

# A Point of View on Parallel Imports

Dhruv Joshi  
*Infosys Limited*

## Abstract

In view of parallel imports, the TRIPS Agreement (Trade Related Intellectual Property Rights) under article 6 states that nothing except the National Treatment and MFN (Most Favoured Nation) clause – article 3 and 4 respectively, shall be addressed by the TRIPS agreement. Hence, the TRIPS agreement sets an international benchmark but does not interfere with any national law on the principle of exhaustion of rights. Thus, till date, there exists a different standpoint on parallel imports among different countries across the globe. This paper refers to qualitative analysis of economics of parallel imports and highlights some of the specific factors that play a vital role in the thriving parallel imports or grey markets. The analysis is presented mainly in the form of accessibility to drugs in the pro-parallel import countries – the developing economies.

## Policy Implications

- The exhaustion regime that enables importation of drugs into the developing economies should be complemented by empowering developing economies to impose specific export restrictions to address the cause of accessibility in view of the fragmented exhaustion regime and the financial arbitrage.
- A three way subsidy sharing burden (involves the MNCs, the Government and the citizens) in case of drug imports should be evaluated by developing economies to address the profitability issue of MNCs that critically oppose legitimacy of parallel imports.

## 1. Introduction

Eminent economist and Noble Laureate in Economics (2001) Professor Joseph Stiglitz - in one of his books titled 'Making Globalization Work' - refers to the current state of globalisation which is more integrated economically, but lacks political

integration (Stiglitz, 2007). The current state of legislation on parallel trade may be deemed as one of the consequences of such political disharmony. While, parallel trade involves exploiting the price arbitrage among different markets across the globe (Gene M. Grossman, 2008), which can be viewed as one of the instances of economic integration,

the political disharmony was reflected in the stance taken by the developed countries and the developing countries at the World Trade Organization (WTO) during the Doha Conference in 2001 (Honorable Edward M. Kennedy, 2007).

A press release dated December 4, 2004 by the prestigious media agency – Forbes reported that a consignment containing Nasonex, a Schering-Plough's prescription nasal spray for allergies was redirected by a middleman from France to Britain, where the price discovery was high as the prices of the same product were regulated in France by the French government. It further states that between June 2001 and July 2002, Africa-bound HIV/AIDS drugs never reached their intended destination (Morais, 2004). Instances like these are representative of parallel trade, which is often referred as grey markets in common parlance. The fragmented legislation as described above and the economic disparity are central to the cause of such instances. The subsequent sections of this paper provide an egalitarian view of economics of such trade in view of the legislation, and the economic and currency disparity.

## **2. Literature Review**

### **2.1 Parallel Imports and Legislation**

Parallel imports involve genuine products that are produced under patent, copyright or a trademark protection, which are imported into another market, (henceforth referred as the destination market), without appropriate authorization of the intellectual property owner in the destination market (Maskus K. , 2001). The Doha Conference 2001 (WT/MIN(01)/DECW/2, 2001), paragraph 5(d) specifies that the members of the WTO are free to choose the exhaustion regime without challenge, provided the clauses of MFN and National Treatment are complied with. The ability of the intellectual property owner to restrict such movement depends on the exhaustion regime followed by the destination country. Currently there co-exists three forms of exhaustion; namely national, regional and international. The national exhaustion principle states that the intellectual property (IP) owner's right is exhausted on the first authorised sale in the specified national territory, for instance the United States, while the patent owner may continue to enforce his rights in the region other than the defined national territory of the USA based on the legislation adopted by the other region. The regional exhaustion principle refers to exhaustion of rights of the IP owner in specific region, for instance the European Union and its member states, while the IP owner continues the right to distribution of the product anywhere outside the European Union. The

international exhaustion refers to exhaustion of rights of the IP owner on the product across all the geographies, irrespective of the territory of the first authorised sale (Abbot, 2007).

A majority of developing countries across the globe have adopted the principle of international exhaustion, which they believe shall enable them to pursue products, mainly medicines and drugs, from other markets at competitive prices eliminating the enforcement hindrances of the IP owner locally (Duncan Matthews, 2007).

