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Joint Group on Trade and Competition

TRADE, COMPETITION AND INTELLECTUAL PROPERTY RIGHTS

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TRADE, COMPETITION AND INTELLECTUAL PROPERTY RIGHTS

I. Introduction

1. Intellectual property rights (IPRs), trade and competition policies all make important contributions to raising standards of living. IPRs do this by fostering the creation of new ideas and services and, through trademarks, by facilitating informed consumer choice. Trade policy contributes by facilitating specialisation according to comparative advantage, and by expanding geographic markets thereby promoting competition and increasing the potential rewards to innovation. Competition policy assists by ensuring that companies have strong incentives to be efficient in both a "static" and "dynamic" sense. The complementary qualities of the three policies, although highly significant, do not erase all possible problems at the interface between them. IPRs can sometimes be used in an anti-competitive fashion and both trade and competition policies could also reduce economic efficiency if they are applied without due regard to certain important tradeoffs. Better understanding and improved co-operation among IPR, trade and competition officials at national and international levels can help ensure the policies work as much as possible together rather than at cross purposes.

2. Since this paper focuses on IPRs, it begins with a brief look at what they are. This is followed by a section listing some issues for discussion.

II. Intellectual Property Rights

3. The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) refers to seven categories of IPRs: patents, trademarks, trade secrets, copyrights, geographical indications, industrial design, and layout-designs (topographies) of integrated circuits. It is beyond this paper's scope to explain what is entailed in each of these and exactly what legal protection is typically offered. Enough of the context can be gleaned by a brief mention of patents, trademarks and copyrights.

Anderson et al. (1998, 408 & 411) have provided a good description of patents and trademarks:

A patent is a statutory right, granted by each nation, which provides an innovator with exclusive rights to make, use, and sell the patented "process, machine, manufacture, or composition of matter" within the national territory of the country granting the patent.

.....

A trademark is a word, name, symbol, mark, or other identifier used by a firm or person to distinguish its goods or services from those of its competitors. It provides its owner with rights of exclusive use in relation to the products associated with the trademark.

4. Using the U.S. as an example, copyright protection is granted to certain statutory categories of original works requiring a modicum of intellectual activity to produce. The protection attaches only to the expression, not the idea expressed. According to Besen and Raskind (1991, 12), U.S. copyright provides five basic rights:

...1) the right to reproduce the protected work; 2) the right to prepare derivative works from the protected work; 3) the right to distribute copies; 4) the right to perform literary, musical,

dramatic, choreographic works publicly, as well as pantomimes, motion pictures, and other audiovisual works; and 5) the right publicly to display literary, musical, dramatic, choreographic, pantomimes, and pictorial, graphic, and sculptural works, including the individual frame of a motion picture and other audiovisual works.

5. Larsson (1999, 17) has provided a good succinct statement of the reasons governments grant IPRs:

The foremost purpose of intellectual property rights is to protect...investments in research and development (e.g. patents, copyright and design registration) and investments in quality and product improvement (e.g. trademarks). If these intellectual property rights are not upheld, individual companies and entrepreneurs are not sufficiently motivated to develop new products as other players may erode the creator's yields on the original investment ('free-riding'). Trademarks also have another important function: they enable...consumers to identify genuine articles and distinguish these from copies or products much alike in appearance. This function is important as the latter category may lack the genuine product's qualities in part or altogether. By noting the trademark, the consumer can identify the genuine product and thereby avoid the costly process of shopping around.

6. Although countries have signed international conventions to improve the protection afforded to IPRs, the rights themselves remain, at most, national in scope. There can be considerable international differences in exactly what they cover and how they are enforced. In any given country, such differences clearly exist as well across the spectrum of IPRs.

