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Import Tariffs and the Flow of Counterfeit Goods into the United States

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Abstract

The world of counterfeit goods is diverse and has grown rapidly throughout the years. The boom of e-commerce has resulted in a devastating increase in the shipment of small packages into the United States, making it easier for every day consumers to be fooled by counterfeiting masterminds. Counterfeit goods are not limited to fake watches and designer purses offered on the streets of Los Angeles or New York City anymore, instead the market has expanded to include many goods like consumer electronics, footwear, apparel, cosmetics, and even medicines and personal care items. Advances in technology at border control points, advertising campaigns that promote the negative effects of counterfeiting to educate consumers, and industry leaders having more control over their suppliers are some of the many effective strategies in the fight against counterfeiting, but what about the effects of international trade and the role of tariffs. This paper examines the relationship between import tariffs and the flow of industrial (non-agricultural) counterfeit goods into the United States.

1. The World of Counterfeit Goods

1.1 Background

The International AntiCounterfeiting Coalition (IACC) defines counterfeiting as a federal and state crime that involves the manufacturing or distribution of goods under someone else's name without their permission. The IACC states that counterfeit goods are usually made from lower quality components, and sold to imitate similar goods that are produced by brands that consumers know and trust. To put it simply, counterfeit goods are fake goods that are sold illegally. Many steps have been taken by the IACC, the US Department of Homeland Security, Immigration and Customs Enforcement, US Customs and Border Protection (CBP), etc., to combat the counterfeit goods crisis; however, their efforts are not enough to stop this trillion dollar industry. Demand and supply side actions can, and are, being taken to reduce the amount of counterfeit goods entering the US, but what impact do tariffs make on the rate of trade in this illegal market?

This paper will focus on the impact of tariffs on counterfeit goods with respect to data on trade and tariffs between the United States and China. China is the source of the highest amount of customs seizures for counterfeit goods; therefore, this paper investigates the impact of the trade wars between the United States and China on the amount of counterfeit goods entering the United States. I used data on the annual seizures of counterfeit goods as a reference for the level of counterfeiting taking place. It is difficult to calculate the estimated production of counterfeiting each year because this is an illegal market; therefore, I chose to use seizure data. Annual seizures fluctuate for many reasons such as; an increase in border security and technology, track and trace tactics, and efforts to track down counterfeiters from legitimate manufacturers. Understanding that many things impact the level of annual seizures, this research presents data that shows an inverse relationship exists between import tariffs that are imposed on goods entering the US from China, and counterfeit goods in the Apparel (Clothing and Textiles) product segment.

2. Literature Review

2.1 Growth of Counterfeit Goods

Trade in counterfeit and pirated physical goods is an estimated \$1.7 trillion a year industry (International AntiCounterfeiting Coalition, 2019). In 2013, the value of imported fake goods worldwide was \$461B (*Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact*, 2016) and just three years later in 2016, that number grew to a staggering \$509B (*Trends in Trade in Counterfeit and Pirated Goods*, 2019). Counterfeit goods range from apparel and clothing accessories, footwear, and toys to goods that can physically harm consumers like fake pharmaceuticals, cosmetics, auto parts, and skincare products. Consumers aren't the only ones at a loss when it comes to counterfeit goods, the International Chamber of Commerce projects that globally, net job loss will be between 4.2 to 5.4 million by 2022 due to counterfeiting and piracy (Economics, 2016). With no end in site, trade in counterfeit and pirated physical goods continues to steadily rise, representing 3.3% of global trade (OECD, 2019).

As online shopping becomes a staple in households across America, counterfeit goods are finding their way into consumer hands at an alarming rate. Third-party platforms are an ideal method of transaction for counterfeiters due to the ease of access to consumers and the lack of

control from legitimate brands to police fake goods. The popularity of e-commerce has led to a sharp increase in the shipment of small packages into the United States (US Customs and Border Protection, 2018). Consumers can purchase items that are delivered straight to their doors, often without the proper security screening due to the sheer amount of packages that move through commercial postal carriers.