## 2.2 Parallel Imports and Price Discrimination

Besides legislation, another driving force for parallel imports is the price discrimination of the same product across different geographies. It is mainly the third degree price discrimination, which is a situation where for the same product, a firm sets a different price for different groups of customers based on the region, demographics, or any such segmentation, as defined in elementary economics. In case of price discrimination in view of parallel imports, the reference is to region-based segmentation of customer base that are charged different price for the same product (Hirschey, 2009). For instance, MSD Pharmaceuticals, a Gurgaon, India -based subsidiary of Merck & Co. launched a diabetes drug "Januvia" that was priced at around ₹43 (approx. \$1) per tablet, which was

priced at \$5 in the US. Another Indian company – Cipla Ltd., in past, was accused of selling its anti-AIDS drug "Viraday" at INR 21,000 (approx. \$500) per year in AIDS struck developing countries in Africa and charged INR 54,000 (approx. \$1285) for the same drug in the Indian market (Nair, 2008). The pharmaceutical companies often practice such price discrimination for several reasons. The following are some of the factors that drive the price discrimination practice (Yadav, 2010):

- a) Socially Responsible Pricing: This is mainly in view of addressing the issue of affordability of medicines or drugs in several regions where financial constraints or low income levels make price levels in international markets unaffordable. Hence, the companies tend to sell drugs in such regions at a lower price compared to other regions creating a third degree price discrimination.
- b) Opening New Markets: This factor plays an important role in third degree price discrimination as MNCs, like any other business, would want to expand its footprints across different geographies and achieve economies of scale through high volume and low unit price.

c) Threat of Compulsory Licensing: Under the TRIPS Agreement, countries are empowered to permit third party to manufacture a patented product, without patent owner's consent, in case of national emergencies, which in economic sense deprives the patent owner of the right to exclude third party from such manufacturing practice. Hence, sometimes MNCs prefer to cater to such markets susceptible to compulsory license at a lower price in order to ensure its presence during national emergency.

d) Competition from Generics: Access to low income markets enable patented drug manufacturer achieve economies of scale and compete with generics produced in other jurisdictions. This also enables patented drug manufacturer to maintain significant market share in such markets and deter generics from entering other high income markets.

In some instances, the price discrimination is startling. The following are some of the statistics on price of HIV drugs in specific markets. Though the statistics refer to prices that are a decade old, in a broader frame, it reflects the pricing strategy adopted by most pharmaceutical companies:

Prices in USD estimated for yearly treatment of a single adult patient with regular dosage prepared by Original Manufacturers of Drugs			
Product (US Brand)	Sweden	USA	South Africa
3TC	1709	3271	232
Zerit	3078	3589	252
Viramune	2565	3508	483
Stocrin	3231	4730	500
Combivir	4535	7093	730
Crixivan	3339	6016	600

Source: (Mattias Ganslandt, 2001)

Thus, parallel imports thrive in view of the combination of such financial arbitrage and the principles of exhaustion practiced by the destination country or the destination market.

### 3. A Preliminary View of Economics and Instances of Parallel Imports

#### 3.1 A View from Legislative and Economic Perspective

The economics of parallel import can be viewed from the pricing and legislative perspectives. From a pricing perspective, a survey conducted by prolific researcher in the area of parallel imports, Prof. Maskus, refers to prices of majority of drugs being positively correlated to the macroeconomic performance or the income levels in the country (Maskus K. E., 2001). Hence, it can be said that better the per capita GDP, higher is the price level

of the drugs, which can be corroborated with the instance involving Cipla's anti-AIDS drug "Viraday" referred in the previous section. In this view, the following are the statistics on per capita GDP (PPP basis) across the continents:

Continent	Average GDP (PPP)*
Europe	\$25,454.55
Asia	\$17,309.85
North America	\$15,333.57
Oceania (Australia)	\$11,354.86
South America	\$10,844.51
Africa	\$4,142.59

Compiled by the Researcher based on data retrieved from IMF Website<sup>1</sup>

\* refers to values stated in International dollars (2011 estimates)

The above statistics suggests Europe with highest average GDP (PPP basis); however, not all the European countries form a part of European Union which practices regional exhaustion, but have separate arrangements that facilitate trade (EEAS-Website). Asia ranks second, ahead of North America, since Qatar has exceedingly high GDP per capita (on PPP basis - 102,943.32 international dollars) compared to its peers in Asia. Taking into account this data and as per the survey conducted

by Prof. Maskus, it would provide an economic incentive for the parallel traders in Africa or South America to re-export the procured product to relatively and selectively rich countries in Asia or Australia that practice international exhaustion. This is because prices in selective countries in Asia or Australia would tend to be on a higher side due to their higher economic standard compared to most African or South American countries. To simplify the argument presented, the following may be possible:

In an unrestricted reselling by territory, a parallel trader based out of African country shall actually buy Januvia tablets from MSD pharmaceuticals, than the parent company Merck & Co. in the United States, without being at the mercy of the patent owner in the land of Africa. However, assuming disease and demand know no boundaries and the pricing difference (or premium) offered in other jurisdictions that follow international exhaustion, it incentivizes the parallel trader to re-export the same to a country that has higher macroeconomic standard than itself – let's say New Zealand or Australia in this case, as both the countries follow international exhaustion in terms of patent rights (Kyle, 2010). Assuming the holding and transportation costs are outweighed by the differential price in other market, the trader finds a better incentive in re-exporting it to another country

<sup>1</sup> International Monetary Fund, World Economic Outlook Database, April 2012

and parallel import fails to play a crucial role in addressing accessibility in Africa. The situation may get aggravated even more if countries such as United States, which are said to follow national exhaustion, adopt international exhaustion, which may further deprive the developing nations by export-driven pressures. Recently, President Obama endorsed parallel imports of drugs from European Union, subject to FDA approval, to drive down the drug prices in the United States (JDS Uniphase Corp., 2010). Besides, there have already been instances of illegal importation of drugs in the territories of the United States (Eban, 2001). However, in near future, it seems, the exporting pressures to countries such as United States are unlikely as they may not authorise parallel imports from developing economies due to quality concerns, but such exporting pressure concerns would continue with respect to other developed countries that practice international exhaustion. Thus, the developing countries are more likely to succumb to an export-driven demand pressures more than any other economy because of higher financial arbitrage. Hence, besides the right to parallel import, the developing nations or destination markets for parallel import should be empowered to restrict re-exporting of specific products. Currently, under GATT Article XI (2) (a), the exporting country can only put restrictions on exports in order to relieve critical shortages of

foodstuffs or other products (WTO-GATT, 1986). The word “shortage” if dropped from this clause may enable the exporting countries to hold back such critical products once imported into its territory. A view from the economic perspective takes into account the following two aspects to evaluate whether parallel imports could actually benefit the developing countries:

1. The extent to which the destination country and its citizens are benefitted by such imports, which may be in view of the total availability and the price of the product;
2. The incentive for the parallel trader to involve himself in such parallel trade so that the benefit to its citizens as stated in the above point continues.

In the instance described above, in my opinion, it seems only the second aspect is fulfilled, while it fails to address the first point on the agenda.

From a management stand-point, one of the Porter’s Five Forces – the bargaining power of suppliers may only be a theoretical strength for the destination market. This is because the bargaining power of the suppliers of drugs to the African parallel trader (with Africa as destination market) in the above case shall not be low. In fact, the source market has a high bargaining power since it knows

that for all practical purposes, the suppliers in the parallel market are few since the other sources, like the companies in the United States and other developed countries where the prices are on a higher side, are out of race due to price point.

Also, following the procurement of drugs or products, if the parallel trader continues to cater to the local market, the bargaining power of the customer in such market is often weak. Moving a little away from drugs, a publication record in the Economic Times dated March 23, 2012 states that the latest version of Apple's iPad was being sold in grey markets in Gurgaon and Mumbai in India at a premium of INR 25, 000. This is because there are only a few suppliers, specific to northern and western India; to cater to a huge demand of the iPad across India (March 23, Economic Times, 2012). However, this is an instance of product in the luxury segment and may not have serious consequences unlike the drugs and life-saving medication. Importantly, despite this instance being irrelevant to drug industry, it highlights the bargaining power of the customer in a grey market dominated by few traders.

Hence, from economic and management perspective, prima facie, parallel imports alone, which majorly thrives on fragmented legislation, price arbitrage and demand exploitation may not

be a panacea that addresses the issues that developing countries face.