7. Again with considerable variation depending on the right and country considered, IPRs are generally subject to the application of competition law. This is especially true as regards the licence agreements IPR owners typically employ to extract revenue from their rights. In general one could say that competition agencies rarely directly challenge IPRs, even if they give rise to some market power. They also do not presume that IPRs give rise to dominant positions that are then subject to special review under many countries' competition laws. Competition agencies instead seek, as with other property rights, to prevent IPRs being used in an anti-competitive fashion.¹

8. IPRs have also been affected by international trade rules, most notably the WTO TRIPs Agreement. As with competition law:

...the TRIPs Agreement generally respects intellectual property rights subject to the rules and practices set forth in previous international agreements and conventions relating to intellectual property, and sets forth the minimum standards of enforcement to be applied in domestic law. [OECD(1999c, 39)]

III. Possible Issues for Discussion

9. The IPR/trade/competition policy interface is a complex and multifaceted one that has generated increasing interest of late. The Joint Group on Trade and Competition (JGTC) has already begun to explore that interface, and this is reflected in parts of OECD (1999a), OECD (1999b) and OECD (1999c). Three areas and some possible issues for discussion were laid out in OECD (1999b, 52-53). They were:

1. Overbroad patent rights

10. It could happen that patents are defined so widely that they unduly restrict further (secondary) innovation thus harming both trade and competition. There is considerable debate over what, if anything, competition policy should do about this problem, especially in regard to licenses being reviewed for anti-competitive effects.

2. Using licensing arrangements to extend the term and scope of IPRs

11. Licences containing terms such as exclusive grant-backs, restrictions on challenges to a patent's validity, and coercive licensing, are sometimes used to extend the term and scope of IPRs. The TRIPs Agreement explicitly refers to such terms as examples of anti-competitive practices that governments are permitted to regulate. The TRIPs Agreement does not, however, spell out any further what constitutes anti-competitive practices. As with overbroad patent rights, using licensing terms to extend the term and scope of IPRs can have the effect of over-compensating IPR owners and at the same time inefficiently restricting or distorting competition and trade.

*Possible Issues for Discussion:*²

- a. *Is there a danger that a broad interpretation of anti-competitive practices may lead to over-regulating the exercise of IPRs? How great is the risk that differences in competition policies might lead to international trade frictions if different countries take divergent views on the anti-competitive potential of certain IPR related behaviour?*
- b. *In countries without effective competition policies, is there a significant danger that strengthening IPRs in isolation might have the effect of increasing incentives for anti-competitive conduct?*

3. International Exhaustion of IPRs

12. Where international exhaustion is applied, IPR owners are not permitted to control the resale of a product once it has been sold with the consent of the IPR owner or his licensee. International exhaustion will tend to increase intra-brand competition. It may also simultaneously dampen inter-brand competition through facilitating free-riding, and reduce the returns to and incentives for innovation, by making it more difficult for IPR owners to engage in profitable price discrimination. OECD (1999b, 53) notes that:

There exists a significant difference in the application of the exhaustion doctrine among different IPRs as well as countries. The TRIPs Agreement requires only that national policy for international exhaustion has to respect the principle of non-discrimination, i.e. provide national treatment and most favoured nation...treatment for the IPRs of foreign nationals.

*Possible Issues for Discussion:*³

- a. *What are the pros and cons of the exhaustion principle?*
- b. *Is there a need for an international rule on international exhaustion?*

13. International exhaustion is as complex as it is controversial. In addition, it is perhaps one of the clearest examples of where policy making must simultaneously address IPR, trade and competition

objectives in order to ensure a positive contribution to economic welfare. Accordingly, an Annex to this paper contains an extended discussion of this subject and suggests further, more detailed issues that delegates might wish to discuss.

4. Consultation in IPR cases

Anderson (2000) frames this issue as follows:

...Article 40 of the [TRIPs] Agreement includes a provision under which a Member considering action against an intellectual property owner that is a national or domiciliary of another Member can seek consultations with that Member. The latter Member is required to co-operate through the supply of publicly available non-confidential information of relevance, and of other information available to that Member, subject to domestic law and to the conclusion of mutually satisfactory agreements concerning the safeguarding of its confidentiality.

Possible Issue for Discussion:

What has been the experience to date with this voluntary co-operation provision?

