

ABSTRACT

This paper seeks to determine the economic significance of trademark protection. The analysis covers the implications of the trademark law to consumer information, advertising and product differentiation, competitive behaviour and industry structure in the producing and the distributive trades.

The author argues that trademark protection is partly responsible for strong barriers to entry of new firms into an industry. Not only does it encourage advertising and other forms of differentiation, it also serves to enforce restrictive arrangements such as exclusive distributorship, market sharing, tying, and resale price maintenance. It is also argued that through the above arrangements, trademark protection influences the structure of the distributive trades, hence their relative bargaining strength vis-a-vis the producers. The study shows further that although a trademark serves as a storehouse of information regarding a product's properties, the proliferation of trademarks may serve to confuse rather than inform the consumers. Finally, no reason has been found for associating "real" (as opposed to "fancied") differentiation with trademark protection.

TRADEMARK PROTECTION:
AN ECONOMIC EVALUATION

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PREFACE

The author's interest in this subject has been aroused by recent efforts of the Economic Council of Canada to re-examine public policies towards patents, trademarks, copyrights and industrial designs. This paper represents an attempt to identify and analyse the economic implications of conferring legal protection over trademarks.

The problem is approached from a theoretical standpoint, with a view to formulating a number of hypotheses regarding the impact of protection on product information, on competition, industry structure, product quality and variety. Many of these hypotheses have a bearing on certain theoretical issues particularly with respect to traditional assumptions regarding consumer behavior, the nature of product differentiation, quality competition, and the notion of consumer sovereignty.

Also significant are some of the findings regarding methods used by firms to restrict competition. Trademark licensing has been shown to play a role in establishing "tying" arrangements, exclusive distributorship, and market-sharing agreements. Trademarks have also been used in resale price maintenance and for carrying out price discrimination. Considering their policy implications, these would suggest the avenues for modifying some provisions of the trademark law.

The economic implications of trademark protection have been broadly classified into four major groupings, namely, (a) the effects on the efficiency of information; (b) effects on competition; (c) effects on the distributive trades and the vertical structure of supply; and lastly, (d) the benefits and costs of protection.

The literature in the fields of marketing and law provided very useful insights into the real functions of trademarks in commerce. They provided the main raw materials from which several hypotheses were drawn. This paper represents an attempt to analyze these hypotheses in the light of economic theory.

The author is greatly indebted to Professor J. Handa and Professor P. Briant for their assistance in ironing out some of the conceptual difficulties encountered during the preparation of the study. Professor Vicas also spent valuable time reviewing the paper and providing useful comments and criticisms. I wish to thank also my fellow students Messrs. D. Hull, G. Ruan, D. de Melto and Miss V. Graham for their kind assistance and encouragement in carrying the work through to its completion. Finally, Miss Wendell Edwards deserves high praises for the skill with which she transcribed my jumble of notes into formal form within only a few days.

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INTRODUCTION

There are three important reasons for our interest in studying the economic significance of trademark protection. First, there is a growing feeling among policy makers that the legal protection conferred upon this industrial property right has adverse effects on consumer welfare. Second, unlike patents or copyrights, trademarks have received virtually no attention from the economic profession so that very little information or theory is available to guide public policy. And third, such a study may provide a better understanding of the environment in which business firms are operating and the influences of such environment upon their behavior.

We shall consider three fundamental questions in this study:

- (1) How does trademark protection affect economic efficiency?
- (2) How does trademark protection affect the structure of distribution in our economy?
- (3) What are the social costs and benefits of trademark protection?

The first question considers three distinct areas of efficiency, namely: efficiency in consumption, in production, and in physical distribution. For consumption the relevant questions are: How is trademark protection relevant to market information? Does trademark protection indirectly affect the supply of information relevant for consumer buying decisions? Does it affect the accuracy of information

supplied?

For distribution (here used in the sense of marketing goods) we ask the following questions: Does trademark protection serve as a "sine qua non" condition for advertising and sales promotion? How does it affect the strength of producers vis-a-vis the distributive trades? What are the implications of "private" labeling (or trademarks of distributors)? Does it lead to vertical integration?

