

ASSOCIATION DES INDUSTRIES DE MARQUE  
EUROPEAN BRANDS ASSOCIATION  
EUROPÄISCHER MARKENVERBAND

# AIM® POSITION PAPER



WHAT PRICE PARALLEL  
TRADE? –THE REAL COST FOR  
EUROPE



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# What price parallel trade? – the real cost for Europe

## ***Background***

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Parallel trade is enabled by limiting (*exhausting*) the rights given by trade mark law. The EU follows the concept of *regional (EU-wide) exhaustion* whereby a company marketing a product in one member state cannot object on the grounds of trademark infringement to subsequent sales of that product in any other member state. This limitation is written into article 7 of the 1989 trademark directive 89/104/EEC.

The concept of EU-wide exhaustion is tied to the free movement of goods. It was extended, under an EU agreement with certain EFTA countries, to Iceland, Norway and Liechtenstein, forming the European Economic Area (EEA). The concept of EEA-wide exhaustion applies not just to trademarks but also in other areas of intellectual property such as patents and copyright.

The concept of *global exhaustion*, to allow parallel trade from any country in the world, has been proposed by certain parties. This would be a fundamental change in European intellectual property law. At the international level, there are no agreements on global exhaustion.

AIM wants to ensure that the debate over such a change takes full account of all the implications.

### ***Brands bring benefits ...***

The branding process benefits manufacturers, consumers and ultimately the economy as a whole.

**Manufacturers** benefit from having a means of identifying their product to the consumer and so differentiating their product from the competition. A brand identity enables a manufacturer to talk directly to the consumer and establish a loyalty to the brand.

Branding also provides assurance to a manufacturer that investment in innovation, to develop existing brands or to create new ones, will be protected and communicated to consumers who by their purchases provide a return on that investment.

**Consumers** benefit from being able to recognise the brand they want and to be *reassured* about its constant *quality*. Branding ensures that consumers have a *choice* and that these choices are widely available. If the brand consistently remains *relevant* to the consumer and provides the expected *satisfaction* then a consumer will come to trust in the brand.

**The economy as a whole** benefits. A recent study commissioned by AIM from London-based consultant PIMS found that brand businesses show a greater level of investment and innovation than other businesses and that this leads to a higher rate of growth and more employment both for the companies concerned and the economy as a whole.

Branding is important to international trade. EU companies competing in a global market face the relatively high costs associated with manufacturing in Europe. They compensate through innovation, so establishing a reputation for high quality. Branding identifies that quality.

***...Parallel trade undermines these benefits***

Parallel trade can undermine these benefits. It can make it harder for a brand owner to secure a return on investment in innovation and so reduces the incentive to invest. It does not, typically, offer any significant benefit to consumers.

Of course on occasions, parallel traders offer consumers savings on a well-known brand: but this is the exception not the rule. Parallel trade does not reduce prices overall. At best, it may reduce the price of a given brand, in a given outlet, for a limited time. The effect on the market price is minimal: but the effect on the brand can be severe.

The designer clothing industry is often subject to parallel trade and offers an illustration of the absence of impact on long-term price:

- Designer clothes are a negligible proportion of the total market for clothing, so the price of designer clothes has no effect on the aggregate market price of all clothes. Consumers who choose fashion clothes do so despite, or even because of, the price: they are seeking exclusivity.
- Parallel trade in such designer clothes equally has no effect on the market price. It will not affect the normal clothes buying public at all.
- The principal beneficiaries are the parallel traders themselves. They profit from the opportunity created by the strength of a brand.

In a competitive market, no-one is deprived by the existence of exclusivity. If the brand owner chooses to limit sales through prices, no-one is hurt. Although we may all want to get that exclusivity at a lower price, there is no reason to force the brand-owner to change marketing strategy. Indeed, the moment there is sufficient opportunity to buy exclusivity cheaply, the exclusive brand dies.

## ***Price differences – who decides and why do they exist?***

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### ***Price – who decides?***

A *price* is not a simple concept. Prices differ between markets, between regions and even between stores in the same town. A *price* is not a given thing but an aggregate: the sum of different costs and margins and the balance between demand and supply.

Brand owners do not control retail prices. In the EU resale price maintenance is outlawed: price is set by independent distributors and retailers. Brand owners only negotiate the price at which they sell to these distributors and retailers.

Whether a product will be successful at a given price is decided by the consumer. In a competitive market a consumer is always free to walk away. If prices are too high for the value offered the brand will fail.