5. Compulsory Licensing and Development Concerns

14. Anderson (2000, reference omitted) again notes that:

The TRIPS Agreement...contains specific provisions relating to compulsory licensing in respect of patents and the layout-design of integrated circuits. Article 31, in particular, sets out detailed conditions that must be respected in the granting by Member states of any compulsory licences. These conditions have the effect of limiting the availability of such licences to particular situations, for example where a proposed user has made efforts to obtain voluntary authorisation from the right holder on reasonable terms and conditions and such efforts have not been successful within a reasonable period of time, or of limiting the scope and duration of licences that are issued. However,...the Agreement [also] specifies that Members are not obliged to apply a number of these conditions...in circumstances where the compulsory licence is granted "to remedy a practice determined after judicial or administrative process to be anti-competitive". Thus, the TRIPS Agreement clearly permits the use of compulsory licensing as a legal remedy for practices that are deemed to be anti-competitive in the context of the Agreement. However, it does not define the basis on which a practice might be held to be anti-competitive....⁴

15. In discussions at the WTO, representatives of developing countries have expressed concern that a development standard be applied in decisions to grant compulsory licenses whereas other countries tend to favour a more traditional competition standard.⁵

Possible Issues for Discussion:

- a. *What are the pros and cons of using compulsory licensing to remedy trade and competition problems caused by a refusal to license?*
- b. *Should the compulsory licensing issue be addressed within competition law (applying the "essential facilities" doctrine) or be handled through appropriate IPR legislation? In either*

event, what safeguards should be incorporated to ensure that incentives to innovate are not unduly reduced because of compulsory licensing?

- c. To what extent would developing countries' particular concerns about compulsory licensing of IPRs be met if competition laws took more explicit account of dynamic as opposed to static efficiencies? In what particular kinds of markets would this probably be most important?*
- d. Should a special approach be taken to compulsory licensing regarding products in markets with strong network effects (e.g. information technology)? Why or why not? If special treatment is advisable, what should it consist of?*

6. *Facilitating further progress in international IPR talks*

16. In discussing the negotiation of international agreements regarding intellectual property rights affecting trade, one country has observed that the use of "...the traditional offer and request process..." might not be as successful as it has proved to be in reducing traditional border measures.⁶ The same country pointed out that, "[u]nlike tariff policy, where the least trade restrictive outcomes are easily identified, the least trade restrictive intellectual property rights outcomes are subjectively determined";⁷ and that it is possible, from the economic welfare point of view, to over as well as under-protect intellectual property. Perhaps these points help explain why there are some significant differences across countries regarding the advisability of negotiating greater application of international exhaustion.⁸

Possible Issues for Discussion:

- a. In terms of trade and competition policy objectives, how important are existing international differences in IPR protection? Have such differences been a practical problem, for example in the organisation of international joint ventures?*
- b. Does experience demonstrate that harmonisation in IPRs and/or the application of competition policy to them, is an area better handled at the regional than at the global level?*

7. *IPRs employed as a means to erect barriers to entry against new competition*

17. There are at least three ways in which IPRs can be used to raise barriers to entry. First, companies might decide to acquire patents not with the intention of applying them, but instead to raise rivals' costs by blocking their use of promising new technologies.⁹ Second, companies could enter patent pools with current competitors or work with them to develop standards involving IPRs. New entrants could then be denied the licenses they need to produce patented goods or to meet certain standards mandated by governments or highly desired by consumers. Finally, IPR holders could include exclusive dealing in IPR licenses, not in order to prevent efficiency reducing free-riding on certain promotional or other services they provide, but rather to foreclose distribution channels to their rivals.¹⁰ Insofar as any of these three strategies or similar activities successfully exclude or restrict foreign and domestic rivals, they could potentially harm both competition and trade.

Possible Issues for Discussion:

- a. *What safeguards exist, if any, within IPR law (perhaps by way of compulsory licensing for unworked patents) or competition law to guard against strategic use of IPRs to exclude or restrict rivals?*
- b. *How well do these safeguards work (delegates could be invited to discuss actual cases arising in their jurisdictions)? Is there evidence that exclusionary tactics involving IPRs (including patent pools, standards, and exclusive dealing) are more of a problem for foreign as opposed to domestic rivals?*

Annex

International Market Segmentation and Intellectual Property Rights

There is considerable controversy regarding the costs and benefits of parallel imports, i.e. "...genuine products - not counterfeits - imported by unauthorised resellers."¹¹ The debate over parallel imports (sometimes referred to as "grey goods") mirrors in important respects concerns competition officials have in regard to suppliers granting exclusive territories to their dealers. Such exclusivity clearly reduces intra-brand competition (i.e. among dealers selling the same brand), but does not necessarily harm consumers. Exclusive territories can have the effect of encouraging "inter-brand" competition (i.e. rivalry among suppliers), thereby benefiting consumers with lower prices and expanded product selection.¹² Tradeoffs seem inevitable and these become somewhat harder to make when the exclusive territories are at least partly based on IPRs and are extended to cover entire nations - a phenomenon we will consistently refer to as "market segmentation".

