Parallel Imports — Effects of the Silhouette Ruling

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Foreword

In the summer of 1998, the European Court of Justice delivered a ruling in what is known as the Silhouette Case, concerning the exhaustion of trademark rights. In brief, the ruling means that parallel imports from countries other than those belonging to the European Economic Area – i.e. the EU Member States plus Norway, Liechtenstein and Iceland – are no longer allowed. Parallel imports within the EEA zone, however, remain both permissible and desirable. The existence of a parallel import trade, which arises from and eventually eliminates price differences between different markets, is considered a precondition of a properly functioning Single Market.

In the light of the Court of Justice's ruling, the Government commissioned the Swedish Competition Authority to ascertain the extent of parallel imports into Sweden from various countries and the effects of the Silhouette ruling on prices and competition.

As a basis for its analysis, the Authority has had two consultancy studies carried out, by Åke Hallman and Lena Magnusson (PeHe Konsult HB) and by Stefan Fölster and Peter Nygren (Swedish Wholesale & Retail Research Institute, HUI) respectively. The conclusions and assessments contained in the report, however, are the Authority's own. The consultancy studies are presented in full as appendices to this report.

Stockholm, 23 December 1998

Jörgen Holgersson
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1. Introduction

1.1 Background

Parallel imports from countries both outside and inside the European Economic Area (EEA) are to be found in a large number of trade sectors, such as clothing, footwear, capital goods, cars, pharmaceuticals, etc. In brief, parallel imports involve importing certain products, usually trademark-protected, through sales channels other than those normally used for the product. Such imports are believed to create pressure on costs and prices, and they also contribute to a dynamic trend in the business sector which has considerable significance for the state of competition, especially in a small, open economy like the Swedish one.

On 16 July, the European Court of Justice ruled in what has become known as the Silhouette Case. This was a preliminary ruling in accordance with article 177 of the Rome Treaty and concerned the interpretation of an article in the EU’s Trademark Directive.1

Essentially, the court decided that exhaustion of trademark rights, which has to do with the right to distribute individual specimens of a product, is a regional matter and not a global one. This interpretation contrasts with current Swedish legal practice, which views exhaustion of trademark rights as global.2 Slightly simplified, the Swedish interpretation could be said to derive from a more liberal view of free trade, while the Court of Justice's ruling emphasizes protection of the Single Market against certain types of imports, in this case parallel imports, from a third country. This means that EU legislation protects trademark rights more closely than has been the case in Sweden, where in practice there has been greater emphasis on upholding competition.

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1 The Council's first directive of 21 December 1988 on the harmonization of Member States' trademark laws (89/104/EEG, EGT L 40, 1989).

2 See further below, Section 1.4.
The European Court ruling alters the way Swedish law can be applied in the trademark domain and restricts opportunities for parallel imports into Sweden.

1.2 The Government assignment

On 3 September 1998, the Government commissioned the Swedish Competition Authority to investigate and analyse how the Swedish market and Swedish consumers and producers would be affected were Sweden to change its established legal practice and apply the principle of regional exhaustion of trademark rights. The assignment entails describing the extent and orientation of parallel imports in various product sectors and analysing how prices and competition in these sectors would be affected by such a change in praxis. Study should also be made of the effects of parallel imports on the Swedish market assuming that such imports are not subject to any restrictions. This assessment should focus not only on trade sectors where parallel imports already occur but also spotlight the effects such restrictions might have in the longer term compared to a situation in which parallel imports have spread to further trade sectors where they are not yet to be found. In examining the position, reference should also be made to international studies and experience in this field. The Competition Authority is to present its report to the Government on 31 December 1998.

To procure the basic materials necessary for its task, the Authority appointed PeHe Konsult HB (Hallman) and the Swedish Wholesale & Retail Research Institute (HUI) to examine the above questions from a consumer-economic and political-economic viewpoint respectively. These studies were carried out by Åke Hallman and Lena Magnusson for the former and by Stefan Fölster and Peter Nygren for the latter. The presentation below is based largely on these two studies, which are enclosed in full with this report.

1.3 Definition of terms

When discussing the term ‘parallel imports’ with people who represent the various trade associations active in the parallel

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3 This section is largely based on Hallman, chapter 3.
trading field or who in other ways have come into contact with the term, including ordinary consumers, there would seem to be some confusion about what it in fact implies. Sometimes the term is even associated with another type of trading that has nothing whatsoever to do with parallel imports, namely the sale of counterfeit goods. Sometimes, too, the term parallel imports is associated with the practice of discount retailing, which it usually but not necessarily involves.

Thus it may be worth taking a closer look at the various terms that occur in connection with parallel trade and attempting to give the various terms as precise a meaning as possible.

1.3.1 Parallel imports

The term parallel imports in the present context refers to the import for commercial retailing of products bearing a registered or established trademark when such trading is not done via the trademark owner's general agent in the area. Such imports may involve the regular, standard range of the current year's products or models. They may also involve the previous year's discontinued models or the trademark owner's rejects.

It is not uncommon for instance for a manufacturer anxious to avoid disrupting the regular trade in the current year's models and collections to deliberately release discontinued models, etc, through other channels than the official, regular ones. Such goods may traverse several different geographical markets before finally being sold over the counter to the end consumer. Also, it is claimed, such trading sometimes takes place with the tacit agreement of the general agent, or may even be contractually regulated in the general agent's agreement with the trademark owner. In the latter case, such 'side imports' could hardly be described as parallel imports in the true sense of the term.

Parallel imports may also be taken to mean the import of goods lacking a trademark. Imports of this kind, however, are not affected by the Silhouette ruling.

1.3.2 Private brands

Imports of what are known as private brand products involve the trademark owner's products being imported with the buyer's own
trademark on for instance the box. Sometimes the products are imported in unmarked boxes from the trademark owner – or from a source approved by the owner – and are then marked after their arrival in Sweden. These products are then sold in competition with the trademark owner's own branded products. Motorcar components and spare parts are said to one of the more common product groups in respect of this kind of private brand trading.

1.3.3 Private imports

Private imports are quite considerable in certain sectors, for instance as regards cars, alcoholic beverages and tobacco. Private imports differ in character from parallel imports mainly in that they are not primarily for commercial ends but for the importer's own use. Because of its considerable volume, however, this kind of private trading may in areas where it is extensive have the same effect on the state of competition and pricing as the presence of parallel imports in the same field or other fields.

Recently, direct imports through private channels have increased with the growth of Internet trading. The private consumer products that at present are chiefly associated with trade over the Internet are CD records and books. Once further standards and security routines for the payment process are in place, a sharp increase in Internet trading can probably be expected.

1.3.4 Pharmaceuticals

In the pharmaceutical trade, confusion sometimes arises in relation to the terms parallel import drugs and generic drugs. While the former term is concerned with parallel imports – or re-imports of the manufacturer's products bearing the original trademark but with the addition of the importer's own company label – generic drugs are exact copies of products for which the original patent has expired. Generic drugs, which far outstrip parallel imports in both value and volume, are available either under their scientific name derived from their chemical ingredients, 'generic generics', or under a specific brand name, 'branded generics'. 
1.3.5 Factory outlets

A term often used in connection with parallel imports is factory outlet. Under the original definition, a factory outlet was supposed to be owned by the trademark owner, located at a clear distance from his regular retail outlets, involve simple premises and furnishings and provide low-price goods from the owner's range for the previous year, with discontinued colours and models but also rejects. More recently, the original definition has been widened to embrace factory outlets run on behalf of the trademark owner by a retailer of substance, usually a regular one, or by some other party involved in a business relationship with the trademark owner. There are no factory outlets in Sweden coming under either the original definition or the somewhat broader one.

The factory outlets that do exist in Sweden are owned neither by trademark owners nor by anyone specifically appointed or commissioned by them. The term in this country, referring to outlets that in their style and business set-up are very similar to the original factory outlet approach, has acquired a special 'Swedish' meaning.

Simply put, the factory outlet units operating in Sweden differ from the original definition in that they either sell several brands at one and the same location or in that they sell their goods in close approximation to the 'regular' brand outlets. There are also cases where the retailing facility is rented by an independent property owner, as is the case with the Barkaby Quality Outlet near Stockholm.

1.4 Swedish law prior to the Silhouette ruling

1.4.1 Trademark rights

A prerequisite for the parallel import of trademark-protected products is that the trademark protection for the goods in question has ceased to apply, i.e., has been exhausted. This is because protection of trademark rights means that no-one but the trademark owner himself or someone who with his consent manufactures or

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4 The first factory outlet to be established and which gave rise to the definition was located in Redding outside New York, USA.
sells his products may use the trademark. The trademark owner's powers, however, may expire through exhaustion. Exhaustion of trademark rights occurs when the trademark owner or some other party with his consent puts a specimen of the product on the market. The trademark owner's powers with regard to that specific article are then exhausted, i.e., they expire. Exhaustion of trademark rights does not, however, involve any universal right to freely exploit the trademark, only the freedom to further distribute the single article purchased. Those who sell such goods are subject to certain restrictions on their right to market the actual trademark, especially in cases that involve 'free-riding' on a trademark's goodwill.5

In legal practice, the principle of global exhaustion has hitherto applied in Sweden, i.e., the right to the trademark is exhausted in whichever part of the world a quantity of the goods may have been sold.6

1.4.2 Other intellectual property rights

The exhaustion principle also applies to other kinds of intellectual property rights. In the case of design and patent rights, both the Registered Designs Act and the Patents Act specify that exhaustion is EEA-wide, i.e., regional.7

The question of which exhaustion principles apply for the various rights is not easy to answer. The Copyright Act expressly states that the exhaustion principle for related rights (letting and lending) is EEA-wide.8 In the case of actual copyright (protection for the performance of literary or artistic works, etc), the exhaustion principle is not regulated by law. When the rule on EEA-wide exhaustion of related rights was implemented, the preparatory documents included a discussion about which exhaustion principles should apply with respect to the other forms of

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8 45 § 4 par and 46 § 3 Copyright Act.
copyright. The documents make it clear that Sweden for its part favoured global exhaustion, a position previously established in Swedish legal practice.9 Thus the rights situation is similar to that which applied to trademarks prior to the Silhouette ruling. It might be concluded from this that the Silhouette ruling has clarified the rights position with regard to copyright and related rights as well but a final opinion in this respect can only be supplied by the European Court.

1.5 The Silhouette ruling10

The case concerned an Austrian discount chain, Hartlauer, that had bought a consignment of Silhouette sunglasses from a company in Bulgaria which had previously bought them from Silhouette International in Austria. In court, Silhouette argued that the sale to the Bulgarian company had been agreed on condition that the sunglasses were not sold back to Austria. It proved impossible, however, to verify this claim.

Hartlauer were charged in an Austrian court on the grounds that the trademark rights for the sunglasses had not been exhausted by the act of selling the consignment to the Bulgarian company, and that Silhouette therefore could prohibit Hartlauer from selling them in Austria. During the case, the question arose whether article 7(1) of the special Community directive on trademarks could be interpreted to mean that the trademark entitles the owner to prohibit any third party from using the trademark for goods originally put on the market under that trademark in a state that is not a Contracting State.

Article 7(1) of the 1989 Trademark Directive states:

"The trade mark shall not entitle the owner to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the owner or with his consent."

The Austrian court turned to the Court of Justice for an opinion on how article 7(1) of the Trademark Directive was to be interpreted.


10 For full text of ruling, see Annexe 1.
Like Sweden, Austria has previously applied the principle of global consumption.

The Court of Justice referred in its ruling to the fact that the Directive had been created to facilitate the free movement of goods and services in the Single Market. It is of crucial importance in this respect that registered trademarks are given the same protection in all Member States. With this in mind, the Court decreed that the Directive should be viewed as a complete harmonization of the Member States’ rules for trademarks. It also declared that this was the only interpretation fully capable of ensuring that the aim of the Directive was achieved, namely to safeguard the proper functioning of the internal market. The consequence of this line of reasoning is that all Member States are obliged by the Directive to apply the same principle of regional (EEA-wide) exhaustion of trademark rights.

The Court of Justice pointed out in conclusion that the EU can always enter into international agreements and thereby extend the scope of regional exhaustion.

1.6 The Maglite ruling

About six months prior to the Silhouette ruling, the EFTA Court ruled in a similar case but the outcome was different.

That case involved a Norwegian company that parallel imported ‘Maglite lanterns’ from the US. The Norwegian general agent sued the importer for an alleged breach of both Norwegian trademark legislation and the EU Trademark Directive.

The EFTA Court took the view that the EEA agreement, in contrast to the Treaty of Rome, involved neither a customs union of any kind nor any common trade policy vis-à-vis a third country. The EFTA states were therefore free to conclude foreign trade agreements with a third country. Against this background, a regional exhaustion requirement would place too great a restriction on the EFTA states’ freedom of trade vis-à-vis a third country.

11 For full text of ruling, see Annex 2.
The Court thus concluded that it is up to each EFTA state individually to decide whether it wishes to implement regional or global exhaustion.

1.7 Conclusions

A question that arises from these two rulings is whether they conflict and if so, what this implies for Sweden. The probable answer, however, is that they do not conflict. The EFTA Court for its part points out that the EFTA states have neither entered into a customs unions with the rest of the Community nor agreed to any kind of common trade policy vis-à-vis third countries. With this in mind, it is not feasible to demand harmonized rules between the EU and EFTA countries as regards trade relations with a third country. The Silhouette ruling on the other hand is a matter for the Community alone. An agreement exists between the EU Member States on a common trade policy and a customs union which in itself requires a harmonization of the Member States’ rules on trade relations with third countries. These differing sets of circumstances would indicate that the two rulings do not conflict.

Nevertheless, the Maglite ruling may have certain implications for Sweden. One result of the ruling is that Norway, for instance, has retained the principle of global exhaustion. This could mean that goods originally bought in a non-EU country and parallel imported into Norway on the basis of the EEA agreement could then freely be brought into Sweden and sold here. This is because Norway applies the principle of global exhaustion, which means that the trademark rights for the goods sold there expire. Consequently, the parallel importer should be able to bring the goods into Sweden and sell them without the trademark rights presenting any problem. It should be emphasized, however, that this procedure has not been tested in court.
2. Economic research and parallel imports\textsuperscript{12}

2.1 Introduction

Parallel import trading involves products protected by intellectual property rights. The foremost purpose of intellectual property rights is to protect by legal means 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 the 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.

The possession of intellectual property rights by creators, individuals or companies also makes possible an indirect trade in the kind of investments that would not otherwise fetch a price on the market. This promotes efficiency in the production of knowledge-intensive goods and services as the results can be exploited by the players in the best position to do so.

At the same time as intellectual property rights provide incentives for investing in the development of new ideas and the improvement of existing products, they also confer a degree of monopoly power on the companies holding the patent, the design registration or the trademark for the goods and services in question. Such power can bring about distortions and inefficiency in the economy, which is to the detriment of the consumer. Economic research is addressing

\textsuperscript{12} This section is based principally on HUI, chapter 2. All references to sources are shown in the full report, Annexe 4.
the question of how effective incentives might be preserved so that enough investments are made in new and existing products without distortions in the market becoming too pronounced.

The most serious distortion in a monopoly market arises when the monopoly company puts a price on an article higher than the cost of producing it. When this happens, the product undersells and its benefit to the consumer is lost.

Another type of distortion in monopoly markets involves various kinds of price discrimination. Normally price discrimination generates a change in the volume produced, which in turn results in allocation effects. Occasionally, when price discrimination does not affect the volume sold on the market, the only result is a transfer of income. In order for a distortion to arise, three conditions must be fulfilled: the company must have some kind of monopoly position, different consumer groups must be kept apart and arbitrage opportunities must be limited. These conditions are often fulfilled on international markets and parallel imports are usually an answer to this kind of price discrimination.

The presence of parallel imports affects the latter kind of distortion, but usually not the former. Any economic welfare effects such trading may have are therefore limited compared to measures that bring about a general improvement in market opportunities for new and existing competitors both in Sweden and abroad. Moreover, other trade and competition policy measures, in contrast to parallel import trading, can help increase the number of products available and thus increase consumer benefit.

In the field of economic research, the fundamental question of how price discrimination affects the economy has been studied on several occasions. Often, these studies have not specifically addressed parallel imports but the findings are on the whole generally applicable. There is no difference in principle between arguments favouring trade generated by inter-regional price discrimination and by price discrimination between countries or trade blocs.

13 In some cases, exports of temporary surpluses may help a company maintain monopoly prices within the country concerned by limiting sales. An alternative to exporting temporary surpluses would be to build up stocks and reduce production. Nor is it likely that the company would take a chance and produce too much if there was no prospect of exporting.
Below, we begin by describing an analytical model for the simplest scenario. We then discuss a number of complications and how they affect our conclusions.

2.2 The simplest model

Suppose that a company is selling its product on different markets, e.g., in different countries. The company has a unique product, i.e., occupying something of a monopoly position, even if there may be competitors offering related products. Demand and willingness to pay vary from country to country. If no trade exists between different countries, the company charges prices based on whatever will maximize profit bearing in mind the demand situation in the country concerned. This normally means that higher prices are charged where demand is less sensitive to price increases (less elastic) and lower where demand is more sensitive to price increases (more elastic).

If parallel imports occur, however, and for the sake of simplicity are assumed to lead to perfect arbitrage between the countries concerned, the producer is obliged to set a common price for all countries in accordance with the aggregate demand curve. This results in the price being lower for consumers in countries with less elastic demand and higher for consumers in countries with more elastic demand. A standard outcome is that price discrimination in this situation boosts economic welfare if it leads to an increase in overall production, while welfare is reduced if price discrimination results in a production decrease or no change. Under the kind of conditions often believed to exist, for instance when the demand curve is linear, price discrimination leads to an economic welfare loss for consumers in all countries as a whole.

The price on each market reflects the margin valuation of the last unit sold. If price discrimination occurs, valuation will differ from market to market and the last unit will not be sold to the individual who values it most. Thus part of the consumer surplus is lost. The negative effect of different margin valuations can only be offset when price discrimination results in a greater volume of overall production.

The reason why price discrimination can bring about an economic welfare loss, then, is that consumer valuation of the last unit sold on the low-price market is lower than the valuation in the high-
price market. Thus, given a certain output, it is better to redistribute production so that the bulk is moved from the low-price country to the high-price country until such time as valuation and thereby prices are the same in all markets.

For the purpose of policy analysis in the Community, however, the question can be put differently. In the Silhouette case, the EU is a high-price area whereas non-EU countries are low-price areas. If so, consumers in the EU unquestionably benefit in economic welfare terms if parallel imports from a third country are allowed and price discrimination thereby becomes more difficult. This argument applies to Sweden to an even greater extent. As a certain amount of price discrimination takes place inside the EU as well, and small countries like Sweden tend to be among those with the highest prices, Sweden is assumed to be one of the countries that stands to gain most from allowing parallel imports.

A number of factors can complicate this analysis. These are dealt with in turn below.

2.3 Parallel imports may reduce investment in development or marketing

A frequent argument against parallel imports has been that the importer gets a 'free ride' on the producer's investments in things like market-specific marketing. Extensive parallel import trading means producers are less motivated to make these kinds of market-specific investments.

Viewed from the consumer horizon, however, this argument is no longer clear-cut. It does not concern the kinds of investments in product quality or in marketing that boosts sales in all markets but only marketing or trademark development in a specific market. Such investments, though, do not necessarily increase consumer benefit. In the available research, a number of reasons have been given why there may be over-investment (or under-investment) in this kind of marketing. Over-investment occurs when such marketing seeks mainly to attract customers away from competitors. Under-investment may occur when the marketing supplies information that is of benefit to the consumer. This, then, is an empirical question.
2.4 The importer's transaction costs

According to theoretical analysis, if parallel imports demand resources there is less likelihood of any economic welfare gain. Analysis also shows that the risk of this is greatest when parallel imports involve large volumes, which occurs in situations where it is in the best interests of the producer, parallel trade notwithstanding, to maintain big price differences between countries.

In addition, transaction costs for parallel imports are a reason why prices do not need to be completely equalized, despite inter-market arbitrage.

It should also be noted that the same problems can affect the supply of supplementary goods and services that are wholly or partially a collective benefit for all consumers in the local market. The manufacturer often invests in a local range of auxiliary services that are of benefit to all consumers in the local market. This may involve things like product information, support, service workshops, locally-oriented applications, etc. For small countries in particular the returns on this kind of investment may fall if the manufacturer's earning capacity is drastically reduced because parallel importers are taking advantage of existing investments without themselves contributing to the overall supply of services. The reduced supply may have negative consequences for consumers in high-price countries as well.

2.5 The producer's transaction costs

Parallel imports may engender extra costs for the producer. These are sometimes claimed to be costs to the consumer. These include the following:

• The producer sells a certain quality of goods in one country and a lesser quality in another. If parallel imports occur, it is harder for the consumer to associate a trademark with a certain quality. Alternatively, though, clearly labelling products in accordance with their degree of quality could be viewed as a producer cost. Normally this cost would not be very great.

• After sales service can be standardized in a country where one variety of the product is sold, but becomes dearer if other, parallel imported varieties also have to be offered service. Charging for the
extra cost of providing after sales service for the parallel imported variety would not, however, appear to present any great problem.

• Investment decisions and production planning become harder for the producer if parallel imported goods arrive on the market at unpredictable intervals. The producer can, however, parry a greater influx of goods by means of price cuts in order to offload a planned volume on the market. The price-cutting effect of parallel imports is a consumer benefit. The purely administrative costs of altering prices, however, are more often an extra resource cost for the producer.

• Copies become harder to detect if parallel imports of the product occur in such a way that a number of varieties arrive on the market via more than one channel. This, too, may engender extra costs for both the producer and the consumer.

2.6 Incentives for market division

Parallel imports reduce the profits of price-discriminating companies. A lower price in one market cannot be offset by a higher price in another, which means the companies' total profits are reduced. As a result, price-discriminating companies may feel motivated to influence their prospects of selling goods from one market in other markets. If possible, companies with active strategies will want to bring about a market division, i.e. segmentation, which would make parallel imports impossible or very expensive. Companies can act in various ways, for instance through packaging, insurance and warranty commitments, etc, to reinforce the obstacles that parallel imports encounter.

There is reason to believe, therefore, that parallel imports may result in less efficient resource usage in both the price-discriminating and the parallel-importing countries, compared to a situation in which price equalization can be achieved without cost. In other words, the economic welfare gains will be reduced if parallel imports necessitate considerable resources in order for the products to be adapted for sale on a market other than the one originally intended.
2.7 Distribution of surplus

Under the kind of conditions normally believed to exist, total economic welfare is increased when price discrimination is reduced. The consumers in the high-price country gain more than the companies and consumers in the low-price country lose. In general, therefore, countries with high prices will benefit from reduced price differences between countries.

Distribution of the surplus that arises when prices are equalized, however, is not uncomplicated. If for instance a small country with high prices has a large proportion of price-discriminating production companies, company profits may decline more than the consumers gain and the total surplus in that country will be reduced despite price equalization. In such cases, too, the consumer usually benefits from parallel imports.

2.8 Reduced barriers

Parallel imports are just one way of getting to grips with the problem of major price differences between countries. A relevant question in this context is whether there are other, better ways of reducing price differences. One alternative is to reduce any obstacles to company start-ups in high-price areas so that competition increases as a result of a larger number of foreign players being able to operate in the domestic market. New ventures and potential competition both lead to a reduction in monopoly benefits and better use of economies of scale. The consumers benefit thanks to a greater range of products, lower costs and reduced prices.

2.9 Conclusions

This brief summary of the theoretical arguments advanced in the economic research field with regard to the macroeconomic gains/losses ensuing from price discrimination provides no unequivocal answer to the question of what price discrimination means for the individual country concerned. Parallel imports or other methods that prevent price discrimination may well increase
consumer benefit as a rule, but other factors exist that may stand this trend on its head. Among them is the possibility that demand functions may take a special form, that greater transaction costs may be involved and that market-specific investments resulting in consumer benefit may be present.

If instead the question is whether EU rules preventing price discrimination between the EU and third countries are good for EU consumers, the answer is more unambiguously in the affirmative. In cases involving parallel imports, the Community tends to be the high-price area. Consumers in high-price areas gain when price discrimination is reduced.

However, the above line of argument is based on the assumption that any limitation of parallel imports from third countries would mean that existing price discrimination could be maintained. This is not necessarily true. Consumers may import directly via the Internet to a greater extent than at present. In Section 5 below, it will be shown that this in turn means consumers in high-price areas, such as Sweden, will be able to buy identical goods at a considerably lower price than is charged by traditional outlets.
3. Extent and orientation of parallel imports\textsuperscript{14}

3.1 General statistics

The comprehensive and detailed foreign trade figures provided by Statistics Sweden (SCB) reveal not only total values and trends but also things like how imports into Sweden are distributed by product sector and which regions and individual countries they originated in.

