Parallel Trade & EU Trade Mark Law.
Arguments against reforming the Trade Mark Directive.
Consumers' Association response.

Introduction

Consumers’ Association (CA), publishers of Which? and other consumer books and magazines, is an independent consumer organisation with around 700,000 members. CA has campaigned in the consumer interest for over 40 years. It is funded by its range of magazines and other publications, and is therefore independent and impartial. CA receives no funding from government nor does it take advertising from industry, so its policy decisions and research programmes are undertaken free of influence.

Consumers' Association has been keen to see reform of the Trade Mark Directive to a regime of international exhaustion for some time as we believe it restricts choice, maintains high prices and works for the benefit of large brand manufacturers and against the interests of consumers.

Consumers’ Association believes that consumers should gain from globalisation and freer trade. We believe that intermediaries and consumers should be free to access legitimate goods from wherever in the world they choose to. We believe that restrictions to trade and competition should be reduced wherever possible and that manufacturers should not be able to use intellectual property protection as a ruse for price discrimination, anti-competitive behaviour and the abuse of consumers. We, in short, believe that the ideals of the multilateral trading system and the promotion of a single European market, mean that firms cannot divide the world market.

Below are a series of arguments used by brand manufacturers to defend the current operation of the Trade Mark Directive and the response from CA.

1. The parallel trade issue concerns EU prices and EU trade mark law.

Consumers’ Association reply

The parallel trade issue is not just about EU prices and trade mark law. It is also about the degree to which international firms are allowed to price discriminate between markets. It is about the effectiveness of international competition and the willingness of the European Union to promote free and open trade. It is about consumers gaining from the operation of a truly global market. It is about Europe opening its borders to trade to the benefit of its citizens, not erecting barriers to trade for the benefit of corporate profits.

2. EU prices are higher because EU costs are higher

a) Studies show that typically US prices are 30% lower (Comparative Retail Costs - Management Horizons Europe Sept 1999) than those in the EU while prices in Japan are higher (Trade mark Exhaustion and Parallel Imports of Branded Goods - LECG April 2000).

b) These differences are caused by cost differences:

- λ The US is a low cost market with a single currency;
- λ Fuel costs are 2.5x higher in the EU than in the US; labour costs more too (the French minimum wage is 30% higher than the US);
- λ Taxes and social contributions are higher in the EU than in the US.

c) Typically manufacturers are not making greater profits in the EU than in the US. Price differences are not caused by differences in manufacturer’s profit margins. It is retailers not manufacturers who determine retail prices.

Consumers’ Association reply

a) The report by Management Horizons Europe and that of LECG were both commissioned by the branded goods industry to provide evidence to support their case. We do not think that they should be treated as impartial reports that 'prove' a point.

b) The idea that the only cause of price differences is cost difference is an interesting one. However, it is not supported by a decent array of evidence. The Management Horizons report referred to above has very little in the way of evidence supporting such a blanket assertion and this note reflects the lack of hard evidence.

The issue of fuel costs is, of course, an important one. However, stating that there is a difference in price is hardly proof in and of itself, of a cost difference. We note that CostCo, a US based wholesaler, has commented that although fuel prices, on a unit basis, are considerably higher in the UK than the US, the actual share of total costs accounted for by fuel is about the same - because trucks drive shorter differences in the UK. Simply stating that unit costs are higher is not an explanation in itself of differences. We would need to see detailed data on the breakdown of the share of total costs accounted for by particular inputs and then assess the real extent of the proof offered by such arguments. To date none of the 'evidence' supplied by branded goods manufacturers to fully explain price differentials has been persuasive or complete. However, we fully accept that certain costs in Europe are higher than those in the US and would be pleased to discuss these matters when the branded goods manufacturers can provide some data and analysis of these differences.

c) The ability of a firm to make profit is dependent on a large number of factors. Indeed, in markets where competition is weak one often finds high prices and low profits, as firms become lazy and inefficient and fail to drive efficiency benefits to increase profits. The pre-liberalisation airline industry in the US and EU and the utility sector more generally provide clear evidence of this problem. Simply stating that firms do not make excessive profits as somehow providing proof that a problem does not exist is too simplistic a position. It should also be noted that there are significant differences between the US and the EU on accounting practices making the comparison of profits extremely difficult.