US companies that are trying to protect their products and fight the production and sale of counterfeit goods often find themselves at a loss. Manufacturers of counterfeit goods can be difficult to track because they often use shell companies and ship their products from sub-contractors to avoid detection. Legal action is very difficult for American companies because e-commerce counterfeiters are usually located outside of the US jurisdiction, often residing in China (Homeland Security, 2020).

2.2 Trade with China

China is currently the United States' largest trader of goods. In 2018, total trade with China was worth an estimated \$659.8B with exports totaling \$120.3B and imports of \$539.5B, a deficit of \$419.2B (The People's Republic of China, 2020). Figure 1, from BBC News, shows the trade deficit between the United States and China from 1985 to 2018. The top import categories of goods from China in 2018 were: electrical machinery, machinery, furniture and bedding, toys and sports equipment, and plastics. US imports from China accounted for 21.2% of all US imports in 2018 (The People's Republic of China, 2020). Research discusses the high levels of trade with China and the impact this has on the amount of counterfeit goods entering the United States. The high level of counterfeiting in China is due to the considerable amount of outsourcing taking place there, China's high level of organized crime, the lack of intellectual property rights in China, and the willingness of Chinese consumers to buy counterfeit goods (Chaudhry, 2009).

Mainland China and Hong Kong dominate the world of counterfeit goods and they remain the primary source of counterfeit and pirated goods seizures in the United States. In 2019, The People's Republic of China was at fault for a total of 66% of all counterfeit seizures in the US, a total estimated value of over \$1B in counterfeit goods (US Customs and Border Protection, 2019). In 2018, Mainland China accounted for 46% of total seizures with Hong Kong coming in at a close second at 41% (Homeland Security, 2018). The sharp increase of 20% in counterfeit seizures coming from China, correlates to the beginning of the tariff war between the Trump Administration and China.

In March 2018, a report by the United States Trade Representative concluded that China was conducting unfair trade practices. That same day, the war on tariffs began. Figure 2, from BBC News, gives a visual of the tariffs placed on China and the retaliatory tariffs imposed on the US in 2018 and 2019. The United States is currently imposing tariffs on more than \$360B worth of Chinese imports, 25% tariff on \$250B and 7.5% on \$112B (York, 2020). China has retaliated and currently holds tariffs on approximately \$75B of US goods at a rate of 2.5% and 5% (York, 2020). So what effect do these tariffs have on US consumers in the market for counterfeit goods?

2.3 Consumer Role

Consumers play a vital role in deciding the amount of counterfeit goods being imported into the United States; with fluctuating preferences and changes in income, consumer demand for

counterfeit goods has increased in the last few decades. Previous research examines the complex purchasing process that involves: consumer-brand relationships, personality traits, impulse buys, conforming to social norms, etc., (Randhawa, Calantone, & Voorhees, 2015) and explains how understanding the connection between a consumer and a brand is vital when it comes to combating luxury brand counterfeiting. If a consumer's main goal is to comply with social norms and find themselves in the 'in crowd,' they will go to whatever lengths they deem necessary including deliberately purchasing counterfeit goods. This is a red flag when it comes to the fight against counterfeit goods. If consumers are always going to demand fake goods, nothing the government or firms do will make a difference.

Counterfeiting can either be deceptive, consumers unknowingly purchase a counterfeit good because they cannot easily distinguish it from a genuine item; or non-deceptive, consumers knowingly purchase a product that is fake (Grossman & Shapiro, 1988). Consumers who deliberately purchase counterfeit goods do so for price affordability and to boost their socioeconomic status. Some economists have questioned whether counterfeiting is creating real losses since the consumers who are purchasing counterfeit goods are doing so due to their inability to afford the genuine product, and there is no guarantee they would contribute to the real market if the counterfeit good did not exist (Chaudry, 2009). As legitimate companies work to combat counterfeiters by making their products harder to replicate, ultimately increasing the price per item, consumers find themselves hunting for cheaper alternatives which are often counterfeit goods.