IPR owners might adopt market segmentation to: prevent free-riding; avoid customer confusion; reduce competition; and/or facilitate price discrimination.¹³ Each of these non-mutually exclusive motives requires some elaboration.

1. prevent free-riding

National distributors are often employed not so much for their capital as for their unique abilities to develop local markets for a particular product through advertising, demonstrating how the product can be used, providing after sales services etc. Sometimes the best way to reimburse distributors for such services is simply through the price paid by the consumer. This opens the way, however, for free-riding. For example, consumers may enter a full service computer retailer to learn the attributes of various makes and models, then choose to purchase the equipment from a discounter. If unchecked, such free-riding might result not merely in lower profits for the full service distributor, but also for manufacturers some of whom might even go out of business if they have no adequate alternative to their existing distribution arrangement. In short, in the absence of market segmentation the consumer could end up being deprived of important point of sale information and beneficial inter-brand competition.

2. avoid consumer confusion

Sometimes an IPR owner may wish national distributors to invest in adapting the product to local circumstances, at potentially different costs in each market, and this may mitigate in favour of exclusive territories to prevent consumer confusion. As Gallini and Hollis (1999, 5 - reference omitted) point out:

Many goods with identical TMs [trademarks] are produced in different locations under different specifications, vary according to local tastes, have different packaging and instructions, and comply with different safety standards. A common TM may be used because of economies of scale in brand development, or because information flows easily between countries through newspapers, television, and travel. However, if a common TM is used and prices differ between countries, then gray markets may emerge as unauthorised importers try to pass off one product for another. This undoubtedly will cause confusion and may cause distributors to reduce their investment. Hence, market segmentation is needed to ensure that their efforts will not be undermined by gray marketers.

3. facilitate price discrimination

Because of differences in the costs required to tailor products for local markets, it could well happen that prices differ for similar products across countries. Such cost based international price differences do not amount to price discrimination. Instead, price discrimination arises when an IPR owner decides to charge different prices when selling the same good to distributors in various countries.

Price discrimination will increase a supplier's profits provided three conditions are met. First, the supplier must enjoy some "market power" (ability profitably to raise price above competitive levels) so that consumers in higher price countries cannot easily avoid the product by purchasing close substitutes instead. Second, consumer willingness to pay must differ significantly across international markets. Finally, it must be very difficult for someone to buy products in lower price countries and resell them in nations where there is a higher price. All three conditions could be satisfied for at least some products having a significant IPR component, especially if suppliers grant exclusive territories covering entire nations and the countries concerned forbid parallel imports.

4. facilitate anti-competitive collusion or exclusion

In some cases, IPR owners may employ market segmentation strategies simply to create or reinforce market power. There are two ways in which market segmentation might, at least in theory, create or enhance an IPR owner's market power. First, s/he may find it easier to "discipline" new entrants if national markets are separated. This is because cutting price is generally a more viable strategy for deterring or containing new entry if the cuts can be confined to the nation(s) where new entry is occurring. Second, market segmentation *may* facilitate collusion among suppliers.¹⁴ Such collusion, if it can be made to work and is not detected and eradicated by competition agencies, is a very effective way to obtain and exercise market power. It should be noted as well that IPR owners may sometimes be "forced" to establish exclusive national territories by dealers hoping this will reduce the vigour of competition at the dealer level.¹⁵

There has been some interesting empirical work into the probable causes of parallel imports, focusing especially on the relative importance of free-riding versus taking advantage of arbitrage possibilities created by price discrimination. According to Gallini and Hollis (1999, 5-6): "Attempts to identify empirically which motivations are most pervasive for excluding gray goods reveal that all motivations are important and suggest that more than one explanation may apply in many cases." An earlier but more detailed review by Malueg and Schwartz (1994, 174-175) was summarised as: "Our reading of the [surveyed evidence] is that price discrimination is *a* factor in explaining parallel imports (though not necessarily the major factor)."