### **3.2 A View from Currency Market Perspective**

Since one of the principles of parallel imports is price arbitrage, such activity is also impacted by currency and exchange rate fluctuations. For instance, since a number of European countries have adopted a single currency, but the fact that not all trading partners of the European Union have adopted a single currency, there exists an arbitrage due to currency movements that can be exploited. The depreciation of Romanian Leu in 2009 with respect to Euro, led to importing of drugs from Romania into other territory members of European Union leading to insufficient drug supply in the local Romanian market (NineoClock Daily, 2009). In yet another example, Mr. Andreas Mohringer, the owner of EurimPharm Arzneimittel GmbH, identified such business opportunity using parallel trade and continues to ship drugs from UK to Germany and Netherlands. The article states that such arbitrage is legally allowed which may be true in legal parlance, but would not be justified in economic sense if such trade leads to shortage of drugs in the source market, which is the UK (Bloomberg, 2012). A noteworthy point is – UK is a relatively developed economy and thus has a

capacity to build on to cater to local demand, whereas most of the poor economies or developing economies may not have the capacity by itself to cater to its local demand. Hence, the case of poor economies being source market could have fatal consequences, while UK over a relatively smaller period of time may be able to adapt to the local as well as the export demands. The exporting pressures due to currency depreciation may not be endemic to the geographic area that practices regional exhaustion (like the European Union as stated above), and the principle applies all across the globe.

The United States Dollar and the Euro are the two currencies that dominate the global foreign exchange transaction across the world (Eichengreen, 2001). A report by World Bank suggests that historically the inflation has been high in the lower income and middle-income countries compared to the high income countries (World Bank Publication, 2010). To add to the woes, specifically African countries have had a higher inflation compared to its peers – the other non-developed economies (United Nations Economic Commission for Africa, 2012). It is also alleged that developing countries deliberately tend to devalue its currency to have a better export market (BBC News, 2011). A compounded view of such international and local factors hint at a

depreciating local currency in the poor or developing economies. The depreciating local currency makes exports favourable for the developing economies, but if the consequence of currency depreciation leads to exports analogous to the one in Romania due to depreciation of its currency – Leu, the developing countries may be worse off in terms of affordability (due to inflation) and accessibility (due to exporting pressures).

#### **4. Conclusion and Improvement Areas**

Prima facie, it appears that parallel imports may be a tool that can help procure essential goods from the desired source without being at the mercy of the patent owner in the destination market, but may not be a panacea that addresses the issues faced by the developing countries, specifically the countries with raging epidemics.

The procurement is not the end-point as it would a pre-mature stage to assess the benefit to the citizens. Instead, the developing countries may dedicate their effort to restrict outflow of such procured products which would deter parallel traders to re-export the procured goods. This entails complementing the legality of parallel imports with stricter regulations on exporting of such goods once procured. The United States



Government agency – Food and Drug Administration (FDA) has strict controls on such importation (and hence exports from non-USA territory) of drugs in the USA. For instance, under section 804 (21 USC §384) of Federal Food, Drug, and Cosmetic Act (FD&C Act), an individual is permitted to import drugs from Canada only in quantities that do not exceed 90-day supply as per the quantity specified in the prescription. When export restrictions are levied on manufacturers, the manufacturers tend to make a deliberate first authorized sale to a parallel trader in the national territory who would later ship products back to manufacturer's group company in other jurisdictions where price discovery is on a higher side. Stricter export legislation analogous to the provision in FD&C Act as stated above would dampen such practices. Also, the reduction in supply to high price markets would deter the MNCs that tend to follow monopoly market structure where prices are deliberately maintained high by restricting the production quantity.

The role of the government in effective distribution of the procured goods is vital. An article titled - Cheaper drugs for HIV/AIDS in Africa: What happens next? Suggested strategies for distributing HIV drug proposes a hybrid drug supply network system that ensures government intervention in developing an effective supply

system of the drugs (Ssemakula, 2001). The government intervention to ensure supply and distribution seems to be an effective proposition rather than leaving supply and distribution at the mercy of the parallel traders. The article further suggests the vertical integration shall enhance the efficiency in the system, however, such integration requires government entering into contracts with MNCs; basically the MNCs that continually opposed parallel imports in most of the negotiations in view of the profits that may be dented on their balance sheets.

To address the profitability issue, the governments may have a three-way burden sharing subsidy arrangement, which India has in case of oil imports. The three-way subsidy burden encompasses the MNCs, the government and the citizens contributing the subsidy, thus lowering the final price at which the goods can be distributed to the people in need. The three way subsidy burden also defers the immediate payment to the MNC in form of bonds and enables the government to repay the MNCs at a later day. Referring to Prof. Stiglitz' s optimism in the book – Making Globalization Work, the implementation of the UN Millennium goals and commitment of developed nations to lend 0.7% of their GDP to developing countries would further help the cause of poor

economies to cope up with such payments and alleviate health concerns at home.

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