2.4 Combatting Counterfeiting

As previously mentioned, counterfeit goods are a risk to consumers, employees of legitimate companies, brand trust, and even source countries as they may see a reduction in long term foreign direct investment due to counterfeit activity (Chaudry, 2009). Protection from counterfeiting ranges from the front lines with US Customs and Border Protection; to US laws like the Tariff Act of 1930, the Lanham Act, the Trademark Counterfeiting Act of 1984, and the Stop Counterfeiting in Manufactured Goods Act of 2006. See the article *Preserving Intellectual Property Rights* (Chaudry, 2009) for an in-depth look at the various approaches to fighting counterfeiters and the most frequently used tactics.

With the numerous laws and international agreements in the fight to end the production of counterfeit goods, educating the consumer does not seem to get the attention it deserves. Current literature focuses on US industries protecting their products by making them more difficult to replicate and using track and trace technology; however, the consumer needs to be aware of the risks with buying, knowingly or unknowingly, fake goods. The article, *Strategies to detect and reduce counterfeiting activity* by Barry Berman, was one of the few that explained the education process needed to make the public aware of the signs of counterfeit goods. He also explained the responsibility of marketers and how advertising campaigns that explain the financial risks and safety to consumers, would benefit the fight to end counterfeiting. Berman points out that an effective strategy to detect and reduce counterfeiting activity has several key components including; the importance of early detection, firms budgeting for counterfeit deterrence and the removal of counterfeit merchandise from the market, the firm's ability to monitor the internet and manage outsourcing, and consumer education.

The US Food and Drug Administration, as well as, US Customs and Border Protection, have created public service announcements to inform the public of the dangers of counterfeit goods. The US is doing a great deal to combat counterfeiters, but there are many more resources that can be utilized. Aggressive advertising can be used to explain how purchasing counterfeit goods often leads to the funding of organized crime and drug trafficking. Consumers do not have the realistic picture of the connection between their fake Louis Vuitton purse and the direct impact that purchase has on organized crime in the country it was produced in. The fight against counterfeit goods needs to take an aggressive approach to advertising, similar to the anti-tobacco ads of the late 1990s. Future research should examine the effect of shock advertising what effect there is if consumers are constantly bombarded with the truth behind counterfeit goods, how likely would they be to deliberately purchase them.

Berman discusses an early warning system that alerts firms that counterfeit goods exist for their products; however, he states that an important component of such a system is for final consumers to report the suspected goods. This is putting a certain level of responsibility on the consumer to report suspected counterfeit goods, which they may not be aware of. An early warning system was not common among other research, but it should be implemented in the world of e-commerce. If consumers were asked if the item they purchased is a suspected counterfeit good every time they shopped online, companies would have an immediate notification and a better chance of tracking down counterfeiters.

3. Models and Data

Table 1 is a collection of fiscal year seizures from the US Customs and Border Protection annual Intellectual Property Rights Seizure Reports. This data shows the amount of seizures each year from 2013 to 2019; with the total estimated manufacturer's retail price (MSRP), or value, of the seized items. The table also includes the most common product that was seized and what percent of total seizures that product accounts for. Finding the percent change of seizures from one year to the next shows the increase, and decrease, of seizures over time. A key figure is the decrease from 2018 to 2019 of 18.4% during the tariff wars between the US and China, and interestingly, Apparel and Accessories is no longer the front runner in product segment for counterfeit seizures.

Table 2 is a collection of data from the World Bank showing the import tariffs placed on Textiles and Clothing from China from 2013 to 2018, matching the years of seizure data from Table 1. Year 2019 data was not available on the site; however, below the table I have included data on the tariffs imposed on China in 2019 and 2020. The Trump Administration imposed 15% tariffs on \$120B worth of goods from China in 2019, then reduced that tariff to 7.5% in 2020. It is difficult to find data on the exact product segment; therefore, referencing Figure 3, we see that there are two categories for apparel. One category has a tariff of 18.7% and the other is 15.8%. Apparel is a high tariff product segment, so I will use the rate of 15% for 2019 and assume a drop to 7.5% in 2020 to match the Trump Administration decisions.

