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PUBLIC POLICY ON PARALLEL IMPORTS IN KOREA: THE WELFARE
EFFECT FOR CONSUMERS IN THE KOREAN GOLF MARKET, AND POLICY
SUGGESTIONS

An Abstract

Policy on the parallel imports of medicines is being debated currently in Korea.

This paper looks at several countries' trends, the Trade-Related Aspects of Intellectual Property Rights Agreement, and the Korean golf market to search for policy ideas. A simple consumer welfare benefit-cost and sensitivity analysis shows that parallel imports give not only consumers' surplus on parallel imported golf clubs, but also a much larger consumers' surplus on authorized brand versions.

This paper makes the following recommendations: First, parallel imports should be permitted according to the principle of free trade, if the cost of parallel imports to the country is not much larger than the benefit. Second, even if parallel imports are permitted, some exceptional cases should be allowed where international exhaustion is problematic. Third, governmental intervention, a clear labeling system, for example, is required to protect consumers, and help consumers make rational choices.

I. Introduction

Parallel imports are genuine products imported without the intellectual property rights - copyright, patent or trademark – of the owner’s authorization. When the owner of intellectual property causes the same product to be sold in different countries for different prices, and if someone else imports the low-price good into the high-price country, it is a parallel import. Parallel imports occur when goods produced or sold abroad with the consent of the intellectual property rights holders are subsequently imported into the domestic market (or the third country) without the consent of the right owner. Parallel imports have been the subject of considerable debate and controversy in the international trade-policy arena. There is a variety of issues at stake, including economic, legal, marketing, international and commercial matters. On the one hand, it is desirable to protect the public from confusion or deception regarding the origin of branded products. On the other hand, there are apparent good reasons for preventing copyright and trademarks from being used to divide markets and to create artificial barriers to free trade (Skoko, 1998).

In spite of a lot of debate, parallel trade in the world is increasing. According to NERA (National Economic Research Associates, 1999) reports, the parallel import market share in music compact discs is 10-20%, in consumer electronics is 5%, and in cosmetics and perfumes is up to 13% within the EU. In the U.S., a 1988 estimate of the size of the parallel import market was \$7-10 billion per year, and some 60,000 parallel imported cars were imported from Europe in 1985 (Gallini and Hollis, 1999). The

Canadian Health Ministry estimates that parallel trade represents 1-2% of all U.S. drug sales (www.ey.com/industry/health, August 2003) and there is pending legislation to allow for the re-importation of prescription drugs into the U.S.

Korea, basically, has not allowed parallel imports, but there have been some exceptions since November 1995. Parallel imports were only allowed for trademarked goods, partly to combat high prices of brand products and eliminate inefficiencies in their distribution systems. In 1995, the Korea Consumer Protection Board researched the price of the 20 main imported consumer goods. They are primarily imported through monopolistic distribution channels and their price level is about 2.7 times higher than the average imported cost price. Their margin of profit is 3.6 times higher than the same kind of Korean domestic consumer good (Mygung and Sungmi 2001). The Ministry of Finance and Economy decided to allow parallel imports to lower their margin of profit and reduce rising price. In 1998, the parallel imports of cosmetics were also allowed. The main items of parallel imports were golf clubs, clothing, handbags, ski supplies, bags and cosmetics.

The issue of permitting parallel imports of patented and trademarked medicines is being debated currently in Korea. There are big concerns and controversies about the possibility of parallel imported medicine, protecting intellectual property rights, and the economic, social, and health effects of parallel imports. The supporters of parallel imports emphasize that parallel imports decreases prices, increase consumer surplus and contribute to the liberalization of trade. The opponents, on the other hand, insist that parallel imports don't ensure the safety of medicine and destroy the domestic industry.

They also insist that the effect of lowering the price of parallel imports will be small and will only cause misunderstanding and confusion amongst consumers.

Therefore, in order to know the real effects of parallel imports, we need to analyze the representative parallel import market on many levels. However, there are no empirical studies in this field in Korea. This paper is going to study the International Agreement on parallel imports and simply analyze the consumer benefits and costs of parallel imported golf clubs, one of the main parallel imported items. This study will try to derive public policy ideas that can be applied to parallel imports in Korea.

II. The Understanding of the Parallel Imports

1. The Concept of Parallel Imports

Parallel imports, also known as the gray market (normal products or the imported products from authorized channels are called white goods, and black market goods are called black goods), are genuine products which are protected by intellectual property rights but are imported without authorization from the holders of the intellectual property rights. These goods, however, are not counterfeited or pirated merchandise. For example : At the University of Oregon, a student imported 20 public policy books published by an American author from Canada this spring and sold them outside his classroom for less than the University of Oregon bookstore price, netting a \$500 profit. The public policy books are not copybooks but the same books that are sold in the US. Next term, if all goes well, he plans to expand the operation. In this case, the student imported public policy textbooks without the authorization of the copyright owner. Should this be allowed?

We have already seen a great deal of this kind of arbitrage in the drug market, where U.S. residents are buying drugs from Canada at prices much lower than are available in the United States. The drug importation arbitrage is based on patent law instead of copyright, but the principle is the same. Parallel imports arise where international price differences exceed the costs of transporting and selling goods across borders (Maskus 2000).

2. Parallel imports and the geographical limit of intellectual property right

Parallel goods are not counterfeit but they are goods imported without the consent of the original right holders. Therefore, whether parallel imports infringe upon the rights of the original patent or trademark depends on the exhaustion of intellectual property rights. At the first sale, the geographical limit of rights is usually recognized within national borders, but there is no consensus for products that cross the borders. It is possible for parallel imports to infringe upon right holders in the importing country, depending on the legal framework in the importing country.

There are three principles concerning the geographical limit of rights. Under national exhaustion, rights at the first sale end within a country's territory. Intellectual property right owners may exclude parallel imports from other countries (U.S.). Under international exhaustion, intellectual property rights at first sale end anywhere (within or outside a country's territory) and parallel imports cannot be excluded (New Zealand, Singapore). Under regional exhaustion, intellectual property rights on the first sale end within a group of countries, thereby permitting parallel trade among them; they are not exhausted by first sale outside the region (EU).

Those countries that argue for international exhaustion, and therefore the allowance of parallel imports, emphasize the need for the free movement of goods in today's world economy. This economy is increasingly becoming integrated. Those countries that argue for national exhaustion point to the territorially-based nature of intellectual property

rights in each national territory, including blocking parallel imports, without being affected by whether the right has been exhausted elsewhere.

Which of these principles should hold is not a settled issue. This issue had been extensively debated during the negotiation of the Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPS), but was not resolved. American negotiators in the Uruguay Round tried to incorporate a global standard of national exhaustion into TRIPS (Maskus 2000). However, it was impossible to reach such an agreement because of divergent views on the benefits of parallel imports. Currently, it is not subject to dispute settlement under the TRIPS Agreement, and therefore each member nation can freely decide which exhaustion policy to adopt (Mikyung and Sungmi 2001). Therefore, the issue of allowing parallel imports of patented and trademarked medicines currently in Korea is not the question of the infringement of intellectual property rights but the policy question. A country's regime stating the territorial exhaustion of intellectual property rights is a key component (Maskus 2000). The global system of intellectual property rights, as established in the World Trade Organization, permits each country to establish its own legal regime.

3. Parallel Import Policies in Many Countries

3-1. U.S.