The statistics do not, however, shed any light on the question of parallel imports and their place in international trade in general, and more specifically on the origin of goods that, parallel to the flow of imports to general agents, are brought into Sweden. Thus it is not possible to deduce from these public statistics the total extent of parallel imports, their distribution by sector or their origin, i.e. whether they come from a country in the EEA zone or from a non-EEA country. Nor do Swedish Customs have access to any data that might be of use in this connection. The possibility they have under a Community directive of stopping certain consignments of goods on entry inwards does not apply to the realm of parallel imports but is intended purely to prevent counterfeits of trademark products from reaching the market.

Even if it were possible to determine whether the imports in question were parallel imports, based on things like the recipient’s position as general agent or not for the Swedish market, determining the actual origin of the goods would prove difficult, not to say impossible. In respect of certain kinds of goods, e.g. clothing that has been parallel imported into Sweden, it tends to be the rule rather than the exception that the consignments – regardless of whether they actually originated from an EEA country or from a non-member country – in fact reach Sweden from another EEA country. Thus it is not unusual for, say, consignments of clothing exported from the US with well-known American trademarks and from American suppliers – intended for

\textsuperscript{14} This chapter is based largely on Hallman, chapter 2.
the parallel trade – to arrive in Britain, for example, where they are divided up and distributed to other parts of Europe. In certain cases, Sweden, too, is said to be one such spider in the web of international parallel trade, although on a modest scale. Nor is it unusual for a trademark owner in an EEA country – so as not to upset his relationship with his general agents in the EEA zone – to export goods that are really intended for the parallel trade in the EEA zone to a non-EEA country first, fully aware of the fact that the consignments via one channel or another will find their way back to one or more of the EEA countries.

What looks like, or rather de facto is, a case of parallel imports from an EEA country and as such unaffected by the implications of the Silhouette ruling may thus in reality be essential supply channels for parallel imports from countries outside the EEA zone. These would be blocked by the Silhouette ruling except where the trademark owner has a special agreement with the initial consignee in the EEA zone. The same applies to the parallel import supply channels that have been built up for, or rather are built on, the practice of bringing consignments intended for parallel trading in the EEA zone, and originating in an EEA country, to a non-EEA country first before they are brought back.

Replacing these supply channels with direct contacts with the original suppliers concerned is difficult as the quantities involved are often so large that very few recipients of sufficient financial stature are available to deal with the goods and divide them up. Should the original supplier be located outside the EEA zone, moreover, the Silhouette ruling excludes such contacts. In addition to this – where suppliers in the EEA zone are concerned – certain situations arise from the fact that the quantities in many cases are allowed to take a roundabout route because the trademark owner in his regular business operations does not wish for any direct business contacts in the EEA zone other than those he has with his general agents.

Thus, as noted above, it is not possible on the basis of the available public statistics to gauge the volume of parallel imports, their presence in the various product sectors or their actual origin by country or region. The only viable sources of information about parallel imports in the Swedish market at present are representatives of the various sectors and companies engaged in parallel trading to a greater or smaller degree. It is on the basis of this information, which tends to diverge considerably, even between players in one and the same line of business, that analysts have to try and form an opinion on the extent and orientation of
parallel imports in Sweden and thereby of the dynamic effects on market workings, competition and pricing. The figures, etc, provided below rest therefore upon assessments and analyses based on a large number of interviews. So as not to give the impression that these figures are anything but approximate, they have been rounded off considerably.

In two sectors, however, those for motor vehicles and pharmaceuticals, public statistics provide access to information that makes it possible to determine the extent of parallel imports with some accuracy. This has to do with the fact that both these sectors, each in its own way, are subject to special registration procedures that must be complied with if someone is to use a product or sell it on the Swedish market.

At the Motor Vehicle Register, where cars, motorcycles and snow scooters, etc, are registered, type inspections can only be carried out at the request of general agents, which is why all other kinds of registration inspections are performed without the involvement of the general agent, i.e. through parallel channels. In the case of cars, these parallel channels almost always turn out to be private persons. In the case of motorcycles and snow scooters, however, parallel imports for commercial ends also occur.

In the case of pharmaceuticals, which are imported or sold parallel to the trademark owner’s products, the Medical Products Agency requires that they be registered in accordance with a special procedure. This ensures total control both in respect of which companies are involved in the parallel import of pharmaceuticals and which drugs are involved. As for the market value of parallel imported pharmaceuticals, this too can be ascertained as drugs in Sweden can only be sold by one player, Apoteket AB. In the pharmaceuticals field there is also a comparatively new trade association for parallel import companies, something that as far as is known does not occur in any other market sector.

3.2 Preconditions for parallel imports

Over and above the legal prerequisites necessary for proper parallel trading/imports, certain other conditions must be met, chiefly of a commercial nature. Foremost among these is the need to be involved with an internationally renowned and respected trademark, often associated with high prices and status.
3.2.1 Access to surplus products

One important prerequisite is access to surplus products, either a temporary or a permanent surplus. Temporary surpluses can arise in business sectors that have been delaying necessary structural measures for too long. When the necessary streamlining has been carried out, the sector returns at least for a while to a situation in which supply and demand are better balanced. Permanent production surpluses are commonly found in sectors with strong fluctuations in fashions and more than one ‘season’ in the same calendar year. The most notable examples of such sectors are probably clothing and footwear.

In this connection, a further precondition is the presence of trademark owners seeking actively or tacitly to offload surplus quantities such as the previous year's models or rejects without seemingly being involved themselves, or who, because they have licensed out the manufacture of the goods on a franchise basis to a fairly large number of companies in geographically diverse markets, lack proper control of the products' stocks and distribution.

3.2.2 Price differences

Sufficiently large price differences between different geographical markets are needed if parallel imports are to be profitable to the parallel importer. In many cases, existing price differences – over and above the margins that represent the parallel importer's incentive and the profit-taking costs involved – are also supposed to cover costs for repackaging, relabelling, marketing and handling. The size of the price differences required to attract parallel imports varies sharply from sector to sector. In the case of pharmaceuticals, price differences of 25-30% are quoted as a yardstick.

Price differences between different markets can be attributed to a wide range of factors, including historical and cultural differences, a desire on the trademark owner's part to segmentalize the market from a profitability viewpoint taking into account local purchasing power, and differences in insurance systems, charges and taxes, as
well as state price controls affecting the trademark owner's pricing policy in the market concerned.

In some cases, parallel import prices are conditional more on whether the number of intermediaries in the processing chain can be limited than on things like geographical market segmentation on the brand supplier's part. Product groups often mentioned in this respect include snow scooters and golf equipment.

From time to time, movements in foreign exchange rates have had a considerable impact on the extent of parallel imports from some countries.

3.2.3 Transparency

In different forms – both within the EU and within other internationally active organizations, both supranational and privately-based – a search is under way for greater transparency in various markets for the purpose of facilitating things like trade across national boundaries. The openness that such transparency leads to is one of the preconditions of parallel trade and parallel imports. Parallel trading helps channel quantities of goods openly for sale on the world market to those geographical markets where demand currently exists while at the same helping in the longer term to equalize prices on different geographical markets. In markets where surpluses are temporary in character, perhaps over a period of a few years when the trade sector in question is undergoing essential structural changes, parallel trading also tends to be of a temporary nature. The same applies during periods when distortions in pricing between different markets may be caused by sizeable movements in foreign exchange rates. Where surpluses are of a more permanent nature, for instance in sectors with strong fluctuations in fashions, parallel trading is probably an even more vital component in the constant struggle to achieve concordance between demand for fast-moving fashion products, efficient production planning and effective geographical pricing. By offloading discontinued branded goods at cut prices through clearly-separated sales outlets such as factory outlets, a market is found for what remains of the previous year's production and rejects without this unduly disrupting business and pricing in the channels that are marketing the latest product range.
3.2.4 Conclusions

In summary, the existence of parallel imports could be said to either facilitate the marketing of products in connection with essential rationalization measures in a particular sector or act as a lubricant in sectors where manufacturing is exposed on a more permanent basis to strong fluctuations in fashion, both in design and colour.

For the consumers, parallel imports offer the chance of buying at a lower price than in the regular retail trade products that bear a strong brand name, even if these may not always be the latest in the trademark owner's range.

In so far as parallel import trading takes place in a growth economy, such imports and their spin-off activities, relabelling, repackaging, etc, create additional job opportunities.

3.3 Extent of parallel imports

The present study has focused on product sectors related to private consumption. By means of the interviews, etc, conducted as part of the study, just over 43% of total private consumption has been covered, according to the weighted averages on which the 1998 retail price index was based. The major sectors in the retail price index not covered by the study are housing, heating and household electricity (33.6%), amusements and recreation (3.73%), travel and transportation (3.36%) and postal and telecommunications services (2.71%), sectors where in all likelihood there is no trading of a kind similar to parallel imports. The same cannot be said of furniture, cosmetics, CD records and books, sectors which for various reasons have not been included in this study. Furniture and cosmetics have, however, not once been mentioned in the interviews as sectors in which parallel imports occur, at least to any marked degree. CD records and books on the other hand are often mentioned as sectors where private imports via the Internet have become relatively extensive and are also growing rapidly in volume. In the case of CD records, parallel imports of any great size were more common a few years ago. Because of negative changes in the foreign exchange rate, such imports have now more or less ceased.
There is general agreement that Internet trading will grow substantially in the near future. It is estimated that the number of European companies selling goods and services over the Internet will be ten times the present number within the next few years. In particular, large groups of young people, who are already experienced Internet users, are expected to make use of the new commercial channels. According to a Swedish survey, carried out by Interactive Research, over 40% of the total number of Internet users in Sweden (approximately 2,990,000) will trade via the Net in 1999, i.e. some 1,300,000 persons. The product groups that most affect the parallel import sectors, and where the number of people expected to make purchases via the Net has been estimated as a percentage, include CD records (12%), books (approximately 9%), clothing (approximately 7%), foodstuffs (approximately 5%) and computer games (approximately 3.5%).

In the private consumption sectors that have been subjected to special surveys and information-gathering, parallel imports have been traced to sectors that together encompass almost 38% of total consumption. These include sectors in which parallel imports occur to only a very small extent, such as foodstuffs, as well as sectors where parallel imports constitute a relatively large proportion of total turnover in the line of business concerned, e.g. motorcar components and spare parts, clothing, footwear and pharmaceuticals.

Based on the estimates gathered from various trade representatives, etc. – and which have been exposed to various 'tests' and reliability assessments – parallel imports on an annual basis and calculated at the end cost to the consumer are currently put at almost SEK 9,000 million. The sums involved have been overestimated rather than underestimated. As a proportion of total private consumption, which in 1997 amounted to approximately SEK 925,000 million, parallel imported products would thus account for about 1%. For the various trade sectors involved, market shares vary considerably for parallel imported products, from a mere 0.01% for the food trade to approximately 20% for the trade in motorcar parts. For clothing, for instance, the market share for parallel imported products is approximately 10%, for snow scooters and golf equipment approximately 8% and for footwear approximately 5%, the same share as for pharmaceuticals.

Of total sales of parallel imported products – worth almost SEK 9,000 million – just over 60%, or about SEK 5,300 million, are believed to have originated from a country outside the EEA zone.
When emphasis is placed on the various consignments' actual origin, the information is of greater relevance to an assessment of the effects of the Silhouette ruling, as the bulk of the products parallel imported into Sweden are discharged here from another EEA country.

Strict compliance with the Silhouette ruling, then, would mean sales worth approximately SEK 5,300 million being removed from the Swedish market. This corresponds to about 0.6% of total private consumption in 1997.

Below is a summarized account of the extent and structure of parallel imports in certain specific trade sectors. The effects of parallel imports on prices will be discussed in chapter 5.

3.3.1 Foodstuffs

Parallel imports of food products – and of chemical-technical goods – are said to have been fairly extensive prior to Sweden's entry into the EU but have thereafter virtually ceased, chiefly because of the labelling rules pertaining in the EU and the national interpretations and regulations that these engendered. Thus according to Swedish labelling rules, all declarations of ingredients, etc, on packaging, wrapping or the like must be in Swedish, or alternatively in easily-understood Scandinavian. Naturally, this set of rules limits the scope for parallel imports, regardless of whether the trading was to have taken place within the EEA zone or involved parallel imports from a third country.

The parallel imports found today in the food sector chiefly involve the import of Coca Cola from Poland and to a lesser extent biscuits and confectionery. According to trade representatives, the Swedish labelling rules are sometimes complied with in the case of parallel imported products, but just as often they are not.

In all, total sales of parallel imported foodstuffs are probably worth less than SEK 100 million annually. This may be set against a total figure for the private consumption of foodstuffs in 1997 of around SEK 130,000 million.

Even if direct parallel imports of foodstuffs are insignificant in volume, representatives of leading retail chains have pointed out that the potential embodied in such imports may be of considerable
importance for the chains' business dealings with the owners of trademark rights.

3.3.2 Motorcar components and spare parts

The total 'replacement market' for motorcar components and spare parts is put at an estimated SEK 15,000 million. Of this total figure, trade analysts estimate that parallel imported branded products account for about 20%, or approximately SEK 3,000 million. Of the parallel imported volume of sales, an estimated two-thirds has its origins in the EEA zone while the remainder, about one-third, is said to derive from a 'third' country, namely the US.

The motorcar parts trade, as has been noted, embraces the entire spectrum of import types, from strictly trademark imports to parallel imports of well-known marks and 'private brands' originating from the trademark owner's regular manufacturing. All these flows of goods tend more or less to converge, which makes it difficult to ultimately resolve the status of the product as regards origin.

Price differences between what in the trade are known as original parts and pirate copies vary greatly according to both the make of motorcar and type of part involved, e.g. exhaust control systems, brake blocks, brake discs, etc. Examples can be found of price differences of up to 60-70%, while margins elsewhere would appear to be more modest. It does not, however, seem an exaggeration to view price differences of around 20-25% as a fairly common occurrence. This means that a decline of parallel imported products from a non-EEA country would have a marked effect on the price situation.

In the spare part trade, there are a number of strongly targeted parallel import companies that are interested not so much in a low-price profile as in maintaining a broad range of stock for one or other of the lesser-known car makes. Thus there are companies that specialize in stocking components and spare parts for all American makes with models from 1907 onwards. In many cases, these parallel import firms act as suppliers to the official branded repair shops, which often have a stock-keeping limit for motorcar parts of 10 years.
3.3.3 Tyres

According to trade representatives, almost 5 million tyres were sold on the Swedish market in 1997, some 97% of them through general agents or similar, regular sales channels. The remaining 3% are referred to in the trade as side-imported tyres. Of these, about half, or 80,000 tyres, are believed to be parallel imports. The purchase value of these for the consumer is estimated at SEK 40 million, which represents a market share of about 2%.

The bulk of these parallel imported tyres originated from what may be described as ‘warmer countries’, which in this context means countries whose road surfaces are warmer than what we are accustomed to in our Nordic climate. These tyres, of the same make and bearing the same product designation as tyres manufactured for the Nordic markets, are made from a harder rubber compound and can therefore, according to trade representatives, solidify further at low temperatures (< 8°C), thereby constituting a traffic hazard.

Parallel imports are not considered in the trade to exert pressure on prices to any great extent. What is considered more important for price levels is the ongoing competition between leading makes like G Year, Michelin, Continental, Firestone and Bridgestone.

3.3.4 Motorcycles

A few years ago, the proportion of parallel imported motorcycles totalled 20-30% of total sales on the Swedish market. Today, however, chiefly as a result of active competition and price adjustments on the part of general agents, the market share for parallel imported motorcycles has been reduced to approximately 10% of total sales in 1997 of some 8,700 units. This market share is worth slightly less as parallel imports tend more towards models at the lower end of the market and the price differences between parallel imported motorcycles and those imported through regular channels are usually around 10-15%.

The parallel imports occurring today originate mainly from the US, but encompass both American makes, e.g. Harley Davidson, and Japanese makes, e.g. Yamaha, Kawasaki and Honda. The number of parallel import companies in the Swedish market is said to vary
from one year to the next, but three companies have apparently been more active than others on a continuous basis.

Irrespective of the effects of the Silhouette ruling, the trade expects parallel imports to decline, partly due to a gradual adjustment on the part of regular retailing and partly due to the implementation in late 1998 and early 1999 of the requirement whereby imported motorcycles must have European certification. Similar types of certification in the EU already exist with regard to cars. Certification is expected to mean that it will be harder, or perhaps more importantly dearer, to adapt products from a third country to the standards, etc, agreed on within the EU.

3.3.5 Clothing

Clothing is the sector primarily associated with parallel imports. Despite the fact that parallel imports in this sector are comparatively widespread and have been occurring for quite a time, here too it is difficult to get a firm grasp on the economic dimensions. Estimates have indicated that parallel imported clothing accounts for something like 10% of a total trade turnover of almost SEK 40,000 million. The countries of origin are chiefly the US, China and countries in South-East Asia, and the products involve trademarks well-known throughout the world. About 90% of the total volume of parallel imports are believed to have their origin in these countries or regions. The remaining 10% involve branded products originating from Italy, Germany and France, etc.

Parallel imported clothing can be marketed at most outlets where clothes are sold, not just at factory outlets or similar clearance points. One type of outlet that is said to be less involved than others in the import and sale of parallel imported products is the sports dealer. Such outlets are often to be found in the form of strong chains actively seeking to establish their own trademarks in addition to their more regular range.

As a rule, parallel imported clothing, which usually but not always encompasses the previous year's models and colours, is sold at heavily reduced prices. For the kinds of garments that are not as sensitive to fashion as others, e.g. piqué T-shirts and ordinary shirts, the price cuts – compared to normal prices in regular retail outlets – are around 30%. For other kinds of garments, prices may be cut by 50-70%.
Apart from the direct effects that parallel imports have on pricing, the pricing of parallel imported clothing is also believed to influence the pricing of the current season's models and colours in the regular retail trade. Just how strong this competitive pressure is cannot of course be measured objectively but should not be underestimated as a result. A striking feature of the trade is that apparently almost half of all sales of clothing always involve discounts.

3.3.6 Footwear

As regards footwear, sales of parallel imported products are estimated at about 5% of total trade turnover, or approximately SEK 400 million. Virtually all these imports are believed to originate from countries outside the EEA zone – primarily the US – and would thus vanish if the Silhouette ruling were strictly applied.

3.3.7 Pharmaceuticals

The parallel import of pharmaceuticals into Sweden began comparatively late, whereas parallel imports into other European countries – e.g. Belgium, Britain and Denmark – have been around for some time.

At present, all parallel imports of pharmaceuticals to Sweden come from other EEA countries, which means that the trade in its present state and form is not affected by the Silhouette ruling. In contrast to other areas that are affected by parallel imports – with the exception of motor vehicles – there is in the case of pharmaceuticals a good chance of keeping closer track of the extent and development of the trade, due above all to the registration procedure for parallel imported pharmaceuticals administered by the Medical Products Agency.

At present, eight companies are engaged in the parallel import of pharmaceuticals for the Swedish market. The biggest is Cross-Pharma AB, followed by Medartrum AB. If the term ‘market’ is broadened to cover the Nordic market as a whole, the biggest of the companies involved in parallel imports into Sweden is Sverige
Paranova Läkemedel AB, whose parent company is based in Copenhagen.

The eight parallel import companies recently established their own trade association – the Association of Parallel Importers of Pharmaceuticals – for the purpose of coordinating contacts, etc, primarily vis-à-vis the public authorities concerned with the pharmaceuticals market, in particular the Medical Products Agency and the National Social Insurance Board.

Altogether, the Medical Products Agency has 25 drugs registered in the parallel import category. Total turnover for these products amounted in the first six months of 1998 to SEK 500 million, calculated in the pharmacies’ sales prices. For 1998 as a whole, the sales volume to the final consumer is expected to be doubled, which would mean a total value of SEK 1,000 million. Of total sales during Jan-June 1997, the ulcer medicine Losec accounted for approximately 67%.

In relation to total pharmaceuticals sales to consumers and hospitals – at present about SEK 20,000 million a year – the market share for parallel imported pharmaceuticals would thus amount to about 5%. This market share is expected to decline in 1999, at least temporarily, as the Medical Products Agency, at the request of Astra, owners of the Losec trademark, has decided to deregister Losec for the Swedish market in the drug’s present form, i.e., as a capsule. Astra replaced the Losec capsule with a Losec granulate (tablet). At the same time, Astra reduced the price of the new formula by 10% compared with the price it charged for the original.

In a recent judgment15, however, the Uppsala County Court declared that a state of ‘substantive identity’ existed between the two forms of Losec. Further, the court felt that the Swedish rules should be interpreted in the light of developments in Community law in this particular field. With this in mind, the court declared that as nothing had emerged to suggest that the capsule form of Losec was a public health hazard, priority should be accorded the pro-integration aims of EU legislation emphasizing the removal of any barriers impeding a free exchange of goods. The court ruling established that there was nothing to prevent further parallel

15 Case No 2021-98 et al.
imports of Losec in capsule form. An appeal against the verdict has, however, been lodged by the Medical Products Agency.

Judging by an international survey that studied the practice of parallel importing pharmaceuticals from a European perspective, the market share of these parallel imports for Europe as a whole amounts to almost 2%. The study puts the accumulative effect on price levels at about 0.25%.

In contrast to other trade sectors affected by parallel imports, the price differences between different countries that are imperative to parallel trading in pharmaceuticals are often a result of disparities in state price controls and insurance systems. Another explanatory factor is that the research industry behind a company’s own patented drugs is constantly striving for higher prices on its own domestic market. This in turn stems from things like the fact that no country’s price control authority would normally allow higher prices for an imported drug – if it is to be part of the insurance system – than the original manufacturer obtains on his own domestic market. This more general pricing rule paves the way for that reimport of pharmaceuticals to the country of origin which also tends to come under the heading of parallel imports.

In order for a parallel imported drug to be incorporated into the existing insurance system, the price control authority, the National Social Insurance Board, requires that it be furnished with a price at least 10% below that of the original supplier. This pricing philosophy has been called into question, for instance in a pricing case involving the parallel imported drug Imigran Paranova. In that particular case, the National Social Insurance Board rejected an application for the drug to be sold at a price that undercut the price of the original drug by less than 10%. The case was appealed to the Government, which ruled that there was no legal basis for such a calculation when establishing the price of parallel imported pharmaceuticals. The 10% rule is currently being reviewed by the National Social Insurance Board.

As a result of the pricing rule on parallel imported pharmaceuticals, such imports directly affect the prices of the drugs involved in this kind of trading, assuming that the parallel import companies can maintain a continuous supply of goods and thereby maintain stocks at the pharmacies. Hitherto, there is nothing to suggest that it has not been possible to maintain a sufficient supply of goods.
Apart from the direct impact on prices noted above, there are instances of potential parallel imports having an indirect impact on prices. Faced with the prospect of competition from an incipient parallel import trade, some original suppliers of drugs have on occasion voluntarily chosen to cut prices by over 10%, which had the effect of eliminating the conditions necessary for parallel imports.

3.3.8 Golf equipment

Golf equipment is subject to both parallel and private imports. Total annual sales of golf equipment are estimated at approximately SEK 650 million, of which around SEK 50 million is believed to derive from parallel imports. Private imports are believed to account for roughly the same amount, which means that parallel and private imports together account for around 15% of the total market for golf equipment. The bulk of these imports originate from the US.

In price terms, parallel imported golf equipment initially undercut the original supplier's prices by about 30%. As a result of successive adjustments by the regular retail trade, general price levels for golf equipment have declined to such an extent that price differences today are considerably lower and may even have been wiped out altogether.

3.3.9 Snow scooters

Sales of snow scooters amount to some 8,000 units a year, of which about 60% are parallel imported. These imports are believed to be worth approximately SEK 60 million, taking into account the fact that parallel imported scooters are usually 10-20% cheaper than scooters reaching Sweden through regular sales channels.

Parallel imports in this sector come almost exclusively from the US and Canada, which together command some 97% of the world market for snow scooters. Thus these parallel imports would vanish completely were the Silhouette ruling to be strictly applied.
3.4 Negative effects connected with parallel imports

In the discussion on parallel imports, negative opinions are sometimes voiced with regard to this form of trading. Such opinions are both of a general nature and more specific in character, and in the latter case are usually associated with a particular product sector.

Without any claim to exhaustive analysis or classification of the opinions voiced, below is a list of negative effects of this kind that the authors have come across in the course of the present study.

Among the views of a more general nature are the following:

• Parallel imports are basically unethical, as they profit on established trademarks for the sake of personal gain. The existence of parallel imports erodes the trademarks' reputation for quality and successively reduces the trademark owner's interest in and opportunities for maintaining the mark's repute, for instance through marketing efforts. Thus parallel imports help erode capital value, in contrast to regular commerce, which creates added value.