I am focusing on the Textiles and Clothing product market since Apparel and Clothing has consecutively been the leading product of counterfeit seizures, and the purpose of this data is to observe the effect of import tariffs on counterfeit goods entering the United States.

Table 3 is a collection of data from the International Trade Administration, on imports of Apparel from China. We can assume that the level of counterfeit goods entering the US follows the fluctuation in imports; therefore, I will use this data to measure the impact of tariffs on the level of imports from China.

Figure 1 is a graph of the US and China trade deficit mentioned previously in this paper. Figure Two is a visual of the dollar value of the US imposed tariffs on imported Chinese goods, as well as, the retaliatory tariffs from China from July 2018 to June 2019. This timeline shows the escalation in the tariff wars previously mentioned in this paper.

Figure 3, from an article by PEW Research (DeSilver, 2018), shows that the largest categories of US imports tend to have relatively low tariff rates, with the exception of 'Apparel and clothing accessories'. The purpose of including this chart is to show that the two categories of 'Apparel and clothing accessories' accounted for \$80.6B worth of imports in 2017, making up 3.5% of total imports, with nearly \$64B of those imports subject to duty. The average tariffs on the 'Apparel and clothing accessories' category were 18.7% and 15.8% (knitted or crocheted vs not knitted or crocheted); these two rates were the highest out of the hundreds of import categories for goods entering the US. Footwear is the other category to notice in this chart because it is one of the most popular items being seized, after apparel, for counterfeit goods by US Customs and Border Protection every year. This chart shows that nearly 95% of footwear entering the US is subject to duty at a rate of 11.9%. This chart connects the two highest tariff rates to two of the most popular products that are subject to counterfeiting.

Figure 4 is a scatter plot that shows the correlation between the annual seizure data in Table 1, and the import tariff rates from Table 2. This scatter plot explains that an increase in tariffs correlates to a decrease in counterfeit goods seizures.

4. Results

This research shows that an inverse relationship exists between import tariffs placed on China in the Apparel (Clothing and Textiles) product segment, and the amount of counterfeit goods seizures in the United States. Based on the data presented, as import tariffs rise, counterfeit goods seizures fall. I am equating seizures to the level of counterfeit goods entering the United States. This phenomenon follows the inverse effect that tariffs normally have on imports; tariffs increase the price of imported goods and domestic consumers are left paying higher prices as a result therefore demanding less imported goods. As stated previously, customs seizure data can fluctuate based on an increase in border security; however, for this paper I am holding all other variables constant and purely observing the relationship between counterfeit seizures and tariffs.

Table 1 shows the decline in seizures from 2018 to 2019 of 18.4% which correlates to an increase in tariffs from 10.92% to 15%. In 2019, the decline in imports of Apparel from China is around 36% and we can assume this reduction in trade is also a reduction in the ability to move counterfeit goods into the United States. Figure 4 includes the R-squared value of 0.0417. R-Squared is a statistical measure that explains to what extent the variance of one variable (import tariffs), explains the variance of the second variable (seizures). R-Squared is always between 0 and 100% with 0% indicating that the model explains none of the variability of the response data

around its mean; therefore, the R-Squared value of 0.0417 shows the very minimal effect that tariffs have on counterfeit seizures.