Basically, the U.S. has a policy that doesn't allow parallel imported goods. There are three key trademark statutes regulating or relating to parallel imports (Gallini and Hollis 1999). First, '42 of the Lanham Act, prohibits the imports of an article which shall copy

or simulate the name of any manufacturer or trader registered in the U.S. or abroad. Second, the Tariff Act (19 U.S.C. '526) prohibits the importation of any merchandise of foreign manufacture if merchandise....bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States without consent. Third, Customs regulation 19 C.F.R. 133.21 forbids the importation of foreign-made articles bearing a trademark identical to one owned and recorded by a U.S. citizen or corporation. By these three key trademark statutes, parallel imports are regarded as an infringement upon Intellectual Propriety Rights (Gallini and Hollis 1999).

However, there is an exception which is called the Common Control Exception. These conclusions were reached by the Supreme Court. First, rule 1: If the authorized and gray goods differ materially, the goods may be excluded under the Tariff Act (19 U.S.C. '526). Second, rule 2: Regardless of product similarity, if the U.S. trademark holder is independent of the foreign manufacture, or if it authorizes production of the trademarked goods by a U.S. trademark holder that is independent firm abroad, then the gray goods may be excluded under '526 (Gallini and Hollis 1999).

Table 1
Summary of IPR Exhaustion Regime in the U.S.

Trademarks	Patents	Copyrights
National exhaustion - but has limited exceptions by "common control" and no consumer confusion	National exhaustion	National exhaustion

Basically, the U.S. has a policy that doesn't permit parallel imported goods. However, many U.S. industries, especially recently the U.S. pharmaceutical industry, are potentially enormous targets for parallel traders. As mentioned in the introduction, the Canadian Health Ministry estimates that parallel trade represents 1-2% of all U.S. drug sales. This means that while a fair amount of medicine is purchased on a daily basis along U.S. borders, widespread parallel trade by official wholesalers and U.S. pharmacies has not occurred to the same degree as it has in the EU. But price variations across countries tend to give rise to parallel trade, and Americans would eventually find a way to re-import lower-priced life sciences products from Canada.

3-2. EU

The legal foundations of parallel trade are Articles 30 and 36 of the Treaty of Rome and Trade Directive in 1986 (Arfwedson 2003). First, there are Articles 30 and 36 of the Treaty of Rome: It authorizes the free movement of goods and confers the right to control the import of goods on national governments. Second, Trade Directive (1986) upholds the principle of international exhaustion of Intellectual Property Rights. However, exhaustion will not apply where there are "legitimate reasons" for a trademark owner to oppose further commercialization of the goods, especially where the condition of the good is changed or impaired after it has been put on the market. The European Union is legally a single market. The European Court of Justice (ECS) has declared that, in the context of patent goods, the free circulation of goods takes precedence over intellectual property rights (Arfwedson 2003).

Table 2
Summary of IPR Exhaustion Regime in EU

Trademarks	Patents	Copyrights
Community exhaustion	Community exhaustion	Community exhaustion

Parallel Trade in the EU is forecasted to increase to \$7.4 billion in 2006 compared to \$3.3 billion in 2001(Wall Street Journal, March 26, 2003). The UK has a large proportion of parallel trading within Europe. This is because of higher prices on selected products, one of the easiest licensing procedures for parallel imported products in Europe, and a reimbursement system in the National Health System that provides an incentive to parallel trade.

3-3. New Zealand

The copyright Act of 1994, which included software and additional legislation (The Copyright Border Protection Regulations 1994), strengthened the parallel import ban (Skoko 1998). These regulations have always been contentious and the Ministry of Commerce has expressed some concern that the current copyright protection may be too strong.

After much discussion and review, the New Zealand Government, in its 1998 budgets, removed the ban. The recent NZIER (the New Zealand Institute of Economic Research) review found that liberalized import laws generally benefit consumers. Books, for example, cost up to 30% more in New Zealand than elsewhere, and copyright holders do not supply all titles. Parallel importing should bring these prices down, as well as broaden the range of books available for local sales.

Table 3
Summary of IPR Exhaustion Regime in New Zealand

Trademarks	Patents	Copyrights
International exhaustion	National exhaustion unless sold by patent owner without clear restriction	National exhaustion except for compact discs and books

3-4. Japan

The legal status of private obstruction of parallel imports depends both on intellectual property law and upon antitrust law. Japan's intellectual property law neither precludes nor sanctions parallel imports. But under the antimonopoly law of Japan, private obstruction of parallel imports is per se illegal (Flath and Nariu 2002). Its case law, however, makes Japan considerably more open to parallel imports than the U.S. Japan allows parallel imports in patented and trademarked goods unless the goods are explicitly barred from parallel trade by contract provisions, or unless their original sale was subject to foreign price regulation. The Aluminum Wheel Case (1994) is a turning point (*Japan-Auto Products v BBS Kraftfahrzeug Technik AG*) in permitting parallel imports.

Table 4
Summary of Japan-Auto Products v BBS Kraftfahrzeug Technik AG Case

Background	<p>BBS company of German held both German and Japanese patents for certain aluminum automobile hubcaps. The hubcaps were legitimately purchased in Germany by a Japanese company called Autoproductor. Autoproductor sold the hubcaps in Japan through another Japanese company called Laschmax-Japan. These two companies were virtually under the same management when the goods were imported into Japan for sale at a price lower than that charged by BBS dealerships in Japan.</p>
The Supreme Court of Japan decision	<p>It is understood that a patentee and a Japanese buyer may legally contract with one another to preclude imports by anyone else if that stipulation is indicated on the patented product itself (the products not sold to the authorized distributor are stamped “not for sale in Japan”). Failing this, the international exhaustion doctrine applies, and the first sale terminates the patent rights around the world. The same presumably applies not only to patents but also trademarks (Naoko 1996).</p>

III. Parallel Imports in Korea

1. Border Protection on Commodity of Intellectual Property Rights

Korea had not allowed parallel imports until 1995 because they were regarded as an infringement on intellectual property rights. However, as the price of some branded commodities have continuously increased, the Korean government has allowed parallel imports in order to remove the monopoly position of distribution systems.

Parallel imports have been allowed from the end of 1995 and apply only to commodities related to trademark. Allowing parallel imports in Korea stems from the import case of Levi's Jeans in 1995. When Price Club, a Korea's membership discount mall, imported a lot of Levi's Jeans from Costco Company, a large U.S. membership discount mall, Levi's Korea (the child company of Levi's) requested the Customs office not to pass customs clearance. At that time the Korea Customs Service did not pass them because Levi's Korea had an exclusive right to use the Levi's trademark in Korea. However, after this case, the Ministry of Finance and Economy and the Korea Customs Service decided to allow parallel imports to combat high prices of branded products and inefficiencies in their distribution systems. The Korea Customs Service revised the Customs Act and set up the criteria for allowing parallel imports.

The principal criteria are as follows:

- 1) If a foreign trademark right holder and a domestic importer are an identical company or identical relationship, parallel imports are allowed. If a foreign trademark

right holder has over 30% of the whole stocks of a child company, or a company is an import agency of a foreign trademark right holder, they are regarded as an identical relationship.

2) If parallel importers get an exclusive right to use a trademark from a domestic trademark right holder that has an identical relationship with a foreign trademark owner, parallel imports are allowed.

Therefore, if the foreign trademark holder and domestic trademark holder have no relations (for example: a foreign trademark holder sells to a domestic company to use its rights exclusively in a country, and the foreign trademark holder has no right in the country), the parallel imports are not permitted.