The effects on the efficiency of production are more indirect and perhaps less apparent. Does trademark protection act as a barrier to entry? Does it lead to or encourage 'wasteful' product differentiation? Does it lead to or facilitate restrictive trade practices?

Most of these questions are unavoidably qualitative in dimension and therefore lend themselves less easily to empirical investigation than would be desirable. Nevertheless we shall whenever possible, support our premises and conclusions with data derived from related investigations.

The second question hopes to examine the role of trademarks in establishing a link between producers and consumers, and how this becomes significant in the former's control over pricing, product and sales policies of distributors. Does the existence of trademark pro-

tection to society. What criteria may we use to evaluate the desirability of having trademark protection? Is the efficiency criterion from the conventional perfect competition model a relevant guide for public policy? Would it be possible to measure social costs and benefits for comparison?

It is noteworthy that in spite of the frequent mention of trademarks in discussions of product differentiation and monopolistic competition very little serious consideration has been devoted to the economic aspects of trademark protection. In the United States, the Committee of the Judiciary of the Senate produced no report on the economic questions related to trademark protection, while reports on patents and copyrights were prepared.¹ In Canada, the Ilesley Commission studying the effects of granting protection to industrial property rights, omitted evaluation of trademark protection while devoting long discussions on the economic issues relating to patents, industrial designs, and copyrights.²

There are two possible explanations for this omission. One is perhaps the common belief that trademark protection carries no implications fundamentally different from those of patent protection.

¹See U.S., Congress, Senate, Committee on the Judiciary, Subcommittee on Patents, Trademarks, and Copyrights, 87th Congress, 1st. session 1961 (Washington D.C., U.S. Government Printing Office, 1961).

²Canada, Royal Commission on Patents, Copyrights and Industrial Designs (Ottawa, Queen's Printer, 1960).

This is most notable in the joint mention of these two forms of protection very frequently in the literature.³ Another reason, although a less convincing one, is the possibility that many people can see no problem in trademarks as opposed to patents.⁴

Review of the literature leaves little doubt that most economists fail to see any substantial difference between the economic effects of trademarks and patent protection. Some find in patents clear elements of monopoly and in trademarks some form of quasi-monopoly, but little effort is exerted to determine the exact nature of the distinction.⁵

³For instance see Thomas Anderson, Our Competitive System and Public Policy (Cincinnati, South Western Publishing Co., 1958), p. 27 and Charles Hession, S. Miller and Cronuen Stoddart, The Dynamics of the American Economy (New York, Knopf, 1956), p. 371.

⁴There are those who argue that there is no monopoly problem with trademarks. "These things [patents and copyrights] are monopolies created by law ... A trademark is quite a different thing. There is no element of monopoly involved at all ... A trade-mark precludes the idea of monopoly". See Edward Rogers, Goodwill, Trade-marks and Unfair Trading (New York: Shaw Co. 1914) See Chapter III.

⁵"Somewhat analogous to the profits arising from a patent" according to Johnson, "are the profits arising from the use of a trademark or from the 'goodwill' of a concern". These returns "fall under the general head of monopoly profits", See Alvin Johnson, Introduction to Economics (Boston, Ginn & Co., 1922) p. 246. Professor Young says, "He (user of trademark) may even find that he can increase his net profits by putting the price of his goods somewhat higher than that at which precisely similar goods are sold in the market ... he is able to obtain what might be termed a quasi-monopoly". In R.T. Ely and Ralph Hess, Outlines of Economics, (New York: MacMillan Co. 1939) pp. 562-63.

There is therefore an immediate need for justifying a distinction between the theory of patents, and, if you will, the theory of trademarks before we proceed with the study. Our justification is provided in Section C of the following chapter. Some definitions are also in order before discussing the economic consequences of trademark protection. These, together with a discussion of the "social" and "private" functions of trademarks are given in Chapter I.