• Parallel imports break down the transport systems that have been built up and which have often been created in such a way as to help improve the environment. Parallel imports entail the risk of greater environmental destruction through the emergence of new, parallel channels of supply.

Among the negative views of a more specific kind, associated with a particular product or line of goods, are the following:

• Parallel imported consignments of clothing in particular sometimes contain pure counterfeits as well, which distorts competition and devalues the trademark.

• Many of the parallel imported food products marketed in Sweden – primarily drinks – usually lack declarations of ingredients in Swedish or in easily-understood Scandinavian.
• Many tyres parallel imported into Sweden are designed for markets with warmer road surfaces, so their rubber compounds are harder than in tyres intended for the Swedish market. If the proper information is not available to them, consumers may buy tyres that constitute a direct traffic hazard when temperatures begin to fall.

• In the case of pharmaceuticals, it is often argued that parallel imports erode the rights that patents were created to protect. As a result, the basis for future research is eroded.

• According to statistics from the Medical Products Agency, the frequency of complaints and enforced withdrawals from the market is relatively higher for parallel imported pharmaceuticals than for others. This has to do with the fact that all parallel imported pharmaceuticals, although to different degrees, are subject to repackaging and relabelling.

• In the case of pharmaceuticals, the uncertainty that may arise in the mind of the consumer as a result of the inner bubble wrapping on certain products bearing a name (trademark) other than that on the outer label has also generated criticism. This is related to the fact that in the market from which it has been parallel imported, the drug in question has been sold under a different name than the one registered for it in the Swedish market.

• When motor vehicles, e.g. parallel imported motorcycles, are inspected for registration, the care and attention required to ensure that vehicles conform with Swedish standards in every detail are apparently not always present. This means that parallel imported vehicles, primarily from the US, may include components that are permitted in the country of origin but prohibited in Sweden.

• The adjustment and replacement of accessories and components necessary to adapt motor vehicles for the Swedish market may sometimes cause problems for the owners of parallel imported vehicles should they wish to claim their guarantee and service rights. They may then find that the guarantee ultimately covers 'a different product' to the one that has now been created. Usually, however, to preserve the trademark's reputation for quality, the original importer and his branded repair shops will carry out the necessary repairs and service work under the guarantee, even if the wait may be longer than it would have been had the vehicle reached the market via the original importer.
To ensure the long-term credibility of legally-imported parallel products on the market, the public authorities responsible must be strict in their regulatory duties, for instance by taking action against the parallel import of foodstuffs that lack the proper declaration of ingredients in Swedish or by calling attention to shortcomings in essential consumer information.
4. International experiences

Studies on the effects of the Silhouette ruling are currently under way in two parts of Europe: Denmark and Britain. In Denmark, an inter-ministerial working group is reviewing the matter on behalf of the Danish Government. In Britain, the question is being studied by a private research institute on behalf of the European Commission.

4.1 Denmark

The inter-ministerial working group was given its instructions in early April 1998 and is expected to deliver its report in mid-January 1999.

The background to the appointment of this working group was that the Erhvervministeriet (approx. Ministry of Trade & Commerce) discovered that it had no proper strategy or policy for dealing with parallel imports. It had arrived at this conclusion after being petitioned a number of times about the likely consequences of the case then before the European Court of Justice, later known as the Silhouette Case. Primarily, the working group's task is to analyse how the interests of Danish trademark owners will be affected if the Danish Government decides to support the principle of global exhaustion of trademark rights, an approach that it currently favours. In addition, a discussion is taking place among Danish clothing exporters – Denmark is a net exporter of clothes – about the effects of implementing the principle of global exhaustion as opposed to regional exhaustion. Well-known brand names of Danish origin include Vero Moda, Carli Gry, Matinique and Peak Performance.

Immediately after the Silhouette ruling, Danish consumer organizations came out strongly in favour of taking a positive view of parallel imports. Since then, however, the organizations' voices have gradually died away.

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16 This section is based on Hallman, appendices 1 and 2.
By means of interviews and direct mail enquiries to parallel import companies, the working group has so far reached the following conclusions:

No public statistics are available that may offer guidance as to the size and origin of parallel imports. The only exception is pharmaceuticals, which are subject to special registration procedures.

The product sectors in which parallel imports occur to any great extent are clothing, footwear, sports equipment, pharmaceuticals and cosmetics. In the case of pharmaceuticals, the market share for parallel imported products is about 10%, while the market share for parallel imported clothing is about 5%. Parallel imported pharmaceuticals have been reduced in price by at least 5%, while the price reductions for parallel imported clothing is usually about 30%.

The volume of parallel imports amounts to an estimated 0.5% of total private consumption. Further, it has become apparent that the extent of parallel imports is smaller than was initially expected and that factory outlets have been significantly less successful in Denmark than in Sweden. The Silhouette ruling has reportedly made an impact only in isolated instances, e.g. a price increase of about 50% on Levi’s jeans.

4.2 The EU

A research institute, NERA – National Economics Research Associates – has been appointed by the European Commission to review the economic consequences, etc, of broadening the exhaustion concept with regard to trademark rights. Besides studying the effects on pricing and competition, it will seek to describe and analyse how global exhaustion of trademark rights might reflect on other rights, such as patent rights, copyright and the protection of pattern and design rights.

After some initial studies and discussion of the research methods to be used, NERA has decided to make a closer study of some 10 product sectors, including CD records and books, video cassette recorders and other products in the field of 'consumer electronics', motor vehicles, domestic appliances, alcohol and soft drinks, confectionery, clothing and footwear, leather goods and cosmetics.
In addition, based on NERA’s previous knowledge and experience, a special analysis of the pharmaceuticals market will be provided. NERA collaborates with a firm of market survey specialists through which data for the study will be gathered by telephone from selected companies on the basis of questions in a special questionnaire. In the case of pharmaceuticals, as indicated above, different methods have been used for gathering the information needed for the final report.

Frequency of response to the telephone interviews has been comparatively low and the quality of the answers received has varied. On the basis of this information, NERA concluded that parallel trading was less extensive than it had expected. In its final report, NERA will also discuss the impact of parallel imports on the value of established trademarks as well as on trademark owners' willingness to endorse their brands in the future, for instance through advertising. Also, NERA will discuss exchange rate differences and their effects on pricing. The final report is due for delivery in March 1999.
5. Effects for the Swedish market of a switch to regional exhaustion

5.1 Gainers and losers

There are four players who will be either gainers or losers in the event of a switch to regional exhaustion: the parallel importers, the consumers, existing brand outlets/their agents and the state. The effects will be both direct and indirect. It is also possible that the various players involved may be affected in a particular way in the initial stages but that after a certain period the result may be completely different, i.e., various types of dynamic effects.

The present study focuses on the effects that in theory result directly from a ban on parallel imports. A basic assumption for assessment of the macroeconomic effects is that the existing trade in parallel imports – worth approximately SEK 5,500 million – ceases once a ban comes into force.

The effects on the parallel import market are described in diagram 1 below.

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17 This section is based largely on Hallman, chapters 6 and 9, and HUI, chapter 3.
Diagram 1: The parallel import market before and after a switch to regional exhaustion

Prior to the ban, the market for parallel imports showed a balance at price level $p_1$ and quantity $q_1$. When the ban is introduced, parallel imported goods are no longer supplied and the new supply curve moves inwards to $s_2$. This new supply curve, $s_2$, is identical to the supply curve of the existing brand outlets. For the parallel import market, the result is that prices rise to $p_2$. At this price level the quantity of parallel imported goods in demand is $q_2$ – in other words, nought. The market for parallel imports is then no more.
The parallel import sector's sales then pass to the existing brand outlets and to other purchasing channels (primarily the Internet). This shift is shown in diagrams 2 and 3 below.

*Diagram 2: The Internet market before and after a switch to regional exhaustion*

Prior to the ban on parallel imports, quantity $q_1$ is sold at a specific price $p_1$ on the Internet market. Once parallel imports are banned, demand increases on the Internet and the demand curve moves outwards to $e_2$. The Internet market will thus sell quantity $q_2$ at a price $p_1$ after the ban on parallel imports. The straight line denoting the supply curve ($s$) is explained by the fact that the Internet market is a global market.
After the ban on parallel imports, demand at brand outlets will increase – the demand curve moves outwards from $e_1$ to $e_2$. This causes the brand outlets' turnover to increase to $q_2$ while at the same time price levels climb to $p_2$.

The macroeconomic effects of a ban on parallel imports are described below in the form of a calculation based on figures for the parallel import share of total trade, the price relations detailed above and the known connections between trade turnover and tax payments and employment. The most unreliable part of the calculation, however, concerns what share of the parallel imports will pass to the Internet and to the brand outlets respectively. An assumption in this respect is shown in table 1 below. The cautious assumption made here is that less than half of the parallel imports will be replaced by purchases on the Internet.
Table 1: Sales over the Internet, parallel import trading and other retail channels before and after a switch to regional exhaustion, in SEK 1,000 mln

<table>
<thead>
<tr>
<th>With parallel imports</th>
<th>Without parallel imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet</td>
<td>Parallel imports</td>
</tr>
<tr>
<td>1.0</td>
<td>5.5</td>
</tr>
</tbody>
</table>

Source: HUI

Prior to the Silhouette ruling, Internet trading to and from Sweden was estimated to be worth about SEK 1,000 million, parallel imports from a third country approximately SEK 5,500 million and other kinds of retail trading SEK 282,000 million. After the ruling, sales from parallel import trading are expected to pass to both the Internet and other retail trading. Internet trade is expected to receive an extra injection of SEK 2,500 million and other retailing SEK 3,000 million.

The net effects for the players involved are described below. An estimate of the short-term effects for employment, taxes, etc, is also provided. In the longer term, a number of other adjustments will be required, and these will be discussed later in the report.

**Parallel importers** are assumed to lose SEK 2,500 million to Internet trade and SEK 3,000 million to existing businesses, i.e. SEK 5,500 million in all. In terms of the numbers of employees, this would constitute approximately 5,500 persons, as sales per employee in the Swedish retail trade are estimated at about SEK 1 million.18

**Other trade** is expected to get an additional contribution of approximately SEK 3,000 million, which in terms of the number of employees constitutes about 3,000 persons. The increase in business also leads to a growth in profit of about SEK 100 million before tax. Average profits before tax amount to approximately 3% of sales, which is the basis for the above profit growth estimate.

**Consumers**, in the event of a switch to regional exhaustion, lose the possibility of buying branded goods at lower prices. The extent

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18 The source for the estimate of sales per employee is Statistics Sweden, SCB.
of such losses is, however, extremely difficult to gauge. An attempt to estimate the price effects for the consumer is described in Section 5.2 below. It is unquestionably the case, however, that a loss is involved.

The state loses tax revenue. Sales via Internet trading are estimated to increase by SEK 2,500 million. For the most part, value-added tax on these sales will be withheld from the state. This of course presupposes that customers will behave in an unlawful manner. But in practice it may prove extremely difficult for the state to monitor and actually recover these VAT payments.\(^{19}\) The loss in VAT is expected to total around SEK 500 million. The number of employees is estimated to show a net loss of 2,500 persons. This would lead to a loss of income tax revenue of approximately SEK 130 million, as the number of unemployed would increase by 2,500 persons. Unemployment benefit costs would increase by SEK 350 million. Adjusted to take into account income tax from unemployment benefits, total income tax revenue would be reduced by about SEK 20 million net. The state would also miss out on company tax of SEK 75 million net and employer’s contributions totalling approximately SEK 150 million. In all, the state’s costs would thus increase by about SEK 350 million at the same time as income would decline by about SEK 750 million. In addition, the number of jobless persons would increase by about 2,500. The effects are summarized in table 2 below:

\[\text{Table 2: Macroeconomic effects of a switch to regional exhaustion}\]

| **Brand outlets** | Increased sales of SEK 3,000 million |
| **Parallel imports** | Reduced sales of SEK 2,500 million |
| **Consumers** | Higher prices |
| **The state** | |
| - Loss in jobs | 2,500 |
| - Loss in VAT | SEK 500 million |
| - Loss in income tax | SEK 20 million |
| - Loss in company tax | SEK 75 million |

\(^{19}\) In the case of things like computer programs and music that can be delivered over the Internet, it is totally impossible to recover VAT. In the case of parcels, suppliers can be expected to adjust to any attempts to monitor this traffic more closely. Already, for instance, suppliers commonly divide consignments into several parcels of smaller value not requiring customs declarations.
- Loss in employer’s contributions SEK 150 million
- Total loss in taxes, etc SEK 750 million
- Increase in unemployment costs SEK 350 million

Source: HUI

Thus a ban on parallel imports would mean a definite macroeconomic loss.

In the longer run, however, the effects may be rather different. One important aspect is that reductions in employment levels are believed to lead to adjustments or ‘balancing effects’. A decline in employment should in principle create pressure on wages, which would mean that more people could be employed. In time, then, the effect on employment is unlikely to be as great as stated previously, but on the other hand wage levels would be depressed to some degree.

5.2 Price effects if parallel imports into Sweden are reduced

Although not always, parallel imports usually involve low prices, as can be seen from the above. This of course also means that parallel imports exert pressure on prices in the trade sectors or the market segments in which the imports occur, which affects the general price level as well.

Based on calculations of market shares for parallel imported products and of the size of price reductions, the following estimate can be made of the direct impact of parallel imports on the price level within each trade sector as well as on the general price level.20

For those sectors in which parallel imports are fairly widespread, e.g., the trade in motorcar components and spare parts, the trade in clothing and footwear and the trade in pharmaceuticals, the direct effect on prices in each respective sector ranges from 0.5% (pharmaceuticals) to 4-5% (motorcar parts). For clothing and

20 See Hallman, Sub-Annexe 5.
footwear, the direct effect on price levels is estimated at 3% and 1.5% respectively.

Adjusted to the general price level, the estimated direct effect of parallel imports as a whole is about 0.2%, chiefly attributable to clothing and footwear, which account for a relatively large share of private consumption. Described above are the more direct, static effects that the existing parallel imports have on prices. In addition, there are dynamic effects associated with the potential competitive pressure to which parallel imports give rise. This kind of competitive pressure reduces the risk of cartelization and other restrictive trade practices that work to the detriment of the consumer. Bearing in mind the price-sensitivity found in a number of the trade sectors in which parallel imports are widespread, it seems reasonable to assume that the indirect effect on prices of parallel trading could be on the same scale as the direct effect, i.e. around 0.2%.

There is every indication therefore that a switch to regional exhaustion, all other things being equal, would have negative effects on competition and prices. One way of avoiding this would be for companies parallel importing clothing and footwear to obtain branded products from trademark owners in the EEA zone instead. In theory, these could be imported from an EEA country to the same extent and at the same prices as at present. As trade in these types of goods is distinctly brand-linked, however, opening up new sources of supply would necessitate effecting changes in consumer preferences and a switch to new brands. Another possibility would be for present parallel imports to be replaced by other forms of price-squeezing imports (see also Section 5, Internet commerce).

5.3 Effects for parallel importers

The total value of parallel imports into Sweden is almost SEK 9,000 million, in terms of end sales to the consumer. Of this, just over 60% involves parallel imported products originating from a non-EEA country, primarily from the US and countries in Asia, including China. The product sectors in which parallel imports from a third country primarily occur are clothing and footwear, motorcar components/spare parts, motorcycles and snow scooters.
A considerable share of the parallel imports currently arriving on the Swedish market would be eliminated if the Silhouette ruling were to be applied in full. The chances of parallel import companies being able to fully replace the eliminated branded goods with new sources of supply are slight, which means the loss of access would be largely permanent for parallel import companies and consumers alike.

One tendency that can be discerned in the case of parallel import companies, including factory outlets, is that they have begun to seek out new channels and business contacts for their trading. Thus there is an increase, albeit only a modest one as yet, in the parallel import of products from trademark owners based in the EEA zone, such as clothing from Italy. Other indications of some change in direction include the development and marketing of the companies’ own brands, e.g. the Stenmark brand in the HK Factory Outlet chain, and the sales on consignment of products of this kind that may lack representation on the Swedish market through general agents or the equivalent.

The parallel imports occurring today in the pharmaceutical field are not affected by the Silhouette ruling, as trade in this sector has hitherto been confined to the EEA zone. The Silhouette ruling does mean, however, that parallel importers will be unable to extend their network to find suppliers in two such major pharmaceutical countries as Japan and the US. In the shorter term, it seems unlikely that this will affect parallel trading in pharmaceuticals to Sweden as both Japan and the US are generally to be regarded as high-price markets. This does not mean, though, that the occasional product on the American or Japanese market might not be of interest to parallel importers.

Parallel imports of pharmaceuticals to the Swedish market may decline in 1999 unless the county court ruling is upheld and parallel imports of Losec in capsule form are eliminated as a result. This would not, however, be an effect of the Silhouette ruling but of the rules concerning the registration and parallel import of pharmaceuticals. Gradually, however, this drop would probably be offset by the parallel import of other pharmaceuticals, as the registration rate for new parallel imported drugs at the Medical Products Agency is currently quite high. In addition to a greater range of parallel imported drugs, there is the prospect of several of the importers presently active in the pharmaceuticals market broadening their range to encompass generic drugs as well.
The long-term planning that characterizes companies working actively with parallel imports in the various sectors suggests that the effects of the Silhouette ruling on employment described earlier may not primarily afflict the parallel import companies concerned. The companies involved in parallel trading tend to be rich in entrepreneurial spirit and usually come up with a solution to any problems that may arise by developing new ideas and changing their business approach.

5.4 Effects if Silhouette ruling is not taken into consideration

The present study has also considered what the impact on the Swedish market would be if parallel imports were not limited in any way, both as regards product sectors in which such imports occur today and sectors where they are not yet to be found. In this context, it is also worth discussing other circumstances that may affect the continuation of parallel imports from third countries. The idea is not a detailed analysis but rather a rough inventory of various factors that—whether or not the Silhouette ruling is taken into account—impose certain constraints on parallel import trading.

- The global economy is currently experiencing a high degree of concentration at every level of processing—and in virtually all geographical markets—which means that the number of manufacturers and buyers is declining. This has resulted in an increase in direct contacts and direct business transactions between buyers and sellers, from which follows that the number of intermediaries, and thereby the risk of product leakage, is also declining.

- The same kind of concentration is resulting from the gradual changeover taking place in warehousing and logistics, where the trend is toward fewer storage points. In some cases, this involves confining stock to a single central warehouse for the entire European region. In the logistics field, the trend is towards only exploiting intermediaries for transportation purposes, etc.

- Trademark owners are no longer using general agents to represent them in various geographical markets but instead are establishing their own subsidiaries to hold the trademark rights. In this way, a trademark owner is able to keep a closer eye on his flow of goods.
Other circumstances of a more general nature, i.e. irrespective of whether the parallel imports come from a country in the EEA zone or not, include the following:

- National pricing rules, which require a set minimum reduction in the price of parallel imported products if these are to be marketed within the framework of existing insurance rules. In Sweden, for instance, in accordance with a practice established by the National Social Insurance Board, parallel imported pharmaceuticals must be assigned a price at least 10% below that of the trademark owner or his general agent. As has been noted, this practice is being reviewed by the Ministry for Social Affairs and the National Social Insurance Board.

- National regulations on the labelling of foodstuffs. Under the rules that apply in Sweden, all labelling must be in Swedish or in the kind of Scandinavian that Swedes can understand.

In the EU, the existing rules are constantly being developed with the aim of improving conditions for the proper working of the Single Market. These rules, which seek to promote the standardization of products and economic transparency in the Single Market, may at the same time have the effect of making trade from third countries more difficult, for instance in the case of parallel imports. Such rules include things like:

- Regulations for standardizing the designs of cars and motorcycles. As has already been noted, for instance, representatives of the motorcycle trade expect to see a decline in parallel imports, irrespective of the Silhouette ruling, owing to the fact that over the next six months Sweden is due to implement the rules regarding standards, etc., for motorcycles. This is expected to lead to greater care being taken over registration testing of parallel imported motorcycles, which in turn is expected to lead to higher costs for parallel importers obliged to adapt the motorcycles to comply with European standards.

Opinion is divided as to whether the common currency – the euro – will affect parallel import conditions from 1 January 1999 when it is introduced. Only time will tell whether the euro will create a uniform price level for various products throughout Europe — thus eliminating the conditions necessary for parallel imports – or whether pricing in euros will be accompanied by national discount systems or the like, which would mean parallel imports and private
imports continuing to have a future. Representatives of the Internet trade are convinced that uniform pricing in euros — and the simplification of trade this will engender — will as early as 1999 lead to a strong increase in Internet trading. The Internet issue is discussed in the next section.

5.5 Internet trading

Today there is plenty of scope for private individuals to buy branded goods over the Internet. Such opportunities are likely to increase rather than lessen in the years to come. It also seems likely that future consumers will be considerably more accustomed to making their purchases over the Internet than present-day consumers. This is primarily because present-day consumers – i.e., modern youth – are more familiar with computers than their parents. As a result, they seem more likely than older generations to use computers as aids in making purchases. Taken as a whole, this means that Internet trading is likely to be more intensive in the future.

The Internet is full of search channels of different kinds and you can use any of them to look for websites that sell the products you are interested in. If you key in the name of a branded product you wish to buy, a number of websites will appear offering you the possibility of buying the product you sought. Websites provide information about what sizes are available, the cost of the article, the delivery charges and which methods of payment are accepted. Whatever the site, payment by credit card is the most common method. In general, websites are markedly user-friendly and the prices of the articles tend to be considerably lower than in Sweden. The availability of Internet purchasing facilities means that the world has shrunk in the sense that it is just as easy to make purchases from a computer in Sweden as it is to make the same purchases from a computer in, say, the US. In this way, a substantially larger market is opened up for Swedish consumers, which almost certainly means that private imports will increase sharply as most of the goods sold over the Internet cost notably less than the corresponding goods sold through normal retail channels in Sweden. In principle, then, consumers will still be able to buy their branded products at lower prices. The difference is that Internet trading involves the consumer buying directly over the Internet, i.e., importing privately, instead of making purchases via a parallel importer.
There are already a large number of players on the Internet selling branded goods at substantially lower prices than is the case on the regular Swedish market. For instance it is a simple matter to buy a pair of branded jeans over the Internet and have them delivered to your home for about SEK 400 – compared with approximately 650-700 in a brand outlet.

The situation is the same for a large number of branded goods in the clothing, footwear and sports equipment sectors in particular. In the near future, an even greater number of players offering this type of Internet service can be expected. As a result, consumer access will be even greater. Table 2 gives examples of Internet price levels compared with prices in brand outlets and the prices of the equivalent parallel imported products.

Table 2 Price comparisons between Internet trading, traditional retail trading and parallel imports, SEK

<table>
<thead>
<tr>
<th></th>
<th>Internet</th>
<th>Brand outlet</th>
<th>Parallel imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branded jeans</td>
<td>400</td>
<td>600-700</td>
<td>450-500</td>
</tr>
<tr>
<td>Branded shoes</td>
<td>400</td>
<td>600</td>
<td>400-450</td>
</tr>
<tr>
<td>Branded jackets</td>
<td>1,780</td>
<td>3,500</td>
<td>2,500</td>
</tr>
</tbody>
</table>

1: Incl. freight, excl. VAT
Source: HUI

These price relations are typical for many kinds of goods. In all three cases, Internet prices are considerably lower – in one case half the price – compared with direct purchasing in a brand outlet. This also applies to other kinds of goods not shown in the table. Price differences in themselves offer a powerful incentive for consumers to do their buying over the Internet.

At the present time, uncertainty about payments over the Internet is an inhibiting factor in the development of Internet trading. As long as consumers remain concerned that security may not be absolute, they will in all probability remain fairly restrictive in their purchasing over the Internet. The most likely development, however, is that secure payment methods will be introduced in the near future. This would remove one of the main factors inhibiting
Internet trade. Other disadvantages of Internet trading, compared with purchasing from traditional outlets, include problems with quality and service, the difficulty of trying out/on the product, delivery problems, etc, all of which may be viewed unfavourably by the consumers.

In summary, a possible long-term effect of the ban on parallel imports could be either that Internet trade grows explosively or that exponential growth in this kind of trading occurs earlier, a development predicted by many. If this is a correct description of the dynamic process, a switch to regional exhaustion would paradoxically enough entail consumer gains in the longer term – above all in the form of lower prices but also in the form of a wider range of available goods and a more efficient purchasing pattern, as articles purchased over the Internet are often delivered to the customer's door. This saves consumers a certain amount of time. The state, however, would still lose.