The Customs Act understands that if an intellectual property right holder on a commodity is identical between both markets, the intellectual rights are exhausted upon the first sale and parallel imports cannot be excluded. In the case that foreign and domestic right holders have the same economic benefits, parallel imports are allowed. However, the Customs Act is not a substantive law on parallel imports, but a process law on customs clearance. The intellectual property rights laws don't have any specific regulations. Therefore, if an intellectual property right owner insists that the parallel imports do harm his right, the Customs Office can refuse to pass the imported goods by the Customs Act 225 (the protection of intellectual property rights) until the imported goods turn out not to infringe upon the intellectual rights.

2. Competition Policy to Parallel Imports

Another law related to the parallel imports is the Korea Fair Trade Commission's notice about "The unfair pattern on parallel imports". This notice applied only to trademarked goods. This notice does not provide the criteria that allow or prohibit parallel imports, but regulates in order to eliminate interrupting behaviors of parallel imports that were allowed through the Customs Act.

This notice illustrates the unfair principal patterns concerning interrupting behaviors of parallel imports.

1) When a foreign trademark holder contracts with a domestic seller in condition that does not sell parallel imported goods, it will be regarded as an unfair contract.

2) When a foreign trademark holder supplies its goods at higher price to the domestic sellers (only because they sell parallel imported goods), it will be regarded as an unfair trade.

3) If a foreign trademark holder stops the supply of its goods only because domestic sellers treat parallel imported goods it will be regarded as an unfair trade.

4) If a domestic distributor contracts with a foreign trademark holder in condition that does not supply its goods to the parallel importers, this limitation on buyers (or region) will be interrupting behaviors of parallel imports.

After the Levi's jeans case, parallel imports have increased, but Korean court's attitude has not shown consistent decisions. In a Polo apparel case, the Korea Supreme Court judged that parallel imports infringed trademark rights. In a Burberry's apparel

case, the Seoul High Court of Justice ruled that the advertisement of parallel imported goods does not infringe trademark rights, and in that case parallel imports are allowed. However, parallel imports are a recent phenomenon in Korea, and there is no judgment about the essential factors of parallel import, whether parallel imports infringe trademark rights or not.

3. Present Situation and Empirical Studies

Parallel import data are generally hard to come by because customs authorities in many countries do not classify goods as parallel imported (Maskus 2000). There is not a lot of statistical data on parallel imports in Korea. The only official data are parallel import status (results) during 1995~2000 that are recorded by the Korea Customs Service. The Korea Customs Service stopped collecting data after 2001. The main reason for the stop is not clear but it may be because parallel imports are debated now and entail commercial issues from industrialized countries that have many intellectual rights.

According to the Korea Customs Service data, the quantities of parallel imports increased rapidly in 1997. The ratio of parallel imports was 0.04% (\$62,847,399) of total imported goods (\$144.62 billion). However, they were not much during 1998~1999 because of Korea's national currency crisis. Parallel imports seemed to increase rapidly in the year 2000 and the ratio of parallel imports was 0.03% (\$42,563,885) of total imported goods (\$160.48 billion). This statistical data show that the share of parallel imports of total imported goods is still not much. However, it is estimated that the

economic impact of the main parallel imported goods such as golf club, clothing, handbags, ski supplies, bags and cosmetics is very significant.

Table 5
Parallel Imports Trend in Korea: 1995~2000

Year	Money(U.S. \$)	Main items
1995 (Nov-Dec)	1,513,922	Golf clubs, Clothing, Handbags
1996	11,594,716	Clothing, Golf clubs, Watches
1997	62,847,399	Clothing, Handbags, Golf clubs
1998	24,295,516	Clothing, Golf clubs, Handbags, Cosmetics
1999	31,069,133	Clothing, Handbags, Golf clubs
2000	42,563,885	Clothing, Handbags, Bags

Although there is no other official data, we estimate that parallel imports are increasing through newspaper articles and an increasing amount of discount stores that deal with parallel imported goods.

Empirical studies on parallel imports in Korea have not been found. Guak Eun Jin's study (1996) is almost the only one (Mikyung and Sungmi 2001). Besides her study, there are no specific empirical studies and only some cases can be found through some newspapers or general theses on parallel imports. Guak reveals the price difference of goods between monopolistic importers and parallel importers through the survey research of clothing, golf clubs and automobiles. Monopolistic importers' goods are about 30% higher than parallel importers' ones, and golf clubs are 23% higher. This means there is a possibility of parallel import arbitrage in 1996.

IV. The Welfare Effect of Parallel Imports on the Korean Golf Club Market

1. Outline of the Korean Golf Club Market

It is estimated that currently Korea has the 3rd highest market scale relating to the golf industry in the world (1st: America, 2nd: Japan). Golf has been regarded as a high class sports in Korea for a long time. It is one of the reasons that the price of golf clubs in Korea is traditionally expensive. There are many reasons to classify golf as a high class sport. First of all, Korea doesn't have a lot of land for making golf courses. Korea has a lot of high mountains (70% of the land) and doesn't have sufficient fields to build golf course. Many Korean people don't want to construct golf courses; they would rather build rice or paddy fields. A former president and Nobel Peace Prize winner of 2000, Kim Dae Jung, before he became president, used to insist, that "we have to switch current golf courses into rice or paddy fields" (The Hankyoreh21, 03-28-06). The demand for golfing is much bigger than the supply of golf courses. It is natural that golfing fees are very expensive. Foreign golf club companies have used a high price and high quality policy in the Korean market. As a consequence, the price of golf clubs has been higher than any other country for a long time.

In addition to this, the Korean government has imposed a 14% of special consumption tax on golfers who use golf courses and buy golf clubs. Generally, special consumption tax is imposed on the consumption of luxury goods. Golf course fees and golf clubs become much more expensive. The average fee per person is about \$200, and life-time golf course memberships are sometimes traded for average \$600,000 (the highest has

been \$1,500,000 as of 5-1-2005). Therefore, mainly, rich retired people or business men wanting to entertain their buyers have enjoyed golf. However, recently the Korean golf market has been changing very fast. Much of the public has started to enjoy golfing, and the price of golf club is gradually lowering. There are a lot of reasons for this.

First of all, recent economic development in Korea has allows many of the public people to enjoy golf. Income and wealth have increased continuously until now. As Korean people's income and wealth increase, people are starting to focus on leisure and sports. Especially the interest in golf is rapidly increasing. People who begin golfing are also getting younger than before and the number of many woman golfers has abruptly increased.

Secondly, many Korean professional golfers have a good job at famous golf tour contests these days. When a Korean woman golfer, Se Ri Pak, won the LPGA U.S. Open in 1998, many Korean people were happy, and it increased interest in golf. At that time Korea had suffered from a national financial crisis, and many people had a hard time. In that hard time, the woman golfer, Se Ri Pak, gave Korean people a lot of courage to overcome the crisis. This is one reason golf has spread in Korea recently. After overcoming the national crisis, many Korean professional golfers have done well at world wide championships. In 2005, Korean golfers won LPGA titles 8 times and PGA titles 2 times. In addition to this, the Korean-American golfer Michelle Wie has entered the LPGA currently and interest in golf is increasing.

Thirdly, public policy on golfing has changed these days. The Korean government does not regard golf as one of the noble sports anymore. Korea abolished the special consumption tax as of January 1st 2005. As a direct effect, golf course fees have been cut down by \$30~40 and the price of golf clubs is also going down. The Korean government is planning to increase the number of golf courses to twice as many as now.