CHAPTER I

TRADEMARKS IN PERSPECTIVE

The law defines a trademark as "a mark used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, sold, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others."⁶

Registration of such a mark "in respect of any wares or services, unless shown to be invalid, gives the owner the exclusive right to the use of such trade mark ... throughout (the territory of the registering country).⁷ This right is deemed to be infringed by a person who sells, distributes or advertises wares or services in association with a confusing trademark, unless he has been licensed to do so.

A. SOCIAL FUNCTIONS

Upon inspection of the law we are able to identify three main social functions of trademark protection:

(1) To protect the public against false claims as to the source of the goods or services, or to the possible confusion regarding the source of such goods or services;

⁶See Public Law 489: An Act To Provide for the Registration and Protection of Trademarks Used in Commerce, to carry out the Provisions of certain International Conventions, and for other Purposes (Lanham Act; H.R. 1654); U.S. Statutes 1946 79th Congress 2nd session (Washington D.C. Superintendent of Documents, 1947); and Trade Marks Act in Revised Statutes of Canada (Ottawa, Queen's Printer, 1953) Chap. 49, pp. 377-408.

⁷Trademarks Act, Ibid., p. 378.

(2) To protect the rights of registered owners to the good will they may have earned in the course of their business; and

(3) To encourage maintenance of quality standards.

The identification of the source of a produce is generally considered to be the main function of the trademarks. Implicit in this function is the common concern for providing a convenient source of information as to the party or parties responsible for the qualities of a product. It is in one instance a device with which consumer satisfaction with the qualities of a given product can be directed to reward its specific source, and in another, a device through which the source of a bad-quality product can be identified and censured through loss of custom for his trademark.⁸

The second function mentioned above is a most significant one, as we shall see later, around which much of the practical issues concerning the use of trademarks revolve. It is a reflection of a legal precept which considers the right to goodwill as a fundamental right. As this may and as ^{it} shall show this will, result in monopolistic conditions, it also underscores a fundamental inconsistency in public policies towards competition.

Finally, as an incentive to maintain quality, trademark protection seeks to protect consumers against the possibility of deception on account of unannounced changes in quality of trademarked pro-

⁸See infra p. 98

ducts with which many consumers may have already become familiar.

There may be other social functions served by trademark protection but the above seem to be the major underlying principles behind the law. In the final analysis, the ends they pursue are a reflection of social valuations which will serve as standards for determining the social losses traceable to the law's harmful effects.

B. BUSINESS FUNCTIONS

Trademarks, judging from their predominant existence in almost all articles of commerce, occupy very important roles in the physical distribution of goods.⁹ This importance varies from one market to another depending upon such factors as consumer knowledge about the product, physical properties of products being sold, and the success of sellers in relating product use to other than physical human needs.

Consumer knowledge about properties of the product limits the business use of trademarks to that of 'identification'. For instance, in the industrial goods markets buyers are generally very well qualified to determine with precision the properties of products they purchase. Here trademarks are of secondary importance, and where decision problem arises from two or more products having identical qualities, the only determinant in choice is price. On the other hand,

⁹Physical here is used to distinguish the term distribution from its abstract meaning in consumer theory.

where consumers are ignorant about product properties, such as gasoline for their cars or television sets, trademarks often become the major determinant of purchasing decisions.

Consumer knowledge about products depends on a number of factors. Frequency of purchase may be one of them. The housewife who goes to the grocery store more than once a week is often very knowledgeable about the specific qualities of the products offered for sale and is more apt to buy on the basis of rational calculations involving price-quality relations. On the other hand durable consumers goods bought very infrequently are often purchased on the basis of trademark reputation since the buyers are not able to perform the marginal calculations involved if choice is to be on the basis of price and durability relation alone.

There are interesting paradoxical cases such as in drugs. The decision maker for purchases is always a knowledgeable medical doctor who prescribes the medicine for the patient. And yet trademarks occupy a very predominant role in the marketing of pharmaceutical products. Upon inspection it will be noted that prescribing physicians are often uninformed about relative prices and thus rely on the brand.

The physical characteristics of the product or service also influence the importance of trademarks in the distribution of goods. Before the advent of modern packaging methods, meat and fish products,

and fresh vegetables could not have been properly affixed with a distinctive mark or label. Today this no longer presents a big problem since the use of plastics and improvements in conventional packages can be applied on almost all types of products.