Existing brand outlets and general agents for branded goods on the other hand will probably be affected negatively in the slightly longer term. This is based on the assumption that consumers in the near future will make a large proportion of their purchases over the Internet. A cautious assessment is that Internet trading in branded goods may very well exceed the sales of approximately SEK 5,500 million that parallel imports from third countries have been responsible for. If this proves to be the case, it will reduce turnover at existing brand outlets. Price equalization between the various markets is a likely consequence in the longer term. For Sweden's part this means that prices in brand shops on the whole can be expected to fall.
6 Overall assessment

The Government commissioned the Swedish Competition Authority to identify and analyse the consequences for the Swedish market, Swedish consumers and producers of a move to applying the principle of regional exhaustion in the field of trademarks. In the Government's instructions a number of issues related to these consequences are defined.

Extending trademark protection in Sweden is a consequence of the European Court's ruling in what is known as the Silhouette Case. The practice directly affected by this is the parallel import of branded goods, i.e., imports taking place outside normal distribution channels such as through general agents with the right to the trademark on the Swedish market.

As a basis for its analysis, the Swedish Competition Authority has had two consultancy studies carried out which from different starting points have identified the theoretical, actual and potential consequences. The overall assessments presented below are based not only on the results of these studies but also on information which the Authority has acquired by other means.

**What is the extent and orientation of parallel import trading in different product sectors?**

The value of total annual sales of parallel imported products is estimated at approximately SEK 9,000 million. This corresponds to around 1% of total private consumption. Of this, slightly more than 60% - around SEK 5,300 million, or 0.6% of private consumption - has its real origin in countries outside the EEA zone. Thus 40% of all parallel imports originate from within the EEA zone and are consequently not affected by the Silhouette ruling.

The sectors judged to have significant parallel imports of branded goods are clothing (SEK 4,000 million), components and spare parts for cars (SEK 3,000 million) and footwear (SEK 400 million). Parallel imports of some magnitude, but not exceeding SEK 100 million, occur in such sectors as foodstuffs, snow scooters, golf equipment, tyres and motor cycles.
Calculated as a proportion of sales on the Swedish market, parallel imports are particularly important in the area of spare parts for cars, where the market share is estimated at around 20%. In a number of the other areas investigated, the proportion of parallel imports is estimated at 5-10% while the market share for tyres is around 2%. In the foodstuffs sector, however, the market share of parallel imports is significantly lower and is estimated at less than 0.1%.

What would be the impact of a change in the application of the law on prices and competition in the sectors concerned?

Price reductions in relation to normal prices are estimated at around 10-30% in those industries where parallel imports are of major importance. In clothes retailing, however, there are price reductions on parallel imported goods of up to 50-70%. Should a change in legal practice lead to the elimination of parallel imports and their substitution by sales at regular prices, a direct price effect would result, the extent of which would depend on the difference between the prices of parallel imported goods and regular prices as well as on the proportion of parallel goods with respect to total sales in the sectors concerned. It is estimated that the greatest effect on prices of an elimination of parallel imports would occur in the case of motorcar components and spare parts, namely 4-5%. As regards clothing, for example, the estimated price effect would be 3% and for footwear 1.5%.

The impact on the general price level is also affected by the proportion of total private consumption accounted for by the product sector in question. An overall assessment of the direct price effects on different product sectors shows that the elimination of parallel imports would in the short term raise the general price level by 0.2%.

Elimination of parallel imports would, however, also have more indirect and long-term effects on the state of competition in the industries concerned. The existence of low-price imports, and an awareness that such imports can be stimulated by high prices on the Swedish markets, puts pressure on prices of normal sales through established retail channels. It is, of course, difficult to identify the magnitude of the indirect price effect of actual and potential parallel imports with any degree of precision. A reasonable estimate is that the effect could be on the same scale as the effects mentioned above. In total, then, the estimated price
effect of an elimination of parallel imports would be around 0.4% of the general price level.

**What would be the effect on the Swedish market of assuming no limitation on parallel imports?**

In principle, parallel imports imply a type of geographical price equalization between low-price areas and high-price areas. Theoretically, it can be demonstrated that the redistribution of goods occurring as a result of parallel imports leads to economic welfare gains, i.e. an increase in overall production, at least in the high price areas receiving the goods. Parallel imports can thus be assumed to increase consumer benefits in the EU and to an even greater extent in Sweden.

However, a more detailed analysis of the effects of parallel imports shows that different players may be affected in different ways. Consumers, parallel importers, established dealers in branded goods and the state can all to varying degrees be gainers or losers if parallel imports are continued or eliminated. In order to illustrate the impact of parallel imports, an estimate has been made of some of the effects on these four groups comparing a situation without parallel imports to the present situation.

If parallel imports on the Swedish market were eliminated, the effects would be as follows:

**Consumers** would be affected by price increases which in total are estimated as being equivalent to a single inflationary injection of 0.4%, but in some product sectors the increase would not be insignificant.

**Parallel importers** would lose sales of SEK 5,500 million (of which 55% is assumed to pass to normal retailing channels and 45% to Internet trading), which corresponds to a reduction in employment of around 5,500 persons.

**Established retailing** would increase sales by SEK 3,000 million, which could lead to an increase in employment of around 3,000 persons and an increase in profits of around SEK 100 million.

**State tax revenues** would be reduced by SEK 750 million and there would be an increase in unemployment benefits of SEK 350 million as a result of a net increase in unemployment of around 2,500 persons.
What might be the long-term effects of an elimination of parallel imports compared to an extension of parallel imports into other product sectors where they have not yet occurred?

The effects presented so far are based on a static perspective which ignores possible counter measures arising as a consequence of a change in the current legal situation. One possibility, however, which cannot be completely discounted is that parallel imports continue more or less as in the past despite the Silhouette ruling. Another possibility is that low-price goods enter the Swedish market through routes other than via present parallel import channels. One possible development which should be given particular attention is a rapid increase in private imports, mainly through trading over the Internet.

It is impossible to predict future development in the longer perspective with any great degree of certainty, since this is largely dependent on factors such as what initiatives are taken by individual businesses, innovations in the distribution field, technical development and consumer preferences. This uncertainty applies not only to the hypothetical development of parallel imports if the principle of the global exhaustion of trademarks were to remain in place, but also to actual developments under the present circumstances.

One scenario which should not be entirely disregarded is that a noticeable reduction in parallel imports actually takes place and that this in turn provides the incentive at an early stage for a more rapid increase in private imports than would otherwise have been the case. The assessment presented above on gainers and losers would be changed in such a scenario with the result that consumers would be the gainers, mainly as a consequence of lower prices and access to a greater range of products. On the other hand the effects on the established trade in branded goods and on state tax revenues and unemployment benefits would remain negative.

What international studies exist and what experiences have been gained?

From an international perspective, this report from the Swedish Competition Authority is the first overall review to be made public of the effects of the Silhouette ruling on parallel imports. Two similar studies are at present under way. In Denmark,
the government has given an inter-ministerial working group the task of investigating amongst other things how a switch to global exhaustion of trademarks within the EU would affect the interests of owners of Danish trademarks. The group is expected to present its report in January 1999. In addition, the European Commission has assigned the research institute, NERA - National Economics Research Associates - to investigate the economic consequences, etc, of an expansion of the exhaustion concept in relation to trademarks. A final report is due in March 1999.

Other observations

In both research and the public debate a number of arguments are put forward against parallel imports. Some of these concern the risks involved in inefficient use of resources, whilst others deal with the fact that the benefits arising from protection of intellectual property rights would not be fully realized. The examination of such objections contained in the present report, however, does not suggest that they are sufficient to overturn the main findings of the investigation, namely that parallel imports do in fact lead to increased consumer benefits in Sweden.
Annexe 1

The Silhouette Ruling
JUDGMENT OF THE COURT

16 July 1998 (1)

(Directive 89/104/EEC — Exhaustion of trade mark — Goods put on the market in the Community or in a non-member country)

In Case C-355/96,

REFERENCE to the Court under Article 177 of the EC Treaty by the Oberster Gerichtshof (Austria) for a preliminary ruling in the proceedings pending before that court between

Silhouette International Schmied GmbH & Co. KG

and

Hartlauer Handelsgesellschaft mbH,


THE COURT,


Advocate General: F.G. Jacobs,
Registrar: H. von Holstein, Deputy Registrar,

after considering the written observations submitted on behalf of:

— Silhouette International Schmied GmbH & Co. KG, by Klaus Haslinger, Rechtsanwalt, Linz,

— Hartlauer Handelsgesellschaft mbH, by Walter Müller, Rechtsanwalt, Linz,
— the Austrian Government, by Wolf Okresek, Ministerialrat in the Chancellor's Office, acting as Agent,
— the German Government, by Alfred Dittrich, Regierungsdirektor in the Federal Ministry of Justice, and Bernd Kloke, Oberregierungsrat in the Federal Ministry of Economic Affairs, acting as Agents,
— the French Government, by Catherine de Salins, Head of Subdirektorat in the Legal Affairs Directorate of the Ministry of Foreign Affairs, and Philippe Martinet, Secretary in the same Directorate, acting as Agents,
— the Italian Government, by Umberto Leanza, Head of the Legal Service in the Ministry of Foreign Affairs, acting as Agent, and Oscar Fiumara, Avvocato dello Stato,
— the Swedish Government, by Erik Brattgård, Departementsråd in the Foreign Trade Department of the Ministry of Foreign Affairs, Tomas Norström, Kansliråd in the same Ministry, and Inge Simfors, Hovrättsassessor in the same Ministry, acting as Agents,
— the United Kingdom Government, by Lindsey Nicoll, of the Treasury Solicitor's Department, acting as Agent, and by Michael Silverleaf, Barrister,
— the Commission of the European Communities, by Jürgen Grunwald, Legal Adviser, and Berend Jan Drijber, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Silhouette International Schmied GmbH & Co. KG, represented by Klaus Haslinger, of Hartlauer Handelsgesellschaft mbH,

represented by Walter Müller, of the Italian Government, represented by Oscar Fiumara, and of the Commission represented by Jürgen Grunwald, at the hearing on 14 October 1997,

after hearing the Opinion of the Advocate General at the sitting on 29 January 1998,
gives the following

Judgment


2. Those questions were raised in proceedings between two Austrian companies, Silhouette International Schmied GmbH & Co. KG ('Silhouette') and Hartlauer Handelsgesellschaft mbH ('Hartlauer').

3. Article 7 of the Directive, concerning exhaustion of the rights conferred by a trade mark, provides:

   "(1) The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.

   (2) Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialisation of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market."

4. In accordance with Article 65(2), in conjunction with Annex XVII, point 4, of the EEA Agreement, Article 7(1) has been amended for the purposes of the Agreement so that the expression 'in the Community' has been replaced by 'in a Contracting Party'.

5. Article 7 of the Directive was transposed into Austrian law by Paragraph 10a of the Markenschutzgesetz (Law on the Protection of Trade Marks), the first subparagraph of which provides:

   "The right conferred by the trade mark shall not entitle the proprietor to prohibit a third party from using it in relation to
goods which have been put on the market in the European Economic Area under that trade mark by the proprietor or with his consent."

6. Silhouette produces spectacles in the higher price ranges. It markets them worldwide under the trade mark 'Silhouette', registered in Austria and most countries of the world. In Austria, Silhouette itself supplies spectacles to opticians; in other States it has subsidiary companies or distributors.

7. Hartlauer sells inter alia spectacles through its numerous subsidiaries in Austria, and its low prices are its chief selling point. It is not supplied by Silhouette because that company considers that distribution of its products by Hartlauer would be harmful to its image as a manufacturer of top-quality fashion spectacles.

8. In October 1995 Silhouette sold 21,000 out-of-fashion spectacle frames to a Bulgarian company, Union Trading, for the sum of USD 261 450. It had directed its representative to instruct the purchasers to sell the spectacle frames in Bulgaria or the states of the former USSR only, and not to export them to other countries. The representative assured Silhouette that it had so instructed the purchaser. However, the Oberster Gerichtshof noted that it had not proved possible to ascertain whether that had actually been done.

9. In November 1995 Silhouette delivered the frames in question to Union Trading in Sofia. Hartlauer bought those goods — it has not, according to the Oberster Gerichtshof, been possible to find out from whom — and offered them for sale in Austria from December 1995. In a press campaign Hartlauer announced that, despite not being supplied by Silhouette, it had managed to acquire 21,000 Silhouette frames abroad.

10. Silhouette brought an action for interim relief before the Landesgericht Steyr, seeking an injunction restraining Hartlauer from offering spectacles or spectacle frames for sale in Austria under its trade mark, where they had not been put on the market in the European Economic Area ('EEA') by Silhouette itself or by third parties with its consent. It claims that it has not exhausted its trade mark rights, since, in terms of the Directive, trade-mark rights are exhausted only when the products have been put on the market in the EEA by the proprietor or with his consent. It based its claim on Paragraph 10a of the Markenschutzgesetz and on
Paragraphs 1 and 9 of the Gesetz gegen den Unlauteren Wettbewerb (Law against Unfair Competition) and Paragraph 43 of the Allgemeines Bürgerliches Gesetzbuch (General Civil Code, 'the ABGB').

11. Hartlauer contended that the action should be dismissed since Silhouette had not sold the frames subject to any prohibition of reimportation into the Community. In its view Paragraph 43 of the ABGB was not applicable. Moreover, it observed that the Markenschutzgesetz does not grant a right to seek prohibitory injunctions and that, given that the legal position was unclear, its conduct was not contrary to established customs.

12. Silhouette's action was dismissed by the Landesgericht Steyr and, on appeal, by the Oberlandesgericht Linz. Silhouette appealed to the Oberster Gerichtshof on a point of law.

13. The Gerichtshof noted, first, that the case before it concerned the reimportation of goods originally produced by the proprietor of the trade mark and put on the market by the proprietor in a non-member country. It went on to point out that before Paragraph 10a of the Markenschutzgesetz entered into force Austrian courts applied the principle of international exhaustion of the right conferred by a trade mark (the principle that the proprietor's rights are exhausted once the trademarked product has been put on the market, no matter where that takes place). Finally, the Oberster Gerichtshof stated that the explanatory memorandum to the Austrian law implementing Article 7 of the Directive indicated that it was intended to leave the resolution of the question of the validity of the principle of international exhaustion to judicial decision.

14. Accordingly, the Oberster Gerichtshof decided to stay proceedings and refer the following questions to the Court for a preliminary ruling:

"(1) Is Article 7(1) of the First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks (OJ 1989 L 40, p. 1) to be interpreted as meaning that the trade mark entitles its proprietor to prohibit a third party from using the mark for goods which have been put on the market under that mark in a State which is not a Contracting State? (2) May the proprietor of the trade mark on the basis of Article 7(1) of the Trade Marks Directive alone seek an order that the third party cease using the trade mark for goods
which have been put on the market under that mark in a State which is not a Contracting State?"

Question 1

15. By its first question the Oberster Gerichtshof is in substance asking whether national rules providing for exhaustion of trade-mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with his consent are contrary to Article 7(1) of the Directive.

16. It is to be noted at the outset that Article 5 of the Directive defines the 'rights conferred by a trade mark' and Article 7 contains the rule concerning 'exhaustion of the rights conferred by a trade mark'.

17. According to Article 5(1) of the Directive, the registered trade mark confers on the proprietor exclusive rights therein. In addition, Article 5(1)(a) provides that those exclusive rights entitle the proprietor to prevent all third parties not having his consent from use in the course of trade of, inter alia, any sign identical with the trade mark in relation to goods or services which are identical to those for which the trade mark is registered. Article 5(3) sets out a non-exhaustive list of the kinds of practice which the proprietor is entitled to prohibit under paragraph 1, including, in particular, importing or exporting goods under the trade mark concerned.

18. Like the rules laid down in Article 6 of the Directive, which set certain limits to the effects of a trade mark, Article 7 states that, in the circumstances which it specifies, the exclusive rights conferred by the trade mark are exhausted, with the result that the proprietor is no longer entitled to prohibit use of the mark. Exhaustion is subject first of all to the condition that the goods have been put on the market by the proprietor or with his consent. According to the text of the Directive itself, exhaustion occurs only where the products have been put on the market in the Community (in the EEA since the EEA Agreement entered into force).

19. No argument has been presented to the Court that the Directive could be interpreted as providing for the exhaustion of the rights conferred by a trade mark in respect of goods put on the market by the proprietor or with his consent irrespective of where they were put on the market.
20. On the contrary, Hartlauer and the Swedish Government have maintained that the Directive left the Member States free to provide in their national law for exhaustion, not only in respect of products put on the market in the EEA but also of those put on the market in non-member countries.

21. The interpretation of the Directive proposed by Hartlauer and the Swedish Government assumes, having regard to the wording of Article 7, that the Directive, like the Court's case-law concerning Articles 30 and 36 of the EC Treaty, is limited to requiring the Member States to provide for exhaustion within the Community, but that Article 7 does not comprehensively resolve the question of exhaustion of rights conferred by the trade mark, thus leaving it open to the Member States to adopt rules on exhaustion going further than those explicitly laid down in Article 7 of the Directive.

22. As Silhouette, the Austrian, French, German, Italian and United Kingdom Governments and the Commission have all argued, such an interpretation is contrary to the wording of Article 7 and to the scheme and purpose of the rules of the Directive concerning the rights which a trade mark confers on its proprietor.

23. In that respect, although the third recital in the preamble to the Directive states that 'it does not appear to be necessary at present to undertake full-scale approximation of the trade mark laws of the Member States', the Directive none the less provides for harmonization in relation to substantive rules of central importance in this sphere, that is to say, according to that same recital, the rules concerning those provisions of national law which most directly affect the functioning of the internal market, and that that recital does not preclude the harmonization relating to those rules from being complete.

24. The first recital in the preamble to the Directive notes that the trade mark laws applicable in the Member States contain disparities which may impede the free movement of goods and freedom to provide services and may distort competition within the common market, so that it is necessary, in view of the establishment and functioning of the internal market, to approximate the laws of Member States. The ninth recital emphasises that it is fundamental, in order to facilitate the free movement of goods and services, to ensure that registered trade marks enjoy the same protection under the legal systems of all the
Member States, but that this should not prevent Member States from granting at their option extensive protection to those trade marks which have a reputation.

25. In the light of those recitals, Articles 5 to 7 of the Directive must be construed as embodying a complete harmonization of the rules relating to the rights conferred by a trade mark. That interpretation, it may be added, is borne out by the fact that Article 5 expressly leaves it open to the Member States to maintain or introduce certain rules specifically defined by the Community legislature. Thus, in accordance with Article 5(2), to which the ninth recital refers, the Member States have the option to grant more extensive protection to trade marks with a reputation.

26. Accordingly, the Directive cannot be interpreted as leaving it open to the Member States to provide in their domestic law for exhaustion of the rights conferred by a trade mark in respect of products put on the market in non-member countries.

27. This, moreover, is the only interpretation which is fully capable of ensuring that the purpose of the Directive is achieved, namely to safeguard the functioning of the internal market. A situation in which some Member States could provide for international exhaustion while others provided for Community exhaustion only would inevitably give rise to barriers to the free movement of goods and the freedom to provide services.

28. Contrary to the arguments of the Swedish Government, it is no objection to that interpretation that since the Directive was adopted on the basis of Article 100a of the EC Treaty, which governs the approximation of the laws of the Member States concerning the functioning of the internal market, it cannot regulate relations between the Member States and non-member countries, with the result that Article 7 is to be interpreted as meaning that the Directive applies only to intra-Community relations.

29. Even if Article 100a of the Treaty were to be construed in the sense argued for by the Swedish Government, the fact remains that Article 7, as has been pointed out in this judgment, is not intended to regulate relations between Member States and non-member countries but to define the rights of proprietors of trade marks in the Community.
30. Finally, the Community authorities could always extend the exhaustion provided for by Article 7 to products put on the market in non-member countries by entering into international agreements in that sphere, as was done in the context of the EEA Agreement.

31. In the light of the foregoing, the answer to be given to the first question must be that national rules providing for exhaustion of trade-mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with his consent are contrary to Article 7(1) of the Directive, as amended by the EEA Agreement.

Question 2

32. By its second question the Oberster Gerichtshof is in substance asking whether Article 7(1) of the Directive can be construed as meaning that the proprietor of a trade mark is entitled, on the basis of that provision alone, to obtain an order restraining a third party from using its mark for products which have been put on the market outside the EEA under that mark by the proprietor or with his consent.

33. In its order for reference, as clarified subsequently by letter, the Oberster Gerichtshof has pointed out:

   — that the second question was put because the Markenschutzgesetz does not provide for any right to obtain a prohibitory injunction, nor does it contain any provision corresponding to Article 5(1)(a) of the Directive. A prohibitory injunction may be sought in respect of a trade mark infringement only if there is at the same time a breach of Paragraph 9 of the UWG, the application of which presupposes the risk of confusion, which is not the case where the original products of the trade-mark proprietor are concerned;

   — in Austrian law, at least according to current academic legal writing, the proprietor of a trade mark has no right to obtain a prohibitory injunction against a person who makes parallel imports or re-imports of trademarked goods, unless the right to a prohibitory injunction is already available under Paragraph 10a(1) of the Markenschutzgesetz. The question thus arises, under Austrian law, whether Article 7(1) of the Trade Marks Directive, which has the same content as Paragraph 10a(1) of the Markenschutzgesetz, provides for such a right to apply for a prohibitory injunction and whether the proprietor of the trade mark
34. Under the scheme of the Directive the rights conferred by a trade mark are defined by Article 5, while Article 7 contains an important qualification with respect to that definition, in that it provides that the rights conferred by Article 5 do not entitle the proprietor to prohibit the use of the trade mark where the conditions laid down in that provision are satisfied.

35. Accordingly, while it is undeniable that the Directive requires Member States to implement provisions on the basis of which the proprietor of a trade mark, when his rights are infringed, must be able to obtain an order restraining third parties from making use of his mark, that requirement is imposed, not by Article 7, but by Article 5 of the Directive.

36. That being so, it is to be remembered, first, that, according to settled case-law of the Court, a directive cannot of itself impose obligations on an individual and cannot therefore be relied upon as such against an individual. Second, according to the same case-law, when applying domestic law, whether adopted before or after the directive, the national court that has to interpret that law must do so, as far as possible, in the light of the wording and the purpose of the directive so as to achieve the result it has in view and thereby comply with the third paragraph of Article 189 of the Treaty (see, inter alia, Case C-106/89 Marleasing v La Comercial Internacional de Alimentación [1990] ECR I-4135, paragraphs 6 and 8, and Case C-91/92 Faccini Dori v Recreb [1994] ECR I-3325, paragraphs 20 and 26).

37. The answer to be given to the second question must therefore be that, subject to the national court's duty to interpret, so far as possible, domestic law in conformity with Community law, Article 7(1) of the Directive cannot be interpreted as meaning that the proprietor of a trade mark is entitled, on the basis of that provision alone, to obtain an order restraining a third party from using his trade mark for products which have been put on the market outside the EEA under that mark by the proprietor or with his consent.
Costs

38. The costs incurred by the Austrian, French, German, Italian, Swedish and United Kingdom Governments and by the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions referred to it by the Oberster Gerichtshof by order of 15 October 1996, hereby rules:

1. National rules providing for exhaustion of trade-mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with its consent are contrary to Article 7(1) of First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks, as amended by the Agreement on the European Economic Area of 2 May 1992.

2. Article 7(1) of Directive 89/104 cannot be interpreted as meaning that the proprietor of a trade mark is entitled, on the basis of that provision alone, to obtain an order restraining a third party from using his trade mark for products which have been put on the market outside the European Economic Area under that mark by the proprietor or with his consent.

Rodríguez Iglesias Gulmann Wathelet
Schintgen Mancini Moitinho de Almeida
Murray Edward Jann
Sevón Ioannou

Annexe 2

The Maglite Ruling
Annexe 3

Parallel import into Sweden

1998-11-30

PeHe Konsult HB
Åke Hallman
Lena Magnusson
1. Introduction

In the summer of 1998, on 16 July, the European Court of Justice delivered a ruling that was essentially a judicial interpretation of a previously established Community directive concerning parallel imports. It has become known as the Silhouette ruling.

In essence, the Court decided that exhaustion of trademark rights is regional in scope and not global. This interpretation conflicts with the one applied in Swedish courts of law, where the exhaustion of trademark rights is considered global rather than regional or national. Simplifying things somewhat, it might be said that the Swedish interpretation is based on a broader view of free trade, while the European Court's ruling emphasizes protection of the internal market from a certain category of imports, in this case parallel imports from third countries.

As a result of the ruling, parallel imports from a country outside the European Economic Area, EEA, comprising the EU Member States plus Norway, Liechtenstein and Iceland, are no longer allowed. Parallel imports within the EEA zone, however, are most certainly allowed and indeed in most cases, according to the EU authorities, desirable. By creating an open and 'transparent' market in the EEA zone, the EU's decision-making bodies hope to avoid constraints like state price controls and price-related market segmentation. Together with product standardization and common safety standards, etc, this is supposed to pave the way for a properly-functioning internal market. The existence of a parallel import trade, which arises from and eventually eliminates price differences between different markets, is considered one of the preconditions of a common, cohesive Single Market.

