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June 2007

The Exhaustion of Intellectual Property Rights

Should countries favour consumers or private interests?

By Mark Halle

Sometimes, making the right choices on trade policy means going down to the engine room, understanding the machinery and knowing what gauges, dials or valves to adjust. Trade policy, more than most other public policy areas, is vertically integrated and cannot always be got right from the captain's deck. The fact that you emerge covered with grease spots is just part of the price to pay.

A new IISD paper by Frederick Abbott[1] looks at one such issue—that which is known as "exhaustion of rights" under patent, copyright and trademark law. The WTO's agreement on Trade-Related Intellectual Property Rights (TRIPS) accords States the liberty to choose their own exhaustion regime from among three possibilities: national, regional or international. What does that mean, and what is the significance of choosing one option over the other?

First, though, what is exhaustion? The holder of a patent for an invention has the right to a payment when the invention is sold. But when that invention or product is sold, the patent-holder has no further rights over the new owner's private use of the invention. His or her rights under patent law are "exhausted" by virtue of the sale and the patent-holder's recompense. The same is true of copyrights and trademarks. Once you pay for your iPod, you have the right to display and refer to its Apple trademark publicly. And when you buy the latest John Grisham bestseller, your right over that book includes displaying it publicly, lending it to your friends and making photocopies of your favourite pages because the author's rights were exhausted with the purchase.

So far, so good, but *where* exactly have the rights expired? The answer depends on the choice made by each country. Their choice is to define the scope of the exhaustion as being their national territory, a defined region (such as the European Union) or the entire world. "Parallel Importation" by Frederick M. Abbott examines the pros and cons of the different options from economic and social welfare points of view.

A regime of national exhaustion is clearly the most restricted. It allows the producer to set different prices for, say, a new pharmaceutical product, applying higher prices in richer countries, and lower prices where the market cannot bear as much, or where it is seeking to establish a position against strong competition. While retailers may import from cheaper markets, they may then be subject to tariffs or other border measures that could bring the price once again close to those prevailing on the home market. In the language of economics, national exhaustion allows more market segmentation.

> To simplify, national exhaustion tends to favour the producer, while international exhaustion tends to favour the consumer.

1 See Parallel Importation: Economic and social welfare dimensions, by Frederick M. Abbott, at http://www.iisd.org/pdf/2007/parallel_importation.pdf

In a regime of international exhaustion, once a product is put on the market anywhere, it is considered an openly-traded good, with its import and sale subject only to national regulation, such as that governing public safety and health. This allows retailers to take advantage of price differentials to import from the cheapest reliable supplier.

An intermediate solution—which resembles national exhaustion more than it does international—is to define the scope of exhaustion as being a given geographical region. For example, it is in common use in the European Union. But regional exhaustion tends to apply in markets with broadly similar conditions.

What are the implications of the choice for human welfare? In fact they illustrate a conundrum that bedevils the entire trading system. To simplify, national exhaustion tends to favour the producer, while international exhaustion tends to favour the consumer. So, in debating the choice, it is interesting to observe whether governments and parliaments are more attentive to private interests or to the public good. There are no prizes for guessing which way the decision goes in most technologically advanced countries.

This situation is not dissimilar to trade policy cast more broadly. How do governments balance the interests of the wide mass of consumers—usually poorly organized—with the interests of private players—usually vocal and well organized? A forthcoming IISD book examines precisely that.

Mark Halle, based in Geneva, is IISD's Director of Trade and Investment.