5. Conclusion

Higher tariffs on Apparel items have reduced the amount of imports into the United States as well as the amount of counterfeit good seizures; however, there is not a strong enough relationship of tariff rates to counterfeit good seizures to state that a decrease in seizures is solely due to an increase in tariffs. Prior to this research I assumed that an increase in tariffs would increase the amount of counterfeit good seizures because domestic prices will increase with higher tariffs, and consumers will search for cheaper alternatives that are usually fake. I assumed that the demand for counterfeit goods would rise with an increase in tariffs because consumers cannot afford, or do not want to pay, the price for legitimate goods. It is difficult to measure the definite impact that raising or lowering import tariffs will have on the amount of counterfeit goods entering the United States because it is an illegal industry and widely untraceable. It is safe to assume that increasing tariffs, resulting in higher prices for goods, will decrease the level of imports into the United States, real or fake, and reduce the burden on US Customs and Border Protection in their effort to find counterfeit goods.

In order to combat the inflow of counterfeit goods into the United States, consumers need to be smarter. The government, industry leaders, and firms must all play their part in educating the consumer and making them aware of the effects of purchasing counterfeit goods. Counterfeit goods stop at the consumer; if there is no demand for the fake goods then they will cease to exist.

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Tables

Table 1

Fiscal Year Seizures

FY	Seizures	Percent Change from Previous Year	Total Estimated Manufacturer's Suggested Retail Price (MSRP)	Top Product Seized (% of all Seizures)
2019	27,599	-18.4%	\$1.5B	Watches and Jewelry (15%)
2018	33,810	-0.1%	\$1.4B	Apparel/ Accessories (18%)
2017	34,143	8.2%	\$1.2B	Apparel/ Accessories (15%)
2016	31,560	9.3%	\$1.4B	Apparel/ Accessories (20%)
2015	28,865	24.7%	\$1.3B	Apparel/ Accessories (22%)
2014	23,140	-5%	\$1.2B	Apparel/ Accessories (28%)
2013	24,361	—	\$1.7B	Apparel/ Accessories (35%)

Table 2

Textiles and Clothing Import Tariff's Placed on China

FY	Total Import Value of Textiles and Clothing (Thousands)	Percent of Imports that are Textiles and Clothing	Import Tariff Imposed on Textiles and Clothing
2020	No data	No data	7.5%*
2019	No data	No data	15%*
2018	\$42,479,673.90	7.54%	10.92%
2017	\$40,849,010.19	7.77%	10.61%
2016	\$41,243,182.43	8.57%	11.01%
2015	\$44,601,796.97	8.85%	11.06%
2014	\$43,036,931.73	8.85%	11.02%
2013	\$40,714,714.38	9.25%	10.98%

*Data for 2019 was not available on this website; however, on February 14, 2020, the US reduced the 15% tariffs on Chinese goods by half to 7.5% (York, 2020).