In the light of the European Court's findings – and the effects of its ruling – the Government has decided to appoint a commission whose task will be to determine the extent of parallel imports into Sweden from different countries and the dynamic effect of the ruling on competition, prices and employment. The task has been entrusted to the Swedish Competition Authority, KV. The present study constitutes a part of the Authority's assignment in this respect.

As a basis for the study and analysis presented below, some 25 personal interviews have been conducted with representatives of trade associations or equivalent bodies as well as with individuals involved in parallel import trading (Appendix 1). The Appendix also shows what other documentation has been used as a basis for the conclusions, etc, that have been reached. It includes the Silhouette ruling, the Advocate
General's opinion, the Government's instructions to the Competition Authority, articles from international trade journals on the implications of parallel imports — principally from a legal viewpoint – international analyses of the parallel import of pharmaceuticals, and contacts with a Danish inter-ministerial working group charged with analysing the same issues as the Swedish Government has instructed the Competition Authority to examine, but from a Danish viewpoint. Experiences have also been exchanged with economic consultants NERA, National Economic Research Associates Inc, which on behalf of the European Commission is examining the economic consequences of broadening the concept of exhaustion as regards trademark rights.

The issue of parallel imports could be said to incorporate three dimensions, as follows:

• a foreign trade policy dimension, i.e. in the final analysis such matters as contractual law, freer trade and various forms of protectionism.

• a macroeconomic dimension, i.e. primarily the impact on competition, prices, employment and consumer benefits, and

• a dimension connected with the individual trader's prospects and opportunities.

The issues discussed in the present report are chiefly related to the latter two subject areas.

2. General statistics

The comprehensive and detailed foreign trade figures provided by Statistics Sweden (SCB) reveal not only total values and trends but also things like how imports into Sweden are distributed by product sector and which regions and individual countries they originated in.

The statistics do not, however, shed any light on the central issues in this report, namely the question of parallel imports and their place in international trade in general, and more specifically the origin of goods that, parallel to the flow of imports to general agents, are brought into Sweden. Thus it is not possible to deduce from these public statistics the total extent of parallel imports, their distribution by sector or their origin, i.e. whether they come from a country in the EEA zone or from a non-EEA country. Nor do Swedish Customs have access to any data that might be of use in
this connection. The possibility they have under a Community
directive of stopping certain consignments of goods on entry
inwards does not apply to the realm of parallel imports but is
intended purely to prevent counterfeits of trademark products from
reaching the market.

Even if it were possible to determine whether the imports in
question were parallel imports, based on things like the recipient's
position as general agent or not for the Swedish market,
determining the actual origin of the goods would prove difficult,
not to say impossible. In respect of certain kinds of goods, e.g.
clothing parallel imported into Sweden, it tends to be the rule
rather than the exception that the consignments – regardless of
whether they actually originated from an EEA country or from a
non-member country – in fact reach Sweden from another EEA
country. Thus it is not unusual for, say, consignments of clothing
exported from the US with well-known American trademarks and
from American suppliers – intended for the parallel trade – to
arrive in Britain, for example, where they are divided up and
distributed to other parts of Europe. In certain cases, Sweden, too,
is said to be one such spider in the web of international parallel
trade, although on a modest scale. Nor is it unusual for a trademark
owner in an EEA country – so as not to upset his relationship with
his general agents in the EEA zone – to export goods that are really
intended for the parallel trade in the EEA zone to a non-EEA
country first, fully aware of the fact that the consignments via one
channel or another will find their way back to one or more of the
EEA countries.

What looks like, or rather de facto is, a case of parallel imports
from an EEA country and as such unaffected by the implications of
the Silhouette ruling may thus in reality be essential supply
channels for parallel imports from countries outside the EEA zone.
These would be blocked by the Silhouette ruling except where the
trademark owner has a special agreement with the initial consignee
in the EEA zone. The same applies to the parallel import supply
channels that have been built up for, or rather are built on, the
practice of bringing consignments intended for parallel trading in
the EEA zone, and originating in an EEA country, to a non-EEA
country first before they are brought back.

Replacing these supply channels with direct contacts with the
original suppliers concerned is difficult as the quantities involved
are often so large that very few recipients of sufficient financial
stature are available to deal with the goods and divide them up.
Should the original supplier be located outside the EEA zone,
moreover, the Silhouette ruling excludes such contacts. In addition – where suppliers in the EEA zone are concerned – certain situations arise from the fact that the consignments in many cases are allowed to take a roundabout route because the trademark owner in his regular business operations does not wish to have any direct business contacts in the EEA zone other than those he already has with his general agents.

Thus, as noted above, it is not possible on the basis of the public statistics available to gauge the volume of parallel imports, their presence in the various product sectors or their – actual – origin by country or region. The only viable sources of information about parallel imports in the Swedish market at present are representatives of the various sectors and companies engaged in parallel trading to a greater or smaller degree. It is on the basis of this information, which tends to diverge considerably, even between players in one and the same line of business, that we have to try and form an opinion on the extent and orientation of parallel imports in Sweden and thereby of the dynamic effects on market workings, competition and pricing. The figures, etc, provided below rest upon our own assessments and analyses based on a large number of interviews. So as not to give the impression that these figures are anything but approximations, they have been rounded off by a considerable margin.

In two sectors, however, those for motor vehicles and pharmaceuticals, public statistics offer information that makes it possible to determine the extent of parallel imports with some accuracy. This has to do with the fact that both these sectors, each in their own way, are subject to special registration procedures that must be complied with if someone is to use a product or sell it on the Swedish market.

At the Motor Vehicle Register, where cars, motorcycles and snow scooters, etc, are registered, type inspections can only be carried out at the request of general agents, which is why all other kinds of registration inspections are performed without the involvement of the general agent, i.e., through parallel channels. In the case of cars, these parallel channels almost always turn out to be private persons. In the case of motorcycles and snow scooters, however, parallel imports for commercial ends also occur.

As regards pharmaceuticals imported or sold parallel to the trademark owner’s products, the Medical Products Agency requires that they be registered in accordance with a special procedure. This
ensures total control both in respect of which companies are involved in the parallel import of pharmaceuticals and which drugs are involved. As for the market value of parallel imported pharmaceuticals, this too can be ascertained as drugs in Sweden can only be sold by one player, Apoteket AB. In the pharmaceuticals field there is also a comparatively new trade association for parallel import companies, something that as far as we know does not occur in any other commercial market.

3. Definition of terms

When discussing the term 'parallel imports' with people who represent the various trade associations actively involved with the parallel import of various products, or who in other ways have come into contact with the term, including ordinary consumers, there would seem to be some confusion about what it in fact implies. Sometimes the term is even associated with another type of trading that has nothing whatsoever to do with parallel imports, namely the sale of counterfeit goods. Sometimes, too, the term parallel imports is associated with the practice of discount retailing, which it usually but not necessarily involves.

Thus it may be worthwhile taking a closer look at the various terms that occur in connection with parallel trade and in doing so seek to give the various terms as precise a meaning as possible.

The term parallel imports in the present context refers to the import for commercial retailing of a trademark owner's products without his approval or tacit consent when such trading is not done via his general agent in the area. Such imports may involve the regular, standard range of the current year's products or models, or it may involve the previous year's discontinued models or the trademark owner's rejects. What this range may look like and what impact the trade in parallel imports may have on the regular retail trade is discussed later on.

As has already been indicated, it is not uncommon for a manufacturer anxious to avoid disrupting the regular trade in the current year's models and collections to deliberately release discontinued models, etc, through other channels than the official, regular ones. Such goods may, as we have shown, traverse several different geographical markets before finally being sold over the counter to the end consumer. Also, it is claimed, such trading sometimes takes place with the tacit agreement of the general
agent, or may even be contractually regulated in the general agent's agreement with the trademark owner. The latter type of trade, although it may be parallel, cannot fairly be described as parallel importing in the true sense of the term, but rather as a type of 'side import' trading.

Imports of what are known as private brand products may also be assigned to this category. These constitute the trademark owner's own products but are imported with the buyer's own trademark on for instance the box. Sometimes the products are imported in unmarked or 'white' boxes from the trademark owner – or from a source approved by the owner – and are then marked after their arrival in Sweden. These products are then sold in competition with the trademark owner's own brand products. Motorcar components and spare parts are said to one of the more common product groups in respect of this kind of private brand trading.

In the pharmaceutical trade, confusion sometimes arises over the terms parallel import drugs and generic drugs. While the former term is concerned with parallel imports – or re-imports of the manufacturer's products bearing the original trademark but with the addition of the importer's own company label – generic drugs are exact copies of products for which the original patent has expired. Generic drugs, which far outstrip parallel imports in both value and volume, are available either under their scientific name derived from their chemical content, 'generic generics', or under a specific brand name, 'branded generics'.

A term often used in connection with parallel imports is factory outlet. Under the original definition, a factory outlet was supposed to be owned by the trademark owner, located at a clear distance from his regular retail outlets, involve simple premises and furnishings and provide low-price goods from the owner's range for the previous year, with discontinued colours and models but also rejects. More recently the original definition has been widened to embrace factory outlets run on behalf of the trademark owner by a retailer of substance, usually a regular one, or by some other party involved in a business relationship with the trademark owner. There are no factory outlets in Sweden coming under either the original definition or the somewhat broader one.

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21 The first factory outlet to be established and which gave rise to the definition was located in Redding outside New York, USA.
The factory outlets that do exist in Sweden are owned neither by trademark owners nor by anyone specifically appointed or commissioned by them. The term in this country, referring to outlets that in their style and business set-up are very similar to the original factory outlet approach, is based on a special 'Swedish' interpretation, authorized or recognized, by the Swedish Market Court.

Simply put, the factory outlet units operating in Sweden differ from the original definition in that they either

• sell several brands at one and the same location, and/or in that they
• sell their goods in close approximation to the 'regular' outlets, and/or in that
• the retailing facility is rented by an independent property owner, irrespective of whether it is located close to the regular outlet or some way from the town centre (e.g. Barkaby near Stockholm).

Finally, the term private imports. Such imports, which will also be dealt with to some extent below, are quite considerable in certain sectors, e.g. cars, alcoholic beverages and tobacco. Private imports differ in character from parallel imports mainly in that they are not primarily brought in for commercial ends but for the importer's own use. Because of its considerable volume, however, this kind of private trading may in areas where it occurs extensively have the same effect on competition and pricing as the presence of parallel imports in the same field or other fields.

Recently, direct imports through private channels have increased substantially with the growth of Internet trading. The private consumer products that at present are chiefly associated with trade over the Internet are CD records and books. When further standards and product safety routines have been developed, particularly with regard to the rules drawn up by European and international chambers of commerce, major breakthroughs and a sharp increase in Internet trading will probably be seen. On a larger, more commercial scale, the development of Internet trading will undoubtedly affect the extent of parallel trade, regardless of whether it takes place in the EEA zone or involves parallel imports from third countries.

There is general agreement in the trade that Internet commerce will grow considerably in the near future. It is estimated that the number of European companies selling goods and services over the Net will be ten times the present number within the next few years. In particular, large
groups of young people, who are already experienced Internet users, are expected to make use of the new commercial channels. According to a Swedish survey, carried out by Interactive Research, over 40% of the total number of Internet users in Sweden (approximately 2,990,000) will trade via the Net in 1999, i.e. some 1,300,000 persons. The product groups that most affect the parallel import sectors, and where the proportion of people expected to make purchases via the Net has been roughly estimated, include CD records (12%), books (9%) clothing (7%), foodstuffs (5%) and computer games (3.5%).

Through agreement in the OECD, it is hoped that Internet trading will be declared a global free trade zone in collaboration with the World Trade Organization, WTO.

4. Preconditions for parallel imports

Over and above the legal requirements necessary for proper parallel trading/imports, certain other conditions must be met, chiefly of a commercial nature. Foremost among these are

• the need to be involved with an internationally renowned and respected trademark, often associated with high prices and status.

• access to surplus products, either on a temporary or a permanent basis. Temporary surpluses can arise in business sectors that have been delaying much-needed structural measures for too long. When the necessary streamlining has been carried out, the sector returns at least for a while to a situation in which supply and demand are better balanced. Permanent production surpluses are commonly found in sectors with strong fluctuations in fashions and more than one ‘season’ in the same calendar year. The most notable examples of such sectors are probably clothing and footwear.

• the presence of trademark owners seeking actively or tacitly to offload surplus quantities such as the previous year’s models or rejects without seemingly being involved themselves, or who, because they have licensed out the manufacture of the goods on a franchise basis to a fairly large number of companies in geographically diverse markets, lack proper control of the products’ stocks and distribution.

• the existence of sufficiently large price differences between different geographical markets so that parallel imports are profitable to the importer. In many cases, existing price differences
– over and above the margins that represent the parallel importer's incentive and the profit-taking costs involved – are supposed to cover costs for repackaging, relabelling, marketing and handling. The size of the price differences required to attract parallel imports varies sharply from sector to sector. In the case of pharmaceuticals, price differences of 25-30% are quoted as a yardstick.

Price differences between different markets can be attributed to a wide range of factors, including historical and cultural differences, a desire on the trademark owner's part to segmentalize the market from a profitability viewpoint taking into account local purchasing power, and differences in insurance systems, charges and taxes, as well as state price controls affecting the trademark owner's pricing policy in the market concerned.

In some cases, parallel import prices are conditional more on whether the number of intermediaries in the processing chain can be limited than on things like geographical market segmentation by the brand supplier. Product groups often mentioned in this respect include snow scooters and golf equipment.

From time to time, movements in foreign exchange rates have had a considerable impact on the extent of parallel imports from some countries.

In various forms – both within the EU and within other internationally active organizations, both supranational and privately-based – a search is under way for greater transparency in various markets for the purpose of facilitating things like trade across national boundaries. The openness that such transparency leads to is one of the preconditions of parallel trade and parallel imports. Parallel trading helps channel quantities of goods openly for sale on the world market to those geographical markets where demand currently exists while at the same helping eventually to equalize prices on different geographical markets. In markets where surpluses are temporary in character, therefore, perhaps over a period of a few years when the trade sector in question is undergoing essential structural changes, parallel trading tends to be of a temporary nature. The same applies during periods when distortions in pricing between different markets may be caused by sizeable movements in foreign exchange rates. Where surpluses are of a more permanent nature, for instance in sectors with strong fluctuations in fashion, parallel trading is probably an even more vital component in the constant struggle to achieve concordance between demand for fast-moving fashion products, efficient
production planning and effective geographical pricing. By the offloading of discontinued branded goods at cut prices through clearly-separated sales outlets such as factory outlets, a market is found for what remains of the previous year's production and rejects, without business and pricing in the channels marketing the latest product range being unduly disrupted.

In summary, the existence of parallel imports could be said to either facilitate the marketing of products in connection with essential rationalization measures in a particular sector or act as a lubricant in sectors where manufacturing is exposed on a more permanent basis to strong fluctuations in fashion, both in design and colour.

For the consumers, parallel imports offer the chance of buying, at a lower price than in the regular retail trade, products bearing a strong brand name, even if these may not always be the latest in the trademark owner's range.

In so far as parallel import trading takes place in a growth economy, such imports and their spin-off activities, relabelling, repackaging, etc, create additional job opportunities.

5. Extent of parallel imports

The present study has focused on product sectors related to private consumption. By means of the interviews, etc, conducted as part of the study, just over 43% of total private consumption is covered, according to the weighted averages on which the 1998 retail price index (RPI) was based. The major sectors in the retail price index not covered by the study are housing, heating and household electricity (33.6 %), amusements and recreation (3.73 %), travel and transportation (3.36 %) and postal and telecommunications services (2.71 %), sectors where in all likelihood there is no trading of a kind similar to parallel imports. The same cannot be said of furniture, cosmetics, CD records and books, sectors which for various reasons have not been included in this study. Furniture and cosmetics have, however, not once been mentioned in the interviews as sectors in which parallel imports occur, at least to any marked degree. CD records and books on the other hand are often identified as sectors where private imports via the Internet have become relatively extensive and are also growing rapidly in volume (Appendix 2).
In the private consumption sectors that have been subjected to special scrutiny and information-gathering, parallel imports have been traced to sectors that together encompass almost 38% of total consumption. These range from sectors in which parallel imports occur to only a very small extent, such as foodstuffs, up to sectors where parallel imports constitute a relatively large proportion of total sales in the retail trade concerned, e.g., motorcar components and spare parts, clothing, footwear and pharmaceuticals (Appendix 3).

As has already been noted, no information is available in the official trade statistics that might help us gauge the extent of parallel imports in figures. All we have to go on are the relatively vague estimates provided by trade representatives and players in the parallel import trade, estimates that in many cases may diverge, one of the reasons being that there is no generally-accepted definition of what constitutes parallel imports.

Based on the estimates gathered from various trade representatives, etc. – and which have been exposed to various ‘tests’ and reliability assessments – parallel imports on an annual basis and calculated at the end cost to the consumer are currently put at almost SEK 9,000 million (Appendix 4). The sums involved have been overestimated rather than underestimated. As a proportion of total private consumption, which in 1997 amounted to approximately SEK 925,000 million, parallel imported products would thus account for about 1%. For the various trade sectors involved, market shares vary considerably for parallel imported products, from a mere 0.01% for the food trade to approximately 20% for the trade in motorcar components and spare parts. For clothing, for instance, as can be seen from the Appendix, the market share for parallel imported products is approximately 10%, for snow scooters and golf equipment approximately 8% and for footwear approximately 5%, the same share as for pharmaceuticals.

Of total sales of parallel imported products – worth almost SEK 9,000 million – just over 60%, or about SEK 5,300 million, are believed to have originated from a country outside the EEA zone. When the actual origin of the various consignments is emphasized, the information is of greater relevance to an assessment of the effects of the Silhouette ruling, as the bulk of the products parallel imported into Sweden are discharged here from another EEA country.
Strict compliance with the Silhouette ruling, then, would mean sales worth approximately SEK 5,300 million disappearing from the Swedish market. This corresponds to about 0.6% of total private consumption in 1997.

Below is a summarized account of the extent and structure of parallel imports in the trade sectors specified in Appendix 4. The effects of parallel imports on prices will be discussed in a separate chapter.

Foodstuffs

Parallel imports of food products – and of chemical-technical goods – are said to have been fairly extensive prior to Sweden's entry into the EU but have thereafter virtually ceased, chiefly because of the labelling rules pertaining in the EU and the national interpretations and regulations that these engendered. Thus according to Swedish labelling rules, all declarations of ingredients, etc, on packaging, wrapping or the like must be in Swedish, or alternatively in easily-understood Scandinavian. This set of rules naturally limits the scope for parallel imports, regardless of whether the trading was to have taken place within the EEA zone or involved parallel imports from a third country.

The parallel imports found today in the food sector chiefly involve the import of Coca Cola from Poland and to a lesser extent biscuits and confectionery. According to trade representatives, the Swedish labelling rules are sometimes complied with in the case of parallel imported products, but just as often they are not.

In all, total sales of parallel imported foodstuffs are probably worth less than SEK 100 million a year. This may be set against a total figure for the private consumption of foodstuffs in 1997 of around SEK 130,000 million.

Even if direct parallel imports of foodstuffs are insignificant in volume, representatives of leading retail chains have pointed out that the potential embodied in such imports may be of considerable importance for the chains' business dealings with the owners of trademark rights.

Motorcar components and spare parts

The total 'replacement market' for motorcar components and spare parts is put at an estimated SEK 15,000 million. Of this total
figure, trade analysts estimate that parallel imported branded products account for about 20%, or approximately SEK 3,000 million. Of the parallel imported volume of sales, an estimated two-thirds has its origins in the EEA zone while the remainder, about one-third, is said to derive from a 'third' country, namely the US.

The motorcar component and spare parts trade, as has been noted, embraces the entire spectrum of import types, from strictly trademark imports to parallel imports of well-known marks and 'private brands' originating from the trademark owner's regular manufacturing. All these flows of goods tend more or less to converge, which makes it difficult to ultimately resolve the status of the product as regards origin.

Price differences between what in the trade are known as original parts and pirate copies vary greatly according to both the make of car and type of part involved, e.g. exhaust control systems, brake blocks, brake discs, etc. Examples can be found of price differences of up to 60-70%, while margins elsewhere would appear to be more modest. It does not, however, seem an exaggeration to view price differences of around 20-25% as a fairly common occurrence. This means that a decline of parallel imported products from a non-EEA country would have a marked effect on the price situation.

In the spare parts trade, there are a number of strongly targeted parallel import companies that are interested not so much in a low-price profile as in maintaining a broad range of stock for one or other of the lesser-known car makes. Thus there are companies that specialize in stocking components and spare parts for all American makes with models from 1907 onwards. In many cases, these parallel import firms act as suppliers to the official branded repair shops, which often have a stock-keeping limit for motorcar parts of 10 years.

Tyres

According to trade representatives, almost 5 million tyres were sold on the Swedish market in 1997, some 97% of them through regular sales channels. The remaining 3% are what are known in the trade as side imports. Of these, about half, or 80,000 tyres, are believed to be parallel imports. The purchase value of these tyres to the consumer is estimated at SEK 40 million, which represents a market share of about 2%.
The bulk of these parallel imported tyres originated from what may be described as ‘warmer countries’, which in this context means countries whose road surfaces are warmer than what we are accustomed to in our Nordic climate. These tyres, of the same make and bearing the same product designation as tyres manufactured for the Nordic markets, are made from a harder rubber compound and can therefore, according to trade representatives, solidify further at low temperatures (<8°C), thereby constituting a traffic hazard.

Parallel imports are not considered in the trade to exert pressure on prices to any great extent. What is considered more important for price levels is the ongoing competition between leading makes like good Year, Michelin, Continental, Firestone and Bridgestone.

Motorcycles

A few years ago, the proportion of parallel imported motorcycles totalled 20-30% of total sales on the Swedish market. Today, however, chiefly as a result of active competition and price adjustments on the part of general agents, the market share for parallel imported motorcycles has been reduced to approximately 10% of total sales in 1997 of some 8,700 units. This market share is worth somewhat less in value as parallel imports tend more towards models at the lower end of the market and the price differences between parallel imported motorcycles and those imported through regular channels are usually around 10-15%.

The parallel imports occurring today originate mainly from the US, but encompass both American makes, e.g. Harley Davidson, and Japanese makes, e.g. Yamaha, Kawasaki and Honda. The number of parallel import companies in the Swedish market is said to vary from one year to the next, but three companies have been more active than others on a continuous basis.

Irrespective of the effects of the Silhouette ruling, the trade expects parallel imports to decline, partly due to a gradual adjustment on the part of regular retailing and partly due to the implementation in late 1998 and early 1999 of the requirement whereby imported motorcycles must have European certification. Similar types of certification in the EU already exist in the case of cars. Certification is expected to mean that it will be harder, or perhaps more importantly dearer, to adapt products from a third country to the standards, etc, agreed on within the EU.
Clothing

Clothing is the sector primarily associated with parallel imports. Despite the fact that parallel imports in this sector are comparatively widespread and have been occurring for quite a time, here too it is difficult to get a firm grip on the economic dimensions. Estimates have shown that parallel imported clothing accounts for something like 10% of a total trade turnover of almost SEK 40,000 million. The countries of origin are chiefly the US, China and countries in South-East Asia, and the products involve trademarks well-known throughout the world. About 90% of the total volume of parallel imports are believed to originate in these countries or regions. The remaining 10% involve branded products originating from Italy, Germany and France, etc.

Parallel imported clothing can be marketed at most outlets where clothes are sold, not just at factory outlets or similar clearance facilities. One type of outlet that is said to be less involved than others in the import and sale of parallel products is the sports dealer. Such outlets are often to be found in the form of strong chains actively seeking to establish their own trademarks alongside their more regular range.

As a rule, parallel imported clothing, which usually but not always encompasses the previous year's models and colours, is sold at heavily reduced prices. For the kinds of garments that are not as sensitive to fashion as others, e.g. piqué T-shirts and ordinary shirts, the price cuts – compared to normal prices in regular retail outlets – are around 30%. For other kinds of garments, prices may be cut by 50-70%.

Apart from the direct effects that parallel imports have on pricing, the pricing of parallel imported clothing is also believed to influence the pricing of the current season's models and colours in the regular retail trade. Just how strong this competitive pressure is cannot of course be measured objectively but should not be underestimated as a result. A striking feature of the trade is that apparently almost half of all sales of clothing always involve discounts.
Footwear

As regards footwear, sales of parallel imported products are estimated at about 5% of total trade turnover, or approximately SEK 400 million. Virtually all these imports are believed to originate from countries outside the EEA zone – primarily the US – and would thus be eliminated if the Silhouette ruling were strictly applied.

Pharmaceuticals

The parallel import of pharmaceuticals to Sweden began comparatively late, whereas parallel imports into other European countries – e.g. Belgium, Britain and Denmark – have been around for some time.