### ***Price – why are there differences?***

There are many reasons why prices differ between markets around the world and even if prices were exactly the same today, exchange rate movements and other changes would ensure that this did not remain the case for long. In fact it would be far more remarkable if prices were all the same, all the time.

#### **a. Costs and Taxation**

Costs of production and distribution differ widely between countries, as do the levels of direct and indirect taxation. A component of price is cost and tax. These basic differences mean that it is impossible to draw any conclusions from a simple comparison of retail prices between countries.

#### **b. Import duties and exchange rates**

Import duties mean that a product in its home market (no duty) will have a different cost to that in an export market (duty added). Exchange rates are important in determining relative prices in different markets but they are constantly changing.

#### **c. Market conditions**

A brand owner does not sell in a vacuum. The economic situation and competition ensure that consumers will influence price. Moreover, consumers' price perceptions differ from person to person and from country to country. They are a function of income, the cost of living, and the price and perceived value of alternatives.

#### **d. Post-production costs**

To sell in a competitive market, brand owners promote their brands. The cost of promotion differs between countries: moreover, if the product is relatively unknown in a market (e.g. a new export market) it will be necessary to promote it more. Equally manufacturers may find it desirable to require a specialised retail environment with a high level of retail service, selling their whole range, or one providing high levels of after-sales service. The additional costs of such services will be borne in market (often by the authorised distributor). Also, there may be

specific regulatory costs such as a national waste recovery scheme. All these costs must be recovered and are reflected in the price.

**e. Export pricing strategies**

Typically a manufacturer starts in a home market and faces the costs of the home market. Price differences relative to the home market emerge when the manufacturer starts to export. European manufacturers are located in a high cost environment relative to much of the rest of the world. This has implications for the sort of products which can be exported and the price at which they are exported. It is unlikely that the price in the EU will suit all other markets. There are many possible pricing strategies but two extreme examples illustrate the point:

- ***The marginal pricing strategy.*** If the fixed costs of production are already covered by sales in the home market, then a producer can export at a price covering only the variable costs - allowing a much lower price than would otherwise be the case. This may enable a producer to penetrate markets that would otherwise be impossible: for example, in a relatively poor country. Although such sales may not make significant profits they do allow a manufacturer to build market share and better use the home country production capacity.
- ***The premium pricing strategy.*** If a product has high variable costs and can only be sold at a relatively high price in the export market then one strategy is to establish the product as a *premium* or *luxury* brand. This approach will require a high level of promotional cost borne by a relatively low volume of sales. In this way, a company may penetrate a relatively developed market against domestic competition.

It is essential for EU manufacturers to be able to have the flexibility to adopt these and other strategies to develop their export potential to the full. The suggestion that they could or should have a single price everywhere in the world is divorced from reality.

***What works for the single market does not work for the world***

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***EU exhaustion is part of the creation of a single market...***

The exhaustion of trademark rights between member states of the EU (and now extended to the EEA) was established in 1989. Community exhaustion is a natural part of the single market in which barriers to free movement are removed and the economies of member states converge. Where governments are required to permit the free movement of goods and persons then private enterprise must do the same.

The whole body of EU law is concerned with the removal of such barriers. Thus, for example, EU competition law aims at preventing limitations to market integration, including limitations on the freedom of consumers to buy what they want and where they want within the EU.

The primary purpose of EU exhaustion therefore is the creation of a single market: it was not intended per se to create lower prices for consumers. Only a successful, fully-integrated single market will result in long-term cost reductions that will be

passed onto consumers in lower prices. Here lies the true challenge for policy makers. Enable these cost benefits now by making the EU single market a reality.

**...Global exhaustion has no such single market objective**

There is no similar imperative with regard to the global market. The limited degree to which barriers between countries are being removed under the WTO process is in no way comparable to the process of European integration. No one is suggesting that we are trying to create a single world market.

Equally, there is no parallel political process to remove the huge differences in wealth between the EU and third countries, nor to permit the free movement of people between them.

It is clear that the current law, as set out in the 1989 trademark directive and clarified by the *Silhouette case* is entirely consistent with the body of EU law. There is no reason to change it.

**Global exhaustion would undermine EU manufacturing...**

The case for international exhaustion starts from a premise that manufacturers make things and that the sale of them is a passive exercise. On this premise, all a manufacturer has to do is to propose a price and wait for the orders to come in. This is a false premise. In the real world of fierce global competition a manufacturer must make great efforts to generate demand.