It is also a bit difficult to entirely take on face value the statement that only retailers set prices in the EU. Firstly, consumers do not care who is to blame for excessive prices - they simply want to see them reduced. To that extent we are disinterested about the distribution of profits between elements of the supply chain, we simply want to see reforms to the rules governing that supply chain sufficient to induce further competition. Secondly, there is considerable evidence that selective distribution criteria used by manufacturers within Europe are commonly used to deny stock to discounters and thus restrict competition. The long lived price differentials within Europe attest to the fact that in many retail markets intra-EU trade and competition does not operate effectively.

3. Parallel trade is good for parallel traders not consumers

a) Many goods sold by parallel traders within the EU retail at the same price as goods sold through established channels. Any price advantage is taken by the parallel trader or the retailer as extra profit.

b) Studies (NERA and LECG) show that retail price reductions due to parallel trade would be:

- Small (between 0% and 2%);
- Limited to a few product categories (such as automotive and fashion goods);
- Short term.

Parallel trade will not lead to a reduction in EU prices.

Consumers' Association Reply

a) If there is insufficient competition in the retail market to provide incentives to retailers to compete on price, then competition authorities in the EU and in individual member states should concentrate their efforts on increasing competition. Irrespective of this, if a retailer is gaining access to cheaper input costs, then that retailer has gained and will hopefully become more efficient and effective. Are the branded goods manufacturers really arguing that retailers should only be allowed to source at prices dictated by manufacturers?

If a retailer manages to access cheaper stock, as it should as a capitalist enterprise, then we welcome that. If it fails to pass on savings to consumers, then this is a matter for competition agencies to investigate. This lack of pass through is not a reason to stop retailers accessing the stock in the first place; it is a good argument to investigate competition problems in the sector more generally.

b) An overall reduction in prices of up to 2% is actually quite large and we believe the overall reduction hides large reductions in specific areas. The NERA report (which we otherwise think is flawed in its approach and conclusions) notes that price reductions are actually quite large in certain categories of goods, but small in others. The relative evening out of reductions is, again, not a reason to stop this trade occurring. Indeed if the problem is as small as the branded goods makers think then why are they trying to stop it?

The argument also appears to be that price reductions will be short term. Apart from, again, not being supported by any evidence, it appears to assume that all markets are entirely static. If prices were reduced in particular product categories then we would expect to see that prices in other related categories would start to come under pressure. This is exactly what we have been seeing in the UK market over the last couple of years. The idea that price cuts are not sustainable nor have any knock on effect seems to run counter to the most basic rules of economics. The only feasible way of limiting the effect of price cuts is anti-competitive behaviour.

4. Changing trade mark law is not the answer

Changing EU trade mark law to allow parallel trade will not reduce overall prices in the EU.

But it will have other negative effects on SMEs, on consumers and on employers. It will:

- Enable large retailers to undercut small specialist retailers in sectors previously benefiting from selective distribution agreements;
- Undermine distribution systems designed to ensure product quality, availability and after sales service (Communique from Bolkestein);
- Increasingly force manufacturers to supply world markets from low cost countries reducing both employment (Bolkestein) and innovation (LECG) in Europe.

Consumers' Association reply

a) We believe that parallel trade is a possible route to reducing prices. If retailers, particularly discounters, are able to access goods from everywhere in the world then, given a properly functioning retail market, competition will help to drive down prices. To argue otherwise is either to have no faith in the functioning of markets, a profound lack of understanding of markets, or to have no faith in competition regulation to make markets function effectively. It also appears to run counter to almost fifty years of experience at the GATT and WTO. Lowering import prices through tariff reductions has been one of the great consumer benefits of the post-war era. Parallel trade encourages retailers to access goods at a lower cost than they would otherwise be able to source them. This is effectively offering the retailer a tariff reduction. As post-war history tends to show, lower import costs leads to lower prices; consumers gain, commerce gains, and manufacturers are spurred on to become more efficient and utilise their resources more effectively; in short the market works efficiently. Branded goods manufacturers appear to want to stop the clock on freer trade to ensure that they capture all of the benefits of lower product costs brought on by globalisation and deny any of those benefits to consumers.