At present, all parallel imports of drugs to Sweden come from other EEA countries, which means that the trade in its present state and form is not affected by the Silhouette ruling. In contrast to other areas affected by parallel imports – with the exception of motor vehicles – there is in the case of pharmaceuticals a good chance of keeping closer track of the extent and development of the trade, due above all to the registration procedure for parallel imported drugs administered by the Medical Products Agency.

At present, eight companies are engaged in the parallel import of pharmaceuticals for the Swedish market. The biggest is Cross-Pharma AB, followed by Medartrum AB. If the concept of ‘market’ is broadened to cover the Nordic market as a whole, the biggest of the companies involved in parallel imports into Sweden is Sverige Paranova Läkemedel AB, whose parent company is based in Copenhagen.

The eight parallel import companies recently established a trade association – the Association of Parallel Importers of Pharmaceuticals – for the purpose of coordinating contacts, etc, primarily vis-à-vis the public authorities concerned with the pharmaceuticals market, in particular the Medical Products Agency and the National Social Insurance Board (RFV).

Altogether, the Medical Products Agency has 25 drugs registered in the parallel import category. Total turnover for these products amounted in the first six months of 1998 to SEK 500 million, calculated in the pharmacies' sales prices. For 1998 as a whole, the
sales volume to the final consumer is expected to be doubled, which would mean a total value of SEK 1,000 million. Of total sales in Jan-June 1998, the ulcer medicine Losec accounted for approximately 67%.

In relation to total sales of pharmaceuticals to consumers and hospitals – at present about SEK 20,000 million a year – the market share for parallel imported drugs would thus amount to about 5%.

The market share for parallel imported pharmaceuticals is expected to decline in 1999, at least temporarily, as the Medical Products Agency, at the request of Astra, owners of the Losec trademark, recently decided22 to deregister Losec for the Swedish market in the drug's present form, i.e. as a capsule. Thus the basis for current parallel imports of Losec has been removed.

Astra replaced the Losec capsule in the Swedish market with a Losec granulate (tablet). At the same time, Astra reduced the price of the new formula by 10% compared with the price it charged for the original.

If sales of Losec were deducted from the total sales of parallel import companies in this sector, the market share for parallel imported pharmaceuticals would fall to about 1.7%. This, however, would be taking a static view of developments as parallel import companies are presently registering new drugs with the Medical Products Agency at a comparatively fast rate.

Judging by an international survey that studied the practice of parallel importing pharmaceuticals from a European perspective, the market share of these parallel imports for Europe as a whole amounts to almost 2%. The study puts the accumulative effect on price levels at about 0.25%.

In contrast to other trade sectors affected to some extent by parallel imports, the price differences between different countries that are imperative to parallel trading in pharmaceuticals are often a result of disparities in state price controls and insurance systems. This, however, is not the whole truth as the research industry behind a company's own patented drugs is constantly striving for higher prices on its own domestic market. This in turn stems from things

22 The decision is the subject of an appeal by the parallel importers' trade association.
like the fact that no country's price control authority would normally allow higher prices for an imported drug – if it is to be part of the insurance system – than the original manufacturer obtains on his own domestic market. This more general pricing rule paves the way for that reimport of pharmaceuticals to the country of origin which also tends to come under the heading of parallel imports.

In order for a parallel imported drug to be incorporated into the existing insurance system, the price control authority, the National Social Insurance Board, requires that it be assigned a price at least 10% below that of the original supplier. This pricing philosophy has been called into question by the parallel import companies and the matter is currently being reviewed by the Ministry for Social Affairs and the National Social Insurance Board.

As a result of the pricing rule in force for parallel imported pharmaceuticals, such imports directly affect the prices of the drugs involved in this kind of trading, assuming that the parallel import companies can maintain a continuous supply of goods and thereby maintain stocks at the pharmacies. Hitherto, there is nothing to suggest that it has not been possible to maintain a sufficient supply of goods.

Apart from the direct impact on prices noted above, there are instances of potential parallel imports having an indirect impact on prices. Faced with the prospect of competition from an incipient parallel import trade, some original suppliers of drugs have on occasion voluntarily chosen to cut prices by over 10%, which had the effect of eliminating the conditions necessary for parallel imports.

**Golf equipment**

Golf equipment is subject to both parallel and private imports. Total annual sales of golf equipment are estimated at approximately SEK 650 million, of which around SEK 50 million is believed to derive from parallel imports. Private imports are believed to account for roughly the same amount, which means that parallel and private imports together account for around 15% of the total market for golf equipment. The bulk of these imports originate from the US.

In price terms, parallel imported golf equipment initially undercut the original supplier's prices by about 30%. As a result of
successive adjustments by the regular retail trade, however, general price levels for golf equipment have declined to such an extent that price differences today are considerably lower and may even have been wiped out altogether.

Snow scooters

Sales of snow scooters amount to some 8,000 units a year, of which about 60% are parallel imports. These imports are estimated to be worth approximately SEK 60 million, taking into account the fact that parallel imported scooters are usually 10-20% cheaper than scooters reaching Sweden through regular sales channels.

Parallel imports in this sector come almost exclusively from the US and Canada, which together command some 97% of the world market for snow scooters. Thus these parallel imports would be completely eliminated were the Silhouette ruling to be strictly applied.

6. Price effects of parallel imports

Although not always, parallel imports usually involve low prices, as can be seen from the above. This of course also means that parallel imports help bring pressure to bear on prices in the trade sectors or market segments in which the imports occur, which in turn affects the general price level.

In Appendix 5, an attempt has been made, based on calculations of market shares for parallel imported products and of the size of price reductions, to estimate the direct impact of parallel imports at trade-sector level as well as on the general price level.

For those sectors in which parallel imports are substantial, e.g., the trade in motorcar components and spare parts, the trade in clothing and footwear and the trade in pharmaceuticals, the direct effect on prices in each respective sector ranges from 0.5% (pharmaceuticals) to 4-5% (motorcar parts). For clothing and footwear, the direct effect on price levels is estimated at 3% and 1.5% respectively.

Adjusted to the general price level, the estimated direct effect of parallel imports as a whole is about 0.2%, chiefly attributable to
clothing and footwear, which account for a relatively large share of private consumption.

Described above are the more direct, static effects that the existing parallel import trade has on prices. In addition, there are dynamic effects associated with the competitive potential inherent in parallel imports. The constant competitive pressure that the prospect of parallel imports may generate reduces the risk of cartelization and other forms of market domination that work to the detriment of the consumer.

Should the scope for parallel imports be reduced, there would naturally be a corresponding decline in the chances of such imports contributing to a dynamic market process and thereby indirectly influencing prices and competition in a way beneficial to the consumer. In addition, any elimination of those parallel imports which in content cannot be replaced in other ways would naturally contribute to an almost instantaneous rise in the general price level.

There is every indication therefore that a switch to regional exhaustion would have negative effects on competition and prices. The only way of avoiding this would be for companies parallel importing clothing and footwear to obtain branded products from trademark owners in the EEA zone instead, and import them from an EEA country in the same quantities and at the same prices as at present. As trade in these types of goods is distinctly brand-linked, however, opening up new sources of supply would necessitate effecting changes in consumer preferences and a switch to new brands.

7. Private imports

As was made clear earlier, the private import of various products in connection with travel abroad or in other ways cannot be equated with the practice of parallel import trading, even if the effects on competition and domestic prices may be the same.

It may, however, be appropriate to briefly touch upon this phenomenon as such and identify the sectors primarily affected by private imports, bearing in mind for instance that private imports tend to be confused with parallel imports. A somewhat more detailed account of private imports, their scope and effects, can be found in Appendix 6.
Here, it will simply be noted that private imports – of any magnitude – first and foremost involve second-hand cars, golf equipment, alcoholic beverages and tobacco. In respect of the latter two product groups, only legal imports are referred to for the purpose of this study. The product groups subject to extensive private imports account for some 8% of private consumption according to the weighted averages on which the 1998 retail price index was based (Appendix 7).

For 1997, the value of private imports in the above sectors may be estimated at between SEK 5,500 million and 6,000 million.

Among the effects that this kind of private importing has had are a drop of over 20% in the prices of second-hand cars in Sweden (abolished purchase tax included) and a reduction in the tax on certain kinds of beer and on tobacco.

8. Negative effects connected with parallel imports

In the discussion on parallel imports, negative opinions are sometimes voiced with regard to this form of trading. Such opinions are both of a general nature and more specific in character, and in the latter case are usually associated with a particular product sector.

Without any claim to exhaustive analysis or classification of the opinions voiced, below is a list of negative effects of this kind that the authors have come across in the course of the present study.

Among the views of a more general nature are the following:

• Parallel imports are basically unethical, as they profit on established trademarks for the sake of personal gain. The existence of parallel imports erodes the trademarks' reputation for quality and successively reduces the trademark owner's interest in and opportunities for maintaining the mark's repute, for instance through marketing efforts. Thus parallel imports help erode capital value, in contrast to regular commerce, which creates added value.

• Parallel imports break down the transport systems that have been built up and which have often been created in such a way as to help improve the environment. Parallel imports entail the risk of greater environmental destruction through the emergence of new, parallel channels of supply.
Among the negative views of a more specific kind, associated with a particular product or line of goods, are the following:

- Parallel imported consignments of clothing in particular sometimes contain pure counterfeits as well, which distorts competition and devalues the trademark.

- Many of the parallel imported foodstuffs marketed in Sweden – primarily beverages – usually lack declarations of ingredients in the Swedish language or in easily-understood Scandinavian.

- Many tyres parallel imported into Sweden are designed for markets with warmer road surfaces, so their rubber compounds are harder than in tyres intended for the Swedish market. If the proper information is not available to them, consumers may buy tyres that constitute a direct traffic hazard when temperatures begin to fall.

- In the case of pharmaceuticals, it is often argued that parallel imports erode the rights that patents were created to protect. As a result, the basis for future research is diminished.

- According to statistics from the Medical Products Agency, the frequency of complaints and enforced withdrawals from the market is relatively higher for parallel imported pharmaceuticals than for others. This has to do with the fact that all parallel imported pharmaceuticals, although to differing degrees, are subject to repackaging and relabelling.

- In the case of pharmaceuticals, the uncertainty that may arise in the mind of the consumer as a result of the inner bubble wrapping on certain products bearing a name (trademark) other than that on the outer label has also generated criticism. This is related to the fact that in the market from which it was parallel imported, the drug in question was sold under a different name than the one registered for it in the Swedish market.

- When motor vehicles, e.g. parallel imported motorcycles, are inspected for registration, the care and attention required to ensure that vehicles conform with Swedish standards in every detail are apparently not always present. This means that parallel imported vehicles, primarily from the US, may include components that are permitted in the country of origin but prohibited in Sweden.
The adjustment and replacement of accessories and components necessary to adapt motor vehicles for the Swedish market may sometimes cause problems for the owners of parallel imported vehicles should they wish to claim their guarantee and service rights. They may then find that the guarantee ultimately covers 'a different product' to the one that has now been created. Usually, however, to preserve the trademark's reputation for quality, the original importer and his branded repair shops will carry out the necessary repairs and service work under the guarantee, even if the wait may be longer than it would have been had the vehicle reached the market via the original importer.

To ensure the long-term credibility of legally-imported parallel products on the market, the public authorities responsible must be strict in their regulatory duties, for instance by taking action against the parallel import of foodstuffs that lack the proper declaration of ingredients in Swedish or by calling attention to shortcomings in essential consumer information.

9. Effects of the Silhouette ruling on parallel imports

As stated earlier, the total value of parallel imports into Sweden amounts to almost SEK 9,000 million, in terms of end sales to the consumer. Of this, as has also been noted, a relatively large share, just over 60%, involves parallel imported products originating from a non-EEA country, primarily from the US and countries in Asia, including China. The product sectors in which parallel imports from a third country primarily occur are clothing and footwear, motorcar components/spare parts, motorcycles and snow scooters. To date, parallel imported pharmaceuticals have been confined exclusively to the EEA zone.

A considerable share of the parallel imports currently arriving on the Swedish market would be eliminated if the Silhouette ruling were to be applied in full. The chances of parallel import companies being able to fully replace the eliminated branded goods with new sources of supply are slight, which means loss of access would be largely permanent for parallel import companies and consumers alike.

One tendency that can be discerned in the case of parallel import companies, including factory outlets, is that they have begun to
seek out new channels and business contacts for their trading. Thus there is an increase, albeit only a modest one as yet, in the parallel import of products from trademark owners based in the EEA zone, e.g., clothing from Italy. Other signs of some change in direction include the development and marketing of the companies' own brands, e.g., the Stenmark brand in the HK Factory Outlet chain, and the sales on consignment of products of this kind that may lack representation on the Swedish market through general agents or the equivalent.

The parallel imports occurring today in the pharmaceutical field are not affected by the Silhouette ruling, as trade in this sector has hitherto been confined exclusively to the EEA zone. The Silhouette ruling does mean, however, that parallel importers will be unable to extend their network to find suppliers in two such major pharmaceutical countries as Japan and the US. In the shorter term, it seems unlikely that this will affect parallel trading in pharmaceuticals to Sweden as both Japan and the US are generally to be regarded as high-price markets. This does not mean, though, that the occasional product on the American or Japanese market might not be of interest to parallel importers.

As has been noted, parallel imports of pharmaceuticals to the Swedish market are expected to decline in 1999 with the disappearance of Astra AB's drug Losec in capsule form. This would not, however, be an effect of the Silhouette ruling but of the fact that Astra has deregistered the drug in its original form with the Medical Products Agency. Gradually, however, this drop will probably be offset by the parallel import of other pharmaceuticals, as the registration rate for new parallel imported drugs at the Medical Products Agency is currently quite high. In addition to the greater range of parallel imported drugs likely to be available, there is the prospect of several of the importers presently active in the pharmaceuticals market broadening their range to encompass generic drugs as well.

The long-term planning that characterizes companies working actively with parallel imports in the various sectors suggests that the effects of the Silhouette ruling on employment described earlier may not primarily afflict the parallel import companies concerned. The companies involved in parallel trading tend to be rich in entrepreneurial spirit and usually come up with a solution to any problems that may arise by developing new ideas and changing their business approach. A degree of negative impact on
employment is likely, however, especially if private trading over
the Internet accelerates as a result of the Silhouette ruling.

Those who stand to lose most from the Silhouette ruling are the
consumers, for whom it will mean reduced access to
products/brands in demand and probably higher prices on the
remaining range, followed by the state, which as a result of
diminished competitive pressure may face increased inflation and
less tax revenue (VAT and company tax). Even if the indirect
effects should not be exaggerated, it would be unwise to disregard
the potential pressure on prices that parallel imports exert in
business dealings between trademark owners and their buyers in
various markets.

Irrespective of the Silhouette ruling and the effects it may have, a
discussion of other circumstances that may affect parallel imports
seems warranted. The idea is not a detailed analysis but rather a
rough inventory of various factors that – whether or not the
Silhouette ruling is taken into consideration – impose certain
constraints on parallel import trading.

• The global economy is currently experiencing a high degree of
concentration at every level of processing – and in virtually all
geographical markets – which means that the number of
manufacturers and buyers is declining. This has resulted in an
increase in direct contacts and direct business transactions between
buyers and sellers, from which follows that the number of
intermediaries, and thereby the risk of ‘product leakage’, is also
decreasing.

• The same kind of concentration is resulting from the gradual shift
taking place in warehousing and logistics, where the trend is
toward fewer storage points – in some cases only a single central
warehouse for the entire European region – and only exploiting
intermediaries for transportation purposes, etc, without giving them
access of their own to the goods handled.

The following represents another part of the same pattern:

• Trademark owners are no longer using general agents to represent
them in various geographical markets but instead are establishing
their own subsidiaries to hold the trademark rights. In this way, a
trademark owner is able to keep a closer check on his flow of
goods.
Other circumstances of a more general nature, i.e. irrespective of whether the parallel imports come from a country in the EEA zone or not, include the following:

• National pricing rules, which require a set minimum reduction in the price of parallel imported products if these are to be marketed under the terms of existing insurance rules. In Sweden, for instance, in accordance with a practice established by the National Social Insurance Board, parallel imported pharmaceuticals must be assigned a price at least 10% below that of the trademark owner or his general agent. As has been noted, this practice is being reviewed by the Ministry for Social Affairs and the National Social Insurance Board.

• National regulations – regulated in the case of EU Member States by Community directives – on the labelling of foodstuffs. Under the rules that apply in Sweden, all labelling must be in Swedish or in the kind of Scandinavian that Swedes can understand.

In the EU, the existing rules are constantly being updated with the aim of improving the preconditions for a well-functioning internal market. These rules, which seek to promote the standardization of products and economic transparency in the Single Market, may at the same time have the effect of making trade from third countries more difficult, for instance in the form of parallel imports. Such rules include things like:

• Regulations for standardizing the designs of cars and motorcycles via EU documentation. As has already been noted, for instance, representatives of the motorcycle trade expect to see a decline in parallel imports, irrespective of the Silhouette ruling, owing to the fact that over the next six months Sweden is due to implement the EU rules regarding standards, etc., for motorcycles. This is expected to lead to greater care being taken over registration testing of parallel imported motorcycles, which in turn is expected to lead to higher costs for parallel importers obliged to adapt the motorcycles to comply with European standards.

• Group exceptions in the EU zone for exclusive retailing networks and official branded repair shops for cars.

Opinion is divided as to whether the common currency – the euro – will affect parallel import conditions from 1 January 1999 when it is introduced. Only time will tell whether the euro will create a uniform price level for various products throughout Europe — thus eliminating
the conditions necessary for parallel imports – or whether pricing in euros will be accompanied by national discount systems or the like, which would mean parallel imports and private imports continuing to have a future. Representatives of the Internet trade are convinced that uniform pricing in euros — and the simplification of trade this will engender — will as early as 1999 lead to a powerful increase in commerce over the Net.

Summary

Under the Silhouette ruling, whereby an earlier Community directive was given a judicial interpretation, parallel imports from a non-EEA country (‘third country’) will no longer be allowed. Where Sweden is concerned, the European Court's interpretation of the directive entails revising legal practice, as court verdicts in Swedish trademark cases have hitherto observed the principle of 'global exhaustion' of trademark rights, involving a broader perception of the concept of free trade than the regional exhaustion principle now established by the European Court.

Sweden now has two alternatives: either to change its legislation to comply with Community law or – if that is not considered necessary – to change the way Swedish courts interpret and apply existing legislation in order to achieve the requisite compliance. A number of representatives of trademark owners, including representatives of Johnstone & Murphy and Levi Strauss, have stated that in the light of the Silhouette ruling they may consider taking legal proceedings against parallel importers. To date, however, nothing has transpired in this respect.

As a result of the Silhouette ruling, the Government, at the request of the Minister for Foreign Trade, has called for an inquiry into a number of circumstances surrounding parallel imports, primarily the extent and orientation of such imports, their direct and indirect impact on competition and prices, and what effects the Silhouette ruling might have on the Swedish market in the future.

The Government has commissioned the Swedish Competition Authority (KV) to conduct such an inquiry.

The present report is one part of the Authority’s work in this respect. Below is a brief summary of the findings.
Statistics

In their statistical output, neither Statistics Sweden (SCB) nor Swedish Customs record trade to and from Sweden in such a way that parallel imported goods may be distinguished from other imported goods. Thus no data is available from official statistics to describe either the orientation or extent of the parallel import trading that occurs. It has therefore been necessary to obtain the information on which the present study is based from representatives of the retail sectors in which parallel imports are reported to occur and from companies directly involved in parallel import trading.

The only sectors in which the existence of private or parallel imports can be established with certainty are those involving motor vehicles (Sw. Motor Vehicle Inspection Co./National Motor Vehicle Register) and pharmaceuticals (Medical Product Agency).

The paths taken

Parallel imported products may take many different routes, some of them winding ones, before finally reaching Sweden for retail sale to end consumers. Goods that arrive here from another EEA country may have been discharged there from a third country before being sent on to Sweden. By the same token, goods sent to Sweden from a third country may originally have come from an EEA country.

Definitions

For the purposes of the present report, parallel imports are defined as imports of a trademark owner's genuine products occurring parallel to imports of the same trademark owner's products through his official channels (e.g., a subsidiary or general agent), without his consent and for the purpose of selling them for commercial ends.

Other types of imports, which are sometimes likened to or confused with parallel imports, without fulfilling the above criteria, are:

• imports outside the official channels of supply but with the tacit agreement of the trademark owner;
• direct imports from an original manufacturer who possesses established, well-known brands but where the imports are sold as 'private brands';
• imports of counterfeit copies of branded goods;
• private imports; and, in the case of pharmaceuticals,
• imports of generic drugs.

Prerequisites

Over and above the legal requirements affecting parallel import trading, certain other conditions must be met if parallel imports are to take place. Foremost among these are

• the presence of an internationally renowned and respected trademark, often associated with high prices and status.
• access to surplus products, either on a temporary or a permanent basis.
• the presence of trademark owners wishing to offload surplus consignments outside official supply channels without appearing to be involved themselves, e.g. the previous year’s models or rejects.
• the presence of trademark owners who, because they have licensed out the manufacture of the goods on a franchise basis to a fairly large number of companies in geographically diverse markets, lack proper control of the products’ stocks and distribution.
• the existence of sufficiently large price differences between different geographical markets to make the trade worthwhile.

Volume

The study in hand, focusing on private consumption, covers products that account for just over 43% of total private consumption according to the weighted averages on which the 1998 retail price index is based. The remaining volume of private consumption is principally accounted for by things like housing, heating, transportation, travel, and postal and telecommunications services, sectors where it is difficult to imagine parallel import trading taking place.

The sectors in which parallel imports occur in any measurable quantity account for almost 38% of total private consumption.

In absolute figures, calculated in terms of end prices paid by the consumer, the annual volume of parallel imports into Sweden at present totals almost SEK 9,000 million, which corresponds to approximately 1% of total private consumption (about SEK 925,000 million in 1997). The retail sectors primarily involved in parallel import trading are motorcar components and spare parts, clothing and footwear, and pharmaceuticals. In the case of motorcar components and spare parts, the market share for parallel imports is estimated at around 20%, in the
case of clothing about 10% and in the case of footwear and pharmaceuticals approximately 5% each.

Of total parallel imports amounting to some SEK 9,000 million, about 60%, or approximately SEK 5,300 million, are believed to have originated in a non-EEA country. This trading, which is currently found in all the sectors where parallel imports occur, with the exception of pharmaceuticals, would be eliminated if the Silhouette ruling were to be fully complied with.

Impact on prices

The pricing of parallel imported goods differs from sector to sector but is usually characterized by lower prices than apply in the case of goods that have gone through the original products' official retailing channels. In the case of pharmaceuticals, prices must be at least 10% lower, while price reductions for parallel imported clothing are usually around 30%. In some cases, and for certain consignments, the price cuts with regard to clothing may be as much as 50-70%.

Calculated at sector level, the direct impact on prices of parallel imported motorcar components and spare parts is estimated at 4-5%, for clothing about 3%, for footwear about 1.5% and for pharmaceuticals approximately 0.5%.

Adjusted to the general price level, the direct price effect of parallel trading as a whole is estimated at around 0.2%, mainly affecting clothing and footwear.

Over and above the direct price effects of parallel imports are the indirect effects, i.e. primarily the impact on pricing attributable to the potential threat of parallel imports or to the kind of price adjustments that have to be made if the price gap is not to grow too large between, say, original stocks of the present year's models and parallel imported models from the previous year. Examples of both these phenomena are to be found. Even if the effects on price levels, etc., of the indirect impact of parallel imports should not be exaggerated, there are signs that the dynamic effects in certain sectors, as a result of the existence of or potential for parallel imports, are fairly substantial. Bearing in mind the price-sensitivity found in a number of the trade sectors in which parallel imports are widespread, it seems reasonable to assume that the indirect effect on prices of parallel trading could be on the same scale as the direct effect, i.e. around 0.2%. 
The elimination of parallel import opportunities in major market sectors could conceivably lead to more rigorous internal demands on brand suppliers for range and production planning, in order to reduce the risk of surpluses. All else being equal, such a development ought to lead to higher costs at basic production level, costs that in turn may generate higher prices.

Conclusions

To a great extent, parallel imports into Sweden originate in a ‘third’ country, i.e. in a non-EEA country. This trade would be completely eliminated if the Silhouette ruling were to be strictly applied. Virtually all current parallel imports of clothing and footwear, for instance, would have to cease.

Thus there is every sign that the Silhouette ruling will have negative repercussions on prices and competition in Sweden. Ultimately the chief losers will be the consumers, who will no longer have access to the branded clothing they have hitherto been able to buy at low prices. Companies presently involved in parallel import trading, on the other hand, will be less affected in financial and employment terms as the strong entrepreneurial spirit evident in this field will result in the development of new business concepts.