Finally, a 5 day per week work system has been mandatory to all business since September 1st 2005 in Korea. a 5 day per week work system provides a great advantage to the golf industry. Golfers who enjoy golf on weekends are rapidly and continuously increasing. The Korean Leisure Institute estimates that the number of golfers will go from 2.98 million in 2004 to 3.81 million in 2010, and it will be more difficult to book golf courses especially on weekends.

It is very difficult to measure the total market scale of the golf industry exactly. According to the Korea Economy Newspaper's estimation (05-08-2002), the total scale of the golf industry in 2002 was about \$13.3 billion. The Maeil Daily Economy Newspaper (05-18-2005) estimates that the total scale of the golf industry in 2005 was about \$17 billion. Although it is difficult to compare the two data simply because their count base is different, the Korean golf industry is getting bigger.

Table 6
The Whole Estimated Market Scale (Expenditure) of the Golf Industry

Unit : Million US dollars

Year	Total	Life-time Membership	Course Fee	Golf Clothing	Golf Range	Golf Club	Golf Ball	etc
2002	13343	10000	1700	700	408	385		150
2005	17060	13000	2000	1000	600	400	60	-
Increase rate (%)	27.9	30	17.6	42.9	47.1	19.5		-

Sources: the Maeil Daily Economy Newspaper (05-18-2005) and the Korea Economy Newspaper (05-08-2002)

In golf club markets, it is difficult to know the market sale scale exactly. That's because the principal leading foreign companies have a high market share and they don't want to reveal their sale scale in the Korean golf club market. According to the Maeil Daily Economy Newspaper (05-18-2005), it is estimated that annual total scale is \$400 million. The golf club market has grown at a 5% rate every year since 2000. We can expect a faster increase in the future because of the rapid spread of golfers.

The foreign companies have a 70 % market share on sale scale and a 90% market share on the amount of sale money. Japanese companies like Honma and Yamaha have a big market share on the high priced golf club market and American companies like Callaway and Nike have a big market share at the middle-high level priced golf market.

Korea's parallel imports of golf clubs began in 1995 and is increasing. Most of the parallel imported goods are American company brand products. That's because they are cheaper than Japan and other countries, and have good quality.

Table 7
Import of Golf Club in Korea

Unit: \$1,000

	1999	2000	2001	2002	2003	2004	2005
Import	66,790	83,884 (26%)	88,109 (5%)	113,471 (29%)	148,060 (30%)	150,720 (2%)	189,939 (26%)

Source: Korea Customs Service: the annual record of trade statistic, () is import increase rate: the average increase rate during 2000~2005 is 19.6%

Table 8
The Country of Origin of Imported Golf Club in Korea

Unit: \$1,000

	Total	Japan	U.S.A.	China	Taiwan	etc
1999	66,790	33,543	28,118	846	3,924	269
2005	189,939	128,184	51,293	8,633	697	110

Source: Korea Customs Service: The Annual Record of Trade Statistic

This study has done price research between Korea and America through Internet shopping malls. As a result of market price research on samples, the price level of parallel imports is from 41% to 91% of normal imported goods (white goods). The average price difference between parallel golf clubs and white goods is about 66%.

The major parallel imported golf clubs are TaylorMade and Callaway golf clubs. Both are American companies. Callaway is the most popular in iron golf club sets, and TaylorMade has the leading market share in driver and wood golf clubs. The price of

parallel imported Callaway golf clubs is from 56% to 77% of normal imported goods, and the price of TaylorMade golf clubs is from 41% to 71% of normal goods. One interesting and unusual thing is that the parallel imported R5 Dual driver's price is lower than in the U.S. (72%). It seems that importers imported them too much, and as TaylorMade's new driver (R7) has begun to substitute them, sellers have sold them at a discounted price.

Besides Callaway and TaylorMade, there are parallel imported golf clubs of Titleist, Dunlop, Nike, Mizno and Cleveland. However, their market share is not big yet and a lot of internet shopping malls don't sell them or there is no significant price difference.

Table 9

The Price Comparison between White Market Goods and Gray Market Goods

Research date: 12-16-2005

Internet Shopping Mall Golf Club			Korea Internet Shopping Malls			U.S Internet Malls
			www.Dcgol f.com	Dnshop.daum. net	www.Jasongo lf.com	
Callaway	Driver(Mo del 454)	White market	\$470	\$440	\$475	\$299
		gray market	\$265(56%)	\$270(61%)	\$345(73%)	
	Iron set (X-18)	White	\$1,390 (steel)	\$1,500 (graphite)	\$1,290 (steel)	\$699 (steel)
		Gray	\$815(59%)	\$1,020(68%)	\$990(77%)	
Taylor Made	Driver (R5dual)	White	\$399	\$495	\$490	\$279
		Gray	\$202(51%)	\$205(41%)	-	
	Iron set (Rac os2)	White	\$931	-	\$1,050	\$599
		gray	\$660(71%)	\$640	-	
Titleist	Driver (905T)	White	\$525	-	\$810	\$400
		Gray	\$480(91%)	\$512	-	
	Iron set (690)	White	-	-	\$1,200	\$799
		Gray	\$1,080	\$1,139	-	
Average		66%	66%	57%	75%	

* U.S. Internet Shopping Malls: www.golfgods.com/ www.dickssportinggoods.com/
www.edwinwatts.com

In the case of white market golf clubs, the price of golf clubs in Korea is higher than in the U.S. At the current market exchange rate, the Callaway golf club price in Korea is about 1.47~2.15 times higher than in the U.S., and the TaylorMade golf club price in Korea is about 1.33~1.77 times higher. If we apply PPP (Purchasing Power Parity), the price difference between the two countries is even bigger. PPP is an estimate of the exchange rate required to equalize the purchasing power of different currencies, given the prices of goods and services in the countries concerned. PPP means that the price of an item in one country will be the same as the price of the item in another country using existing exchange rates. GDP per capita in Korea is about USD 13,645, while on a PPP basis, it is about USD 17,340 (World Bank 2000). Therefore, the PPP exchange rate is around 1:787, while the market exchange rate is 1:1,000. When we apply PPP to golf clubs, the Callaway golf club price in Korea is about 1.87~2.73 times higher than in the U.S., and the Taylor Made golf club price in Korea is about 1.82~2.25 times higher than in the U.S.

Aside from transportation costs, tariff (8% of the imported price) and other transaction costs, major brand golf clubs are too expensive in Korea. Why are they so expensive in Korea? As this paper states earlier, golfing has been enjoyed by high income people or the upper class for a long time in Korea. The wealthy Korean golfers traditionally prefer only foreign made golf clubs, and golf shops have sold mostly high priced foreign made golf clubs for a long time (Weekly Dong-a, 4-22-04). Callaway and Honma golf clubs

have enjoyed a royal position in Korea. (An informal survey looked at 10 Korean golfers at the Springfield Country Club and 8 of them have Callaway iron golf clubs. Apparently Korean golfers still like famous brand golf clubs.) The major golf club companies have used a high price policy in the Korea golf market by means of their monopolistic child companies. The higher the golf club price was, the more the sale quantity was. Although this policy has been weakened today due to the increase in public golfers, and many golf shops stock Korean made or parallel imported golf clubs, the major brand golf clubs still maintain a high price in Korea. Major brand golf clubs still have a lot of bubble price (Weekly Dong-a, 4-22-04).

