to anti-counterfeiting web platforms, such as the IPM tool, and quickly verify from their smart phones whether or not goods are counterfeit. In this way, such tools not only enhance cooperation among rights-holders and customs officers, but they also enhance consumers' empowerment. Although the IPM tool appears to be very efficient in authenticating products, it does not directly prevent counterfeit goods from entering the market. Preserving the integrity of the supply chain remains a challenging responsibility of brand owners.

The second approach refers to traceability and requires customs officers to: i) ascertain whether the product has a serial number, ii) verify whether this serial number has already been used on a sold product and iii) determine the chain of custody. In this case, each operator records tracking events using the same 2D-code, which allows the authorities to build the chain of custody. Stakeholders can later access this chain of custody to assess whether the product is genuine. Since every company is responsible for putting traceability in place, interoperable tools are required to ensure traceability across the value chain. Craig Stobie (Domino) highlighted the role of public authorities and regulators in ensuring interoperability across different technological platforms, geographies and industry sectors. He reiterated the need for regulators to better leverage well-recognized standards and business practices[3], set the basic requirements for system interoperability and control and encouraged producers and supply chain operators to select the most appropriate technologies that best fit their respective industrial environments. Diane Taillard (GS1) emphasised the role that standards-setting organisations can play in enhancing interoperability among these tools. Using common standards leaves companies free to choose the tools that meet their needs but also allows interoperability across the supply chain. For example, GS1 proposes standard codes, which can be shared by all companies rather than proprietary codes.

Although great improvements have been made to ICTs to combat illicit trade, operational flaws remain. For example, the IPM tool does not work well in countries with poor internet connections. Furthermore, international organisations do not directly control internal factors in third countries, such as corruption, which reinforce illicit trade. One potential solution to such an issue may be to create common regulatory frameworks among countries and expand cooperation among all actors in this field.

The role of institutions in combating illicit trade

The regulatory framework supervising illicit trade is complex as provisions against illicit trade can fall under different regulatory requirements. How can international institutions cooperate to provide a common and efficient answer in the fight against illicit trade?

From a trade perspective, the European Commission works at a multilateral level to remind its trading partners about the value of intellectual property (IP) for industries and SMEs.

[2] Interface Public-Members.

[3] For a recent compilation of practices, see "Business cases on tracking, tracing and authentication systems to combat illicit trade", collaborative report prepared by CAIT members, May 2017.

Indeed, IP-intensive industries account for €5.7 trillion in value and 6 million direct jobs. In addition, IP goods and services represent 93% of EU exports and more than 80% of EU imports. The Commission also works on bilateral trade agreements, which always include a chapter on IP, generally relying on the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Pedro Velasco-Martins (DG Trade) stressed that IP chapters aim to improve standards in partner territories. Furthermore, IP dialogues are on-going with countries with which the EU has not signed a trade agreement (including *inter alia* China, Indonesia, Brazil and Russia). DG Trade also has a number of programmes devoted to increase enforcement and protect EU IP when trading with third countries. One of these technical assistance programmes, IP Key, was co-funded by China, which is poised to play a prominent role in the protection of IP rights globally.

With regards to customs, EU institutions are working in collaboration with countries outside the EU, in particular to enhance traceability. Once customs officers have detected counterfeit goods, they need to understand where these goods come from and who is responsible for them. In this respect, cooperation with third countries is crucial. Therefore, the EU has signed customs mutual assistance agreements with its trading partners, the most prominent being the agreement signed with China in the field of IP rights.

Investigators still face multiple issues, however. First, new customs legislation allows authorised economic operators to import goods without presenting them for customs inspection. These operators declare the imported goods to customs only once they have already sold them. In such cases, customs officers have no choice but to trust authorised economic operators some of whom may not be able to detect counterfeit goods. Second, e-commerce appears as a growing problem. While some consumers involuntarily buy online counterfeit goods, others are well aware of the fraud. Hannes Leo (EESC) emphasised the importance of empowering online consumers to provide feedback on e-commerce websites to identify sellers of counterfeit goods. For example, Alibaba downgrades those that sell counterfeit items, as well as consumers who buy these counterfeits. Furthermore, rights-holders have expressed their discontent with regard to the E-Commerce Directive. Under this directive, platforms are not held responsible for counterfeit products sold by their merchants. Instead, they are only responsible for removing illegal material when informed.[4] Third, Carina Gommers (ECTA Anti-Counterfeiting Committee) expressed her concern with regard to Free Trade Zones: these zones are often misused by criminal organisations to develop more illicit trade and start manufacturing counterfeit products. Free Trade Zones pose a major challenge to customs officers as they cannot trace goods that enter these zones. As indicated by Siegmar Reiss (OLAF), Free Trade Zones should be free of customs duty, but not of customs control. Michael Morants (OECD) presented recent work of the OECD to tackle this major problem. In particular, the OECD will develop a voluntary Code of Conduct for businesses operating in Free Trade Zones.

Enhanced cooperation between institutional organisations and stakeholders, as well as between EU institutions and EU member states, will be a key factor in the fight against illicit trade. Agreeing on common technical standards and sharing information on this topic with all relevant authorities (i.e. not only customs authorities, but also finance ministries, health ministries, etc.) will be primordial to eradicate illicit trade.

[4] See William Echikson, "Limited liability for the net? The Future of Europe's E-Commerce Directive", CEPS Commentary, CEPS, Brussels, 13 April 2017.