One way of avoiding negative repercussions for consumers would be for parallel importers to find sources of supply for branded products that can be imported in full compliance with the Silhouette ruling, e.g. brands originating in Italy or France. In such sectors as clothing, for instance, this would, however, necessitate changes in consumer preferences. In some quarters it has also been pointed out that there is a risk of trademark owners in the EEA zone establishing operations outside the zone as the Silhouette ruling is interpreted to mean that trademark owners outside the EEA will under the ruling be better protected than those inside it.

Another possible alternative is that the brand suppliers themselves, under their own names or otherwise, choose to take over the trade previously in the hands of the parallel importers, and that as a result retail selling to the consumer will continue as before.

If substitute channels were established, it might be possible to maintain the strong growth in parallel import trading that has
hitherto been seen, and the new retail outlets for parallel imported products now in various stages of construction could be completed at the pace and on the scale currently planned. If this proves not to be the case, and in fact there is much to suggest that eliminated parallel imports will not be fully replaced, it seems likely that the pace of development for new retail outlets will slow down, unless these premises can be filled with other products that have their origins in other business concepts than parallel import trading.

Without the Silhouette ruling, parallel imports in sectors with strong fashion and seasonal fluctuations, and thus constant problems with surpluses, would probably have continued to increase in step with real growth in private consumption. As regards pharmaceuticals, in the absence of the Silhouette ruling it would also have been possible to seek out parallel suppliers in the Japanese and US markets, something that is now impossible under the ruling. In the shorter term, however, this would probably not have been of any great significance in view of current price levels in the Japanese and US markets as compared to the Swedish.

Whether parallel imports, without the Silhouette ruling, would have gradually come to penetrate other sectors besides the present ones is a question that cannot easily be answered. All parallel import trading is predicated on the existence of a production surplus within a given product sector, on a willingness on someone's part to offload this surplus, on a willingness to do so at low prices and on the consumer's willingness to buy. Disregarding sectors with a more or less permanent surplus, it is almost impossible to predict where surplus quantities will appear, how long they will last and whether the price differences – and foreign exchange rates – will be such as to permit long-term parallel trading. The important thing, however, is not so much the ability to foresee where parallel trading may be viable as to ensure that there are no obstacles that might make a balancing-off of products and prices between different markets more difficult.

As yet, Internet trading is in its infancy. In many quarters, however, it is estimated that such trade will develop strongly in the years to come. This will lead not only to an increase in private trading and private imports but also to new business opportunities with respect to the organization and form of parallel imports.

In the light of all this, and bearing in mind the efforts of international organizations – both private and supranational (OECD) – to create an arrangement whereby the Net would be
declared a global free zone within the framework of the World Trade Organization (WTO), it is difficult to see how the Silhouette ruling could have any relevance, except from a purely legalistic viewpoint. The possibility cannot be ruled out that the outcome of the Silhouette Case will accelerate private trading over the Internet, as the ruling will physically withhold products from the market that used to be available through visits to retailers. Thus eventually – in the wake of temporary rises in retail prices – the ruling might lead to increased price competition for the regular retail trade due to a rapid increase in private imports via the Internet.
Appendix 1-2 (Annex 3)

1. Memorandum from meeting with the Danish Inter-Ministerial Working Group in Copenhagen on 16 November 1998; represented primarily by Knud Wallberg of the Patent Directorate and Hans Kierkegaard of the Competition Board.

2. Notes from meeting with NERA, National Economic Research Associates, on 23 November 1998; represented by Dr John Ryhs, Director, Theon van Dijk, Consultant, and David Lewis, Consultant.
Appendix 1

Memorandum from meeting with the Danish Inter-Ministerial Working Group in Copenhagen on 16 November 1998; represented primarily by Knud Wallberg of the Patent Directorate and Hans Kierkegaard of the Competition Board.

The working group received its instructions in early April 1998 and is expected to submit its report in mid-January 1999. The report will be delivered to the minister in the Ehrvervministeriet (approx. Ministry of Trade & Commerce), who will take the final decision on whether it is to be made public or is to be regarded as internal working material.

The background to the appointment of this working group was that the ministry discovered it had no proper strategy or policy for dealing with parallel imports. It had arrived at this conclusion after being petitioned a number of times about the likely consequences of the case then before the European Court of Justice, later known as the Silhouette Case. Primarily, the working group's task is to analyse how the interests of Danish trademark owners will be affected if the Danish Government decides to support the principle of global exhaustion of trademark rights, an approach that it currently favours. In addition, a discussion is taking place among Danish clothing exporters – Denmark is a net exporter of clothes – about the effects of implementing the principle of global exhaustion as opposed to regional exhaustion. Well-known brand names of Danish origin include Vero Moda, Carli Gry, Matinique and Peak Performance.

Immediately after the Silhouette ruling, Danish consumer organizations came out strongly in favour of taking a positive view of parallel imports. Since then, however, the organizations' voices have gradually died away.

By means of interviews and direct mail enquiries to parallel import companies, the working group has so far reached the following conclusions. Of the total number of parallel import companies approached, 50% have so far replied.

- No public statistics are available that may offer guidance as to the size and origin of parallel imports. The only exception is
pharmaceuticals, which are subject to special registration procedures.

- The product sectors in which parallel imports occur to any great extent are clothing, footwear, sports equipment, pharmaceuticals and cosmetics. In the case of pharmaceuticals, the market share for parallel imported products is about 10%, while the market share for parallel imported clothing is about 5%.

- Parallel imported pharmaceuticals have been reduced in price by at least 5%, while the price reductions for parallel imported clothing is usually about 30%.

- The volume of parallel imports – once all replies have been received – is expected to amount to something like 0.5% of total private consumption.

- Factory outlets have been significantly less successful in Denmark than in Sweden.

- The Silhouette ruling has reportedly had an impact only in isolated instances, e.g. a price increase of about 50% on Levi's jeans.
Appendix 2

Notes from meeting with NERA, National Economic Research Associates, on 23 November 1998, represented by Dr John Ryhs, Director, Theon van Dijk, Consultant, and David Lewis, Consultant.

NERA has been appointed by the European Commission to review the economic consequences, etc, of broadening the exhaustion concept with regard to trademark rights. Besides studying the effects on pricing and competition, it will seek to describe and analyse how global exhaustion of trademark rights might have repercussions on other rights, such as patent rights, copyrights and the protection of pattern and design rights.

Out of consideration for their clients, the European Commission, the NERA representatives divulged few concrete details about their findings. The general discussion that took place, however, gave the impression that the results of the Swedish investigation largely corresponded with those of NERA’s study and analysis, even if parallel imports in different geographical areas tend to take in different product groups due to the prevailing price differences and institutional conditions. As regards the size of price reductions for parallel imports and the scope of parallel trading in relation to total privat consumption, the two studies appeared to have much in common. The same applied to the development of private importing over the Internet and the impact this commerce was having on both regular retailing and parallel trading.

Apart from this, the NERA representatives provided the following information, recorded here in somewhat abbreviated form:

- After some initial studies and discussion of the research methods to be used, NERA has decided to make a closer study of some 10 product sectors, including CD records and books, video cassette recorders and other products in the field of 'consumer electronics', motor vehicles, domestic appliances, alcohol and soft drinks, confectionery, clothing and footwear, leather goods and cosmetics. In addition, based on NERA’s previous knowledge and experience, a special analysis of the pharmaceuticals market will be provided.
• NERA collaborates with a firm of market survey specialists through which data for the study will be gathered by telephone from selected companies on the basis of questions in a special questionnaire. In the case of pharmaceuticals, as indicated above, different methods have been used for gathering the information needed for the final report.

• Hitherto, NERA was disappointed at the low frequency of response to the telephone interviews and was not completely sure about the quality of the answers received. On the basis of the information gained, the NERA representatives were surprised to find that parallel trading was less extensive than they had thought.

• In its final report, NERA will also discuss the impact of parallel imports on the value of established trademarks as well as on trademark owners’ willingness to endorse their brands in the future, for instance through advertising.

• NERA will also discuss exchange rate differences and their effects on pricing.

• NERA has submitted an oral 'progress report' to the Commission. In January 1999, NERA will be presenting the draft of a final report to the Commission, after which the work will be completed. The final report is due for delivery in March 1999.
Sources

Interviews

1. The following persons in the Swedish Federation of Trade have been interviewed:

- Lars-Olof Eklöf (legal affairs)
- Börje Risingsgård (international trade)
- Johan Leffler (optics, sports equipment, toys and hobby articles, bicycles and equipment)
- Gunnar Öijvall (cross-country trucks, cars, motorcycles, mopeds, tyres and grinding and diamond cutting tools)
- Göran Nilsson (motorcar components, motorcar spare parts, trucks and site construction machinery)
- Lennart Uhlman (radio, TV, domestic appliances, health and medical products, electronics with components, and engineering machinery)
- Magnus Franzell (lamps, fittings and snow scooters)
- Åke Weyler (clothing, fabrics and footwear)

2. Ulf Janzon Paranova Läkemedel AB, chairman of the parallel importers' trade association

3. The following persons from the Association of Swedish Automobile Manufacturers and Wholesalers have been interviewed:

- Kurt Palmgren (Managing Director)
- Mats Mattsson (statistics, marketing)
- Per Johansson The Swedish National Association for Motor Trades and Repair MRF (head of the motorcar trade division)
- Björn Lagerqvist Swedish Marine Industries Federation
- Arne Rosén ICA chain stores
- Göran Sällqvist Dagab Unil AB, wholesale company
- Jan Thagesson Systembolaget AB, wine & liquor retailers
- Ann Colliander-Ringberge Swedish Match AB, tobacco & match company
- Jan Sävenborg Statistics Sweden, SCB
- Torbjörn Spector Sw. Institute for Foreign Law, IUR
12. Peter Egart Stockholm Chamber of Commerce  
13. Lars Göransson Handelskompaniet AB, golf equipment  
15. Ronnie Holm FabriksButiken (American Products)  
16. Marie-Louise Bernhardsson Pre Import AB  
17. Discussions with Danish inter-ministerial working group analysing the significance of parallel imports for the Danish market.  
18. Discussions with National Economic Research Associates Inc, Economic Consultants (NERA); study of the economic consequences of broadening the exhaustion concept with regard to trademark rights (on behalf of the European Commission).

**Other sources**

1. The Swedish Government's written submission in case C-355/96, Silhouette International Schmied vs Hartlauer Handelsgesellschaft mbH (Feb, 1997)  
2. Opinion of Advocate General Jacobs in case C-355/96 (Jan, 1998)  
3. The European Court's ruling in case C-355/96 (July, 1998)  
   Parallel imports, some facts and consequences, Lars-Olof Eklöf, Sw. Federation of Trade  
5. The European Court's ruling in case C-306/96, Javico International and Javico AG vs Yves Saint Laurent Parfums SA(YSLP) (April, 1998)  
6. The Swedish Government's instructions in commissioning the Swedish Competition Authority (KV) to report on the effects of limiting certain parallel imports into Sweden (3.9.1998).  
7. The Danish Government's instructions in commissioning a Danish inter-ministerial working group to study the basis and extent of parallel imports in Denmark (April, 1998).


10. Memo headed The Silhouette ruling and parallel imports to the Swedish market, Lennart Göransson, Swedish Competition Authority (KV), (August, 1998)

11. Figures from Statistics Sweden (SCB) on balance of resources, weighted averages for the Retail Price Index 1998 and distribution of imports by country.


13. Parallel Imports and International Trade, Christopher Heath, International Review of Industrial Property and Copyright Law (October, 1997)

14. Läkemedelsvärlden (Sw. medical journal), No. 10/1998


16. Poll by SIFO Research & Consulting on behalf of the Federation of Tobacco Retailers concerning the legal and illegal import of tobacco (autumn, 1997)

17. Newspaper clippings received from the Swedish Competition Authority and data obtained from the Internet via relevant searchwords and addresses.
Sub-Annexe 2

Orientation – sectors examined

Weighted averages
(proportion of private consumption)

<table>
<thead>
<tr>
<th>Sector</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cars</td>
<td>3.5</td>
</tr>
<tr>
<td>Motorcycles</td>
<td>8.73</td>
</tr>
<tr>
<td>Snow scooters</td>
<td></td>
</tr>
<tr>
<td>Motorcar spare parts, etc</td>
<td>14.0</td>
</tr>
<tr>
<td>Boats and boat accessories</td>
<td>2.41</td>
</tr>
<tr>
<td>Foodstuffs (incl beverages)</td>
<td>2.19</td>
</tr>
<tr>
<td>Alcoholic beverages</td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td></td>
</tr>
<tr>
<td>Tyres</td>
<td></td>
</tr>
<tr>
<td>Domestic appliances</td>
<td>0.58</td>
</tr>
<tr>
<td>Clothing (incl fabrics)</td>
<td>4.56</td>
</tr>
<tr>
<td>Footwear</td>
<td>0.94</td>
</tr>
<tr>
<td>Lamps</td>
<td></td>
</tr>
<tr>
<td>Toys and hobby articles</td>
<td>3.22</td>
</tr>
<tr>
<td>Light fittings</td>
<td></td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>2.76</td>
</tr>
<tr>
<td>Mopeds and bicycles</td>
<td></td>
</tr>
<tr>
<td>Optics</td>
<td></td>
</tr>
<tr>
<td>Radio and TV</td>
<td>0.59</td>
</tr>
<tr>
<td>Health and medical products</td>
<td></td>
</tr>
<tr>
<td>Sports articles</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>43.48</td>
</tr>
</tbody>
</table>

Private consumption sectors of note that have not been studied are housing, heating and household electricity (33.6%), travel and transportation (3.36%), postal and telecommunications services (2.71%), amusements and recreation (3.73%), books, newspapers and magazines (1.46%) and meals outside the home (3.23%). Private imports, and possibly parallel imports as well, may occur to some degree in these sectors in the case of books and CD records. This kind of private importing mainly takes place via the Internet.

1) Whole entry: operating costs for vehicles
2) Whole entry: other recreational articles
3) Whole entry: health and medical care
### Sub-Annexe 3

#### Sectors with some degree of parallel imports

<table>
<thead>
<tr>
<th>Sector</th>
<th>Weighted average 1998 in Retail Price Index (proportion of private consumption) %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motorcar spare parts</td>
<td>8.73 1)</td>
</tr>
<tr>
<td>Foodstuffs (mainly certain beverages, biscuits, confectionery)</td>
<td>14.0 (see above, motorcar spare parts)</td>
</tr>
<tr>
<td>Tyres</td>
<td>4.56</td>
</tr>
<tr>
<td>Clothing (incl fabrics)</td>
<td>0.94</td>
</tr>
<tr>
<td>Footwear</td>
<td>3.5 2)</td>
</tr>
<tr>
<td>Motorcycles (incl parts)</td>
<td>3.22 3)</td>
</tr>
<tr>
<td>Sports equipment (mainly golf equipment)</td>
<td>2.76 4)</td>
</tr>
<tr>
<td>Snow scooters</td>
<td>(see above, motorcycles)</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td></td>
</tr>
</tbody>
</table>

**Total** 37.71%

1. Whole entry: operating costs for vehicles
2. Whole entry: purchases of vehicles, bicycles and mopeds
3. Whole entry: other recreational articles
4. Whole entry: health and medical care
Sub-Annexe 4

Estimated size of parallel imports

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Parallel imports, value to the end consumer (annual sales), SEK million, approx</th>
<th>Parallel imports as proportion of sales in each respective trade, %, approx</th>
<th>Proportion of parallel imports, EEA state (approx)</th>
<th>Proportion of parallel imports, Non-EEA state (approx)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foodstuffs (mainly certain beverages,</td>
<td>&lt; 100</td>
<td>0,0</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>biscuits, confectionery)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Motorcar spare parts</td>
<td>3,000</td>
<td>20</td>
<td>67</td>
<td>33</td>
</tr>
<tr>
<td>Tyres</td>
<td>40</td>
<td>2</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Motor-cycles</td>
<td>85</td>
<td>9</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Clothing</td>
<td>4,000</td>
<td>10</td>
<td>90¹</td>
<td>100</td>
</tr>
<tr>
<td>Footwear</td>
<td>400</td>
<td>5</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>1,000</td>
<td>5</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Sports equipment (mainly golf)</td>
<td>50</td>
<td>8</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Snow scooters</td>
<td>60</td>
<td>8</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Total approx</strong></td>
<td><strong>8,700²</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ The last port of call for much of this import volume before it enters Sweden, however, is another EEA country, where consignments from, say, the US or Asian countries are discharged for customs clearance before being distributed to other parts of Europe.

² Of which 5,300 from non-EEA countries
**Sub-Annexe 5**

Estimated direct price effects on parallel imports

<table>
<thead>
<tr>
<th></th>
<th>Size of reductions, %</th>
<th>Impact on prices in trade sector, %</th>
<th>Impact on the general price level, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foodstuffs</td>
<td>..</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Motorcar spare parts</td>
<td>20 - 25</td>
<td>4 - 5</td>
<td>0.06 - 0.08</td>
</tr>
<tr>
<td>Tyres</td>
<td>20</td>
<td>0.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Motorcycles</td>
<td>10 - 15</td>
<td>0.9 - 1.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Clothing</td>
<td>30 1)</td>
<td>3</td>
<td>0.14</td>
</tr>
<tr>
<td>Footwear</td>
<td>30</td>
<td>1.5</td>
<td>0.01</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>10</td>
<td>0.5</td>
<td>0.01</td>
</tr>
<tr>
<td>Sports equipment (golf)</td>
<td>30</td>
<td>2.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Snow scooters</td>
<td>10 - 20</td>
<td>0.8 - 1.6</td>
<td>0.0</td>
</tr>
</tbody>
</table>

1) Up to 50-70% for certain models
Sub-Annexe 6

Estimate of certain selected private imports and their impact on prices

Cars

Private imports of cars mainly involve used cars – 6 years old on average – from EEA countries, principally Germany. To a certain extent, the cars are being imported by means of special procedures – order-taking, order-linking, selection, etc – through specialized companies, but the business transaction is almost always between the exporter and the private individual concerned.

In 1997, a total of 32,187 cars were privately imported at an estimated average price of approximately SEK 100,000 million each, or a total value of about SEK 3,200 million.

In all, some 275,000 second-hand cars were sold on the Swedish market in 1997, which means the market share for private imports on the used car market amounted that year to approximately 12%. Their share of the motorcar market as a whole in 1997 (275,000 second-hand plus 225,000 new cars) was about 6%.

Private imports have contributed to a substantial lowering of prices on the used car market. The overall price level, abolished purchase tax included, has dropped by over 20%, which has brought prices on the used car market down to the levels pertaining for instance in the northern regions of the European continent. To a certain extent, the prices of new cars have also been affected, especially in the case of German brand makes. This price adjustment to northern Europe is expected to lead to a decline in private imports of second-hand cars.

Alcoholic beverages

Total alcohol consumption in Sweden, according to special studies in this field, is estimated at 668,450,000 volume litres for 1996/97. This includes all alcohol, i.e. both legally and illegally acquired.

The market share for legal private imports of alcohol is estimated at 7% of total consumption or 45,422,000 volume litres for 1996/97. If illegal private imports of alcohol are included as well, the market share is approximately 9%. The value of legal private
imports of alcohol is estimated at approximately SEK 1,500 million for 1996/97.

Certain adjustments have been made in the tax rates for beer in order to curb private beer imports from Denmark in particular.

*Tobacco products*

In 1996/97, some 2 million Swedes are estimated to have imported tobacco products, mainly cigarettes, to Sweden, according to a special SIFO poll. In addition, some 400,000 people imported cigarettes illegally, the poll shows. The value of legal private imports of tobacco is estimated at almost SEK 1,000 million for 1996/97.

Tobacco tax was lowered in the early autumn of 1998.
Sub-Annexe 7

Sectors with some degree of private imports

Weighted averages 1998 in Retail Price Index (proportion of private consumption) %

<table>
<thead>
<tr>
<th></th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cars</td>
<td>3.5¹</td>
</tr>
<tr>
<td>Motorcycles</td>
<td>3.5¹</td>
</tr>
<tr>
<td>Alcoholic beverages</td>
<td>2.41</td>
</tr>
<tr>
<td>Tobacco</td>
<td>2.19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8.1%</strong></td>
</tr>
</tbody>
</table>

¹ Whole entry: purchase of vehicles, bicycles and mopeds.
Annexe 4

Parallel imports

The Swedish Wholesale & Retail Research Institute
(AB Handelns Utredningsinstitut, HUI)
Stefan Fölster, Peter Nygren.
Introduction and Summary

The aim of this study is to bring out the economic consequences of the various effects any limitation of parallel imports into Sweden will have. This report represents neither an exhaustive survey of the situation nor an inventory of the problems but focuses on two specific issues.

The first is a concise discussion of the advantages and disadvantages of parallel imports as presented in economic research. The other issue deals with the opportunities private individuals have of circumventing the ban on parallel imports by way of private imports – for instance via Internet trading.

Research

In the economic research available, a number of aspects of parallel import trading have been examined. The simplest theory assumes that a ban on parallel imports gives the producer the opportunity to practise price discrimination. If parallel imports are allowed, the producer is forced to charge the same prices in all countries. In this simple model, parallel imports lead to economic welfare gains for high-price countries and welfare losses for low-price countries. As Sweden in many respects appears to be a high-price country, this would mean that Sweden stands to gain if parallel imports are allowed.

At the same time, this theory is not very explicit on the question of what the overall welfare gains might be for all the countries as a whole. In addition, there are several aspects to the matter that are not covered by the simple theory. Several of these are discussed in Section 2.

One of the most important aspects, however, has not been dealt with at all in the available research, namely the possibility of replacing parallel imports with private imports.

Can private imports replace parallel imports?

As a rule, the term parallel imports is applied to goods bearing a genuine trademark that are imported into Sweden by non-authorized distributors despite the existence of a Swedish distributor associated with the foreign trademark owner. Thus the term applies only to trading that conflicts with the trademark owner's retail agreement.
and only to imports via distributors. Private imports are not covered by this definition.

A fundamental question concerns the possible consequences if parallel imports were to some degree replaced by private imports, for instance via the Internet.

To clarify this question, a calculation is presented in Section 3 drawing as far as possible on available facts. In some respects, however, the calculation is based on very approximate estimates. This substantially reduces the potential degree of accuracy in the findings. Nevertheless, the calculation gives a rough idea of the magnitude of the effects.

According to this calculation, a ban on parallel imports causing private imports to increase to a certain extent may have the direct effect of depriving 2,500 persons of their jobs and increasing state expenditure for costs such as unemployment benefits by around SEK 350 million while at the same time reducing state tax revenue by SEK 750 million. Eventually, the economic costs will not be so high, as some of the reduction in employment in Swedish retailing will be offset by people finding work in other sectors.

Conclusions

It is important to emphasize that the present discussion concerns the economic effects of a ban on parallel imports, as implied for instance by the Silhouette ruling. A separate matter that is sometimes discussed concerns what is known as contractual freedom, i.e., whether or not a producer should be allowed to stipulate bans on further sales elsewhere in sales agreements. The latter issue involves a number of considerations not discussed here.

As regards a ban on parallel imports, the present analysis indicates that this would result in a macroeconomic loss for Sweden. In actual fact, the analysis of private imports suggests that it is not even certain that the official retail outlets for branded goods stand to gain from a ban in the long term. For these outlets there is certainly a risk that such a ban would give extra impetus to Internet trading, which is on the increase, and thus in time undermine the official brand outlets' market share.
2. Economic research and parallel imports

Parallel import trading involves products protected by intellectual property rights. The foremost purpose of intellectual property rights is to protect by legal means investments in research and development (e.g., patents, copyright, and design registration) and investments in quality and product improvement (e.g., trademarks).23

The possession of intellectual property rights by creators, individuals, or companies also makes possible an indirect trade in the kind of investments that would not otherwise fetch a price on the market. This promotes efficiency in the production of knowledge-intensive goods and services as the results can be exploited by the players in the best position to do so.

At the same time as intellectual property rights provide incentives for investment in the development of new ideas and the improvement of existing products, they also confer a degree of monopoly power on the companies holding the patent, the design registration, or the trademark for the goods and services in question. Such monopoly power can bring about distortions and inefficiency in the economy, which is to the detriment of the consumer. Economic research is addressing the question of how effective incentives might be preserved so that enough investments are made in new and existing products without distortions in the market becoming too pronounced.

The most serious distortion in a monopoly market arises when the monopoly company charges a price for an article considerably higher than the cost of producing it. When that happens, the product undersells and its benefit to the consumer is lost.

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23 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 the 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.
Another type of distortion in monopoly markets involves various kinds of price discrimination\textsuperscript{24}. In order for a distortion to arise, three conditions must be fulfilled: the company must have some kind of monopoly position, different consumer groups must be kept apart and arbitrage opportunities must be limited. These conditions are often fulfilled on international markets and parallel imports are usually an answer to this type of price discrimination.