b) We believe the argument relating to small retailers ie, that larger retailers will undercut them (price competition) and therefore consumers will no longer shop in small retailers follows the line of thinking that selective and exclusive distribution is there to benefit small retailers only – but this is simply not true. There are a number of problems with this argument. Firstly, it appears to admit that selective distribution is actually used to fix prices and restrict competition. This follows from the fact that the manufacturers have a concern about large retailers undercutting small retailers. If selective distribution is not equivalent to price fixing, then retailers would set prices at whatever level they liked and large retailers (on the basis of scale economies or greater efficiencies in the supply chain) would undercut small retailers as a matter of course. The branded goods manufacturers have thus provided a very good reason to encourage parallel trade; selective distribution stifles price competition. These arguments also make the mistake of assuming that consumers only make purchasing decisions on the basis of price. This, as every retailer knows, is simply not the case. What parallel trade does is provide a more realistic assessment of the value that consumers place on different distribution channels.

Branded goods manufacturers regularly argue that their distribution systems automatically ensure product quality, availability and after sales service. Again, this is not borne out by argument or fact. One of the reasons that parallel trade exists in the car sector, for example, is the lack of availability of some goods in Europe (for example the Mitsubishi Pajero - a higher specification version of the Mitsubishi Shogun, or the Nissan Figaro). Official supply channels often limit supply, availability and range.

One also has to ask the question (central to the multilateral trade liberalisation process) of whether this means of 'protecting' supply chains is the least trade restrictive available. To argue that only official retailers can supply quality products, or service them effectively seems to ignore a number of points. Firstly, it is simply insulting to a number of large retailers to assume that they are incapable of selling or servicing products. For example, ASDA/WalMart in the UK now offers a free three year warranty on almost all electrical goods. This offer is better than almost all 'official' suppliers of many electrical goods. Secondly, a large number of manufacturers offer guarantees directly to the consumer on purchase of the product. This guarantee holds whether the product is purchased from an 'official' supplier or not. It has to be noted here that a number of manufacturers divide the globe and offer different warranties and guarantees in different markets. This is a policy designed by manufacturers that operates against the consumer interest. It is within their power to change this policy. There is also considerable evidence from markets that official distributors do not necessarily provide the best service. As in all markets we argue that consumers should be allowed to choose the level of service that they want to pay for. If they want to use the official suppliers, then let them do so, if, however, they want to use unofficial ones, then let them choose. Provided that they are aware of the differences between the two channels and the differences in the choices that that entails then the consumer should be free to choose.

We believe the manufacturers' argument that parallel trade will increasingly force manufacturers to supply world markets from low cost countries reducing both employment (Bolkestein) and innovation (LECG) in Europe means they appear to be arguing that the law of comparative advantage should not hold for them. They appear to argue that the normal economics of trade do not apply to them and that all innovation will be reduced if they are forced to compete more effectively. If a particular firm makes a decision to supply consumers from a different country (by using resources more efficiently) then the consumer will make a consumption decision based on that information. If a firm decides to reduce innovation then other firms will innovate more and the first manufacturer will lose market share. The idea that manufacturers can argue that greater competition and trade will lead to less innovation and force all manufacturers abroad is almost beyond belief. If this were the case Europe would have lost its entire manufacturing base and would lag the world in innovation. This is obviously not the case.

Overview

The parallel trade issue concerns EU prices and EU trade mark law.

- The parallel trade 'issue' is about what sort of Europe we want; one that favours freer trade and consumer choice; or one that thinks legitimate trade marks should be used to restrict trade and divide world markets.