The high price of major golf clubs will continue for the time being as long as Korean golfers keep preferring foreign made golf clubs. It seems that preference for foreign made golf clubs will continue for some time. Many Korean golfers believe that the minor quality difference of golf clubs creates significant results in golfing because golf is a mental sport. Major brand companies also differentiate their golf clubs. For example: Callaway Korea insists that Callaway golf clubs in Korea differ from Callaway golf clubs in U.S. Callaway golf clubs in Korea fit Koreans' physical characteristics and body structure, although there seems to be no big difference of external features. Therefore, major brand companies insist that the high price is the result of long research and effort and is natural.

Table 10
The Price Comparison of White Market Goods between Korea and the U.S.

Research date: 12-16-2005

Internet Shopping Mall			Korea Internet Shopping Malls			U.S Internet Malls
Golf Club			www.Dcgolf.com	Dnshop.daum.net	www.Jasongolf.com	
Callaway	Driver(Mo del 454)	MER	\$470(157%)	\$440(147%)	\$475(159%)	\$299
		PPP	\$597(200%)	\$559(187%)	\$607(203%)	
	Iron set (X-18)	MER	\$1,390(199%)	\$1,500(215%)	\$1,290(185%)	\$699
		PPP	\$1,766(253%)	\$1,906(273%)	\$1,639(234%)	
Taylor Made	Driver (R5dual)	MER	\$399(133%)	\$495(177%)	\$490(176%)	\$279
		PPP	\$507(182%)	\$629(225%)	\$623(223%)	
	Iron set (Racos2)	MER	\$931(155%)	-	\$1,050(175%)	\$599
		PPP	\$1,183(197%)	-	\$1,334(224%)	

* U.S. Internet Shopping Malls: www.golfgods.com/ www.dickssportinggoods.com/
www.edwinwatts.com

** MER (market exchange rate) : 1,000Won=1USD

*** PPP (Purchasing Power Parity): 787Won=1USD

2. The Welfare Effect Analysis of Parallel Imported Golf Clubs in Korea

2-1. Basic Assumptions

- 1) This paper assumes that parallel imports began in 2006 for the first time. This assumption helps this study to see the effects of parallel imports easily.
- 2) This study assumes that before parallel imports the market share of foreign made golf club is 90% and Korean made golf club is 10%. The real market share of Korean made golf club is estimated at about 10% now (The Maeil Daily Economy Newspaper 05-18-2005). This assumption reflects this real market share.
- 3) After permitting parallel imports, the situation of the golf club market changes. Korean made golf clubs and major brand golf clubs for which normal or parallel imported are substituted in consumption. Since parallel imports result in a decrease in the demand for the Korean domestic golf club and normal imported golf club (white market), this causes decrease in the price of brand golf club.

This study assumes that the average market share of parallel imported golf clubs is 10%, and that the market share of Korean made golf clubs would fall from 10% to 7% (some consumers would switch to parallel imported brand golf clubs), and the market share of normal imported golf clubs would fall from 90% to 83%.

Table 11
The Assumption of Market Share Change

	white	Domestic	Parallel imports
Without parallel imports	90%	10%	0%
With parallel imports	83%	7%	10%

4) The assumption of price difference between normal imported golf clubs (white market) and parallel imported golf clubs (gray market) is an average of 30%. This is based on the current real price difference.

Table 12
The Real Price Difference of Iron Golf Clubs

As of 12-14-2005

		Korea Internet Shopping Malls	U.S. Malls
Iron set (Callaway x-18)	Normal	\$1,290 ~ \$1,500	\$699 ~ \$799
	Parallel	\$815 ~ \$1,020	
Korean made iron set		\$ 500 ~ \$850	

Parallel goods are 30% cheaper than white goods. Korean made golf clubs are 30% cheaper than parallel goods. Though iron golf clubs have a bigger difference than driver golf clubs, the average price difference is estimated at 30%.

Therefore, this study assumes that the price of golf clubs is as follows: Before parallel imports, the price of the normal imported golf club set (iron set + driver) is \$1,500, and the price of the Korean made golf club set is \$600 (40% level). With the parallel imports, the price of parallel imported golf club set is \$1,000, the price of the normal imported golf club set falls from \$1,500 to \$1,350 (10% fall), and the price of a Korean made golf club set falls from \$600 to \$540 (10% fall).

5) The assumptions about sale quantity are as follows: before parallel imports, the sale quantity of golf club set is 500,000 per year. 450,000 (90%) of them are white goods and 50,000 (10%) of them are Korean made golf clubs. This is based on the Korea Leisure News (08-17-13).

Table 13
The Assumption of Price and Sale Quantity (Price, Sale Quantity) Change

	white	domestic	Parallel imports
Without parallel imports	(\$1,500, 450,000)	(\$600, 50,000)	(\$0, 0)
With parallel imports	(\$1,350, 415,000)	(\$540, 35,000)	(\$1000, 50,000)

2-2. The welfare effects

Table 14
The Summary of Welfare Effect on Consumers
Unit: Thousands of US Dollars

Bnefits – Costs	77,375– 2,375	74,475
Consumers' Benefits(surplus)	Net	76,850
	* Direct effect	12,500
	Brand golf clubs' (gray goods) consumers' benefit	
	** Indirect effect	64,350
	** -1 Brand golf clubs'(white goods) consumers' benefit	62,250
	** -2 Korea domestic golf clubs' consumers	2,100
	*** Others	
Consumers' Costs	1) The decreased consumer surplus due to AS (after service) cost	2,375
	2) Others	

2-2-1 Consumer Benefits: Increase Consumer's Surplus

The economic literature on the welfare effect is limited. No clear case may be made that parallel imports are necessarily beneficial or harmful in welfare terms, although they do impair the interests of intellectual property right owners (Maskus 2001). Parallel imports arise where international price differences exceed the costs of transporting and selling goods across borders. Parallel imports undermine price differentials, driving prices down to the lowest price in the trading area (Danzan 1999). If parallel imports are permitted, therefore, the manufacturer's profit maximization strategy is to attempt to achieve a

single, uniform price in all connected markets in the long run. Uniform pricing leads to lower consumer welfare than differential pricing, although they could be served under differential pricing. Uniform prices preempt parallel trade, which implies higher prices in traditionally low-price countries (Danzan 1998).

However, parallel import becomes another channel for authentic goods and creates a new product version that allows the manufacturer to price discriminate. That is, the parallel importer gives consumers more choice and the manufacturer a new way to segment the market and price discriminate. One segment of consumers will stay with the authorized version because they place more value on the warranty and services that come with the authorized version. Another segment switches to parallel imports because a lower price is offered, due to its lack of warranties or country of origin. Also generated by parallel imports is the third and new segment that would not have bought this product before (Ahmadi and Yang 2000). Therefore, the effect of lowering price generally will increase consumers' welfare. A study commissioned by the European Commission predicted that parallel imports would reduce music CD prices by just 0.6% (NERA 1999). By contrast, the Australian authorities projected that parallel imports would reduce prices by 5-33% (Parliament of Australia 1997).

* Direct effect: Increase consumers' surplus of brand named golf clubs (gray goods)

Consumers' surplus is the difference between a consumer's willingness to pay for a good and the amount of money that must be spent to obtain the good. Consumer's surplus can be interpreted as a monetary measure of individual welfare change. Allowing parallel imports gets consumers to increase consumers' welfare. Consumers will be better off

because they can purchase genuine major brand golf clubs at a lower price than before. Consider the market for parallel imported golf clubs which is depicted in Fig.1. Suppose a parallel imported golf club set is currently not available. There is going to be a change that will offer parallel imported good club set for sale in a market at the price P_1 (\$1,000).