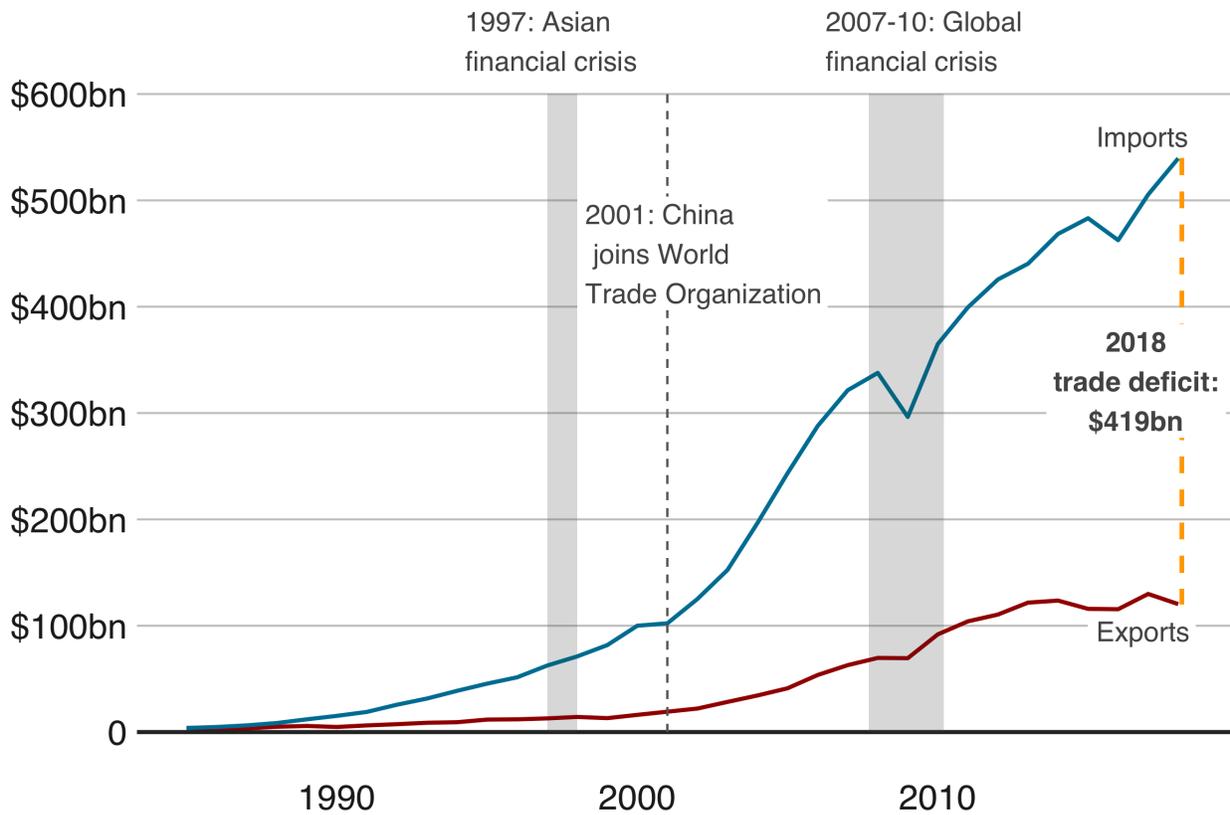
Table 3

Apparel Imports to US from China

Year	Percent Change in Imports from Year-to-Date (Jan)
Jan 2019-Jan 2020	-36.09%
Jan 2018-Jan 2019	8.53%
Jan 2017-Jan 2018	-7.24%
Jan 2016-Jan 2017	4.63%
Jan 2015-Jan 2016	2.67%
Jan 2014-Jan 2015	-10.30%
Jan 2013-Jan 2014	3.90%

US trade with China

US trade deficit with China has soared since 1985



Source: US Census



Figure 1.

How the US-China trade war has escalated



Source: BBC research



Figure 2

Biggest U.S. imports generally carry low tariffs

From all countries; dollar amounts in billions

LOWER VALUE  HIGHER VALUE

10 biggest categories of imports for consumption, 2017:	Customs value	% dutiable	Ratio of duties to:	
			<i>Dutiable imports</i>	<i>All imports</i>
Telecommunications, electronic and electrical equipment	\$346.9	21.3%	2.7%	0.6%
Computer equipment and industrial machinery	\$339.4	16.8%	3.0%	0.5%
Vehicles and parts (excluding rail)	\$292.6	42.6%	2.7%	1.1%
Petroleum and petroleum products	\$186.5	60.3%	0.2%	0.1%
Pharmaceutical products	\$99.7	>0.1%	4.7%	0.0%
Medical, scientific and other precision instruments	\$84.7	18.0%	2.2%	0.4%
Furniture, bedding, lighting and other furnishings	\$62.7	18.7%	5.7%	1.1%
Jewelry, gemstones and precious metals	\$59.2	14.4%	5.9%	0.8%
Plastics and plastic products	\$51.8	59.2%	4.6%	2.7%
Apparel and clothing accessories, knitted or crocheted	\$44.2	75.8%	18.7%	14.2%