Possible Issues for Discussion:

- a. *In what particular markets and nations are parallel imports particularly prevalent? What characteristics do these situations have in common?*
- b. *What appear to be the principal reasons why IPR owners sometimes practice market segmentation (i.e. international exclusive territories based at least in part on IPRs)? What in particular is the relative importance of each of the four motivations discussed above (i.e. prevent free-riding; avoid customer confusion; facilitate price discrimination; and/or reduce competition)?*

Costs and Benefits of Parallel Imports

To the extent market segmentation is instituted in order to prevent free-riding and avoid consumer confusion, it should have a net beneficial effect on IPR owners by ensuring that products are suitably modified and supported by local distributors, and goodwill in trademarks is optimally developed and maintained. Consumers should also benefit from higher product quality, variety, service and information. This conclusion applies whether one takes a national or global welfare point of view.

Turning to cases where the sole motive of market segmentation is to reduce competition in various markets, the effects once again are easy to predict. Producers will benefit but by less than consumers will be harmed. Certain nations could, however, benefit from such policies if they are home to most or all of the benefiting producers and few or none of the harmed consumers.

Things are not nearly so straightforward as regards price discrimination. In order to obtain a patent or copyright, or to build up the goodwill that a valuable trademark represents, suppliers must often make substantial investments. No one will systematically do this unless they expect to make at least a normal rate of return on them. In situations where IPR owners have market power and can segment markets, profits will be increased through price discrimination. Typically, market segmentation combined with price discrimination, referred to simply as "price discrimination" in the next few paragraphs, will take the form of charging higher prices in countries having, other things equal, higher per capita incomes.¹⁶

In terms of *dynamic* global economic efficiency, price discrimination could improve matters if it raises the rewards to innovation to more appropriate levels, and does this more efficiently than could be arranged, for example, by extending patent life.¹⁷

In terms of *static* global economic efficiency, price discrimination has ambiguous effects. About the only generalisation that can be made is that price discrimination will *not* increase total global welfare unless it increases the number of units sold. That is, however, only a necessary not a sufficient condition for improvement.¹⁸ By "total global welfare", we mean the total across nations of consumers' and producers' surplus.¹⁹ Price discrimination is more likely to improve total global welfare the greater the variation in market demand conditions (due to differences in things like per capita incomes, competitive conditions and tastes and preferences) across the countries subject to it, and the more significant are economies of scale and learning economies.²⁰

So far we have taken a global perspective regarding price discrimination, but policies affecting parallel imports are largely decided at the national level, or in some cases by treaties applying to relatively small groups of countries. Not surprisingly, price discrimination is not generally popular with policy makers in nations having the higher prices, especially if the associated higher profits will mostly or entirely accrue to investors resident in other countries.

Summing up, the economic costs and benefits of parallel imports strongly depend on what motivates them, and such effects could easily vary from country to country and product to product.

Possible Issues for Discussion:

- a. *What do delegates see as the costs and benefits of market segmentation? How might these possibly vary in some systematic way across different product markets? What does the nature of the principal products involve reveal, if anything, about the welfare effects of parallel imports?*

- b. Which countries or groups of countries appear to be the major winners or losers from market segmentation?

Exploring Policy Options

Faced with what they consider to be anti-competitive effects and/or harmful price discrimination, disadvantaged countries could respond by applying "exhaustion" (or "first sale") policies. These specify that once a product has been legally marketed in one country, IPR laws cannot be used to block it being re-sold in another market. Many countries apply such an exhaustion policy to all or some IPR within their borders ("domestic exhaustion"), and probably a smaller number apply it to their international trade ("international exhaustion").²¹

There are at least two reasons why international exhaustion could enhance economic welfare. To begin with, in the absence of free-riding problems, IPR holders typically wish to encourage a healthy degree of competition among their dealers so that distribution costs are minimised. This argues against giving the dealers exclusive territories. At the same time, however, IPR owners may wish to license their distributors in order to enlist their help in excluding pirated and counterfeit goods from their markets. In the absence of international exhaustion policies, IPR holders may find it impossible to obtain that help without *de facto* giving the dealers what amounts to inefficient exclusive territories. Admittedly, this dilemma can sometimes be avoided by giving licenses to a number of dealers in the same country. The other reason why international exhaustion could enhance economic welfare has to do with the fact that in the absence of that policy, IPR laws *might* have the effect of insulating exclusive territories from the application of competition laws.²² It is perhaps possible to address this point by somehow requiring courts to explicitly consider competition effects when deciding whether or not to grant remedies against parallel imports.