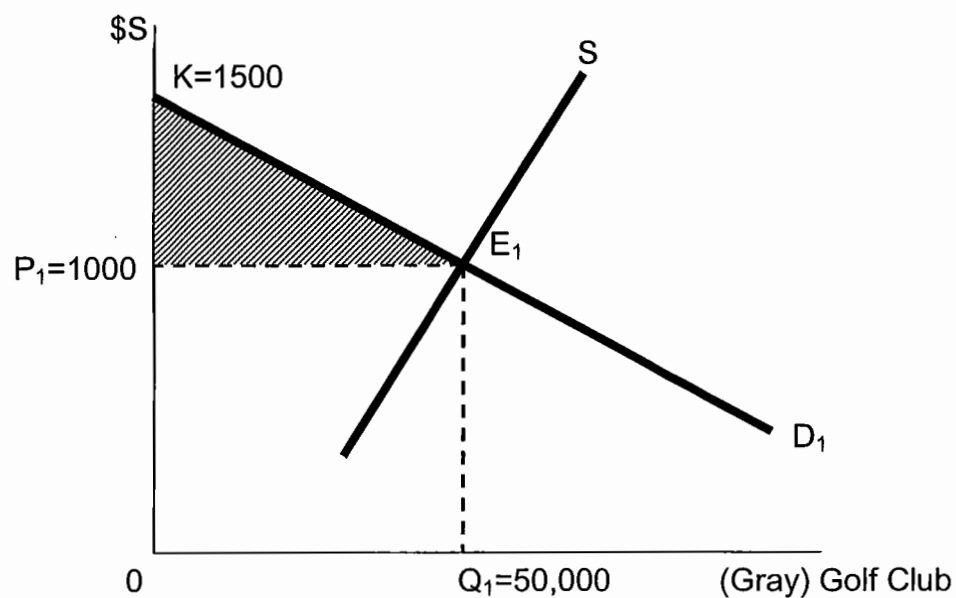


Figure 1. Consumers' Surplus of Parallel Imports ($=KE_1P_1$)

Since consumers will purchase Q_1 units (50,000), as assumption 5), at this price they must be better off because of this change. A monetary measure of this benefit would be given by the consumers' willingness to pay for a change that would make them better off. What is the largest amount of money they would be willing to pay to be able to purchase the parallel golf club (in any desired quantity) at the price P_1 (\$1,000)? How about

KE_1P_1 , or the consumers' surplus? By paying KE_1P_1 for the opportunity to buy golf clubs at the price P_1 (\$1,000), and then spending $OP_1E_1Q_1$ to purchase Q_1 units (50,000), the consumers would be exactly spending their OE_1Q_1 for Q_1 units of gray golf club. But they would spend no more than KE_1P_1 for this opportunity because that would mean they spent more on 50,000 units of golf club than their OE_1Q_1 for 50,000 units of golf club.

When the price of the parallel imported golf club set is the same as the price of the normal imported golf club set (= \$1,500), no one is willing to buy the parallel goods. Therefore, $K=\$1,500$, and consumers' surplus of parallel imported golf club (KE_1P_1) is counted as \$12,500,000 ($=\$500 \times 50,000 \times 1/2$).

**** Indirect (Secondary) effects**

**** -1 Increase consumers' surplus of brand golf clubs (white goods)**

The market equilibrium without parallel imports is determined by the intersection of D_1 and S in Fig.2. Since the parallel imports of brand golf clubs (gray goods) result in a decrease the demand for the substitute, this causes a decrease in the price of brand golf clubs (white goods), and the white market golf club with the parallel imports is given by D_2 and S . As a result of the government's policy to permit parallel imports, the price of normal imported golf club (white goods) is P_3 rather than P_2 , and white market golf club consumers are better off, other things being equal.

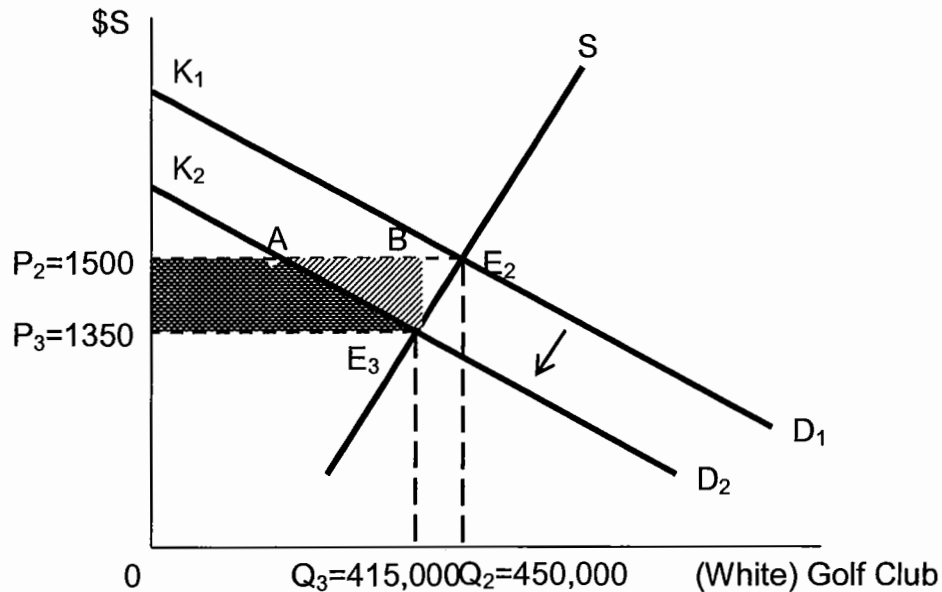


Figure 2. Consumers' Surplus of White Golf Clubs

By assumption 2), 3) and 4), $P_2 = \$1500$, $P_3 = \$1350$, $Q_2 = 450,000$, and $Q_3 = 418,500$. What would white market golf club consumers be willing to pay for? The change in consumers' surplus is given by the shaded area in Fig 2. This change in consumers' surplus of white market golf club is an indirect (secondary) benefit of parallel imports.

A mistake is often made in the interpretation of consumers' surplus in the white golf club market, by noting there is a decrease ($K_1K_2E_2E_3$) in white market golf clubs. It is sometimes mistakenly asserted that this decrease in white golf clubs is associated with a cost that must be netted against the benefit in the gray market for golf clubs. But there is no lost utility for consumers of white goods due to the parallel imports. Some consumers voluntarily switch from white goods consumption to gray goods consumption because the

gray goods are cheaper than white goods in spite of the same quality. They make this switch because they are better off, which means they benefit. Of course this leads to a decrease in demand for white goods which leads then to a decrease in the price for white goods. Therefore, those consumers who remain in the white good market are also better off because of a lower price. There simply is no cost to consumers of either white goods or gray goods to net because none of these consumers ends up on lower indifference curves. All the consumers in these two markets move to higher indifference curves.

In this study's case, estimation of the parallel imports' benefits would require estimation of the demands for white goods and gray goods, along with estimation of the prices of both commodities with and without the parallel imports. However, deriving or estimating supply and demand curve is very difficult because exact data are not sufficient. Thus, although this is a little overestimated (triangle ABE_3 in figure 2), this study approximately counts consumer surplus by multiplying price decrease and the quantity of white goods with parallel imports. The consumer surplus = the price decrease x the quantity of white golf clubs with parallel imports = $\$150 \times 418,500 = \$62,250,000$.