The international exhaustion of trademark rights, leading to unfettered parallel trade into the EU, would undermine these efforts.

- An established EU brand owner could not penetrate developing markets using a *marginal pricing strategy*: the brands would immediately flow back into the EU and destroy the home market.
- Equally, given international exhaustion in the export country, a brand owner would not invest in a *premium pricing strategy* if it were clear that parallel goods would immediately start to flow out of the EU and destroy the new export market.

Faced with these possibilities the choice would be simple:

- The company pursuing a *marginal pricing strategy* would choose either not to export (indeed manufacturers have withdrawn from markets in the past), or, to move manufacturing out of the EU to the low-cost market. Where this has happened lets not accelerate the trend.
- The company choosing a *premium pricing strategy* could choose either to develop different brands in export markets, or to withdraw from certain export markets. This has long-term implications for the EU balance of trade.

### ***...And global exhaustion would undermine Europe's industrial future***

In the words of Mr. Prodi to the European Parliament: “*The key to the future of our continent is in the hands of hi-tech, knowledge-based industries, at the cutting edge of research. These industries are not just the future of European industry or finance; they are the future of European society as a whole*”.

AIM completely supports this. European manufacturers will increasingly have to innovate to compete and so continually provide more *added value* to the consumer. Such *added value* is increasingly to be found in the *intellectual* content of the brand (be it technical innovation or image) and therefore it is increasingly important that this intellectual property is protected. Global exhaustion undermines this property by diverting the return on any investment in innovation away from the producer to the parallel trader.

### ***There is no case for global exhaustion***

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The case presented by parallel traders is founded on the allegation that long-term and across all brands, owners are charging excessive prices in the EU to the detriment of consumers. Parallel traders present themselves as championing the interests of consumers against such *rip-offs*.

The NERA/Berwin study destroys this argument. For the most part, parallel trade does not lead to a significant advantage to consumers (price reductions between 0 and 2% were identified) but it does lead to a reduction in manufacturers' profits of up to 35%. This long-term conclusion is supported by the real-world evidence of AIM members who find typically parallel goods sell at the same price.

At heart NERA has shown this is not primarily a consumer issue. Of course consumers would like to buy their brands cheaper – after-all we all like an occasional bargain. But, unless there is evidence of market failure there is no public reason to intervene in the relationship between the brand owner and the brand consumer.

At heart it is a business to business issue: an attempt by parallel traders to profit from the investment and innovation made by manufacturers in their brands.

### ***Conclusion: a single European economy is the real solution***

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**Isolated examples.** It is noticeable that the case for international exhaustion is founded on *examples* rather than *research*: and this may explain some of the discrepancies between the picture presented by parallel traders and the findings of the NERA study. AIM recognises that for a given brand on a given occasion it may be possible to find large price differentials: either as a feature of the different markets or as a one off (e.g. a liquidation sale). However, these instances do not make a case.

**Trademark law is no solution.** AIM cannot exclude the possibility that, in particular instances, problems need to be addressed. However, it would be inappropriate to address such instances through the introduction of global exhaustion of trademark rights and unfettered parallel trade. The appropriate means of addressing problems of market failure are to be found in other areas of the law.

**Harm to knowledge-based industries.** Parallel trade from third countries would be a considerable disincentive to EU manufacturing and investment in innovation. The probable consequence would be:

- the undermining of EU exports and a deterioration in the balance of trade: and
- an increased incentive to shift production out of high cost regions like the EU.

AIM maintains that no objective case has been made for changing the rules on trademarks. Such a change would benefit a few parallel traders: but there is no long-term evidence that it would benefit consumers. There is however, good reason to believe that it would harm EU producers, harm EU exporters and harm EU innovators.

The real solution is written into the Amsterdam Treaty. The effective removal of all barriers to trade and effective enforcement resulting in the true convergence of the economies of member states to create a high-value low-cost single market.

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For information about the negative effects on consumers of unfettered parallel trade and to learn about the myths of the grey market ask for the AIM position paper *Parallel trade – consumer benefit or consumer loss?* For AIM comment on recent parallel trade studies ask for the AIM Briefing Paper.

## **AIM**

AIM is the European Brands Association. It represents the branded goods industries in Europe on key issues which affect the ability of brand manufacturers to design, distribute and market their brands. AIM's membership groups 1600 companies of all sizes through corporate members and national associations in 20 countries. These companies are mostly active in fast moving consumer goods.