Abbott (1998) attempts to strengthen the case for international exhaustion by arguing that blocking parallel imports reduces the gains from trade that could be reaped by locating production based on comparative advantage. Anderson et al. (1998, 425) have pointed out that this is not necessarily so:

...the application of IP-based import control rights, unlike traditional tariff and non-tariff barriers, is subject to the discretion of the rights holder. Consequently, the rights holder remains free to engage in unimpeded trade itself or to structure its licensing or other arrangements in a manner that prohibits its licensees from exporting products. Furthermore, the rights holder retains a clear incentive to locate its production activity where there are cost advantages or economies of scale to exploit. This is in contrast to the situation of traditional tariff and non-tariff barriers, which create an artificial incentive for production of commodities in countries that lack a comparative advantage in these goods.

While there is considerable variation across countries in the degree to which they apply international exhaustion policies,²³ many have this in common - they apply a higher degree of exhaustion domestically than internationally.²⁴ This does not mean, however, that exclusive territories are any less common with regard to products involving IPRs within nations than they are internationally. Instead it merely indicates that domestically, IPR holders wishing to benefit from exclusive territories are more often forced to rely exclusively on contract and tort law than is the case internationally.

As previously mentioned, contractually based exclusive territories may be more subject to review under competition law than is the case for market segmentation.²⁵ Abbott (1998) characterises domestic exhaustion as a means to ensure that exclusive territories surviving competition law scrutiny are further "policed" by the domestic equivalent of parallel imports. Abbott advocates that the same policy be

followed at the international level. At least as regards trademarks and copyrights, Gallini and Hollis (1999) arrived at a similar conclusion. They elaborate on their preferred approach as follows:

...a distributor granted an exclusive territory in its contract could appeal to *contract law* to enforce it in the event that an authorised distributor or the manufacturer sells the good outside of its territory. However, because contract law does not permit a distributor to file a suit against a party outside the contract, manufacturers could police the distribution system to prevent supplies to gray marketers or could appeal to the *common law tort* of unfair competition to prevent gray marketers who are free riding. Finally, the *competition law* of the country into which gray goods are imported would evaluate anticompetitive implications of gray market exclusion. Consistent with the treatment of exclusive territories in competition policy cases, the burden of proof that gray goods exclusion is socially harmful should reside with the gray marketer or violator of the [exclusive territory]. (13-14)

Against the previous arguments favouring international exhaustion, it is sometimes maintained that it is more difficult internationally than domestically to maintain exclusive territories based on contract and tort law.²⁶ This could be especially so in nations having under-developed contract and tort laws, and/or competition laws that are overly harsh on exclusive territories. Even if true, however, it is not entirely convincing to rest one's case on these points. This is because market segmentation is not always beneficial, nor is it obvious that more will be gained by erring on the side of blocking than of permitting parallel imports.

Those advocating international exhaustion appear to be on stronger ground when they urge that it be practised among nations having similar demand characteristics. As Malueg and Schwartz (1994) have pointed out, the more similar the demand conditions across countries, the more likely is international price discrimination to prove detrimental rather than helpful to economic welfare.²⁷ Proceeding to adopt exhaustion regionally rather than unilaterally also reduces the risk of retaliation from other countries whose IPR owners suffer harm as a result of parallel imports.²⁸ International exhaustion advocates are also more persuasive when urging that such policies be adopted by groups of nations, such as those within the European Union, which are seeking greater economic integration for both economic and non-economic reasons. Finally, it should be noted that international exhaustion could make more sense for trademarks than for copyrights and patents. For at least one aspect of free-riding relating to trademarks, there are other less restrictive ways to tackle the problem. Instead of blocking parallel imports of similar but not identical goods sold under the same trademark, one could simply require adequate disclosure of the product differences.