** -2 Increase consumer surplus of Korean made golf clubs

The logic of consumer surplus on the white market is applied equally to the Korean made golf club market. Since parallel imports result in a decrease in the price of major brand golf clubs, this causes a decrease in the demand for the substitute, and the Korean domestic golf club market with the parallel import is given by D_2 and S . As a result of the parallel imports of major brand golf clubs the price of Korean domestic golf clubs is P_5 rather than P_4 , and Korean domestic golf club consumers are better off, other things

being constant. The change in consumers' surplus is given by the shaded area in the diagram. By assumption 2), 3) and 4), $P_4=\$600$, $P_5=\$540$, $Q_4=50,000$, and $Q_5=35,000$. Thus, although this is a little overestimated (in figure2, triangle KME_2 is overestimated), this study roughly counts consumer' surplus by multiplying price decrease and the quantity of normal imported golf clubs (white goods) with parallel imports. The consumers' surplus = the price decrease x the quantity with parallel imports = $\$60 \times 35,000 = \$2,100,000$.

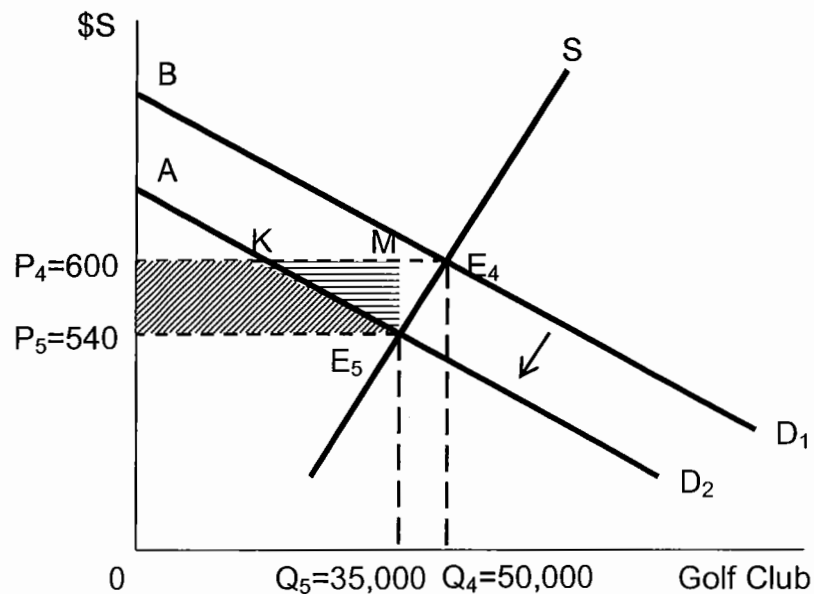


Figure 3. Consumers' Surplus of Korean Made Golf Clubs

*** Other Benefit

***-1 Reduce counterfeit goods

Parallel imports can reduce counterfeit goods. The price difference of golf clubs in Korea is too diverse. The price difference of a set of golf clubs is from \$500 to \$5000-6000. Korean made full golf club sets are sold well below \$1000, U.S. products have a nearly monopolistic market share between \$3000 and 4,000, and Japan products are sold for well over \$4000. Parallel imports are mostly made in U.S. and are sold from \$2,000 to 3,000. Counterfeited golf clubs are sold for just \$150-250. We cannot know exactly the sale quantity of counterfeited golf clubs. Most counterfeited golf clubs imitate Japanese products. That's because U.S. companies have lowered price continuously, and the parallel imports of U.S. products substituted for them have increased rapidly. As a result of that, many imitators have given up making U.S. products.

***-2 Increase major brand value

Parallel imports have the possibility to increase major brand value. Parallel imports give the manufacturer a new way to segment the market and price discriminate. One segment of consumers stays with the regular imported goods (white goods) because they place more value on the warranty and services that come with the white goods. Another segment switches to parallel imports because a lower price is offered, due to its lack of country specific features or warranties. Also generated by parallel imports is the third and new segment that would not have bought this product before (Reza Ahmadi, 2002).

Unlike counterfeits that are fabricated by imitators, parallel imported golf clubs are genuine and sourced from the manufacturer in the lower priced country through an

authorized dealer. Therefore, the manufacturer's total global sales quantity should increase. In Korean golf markets, most of parallel imported golf clubs are Callaway or TaylorMade clubs. Actually, their sale quantities including parallel imported goods have increased more than 10% every year, but profit may rise or fall depending on the relative sizes and profitability of the segments. Anyway, because the market share is one of the most important things on determining brand value, the bigger market share can increase the brand value. However it is very difficult to measure market share as money.

2-2-2. Consumer Costs

1) The decreased consumer surplus due to AS (after service) cost

The biggest difference between normal imported golf clubs and parallel imported golf clubs is in AS. Most parallel importers in Korea are small companies or individuals. They cannot supply AS with their golf clubs. Normal imported goods can receive AS for free. However, some companies like Callaway give after service to the gray goods for money (not for free) on defects. Of course consumers of parallel imported golf clubs can receive in the U.S. because parallel imported golf clubs are not counterfeits but genuine products. Consumers can receive AS service for free if they send their golf clubs to the brand company in the U.S. However, it must much more expensive because of transportation cost and time. Therefore, the absence of AS increase cost to consumers. In the Korean used golf club market, golfers who want to sell their parallel imported golf clubs should discount an additional 5-10% of the golf club price as an AS cost. This study adds an

assumption that if the average AS cost is 5% of the golf club price, supply curve will shift upward ($S_1 \rightarrow S_2$) and equilibrium quantity will fall 5%.

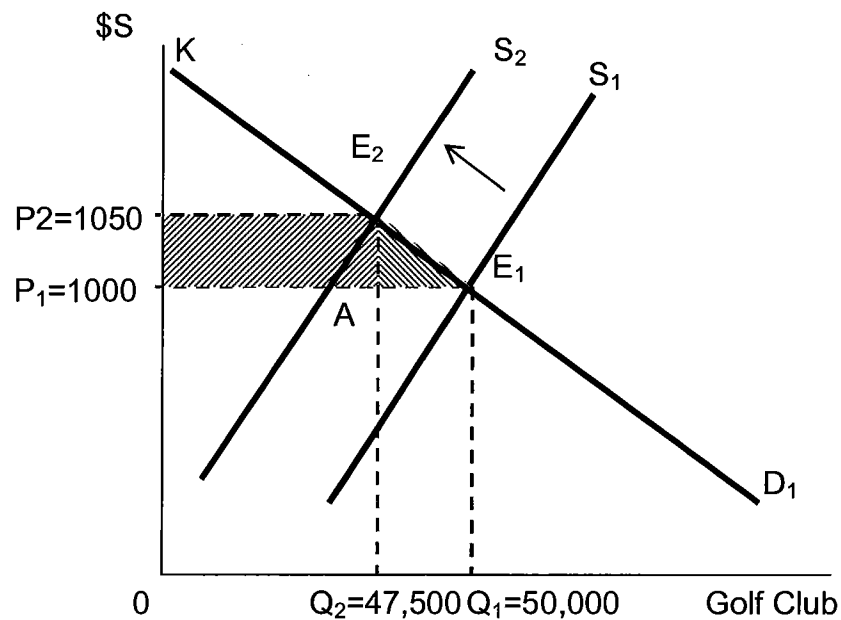


Figure 4. The Decreased Consumers' Surplus due to AS Costs >

The decreased consumer surplus due to AS costs is counted as $P_1P_2E_2E_1$ in Fig 4. It is counted as \$2,375,000 ($=\$50 \times 47,500$). It is underestimated as triangle E_2E_1A in Fig 4)

2) The problem of encouraging consumer deception and trade in counterfeit goods and pirated goods

It is often argued that permitting parallel imports encourages consumer deception and trade in counterfeit goods and pirated goods. However, such arguments are irrelevant

in the strict sense of assessing the impacts of parallel imports. Consumer deception would occur if lower-quality parallel imports were marketed as legitimate versions of higher-quality products (Maskus 2000). Counterfeiting and piracy are trade in unauthorized versions of products, which is a different concept than parallel imports. In either case, customs authorities are empowered to act against such trade without restricting genuine parallel imports. Therefore this is not a cost of parallel imports.