These differences are caused by cost differences:

- The reason for price differences between the EU and USA are considerably more complex than simple cost differences - a fact borne out by the studies commissioned by brand owners themselves.
- Part of the reason for price differences lies in international price discrimination bolstered by the pincer movement of tight selective and exclusive distribution channels and an effective ban on parallel trade.

Typically manufacturers are <u>not</u> making greater profits in the EU than in the US. Price difference are <u>not</u> caused by differences in manufacturers profit margins. It is retailers not manufacturers who determine retail prices.

- Profitability is generated by many more factors than just pricing. It is simplistic and wrong to argue otherwise.

Changing trade mark law is not the answer

- Changing trade mark law to enhance consumer choice and encourage free trade and commerce is PART of the answer. No single policy will ever solve all competition problems.

Changing EU trade mark law to allow parallel trade will not reduce overall prices in the EU.

- Encouraging parallel trade will do the following to prices:
  - In specific sectors reduce them quite drastically
  - In the round - reduce prices by a relatively small amount
  - Generally - enhance the environment for competition
- Encouraging parallel trade will also provide evidence to EU consumers that their interests are being put ahead of those of transnational businesses. At a time when support for freer trade and competition is generally agreed to be ebbing, allowing brand owners to use a legitimate method of protection (a trade mark to guarantee authenticity) for an illegitimate end (to restrict trade and competition) will make the case for public support of freer trade ever more difficult

...it will have other negative effects on SMEs, on consumers and on employers.

- Increased parallel trade will give consumers greater choice of goods and outlets from which to buy those goods. It will enhance price competition and channel competition.

- SMEs will gain from parallel trade in that they will be able to access goods and sell them at prices that they choose, rather than be part of the efforts by brand owners to restrict competition and choice.
- Employers will gain in the retail sector as they increase their attractiveness to consumers. Employers in the branded goods sector will gain as they see sales increase.

In conclusion, the suggestion that prices in the EU are higher than, for example, prices in the US, because manufacturers make excessive profits in the EU is wrong.

- This argument is a total ruse: the proponents of parallel trade do not make this argument.
- Prices are higher in the EU than the US for a large number of reasons. Price discrimination, encouraged by bans on parallel trade, is one of them, but not the only one. Freer trade means that retailers and intermediaries should source goods from anywhere in the world and then sell them in their home markets. If this means that goods are sourced in the EU and shipped elsewhere, then consumers in third countries gain. Philosophically we do not care if the EU is a high or low price environment; what we care about is that trade should be allowed to flow freely and large price differences (of whatever sort) should be reduced through the power of arbitrage.

Conclusion

The arguments put forward to defend the current state of play in relation to trade mark exhaustion are extremely weak. The status quo is undoubtedly used by trade mark owners to restrict trade and limit consumer choice. It has the effect of keeping prices for many trade marked goods higher than they would otherwise be in a more liberal trading environment.

The key problem that Consumers' Association has with regional trade mark exhaustion is philosophical not practical. It boils down to the issue of the sort of European Union we want to see. We want a European Union built on the interests of consumers; where consumers are free to choose from competing suppliers and have firms compete on both price and quality for their money. We want a Europe that removes barriers to trade that solely benefit corporations. We want a Europe that encourages competition and spurs innovation in retailing formats and channels. The attitude that the European Union takes on trade mark exhaustion will very clearly signal to the consumers of Europe on whose side they see themselves.

While our main problem with regional trade mark exhaustion is philosophical we also have practical objections. Prices for many consumer goods in Europe are significantly higher than those in the USA. While the rationale for this situation is a complex two simple facts emerge. Firstly, that simplistic explanations of the differences do not hold water and that price discrimination by international brands is a contributory factor. Secondly, the fact that such price differentials are maintained for significant periods of time suggests that trade is not operating efficiently. A major part of the reason for this is the fact that branded goods owners can restrict the ability of retailers to purchase goods on a global basis.

Regional trade mark exhaustion must be changed to international exhaustion firstly because it offends the principals of consumer choice, freer trade and greater competition, on which the European Union should operate and secondly, because it allows international brand owners to price discriminate and overcharge European consumers.

Consumers' Association
April 2001