As regards patents, there seems to be a special risk that international exhaustion could effectively reduce IPR protection below what certain countries consider optimal. For instance, under a radical form of exhaustion, once patent protection has expired in the country with the shortest duration patents, suppliers in that country could begin to sell their goods to firms that in turn freely export them around the world. Less radical forms of international exhaustion might mean that IPR owners have to cease selling in markets where patent protection has lapsed or face effectively losing patent protection in all countries. There is a similar problem with regard to countries imposing compulsory licenses or price controls in order to lower the prices of patented goods, e.g. pharmaceuticals. This might well call for some modification of an international exhaustion rule.²⁹ In addition it might provide a further reason for trying to harmonise patent protection across countries.

In the copyright protection domain, there are also grounds for arguing that international exhaustion may require some fine-tuning particularly as regards movies and related product distribution.³⁰

Possible Issues for Discussion:

- a. *What interest groups and countries are generating the most significant pressures for or against unilateral or multilateral exhaustion, and what arguments do they present?*
- b. *What differences of opinion, if any, are there among IPR, competition and trade officials concerning the benefits/costs of exhaustion policies?*
- c. *How, if at all, are IPR, trade and competition policy goals frustrated by international differences in policies towards parallel imports?*
- d. *How does the growing opportunity for consumers to purchase internationally over the Internet affect the need for countries to re-think their policies regarding parallel imports?*
- e. *What are the pros and cons of introducing competition policy considerations in legal actions brought to block parallel imports? If that would be a desirable policy change, what would be the best way to bring it about (e.g. should pertinent courts or tribunals be required to withhold requested remedies if they would significantly harm competition in the domestic market; should the competition agency be given intervenor status; etc.)?*
- f. *What has been the experience with domestic exhaustion in countries practising it?*
- g. *Why is domestic exhaustion of IPRs sometimes practised in countries that simultaneously refuse to adopt international exhaustion?*

NOTES

1. Readers are referred to OECD (1998), and in particular the "Background Note" (pp. 21-44) by Willard Tom, for further discussion of the competition/IPR policy interface.
2. These are taken verbatim from the Secretariat's "Issues Paper" found in OECD (1999b, 53).
3. loc. cit.
4. See OECD (1998, 32-34) for a discussion of the compulsory licensing issue in relation to products incorporating substantial IPR.
5. This issue has a more general aspect in that developing countries appear to favour giving innovation or dynamic efficiency considerably more weight in competition cases with a concomitant reduction in concern for static efficiency. See India (2000, 2).
6. New Zealand (1998, 3)
7. New Zealand (1998, 4)
8. Japan (1998, 3) has noted "...large differences in standpoints on parallel imports among countries." More detail as to the differences can be found in Abbott (1998, 609).
9. See Anderson (2000) where it is noted that this strategy is taking new forms that deserve a close look.
10. This strategy makes commercial sense only if the IPR owner is a dominant firm and there are considerable barriers to entry into distribution.
11. This definition is taken from Malueg and Schwartz (1994, 168).
12. For more discussion of this point in a trade context, see OECD (1999a).
13. The author is indebted to Gallini and Hollis (1999) for inspiring the four motive classification used here.
14. In some cases, exclusive national territories may result in supra-competitive profits for dealers, i.e. the colluding suppliers may find they are in a double margin situation. This is normally bad for suppliers. But if they are colluding, they may welcome the fact that double margins mean suppliers stand to gain less in the way of extra profits by cheating on their agreement. That in turn should tend to make anti-competitive agreements among suppliers more profitable and probable. There are other effects to consider as well, however. The expected profitability of cheating is very much influenced by the probability of being caught and punished. On its own market segmentation should make it easier to attribute changes in retail prices to changes in wholesale prices charged by suppliers. But when market segmentation itself causes distributors to enjoy extra profits, that situation changes. As for the punishment factor, market segmentation should lower the cost of punishing cheating (because retaliatory price reductions need not be made across the entire world). All in all, one cannot be sure that market segmentation significantly increases the probability of collusion among suppliers. Competition agencies are justifiably more concerned, however, when such arrangements result in increased market power for dealers, because this is something that suppliers would normally wish to avoid.
15. It is also possible but not very likely that suppliers might set up exclusive territories in situations where they lack market power but are still able to siphon off some or all of any extra dealer profits attributable to their enjoying exclusive territories.