3) Free-riders

Parallel imports are sold at a lower price to consumers than regular imported golf clubs. However, these may not necessarily have a lower profit margin because they can free ride on the promotional efforts of authorized dealers. In general, many firms do a lot of advertisements to inform people about their goods. In the case of general consumption goods, it is known that on average, 4-8% of the total sale amount is used for advertising costs. If golf club companies like Callaway and TalyorMade or franchisers invest in advertisements or post-service, such as supporting golf contests, this can play an important role in maintaining brand value. However, parallel importers don't need to pay these costs. Therefore, parallel importers are free-riders that gain benefits out of a brand company's advertisement and fame. Parallel imports may undermine authorized dealers' selling efforts.

*Authorized dealers
will go to 0%*

2-3. Sensitivity Analysis

This study changes 2 assumptions to know the change of consumer's welfare sensitively, and the other assumptions remain unchanged. First of all, this study changes an assumption that the market share of parallel imported golf clubs is 10%. If the market share of parallel imported golf clubs is 20%, what is the change of consumers' welfare? Secondly, this study assumes that before parallel import the sale quantity of a full golf club set is 500,000 per year. However, if the current market is bigger than our assumption, what is the change of consumers' welfare benefit?

A simple sensitivity analysis of the Korean golf market shows that parallel imports give not only consumers' surplus on parallel imported golf clubs (gray goods), but also much more consumers' surplus on authorized brand versions (white goods). However, the more the market share of parallel imports is, the less consumer surplus of white goods. That is because the more the market share of parallel imports is, the more consumers switch to parallel imports. If current the market scale is bigger than this paper's assumption (Alternative 3), the consumer benefits are getting bigger. Therefore, accurate estimates about market scale help the decision on whether parallel imports should be permitted or not. The result of simple sensitive analysis is as follows:

Table 15

The Result of Simple Sensitive Analysis

Unit: thousands of U.S. dollars

Assumptions	Basic result	Alternative 1	Alternative 2
The average market share of parallel imported golf club	10%	20%	10%
The annual sale quantity of golf club full set.	500,000 units	500,000 units	1,000,000 units
Net (Benefits-Costs)	74,475	79,575	148,950
Consumer Benefits	76,850	84,325	153,700
* Brand golf clubs' (gray goods) consumers' benefit	12,500	25,000	25,000
** -1 white goods' consumers' benefit	62,250	58,125	124,500
** -2 Korean made golf clubs' consumers'	2,100	1,200	4,200
	2,375	4,750	4,750
Consumer Costs	2,375	4,750	4,750
* The decreased consumer surplus due to AS (after service) cost			

2-2-3 Producer or Distributor Welfare

Until now, this paper has studied the consumer benefits of parallel imports in the Korean golf market. Korean golfers' benefits increase because they can buy major brand golf clubs or Korean made golf clubs at a lower price. However, Korean golf producers lose some benefit because parallel imported golf clubs substitute for Korean made golf clubs.

Major brand golf club producer benefits depend on the profit of parallel imported golf clubs. If the profit of parallel imported golf clubs is bigger than the loss of white golf clubs, benefits will increase.

To summarize, the winners and losers are as follows:

Table 16
The Winners and Losers in Parallel Imports in the Korean Golf Club Market

Participants	Entry of Gray Goods		Contents
	Winner	Loser	
Korean golfers	○		Lower prices
Korean golf club producers		○	Fewer goods sold
Major brand golf club producers			Indeterminate
Korean gray market distributors	○		More goods sold
Korean white market distributors		○	Fewer goods sold

↑
go to zero?

Policy solution - logo for
the white-market clubs

V. A Proposal of Public Policy on Parallel Imports

The issue of permitting parallel imports of patented and trademarked medicines is being debated currently with much concern and controversy. In this situation, this study looks at many countries' trends, TRIPS regulation, and a simple consumer benefit-cost analysis of parallel imports. Through this study, we recommend some rules regarding when parallel imports should be allowed and when they should not be. This paper makes the following recommendations.

First of all, parallel imports should be permitted according to the principle of free trade, if the cost of parallel imports to the country is not much larger than the benefit to consumers. Parallel imports provide much consumer benefit, and the restraints against parallel imports might constitute non-tariff barriers to trade. However, policymakers should consider the economic effects which parallel imports give to the country. If the cost of parallel imports is much bigger than benefit, it should not be allowed. The TRIPS Agreement states that each country has established its own public policy covering parallel imports.

When we see the simple consumer welfare benefit-cost analysis of the parallel imports of the Korean golf club market through a lot of assumptions, the benefits, especially consumer surplus, are very big. A simple consumer welfare benefit-cost and sensitivity analysis of the Korean golf market shows that parallel imports give not only consumers' surplus on parallel imported golf clubs (gray goods), but also much more

consumers' surplus on authorized brand versions (white goods). However, the parallel import cost might be much bigger. Producer surplus, above all, is decreased. For Korean made golf clubs, the decrease of producer surplus may be small because the market share is not big. However, the situation in other industries may be totally different.

According a research, drug parallel trade would cost the California State economy at least \$670 million and 23,900 jobs, and as much as \$3 billion and 105,600 jobs, because pharmaceutical and biotech research are heavily concentrated in California (Romero 2006). After the analysis of economic effects, other issues should be considered. In the case of medicines, of course, issues other than free trade come into play. Public safety, availability, and the difference in health insurance systems and pricing policies must all be considered.

Second, even if parallel imports are permitted, there can be allowed some exceptional cases where international exhaustion is problematic. For example, when the intellectual rights holders in the exporting country and importing country are different, it is difficult to presume that the owner's rights have exhausted in the importing country, on first sale in the exporting country. Therefore, parallel imports should be restricted. The Korea Customs Service Act now regulates these principles. However, the Act just processes regulations relating to customs clearance and has legal uncertainties. Therefore, customs regulations on parallel imports must change into substantial law that has legal validity.

Third, governmental intervention or public policy is required to protect consumers and to reduce the cost of parallel imports. Government has to inform and educate

consumers. Consumers have to have full information about parallel imported products. For example, the government has to set up a clear labeling system of all parallel imported goods. The government also must disclose to customers of parallel importers and their distributors that they are not authorized dealers and that the product is not sourced through authorized channels, and that therefore parallel imports may not offer the same guarantee. Under complete information, consumers can choose rationally which product is the best choice. Government's public policy to help consumers' rational choice is necessary.

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