10 highest average tariff rates, 2017:	Customs value	% dutiable	Dutiable imports	All imports
Apparel and clothing accessories, knitted or crocheted	\$44.2	75.8%	18.7%	14.2%
Apparel and clothing accessories, not knitted or crocheted	\$36.5	83.3%	15.8%	13.2%
Cork and cork products	\$0.26	0.7%	14.0%	0.1%
Natural wool, yarn and woven fabrics	\$0.27	68.8%	13.1%	9.0%
Travel goods, handbags, wallets and other leather goods	\$12.8	90.4%	12.0%	10.8%
Footwear	\$25.5	94.9%	11.9%	11.3%
Knitted or crocheted fabrics	\$0.98	78.5%	10.8%	8.4%
Manmade yarn and woven fabrics	\$2.06	57.7%	9.9%	5.7%
Titanium, cobalt, chromium and other base metals	\$2.57	53.6%	8.5%	4.6%
Vegetables	\$9.65	8.8%	8.4%	0.7%

Note: Excludes goods imported under "special classification provisions," most of which involve product repairs or returns.
 Source: Pew Research Center analysis of data from Census Bureau (accessed via the U.S. International Trade Commission's DataWeb).

PEW RESEARCH CENTER

Figure 3.

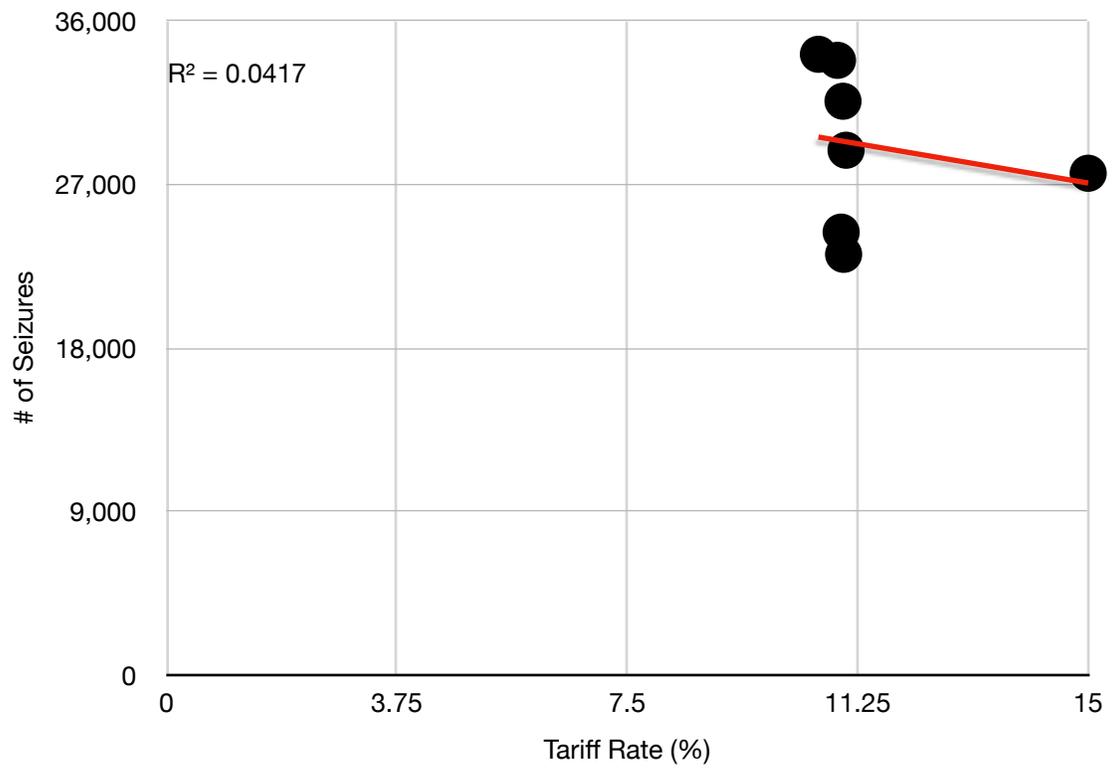


Figure 4.