16. There could be notable exceptions to the general rule that prices will be set higher where consumers enjoy higher per capita incomes. For example, prices might be higher in lower per capita countries if their markets experience less competition than is found in some higher per capita income countries. Exceptions could also be due to significant differences in tastes and preferences across countries.
17. See Hausman and MacKie-Mason (1988, 253-254 and 263-264).
18. See Hausman and MacKie-Mason (1988, 255).
19. Consumers' surplus can be thought of as the additional amount of money consumers as a group would be willing to pay for their current consumption rather than go completely without the product. Producers' surplus is equal to their supra-competitive profits.
20. For more detail on this point, see Hausman and MacKie-Mason (1988) and Malueg and Schwartz (1994).
21. The simplest rationale for exhaustion policies begins by observing that although IPR owners should be allowed to earn the reward that IPR laws are partly designed to assure, this arguably happens the first time they sell the product. It is then maintained that allowing IPR owners to use licences to control pricing of resold products essentially goes beyond the protection legislatures intended, and results in over-rewarding IPR owners.
22. This is not to say that courts are indifferent to the consumer harm that may result from restrictions on parallel imports. See for example, *obiter dicta* of the United States Supreme Court in para. 32 of *Quality King Distributors v. L'anza Research International*, 1998 U.S. Lexis 1606.
- The general interface between IPR and competition law is extensively discussed in the background note and various national contributions relating to an OECD Competition Law and Policy roundtable discussion on Competition Policy and Intellectual Property Rights - see OECD (1998).
23. Abbott (1998, 611, references omitted) describes the existing spectrum as regards international exhaustion of IPRs as follows:
- Legal solutions to the parallel imports question that legislatures, courts and commentators have laid out include:
1. A rule of international exhaustion of a particular IPR, which in some cases will depend on the relationship between the holder of the IPR and the party that places the good on a foreign market. Whether or not the right is exhausted may depend on whether the party placing the good on the market is: (a) the IPR holder in the country of import; (b) another entity in the same corporate group; or (c) a manufacturing licensee.
 2. International exhaustion as under (1) unless the original marketer has given sufficient notice that the goods are not licensed for import into the country in question.
 3. No international exhaustion of a right.
24. The European Union, although better referred to as a "jurisdiction" than a country, provides a good example of this policy difference. It is also broadly descriptive of Canadian and United States policy.
25. This by no means implies that competition law is powerless against companies using market segmentation for anti-competitive purposes. Even if competition considerations may not feature in decisions to block parallel imports, competition law prohibitions can be directly applied to the collusion and predatory pricing that may lie behind some instances of market segmentation. In addition, in some jurisdictions high pricing, including that associated with price discrimination, can be prohibited if it amounts to an abuse of dominance. One should note, however, that applying such prohibitions without regard to the positive

effects price discrimination might be having on consumers and producers in other nations could result in reducing global economic welfare.

26. Chard and Mellor (1989, 72) state:

Many countries enforce laws that prevent firms from using private contracts to restrict parallel trading. Competition laws may prevent firms from requiring that their licensees or authorised distributors do not sell products to purchasers for resale abroad (or from using contractual terms with the same effect) and from terminating agreements with those licensees and distributors that knowingly sell to parallel traders. Also a number of developing countries have laws concerning licensing arrangements that prevent owners of intellectual property rights from enforcing restrictions on exports.

27. Malueg and Schwartz (1994) point out that the probability of price discrimination having a net beneficial impact would be considerably increased if countries are grouped according to similarity in demand conditions. Within each group there would be uniform pricing, which would promote exchange efficiency, but prices could vary across groups in order to ensure that all markets are served (provided marginal revenue exceeds marginal costs).

28. This point is made by Anderson et al. (1998, 426). It has received reinforcement from Abbott (1998, 634) who noted that:

The US government has already signalled that it may react adversely to a decision by Japan that permits parallel importation of patented products. It may be recalled that Section 301 of the US Trade Act of 1974 was amended during the Uruguay Round implementation process to authorise the US Trade Representative to impose sanctions on countries that fail to adequately protect IPRs, notwithstanding that such countries are in compliance with the TRIPS Agreement.

29. See Abbott (1998, 623 & 635-636).

30. See Abbott's (1998, 625-626) description of two European Union copyright-related parallel importation cases.

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