The presence of parallel imports affects the latter kind of distortion, but usually not the former.\textsuperscript{25} Any economic welfare effects such trading may have are therefore limited compared to measures that bring about a general improvement in market opportunities for new and existing competitors both in Sweden and abroad. Moreover, other trade and competition policy measures, in contrast to parallel import trading, can help increase the number of products available and thus increase consumer benefit.

In the field of economic research, the fundamental question of how price discrimination affects the economy has been studied on several occasions. Often, these studies have not specifically addressed parallel imports but the findings are on the whole generally applicable. There is no difference in principle between arguments favouring trade generated by inter-regional price discrimination and by price discrimination between countries or trade blocs.

Below, we begin by describing an analytical model for the simplest scenario. We then discuss a number of complications and how they affect our conclusions.

2.1 The simplest model

Suppose that a company is selling its product on different markets, e.g. in different countries. The company has a unique product, i.e. something of a monopoly position, even if there may be competitors offering related products. Demand and willingness to pay vary from country to country. If no trade exists between

\textsuperscript{24} Normally price discrimination generates a change in the volume produced, which in turn results in allocation effects. Occasionally, when price discrimination does not affect the volume sold on the market, the only result is a transfer of income.

\textsuperscript{25} In some cases, exports of temporary surpluses may help a company maintain monopoly prices within the country concerned by limiting sales. An alternative to exporting temporary surpluses would be to build up stocks and reduce production. Nor is it likely that the company would take a chance and produce too much if there was no prospect of exporting.
countries, the company charges prices based on whatever will maximize profit, bearing in mind what the demand situation is like in each country. This normally means that higher prices are charged where demand is less sensitive to price increases (less elastic).

If parallel imports occur, however, and for the sake of simplicity are assumed to lead to perfect arbitrage between the countries concerned, the producer is obliged to set a common price for all countries in accordance with the aggregate demand curve. This results in the price being lower for consumers in countries with less elastic demand and higher for consumers in countries with more elastic demand.

A standard outcome is that price discrimination in this situation boosts economic welfare if it leads to an increase in overall production, while welfare is reduced if price discrimination results in a production decrease or no change. Under the kind of conditions often believed to exist, for instance when the demand curve is linear, price discrimination leads to a welfare loss for consumers in all countries as a whole 26.

The price on each market reflects the valuation on the margin of the last unit sold. If price discrimination occurs, valuation will differ from market to market and the last unit will not be sold to the individual who values it most. Thus part of the consumer surplus is lost. The negative effect of different margin valuations can only be offset when price discrimination results in a greater volume of overall production.

The reason why price discrimination can bring about a welfare loss, then, is that consumer valuation of the last unit sold on the low-price market is lower than the valuation in the high-price market. Given a certain output, it is thus better to redistribute production so that the bulk is moved from the low-price country to the high-price country until such time as valuation and thereby prices are the same in all markets.

For the purpose of policy analysis in the Community, however, the question can be put differently. In the Silhouette case, the EU is a high-price area whereas non-EU countries are low-price areas. If

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26 For a presentation of this model, see Tirole (1988). When the demand curve is linear, price discrimination for instance leads to a loss in economic welfare.
so, consumers in the EU unquestionably gain in economic welfare terms if parallel imports from a third country are allowed and price discrimination thereby becomes more difficult. This argument applies to Sweden to an even greater extent. As a certain amount of price discrimination takes place inside the EU as well, and small countries like Sweden tend to be among those with the highest prices, Sweden is assumed to be one of the countries that stands to gain most from allowing parallel imports.

A number of factors can complicate this analysis. These are dealt with in turn below.

2.2 Parallel imports may reduce investment in development or marketing

A frequent argument against parallel imports has been that the importer gets a ‘free ride’ on the producer’s investments in things like market-specific marketing (e.g. Lexecon, 1985). This line of argument is developed further in a theoretical model in Ganslandt (1998). Extensive parallel import trading means producers are less motivated to make these kinds of market-specific investments.

Viewed from the consumer horizon, however, this argument is no longer clear-cut. It does not concern the kinds of investments in product quality or marketing that boost sales in all markets but only marketing or the development of a trademark in a specific market. Such investments, though, do not necessarily increase consumer benefit. In the available research, a number of reasons have been developed to explain why there is over-investment (or

27 The only exceptions are when parallel imports result in the producer not selling to the low-price market at all. In theory, this means a welfare loss for consumers on the low-price market, which increases the likelihood that parallel imports will mean a welfare loss for the world as a whole (e.g. Malueg and Schwartz, 1994). This theoretical argument, however, assumes that consumers from the low-price country cannot buy directly or via an importer from the high-price country. If such imports occur, the analysis is the same as above.

28 Price reductions in high-price areas can be even more pronounced when strategic considerations are introduced, e.g. when the producer does not sell directly to the consumer but to the retail company. In an analysis of this situation, Katz (1987) concludes that consumer loss from price discrimination may be substantially greater. He looks at a situation in which the producer sells both to local retail outlets and to large chains. If the producer charges them too high a price, the large chains can start their own production. An outcome of this situation may be that the producer is able to increase prices to the chains without causing them to start importing competing products by increasing the price charged to the local retail outlet by an even greater margin. Such a mechanism may mean that differential pricing between chains and local outlets may result in price increases for both. If parallel imports were allowed in this situation, local outlets would be presented with a negotiating opportunity vis-à-vis the producer similar to that of the large chains, which might result in reduced prices for both the local businesses and the chains.
under-investment) in this type of marketing (e.g. Grossman & Shapiro, 1984). Over-investment occurs when such marketing seeks mainly to attract customers away from competitors. Under-investment may occur when the marketing process supplies information that is of benefit to the consumer. This, then, is an empirical issue.

2.3 The importer's transaction costs

According to theoretical analysis, if parallel imports demand resources there is less likelihood of any economic welfare gain, e.g. Ganslandt (1998). Analysis also shows that the risk of this is greatest when parallel imports involve large volumes, which occurs in situations where it is in the best interests of the producer, parallel trade notwithstanding, to maintain big price differences between countries.

In addition, transaction costs for parallel imports are a reason why prices do not need to be completely equalized, despite inter-market arbitrage.

It should also be noted that the same problems can affect the supply of supplementary goods and services that are wholly or partially a collective benefit for all consumers in the local market. The manufacturer often invests in a local range of auxiliary services that are of benefit to all consumers in the local market, such as product information, support, service workshops, locally-oriented applications, etc. For small countries in particular the returns on this kind of investment may fall if the manufacturer's earning capacity is drastically reduced because parallel importers are taking advantage of existing investments without themselves contributing to the overall supply of services. The reduced supply may have negative consequences for consumers in high-price countries as well.

2.4 The producer's transaction costs

Parallel imports may engender extra costs for the producer. These are sometimes claimed to be costs to the consumer (e.g. Chard and Mellor, 1989). They include the following:

A) The producer sells a certain quality of goods in one country and a lesser quality in another. If parallel imports occur, it is harder for the consumer to associate a trademark with a certain quality.
Alternatively, though, clearly labelling products in accordance with their degree of quality could be viewed as a producer cost. Normally this cost would not be very great.

B) After sales service can be standardized in a country where one variety of the product is sold, but becomes dearer if other, parallel imported varieties have to be offered service as well. Charging for the extra cost of providing after sales service for the parallel imported variety would not, however, seem to present any great problem.

C) Investment decisions and production planning become harder for the producer if parallel imported goods arrive on the market at unpredictable intervals. The producer can, however, parry a greater influx of goods by means of price cuts to offload a planned quantity on the market. The price-cutting effect of parallel imports is a consumer gain. The purely administrative costs of altering prices, however, are more often an extra resource cost for the producer.

D) Copies become harder to detect if parallel imports of the product involve a number of different varieties arriving on the market via a number of channels. This, too, may engender extra costs for both the producer and the consumer.

2.5 Incentives for market division

Parallel imports reduce the profits of price-discriminating companies. A lower price in one market cannot be offset by a higher price in another, which means the companies' total profits are reduced. As a result, price-discriminating companies may feel motivated to influence their prospects of selling goods from one market in other markets. If possible, companies with active strategies will want to bring about a market division, i.e., segmentation, which would make parallel imports impossible or very expensive. Companies can act in various ways, for instance through packaging, insurance and warranty commitments, etc., to reinforce the obstacles that parallel imports encounter.

There is reason to believe, therefore, that parallel imports may result in less efficient resource usage in both the price-discriminating and the parallel-importing countries, compared to a situation in which price equalization can be achieved without cost. In other words, the economic welfare gains will be reduced if parallel imports necessitate considerable resources in order for the
products to be adapted for sale on a market other than the one originally intended.

2.6 Distribution of surplus

Under the kind of conditions normally believed to exist, overall welfare increases when price discrimination is reduced. The consumers in the high-price country gain more than the companies and consumers in the low-price country lose. In general, therefore, countries with high prices will benefit from reduced price differences between countries.

Distribution of the surplus that arises when prices are equalized, however, is not uncomplicated. If for instance a small country with high prices has a large proportion of price-discriminating production companies, company profits may decline more than the consumers gain and the total surplus in that country will be reduced despite price equalization. In such cases, too, consumers usually benefit from parallel imports.

2.7 Reduced barriers

Parallel imports are just one way of getting to grips with the problem of major price differences between countries. A relevant question in this context is whether perhaps there are other, better ways of reducing price differences. One alternative is to reduce any obstacles to company start-ups in high-price areas so that competition increases due to a larger number of foreign players being able to operate in the domestic market. Ganslandt (1998b) shows that new ventures and potential competition both lead to a reduction in monopoly gains and better use of economies of scale. The consumers gain thanks to a greater range of products, lower costs and reduced prices.

2.8 Conclusions

This is a brief summary of the theoretical arguments advanced in the economic research field with regard to the macroeconomic gains/losses resulting from price discrimination. The findings provide no unequivocal answer to the question of what price discrimination means for all countries. Parallel imports or other methods that prevent price discrimination may well increase consumer benefit as a rule, but other factors exist that may stand this trend on its head. Among them is the fact that demand
functions may take a special form, that greater transaction costs
may be involved and that market-specific investments resulting in
consumer benefit may be present.

If instead the question is whether EU rules preventing price
discrimination between the EU and third countries are good for EU
consumers, the answer is more unambiguously in the affirmative.
In cases involving parallel imports, the Community tends to be the
high-price area. Consumers in high-price areas gain when price
discrimination is reduced.

However, the above line of argument is based on the assumption
that limitation of parallel imports from third countries would mean
that price discrimination could be maintained. This is not
necessarily true. Consumers may import directly via the Internet to
a greater extent than at present. In the following section, it will be
shown that this in turn means consumers in high-price areas, such
as Sweden, will be able to buy identical goods at a considerably
lower price than is charged by traditional outlets.

3. Can private imports replace parallel imports?

In this section, we review the question of to what extent consumers
may be able to replace parallel imports with purchases over the
Internet. In conclusion, we provide a macroeconomic assessment
of the effects of a ban on parallel imports.

Today there is plenty of scope for private individuals to buy
branded goods over the Internet. Such opportunities are likely to
increase rather than lessen in the years to come. It also seems likely
that future consumers will be considerably more accustomed to
making their purchases over the Internet than present-day
consumers. This is primarily because present-day consumers – i.e.
modern youth – are more familiar with computers than their
parents. As a result, they seem more likely than older generations
to use computers as aids in making purchases. Taken as a whole,
this means that Internet trading is likely to be more intensive in the
future.

The availability of Internet purchasing facilities means that the
world has shrunk in the sense that it is just as easy to make
purchases from a computer in Sweden as it is to make the same
purchases from a computer in, say, the US. In this way, a
substantially larger market is opened up for Swedish consumers,
which almost certainly means that private imports will increase sharply as most of the goods sold over the Internet cost notably less than the corresponding goods sold through normal retail channels in Sweden. In principle, then, consumers will still be able to buy their branded products at lower prices – notwithstanding the ban on parallel imports. The difference is that Internet trading involves the consumer buying directly over the Internet, i.e., importing privately, instead of making purchases via a parallel importer as used to be the case.

3.1 Importance of parallel imports and private imports for the retail trade

Parallel imports from countries outside the EEA and EU zone have primarily been noted in such sectors as clothing, footwear, and to some extent sports and recreational goods. But parallel imports also occur sometimes in the trade in input goods, e.g., construction materials, foodstuffs, etc. Total parallel imports before the ban was introduced have been estimated at approximately SEK 9,000 million. Of this, an estimated 60% involves parallel imports from outside the EEA and EU zone. Thus sales worth approximately SEK 5,500 million would be eliminated as a result of the ban on parallel imports if the ban were to be implemented in practice. For the sake of further argument, a ban on parallel imports is assumed to have the desired effect.

How would the elimination of parallel imports affect the players concerned? As a result of the ban, parallel importers would have to stop importing from areas outside the EEA and EU zone. This would mean the loss of sales worth a total of SEK 5,500 million to the parallel importer, which in turn would probably mean a number of companies being eliminated while others would switch to other activities. In the initial stages, consumers would be negatively affected by the elimination of cheaper parallel imports and the necessity of paying a higher price for the article previously purchased via a parallel importer. Other players primarily affected are the state and the existing retail outlets for branded goods and their agents. We will look at the effects on these players later in this study.

As the intention is not to provide an inventory of all parallel imported goods on the market but simply to exemplify the private import

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29 No definite level is available for the value of parallel imports. The figure SEK 9,000 million is the most reasonable estimate in the view of HUI. The referee for this estimate is Åke Hallman.
opportunities currently available, the survey below will not identify the products we have studied by name. It is already quite easy to seek out various players on the Internet selling branded goods at substantially lower prices than is the case on the regular Swedish market. For instance it is a simple matter to buy a pair of branded jeans over the Internet and have them delivered to your home for about SEK 400 – compared with approximately SEK 650-700 at an ordinary brand outlet.

The situation is the same for a large number of branded goods in the clothing, footwear and sports equipment sectors in particular. In our estimate, an even greater number of players offering this type of Internet service can be expected in the near future, and as a result consumer access will be even greater. Table 2 gives examples of Internet price levels compared with prices in brand outlets and the prices of the equivalent products previously available from parallel importers.

Table 2 Price comparisons between Internet trading, traditional retail trading and parallel imports, SEK

<table>
<thead>
<tr>
<th></th>
<th>Internet</th>
<th>Brand outlet</th>
<th>Parallel imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branded jeans</td>
<td>450-500</td>
<td>400</td>
<td>600-700</td>
</tr>
<tr>
<td>Branded shoes</td>
<td>400-450</td>
<td>400</td>
<td>600</td>
</tr>
<tr>
<td>Branded jackets</td>
<td>2,500</td>
<td>1,780</td>
<td>3,500</td>
</tr>
</tbody>
</table>

1: Incl. freight, excl. VAT
Source: HUI

The above price relations are typical for many kinds of goods. In all three cases, Internet prices are considerably lower – in one case half the price – compared with direct purchasing at a brand outlet. This also applies to other kinds of goods not shown in the table. Price differences in themselves offer a powerful incentive for consumers to do their buying over the Internet.

At the present time, uncertainty about payments over the Internet is an inhibiting factor in the development of Internet trading. As long
as consumers remain concerned that security may not be absolute, they will in all probability remain fairly restrictive in their purchasing over the Internet. The most likely development, however, is that secure payment methods will be introduced in the near future. This would remove one of the main factors inhibiting Internet trade. Other disadvantages of Internet trading, compared with purchasing at traditional outlets, include problems with quality and service, the difficulty of trying out/on the product, delivery problems, etc, all of which may be viewed unfavourably by the consumers.

The Internet is full of search channels of different kinds and you can use any of them to look for websites that sell the products you are interested in. If you key in the name of a branded product you wish to buy, a number of websites will appear offering you the possibility of making the purchase. Websites provide information about what sizes are available, the cost of the article, the delivery charges and which methods of payment are accepted. Whatever the site, payment by credit card is the most common method. In general, websites are markedly user-friendly and the prices of the articles tend to be considerably lower than in Sweden. Thus the prospects for making purchases over the Internet are already virtually unlimited.

3.2 Gainers and losers as a result of the parallel import ban

There are four players who will be either gainers or losers as a result of the parallel import ban: the parallel importers, the consumers, existing brand outlets/their agents and the state. The effects will be both direct and indirect. It is also possible that the various players involved may be affected in a particular way in the initial stages but that after a certain period the result may be completely different.

The present study focuses on the effects resulting directly from a ban on parallel imports. A basic assumption for assessment of the macroeconomic effects is that the existing trade in parallel imports – worth approximately SEK 5,500 million – ceases once a ban comes into force.
The effects on the parallel import market are described in diagram 1 below.

*Diagram 1: The parallel import market before and after the ban*

Prior to the ban, the market for parallel imports showed a balance at price level \( p_1 \) and quantity \( q_1 \). When the ban is introduced, parallel imported goods are no longer supplied and the new supply curve moves inwards to \( s_2 \). This new supply curve, \( s_2 \), is identical to the supply curve of the existing brand outlets. For the parallel import market, the result is that prices rise to \( p_2 \). At this price level the quantity of parallel imported goods in demand is \( q_2 \) – in other words, nought. The market for parallel imports is then no more.
The parallel import sector's sales then pass both to the existing brand outlets and to other purchasing channels (primarily the Internet). This shift is shown in diagrams 2 and 3 below.

*Diagram 2: The Internet market before and after the ban on parallel imports*

Prior to the ban on parallel imports, quantity $q_1$ is sold at a specific price $p_1$ on the Internet market. Once parallel imports are banned, demand increases on the Internet and the demand curve moves outwards to $e_2$. The Internet market will thus sell quantity $q_2$ at a price $p_1$ after the ban on parallel imports. The straight line denoting the supply curve ($s$) is explained by the fact that the Internet market is a global market.
Diagram 3: The market for official brand outlets before and after the ban on parallel imports

After the ban on parallel imports, demand at brand outlets will increase – the demand curve moves outwards from e1 to e2. This causes the brand outlets' turnover to increase to q2 while at the same time price levels climb to p2.

The macroeconomic effects of the ban on parallel imports are described below in the form of a calculation based on figures for the parallel import share of total trade, the price relations detailed above and the known connections between trade turnover and tax payments and employment. The most unreliable part of the calculation, however, concerns what share of the parallel imports will pass to the Internet and to the brand outlets respectively. Our assumption in this respect is shown in table 1 below. The cautious assumption we make is that less than half of the parallel imports will be replaced by purchases on the Internet.
Table 1: Sales over the Internet, parallel import trading and other retail channels before and after the ban on parallel imports, SEK 1,000 mln

<table>
<thead>
<tr>
<th></th>
<th>With parallel imports</th>
<th>Without parallel imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet Parallel imports</td>
<td>1.0</td>
<td>3.5</td>
</tr>
<tr>
<td>Other retailing</td>
<td>5.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Internet Other retailing</td>
<td>282.0</td>
<td>285.0</td>
</tr>
</tbody>
</table>

Source: HUI

Prior to the Silhouette ruling, Internet trading to and from Sweden is estimated to have been worth about SEK 1,000 million, parallel imports from a third country approximately SEK 5,500 million and other kinds of retail trading SEK 282,000 million. After the ruling, sales from parallel import trading are expected to pass to both the Internet and other retail trading. Internet trade is expected to receive an extra injection of SEK 2,500 million and other retailing SEK 3,000 million.

The net effects for the players involved are described below. An estimate of the short-term effects for employment, taxes, etc, is also provided. In the longer term, a number of other adjustments will be required, and these will be discussed later in the report.

Parallel importers are assumed to lose SEK 2,500 million to Internet trade and SEK 3,000 million to existing businesses, i.e. SEK 5,500 million in all. In terms of the numbers of employees, this would constitute approximately 5,500 persons, as sales per employee in the Swedish retail trade are estimated at about SEK 1 million.30

Other trade is expected to get an additional contribution of approximately SEK 3,000 million, which in terms of the number of employees constitutes about 3,000 persons. The increase in business also leads to a growth in profit of about SEK 100 million.

30 The source of the estimate for sales per employee is Statistics Sweden, SCB.
before tax. Average profits before tax amount to approximately 3% of sales, which is the basis for the above profit growth estimate.

**Consumers**, as a result of the ban on parallel imports, lose the chance of buying branded goods at lower prices. The extent of such losses is, however, extremely difficult to gauge. An attempt to estimate the price effects for the consumer is described in Section 5.2 below. It is unquestionably the case, however, that a loss is involved.

**The state** loses tax revenue. Sales via Internet trading are estimated to increase by SEK 2,500 million. For the most part, value-added tax on these sales will be withheld from the state. This of course presupposes that customers will behave in an unlawful manner. But in our view it is very difficult for the state to monitor and actually recover these VAT payments. The loss of VAT revenue is expected to total around SEK 500 million. The number of employees is estimated to show a net loss of 2,500 persons. This would lead to a loss of income tax revenue of approximately SEK 130 million, as the number of unemployed would increase by 2,500 persons. Unemployment benefit costs would increase by SEK 350 million. Adjusted to take into account income tax from unemployment benefits, total income tax revenue would be reduced by about SEK 20 million net. The state would also miss out on company tax of SEK 75 million net and employer’s contributions totalling approximately SEK 150 million. In all, the state’s costs would thus increase by about SEK 350 million at the same time as income would decline by about SEK 750 million as a result of the ban on parallel imports. In addition, the number of jobless persons would increase by about 2,500. The effects are summarized in table 4 below:

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31 In the case of things like computer programs and music that can be delivered over the Internet, it is totally impossible to recover VAT. In the case of parcels, suppliers can be expected to adjust to any attempts to monitor this traffic more closely. Already, for instance, suppliers commonly divide consignments into several parcels of smaller value not requiring customs declarations.
Table 4: Effects of the ban on parallel imports

<table>
<thead>
<tr>
<th>Category</th>
<th>Effect Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Brand outlets</strong></td>
<td>Increased sales of SEK 3,000 million</td>
</tr>
<tr>
<td><strong>Parallel imports</strong></td>
<td>Reduced sales of SEK 2,500 million</td>
</tr>
<tr>
<td><strong>Consumers</strong></td>
<td>Higher prices</td>
</tr>
<tr>
<td><strong>The state</strong></td>
<td></td>
</tr>
<tr>
<td>- Loss in jobs</td>
<td>2,500</td>
</tr>
<tr>
<td>- Loss in VAT</td>
<td>SEK 500 million</td>
</tr>
<tr>
<td>- Loss in income tax</td>
<td>SEK 20 million</td>
</tr>
<tr>
<td>- Loss in company tax</td>
<td>SEK 75 million</td>
</tr>
<tr>
<td>- Loss in employer's contributions</td>
<td>SEK 150 million</td>
</tr>
<tr>
<td><strong>Total loss in taxes, etc</strong></td>
<td>SEK 750 million</td>
</tr>
<tr>
<td>- Increase in unemployment costs</td>
<td>SEK 350 million</td>
</tr>
</tbody>
</table>

Source: HUI

Thus a ban on parallel imports would mean a pretty definite macroeconomic loss.

In the longer term, however, the effects may be rather different. One important aspect is that reductions in employment levels lead to adjustments or 'balancing effects'. A decline in employment keeps down wages, which means that more people can be employed. In time, then, the effect on employment is unlikely to be as great, but on the other hand wage levels are depressed to some degree.

Another possible long-term effect, although this is more speculative, is that the ban on parallel imports boosts Internet trade to such an extent that growth is explosive. Or that exponential growth in Internet trading occurs earlier, a development predicted by many. If this is a correct description of the dynamic process, a ban on parallel imports would paradoxically entail consumer benefits in the longer term – above all in the form of lower prices but also in the form of a wider range of available goods and a more efficient purchasing pattern, as articles purchased over the Internet
are often delivered to the customer's door. This saves consumers a certain amount of time. The state, however, would still lose as a result of the ban.

Existing brand outlets and general agents for branded goods on the other hand will probably be affected negatively in the slightly longer term. We base this on the assumption that consumers in the near future will make a large proportion of their purchases over the Internet. Our assessment is that Internet trading in branded goods may very well exceed the sales of approximately SEK 5,500 million that parallel imports from third countries have been responsible for. If this proves to be the case, it will reduce turnover at existing brand outlets. Price equalization between the various markets is a likely consequence in the longer term. Where Sweden is concerned, this means that prices in brand outlets on the whole can be expected to fall.

3.3 Summary

A ban on parallel imports entails a definite macroeconomic loss for Sweden. Consumers are obliged to pay a higher price for the products they seek, former parallel importers have to revise their business ideas altogether and state revenue in the form of VAT and other taxes is reduced by about SEK 750 million while at the same state expenditure is increased by about SEK 350 million as a result of the ban. Existing brand outlets can expect increased sales and are thereby the only domestic players who stand to gain from the ban on parallel imports.
References