Finally sellers may be successful in diverting consumer attention away from physical properties of the product to the reputation of the trademark. It is a well known fact in marketing that higher income groups tend to be more brand conscious.¹⁰ The desire to emulate people of higher status may be a stronger determinant than price and quality in the choice of a brand. Sellers recognizing this fact have been known to profit from the situation by creating a "luxury image" for their brands.

These are the circumstances which enhance or limit the uses of trademarks in the physical distribution of goods. The uses of trademarks, in turn, are related to the marketing objectives of firms. Our discussion of the functions of trademarks will be incomplete without examining the way trademarking is viewed by the business firm.

There are many advantages in branding, according to marketing specialists. From popular marketing textbooks we note the following

¹⁰See Burleigh Gardner and Sidney Levy "The Product and the Brand" Harvard Business Review (March-April 1955). Also interesting are the results of a survey reported in Ross Cunningham, "Brand Loyalty - What, Where, How Much" Harvard Business Review (Jan. - Feb. 1956).

benefits which a brander is supposed to enjoy:

- (1) he develops a strong "consumer franchise" and may become a price leader in the field;
- (2) branding reduces the amount of selling time;
- (3) it enables him to control a share of the market; and
- (4) it enables him to force retailers to carry his products.¹¹

The emphasis placed by producers on developing strong consumer franchise is so evident that we need not spend time on it. We may instead look at some of the main reasons why it is an important preoccupation of marketing men. According to another textbook a strong consumer franchise is important because it leads to greater stability of demand. But a "steady demand facilitates planning and ... makes possible the attainment of reasonable costs per unit of output."¹²

Another benefit of having a strong consumer franchise as seen by marketing men is the possibility it affords the brander to set prices for the industry. In highly concentrated industries characterized by oligopolistic conditions, monopoly profits can be

¹¹See Jerome McCarthy, Basic Marketing: A Managerial Approach (Homewood, Ill., Irwin, 1960) p. 86. Also Ralph Alexander and Thomas Berg, Dynamic Management in Marketing, (Homewood, Ill., Irwin, 1965) pp. 111-16.

¹²See Maynard Phelps and Howard Westings, Marketing Management (Homewood, Ill., Irwin, 1960) p. 91.

maximized for the industry by having one firm set the industry price. But since size of plants and cost conditions vary from firm to firm, the price set may not correspond to the profit maximizing output ($MR=MC$) of some firms. The price leader has the advantage of setting the price which best suits the maximizing conditions in his firm.¹³

A third benefit recognized from possession of strong consumer franchise is that it facilitates the entry of already established firms into new product markets.¹⁴ A well established firm may find it worthwhile to add another product to its product line and sell it under its already well known trademark. Thus in Australia, as Hines points out, we find Frigidaire washing machines and His Master's Voice refrigerators!¹⁵ There is clearly a distinct advantage here in entering a new field with a well-established trademark.

A strong consumer franchise also suggests the third advantage

¹³Of course branding as used here also involves advertising and developing the brand. The price leader, according to a study of American industry, always holds a substantial share of the market and normally is an 'old timer' in the industry. See Richard Caves, American Industry: Structure, Conduct, Performance (New Jersey: Prentice Hall, 1964) p. 43. Incidentally Caves affirms for the present the pre-World War II observation that "prices determined under the price leadership regime probably constitute the most common form of controlled prices in the American market." See David Lynch, The Concentration of Economic Power (New York: Columbia University Press, 1946) p. 174

¹⁴At first glance this may seem paradoxical for as we shall see later trademarks act as barriers to entry. But it is clear that this barrier only works against "new" brands.

¹⁵See Howard A. Hines, "Effectiveness of Entry by Already Established Firms", Quarterly Journal of Economics, February, 1957, p.145.

mentioned, namely control of a share of the market. Perhaps by control here is meant monopolistic power gained by the brander who succeeds in differentiating his product to such an extent that it becomes, in a sense, another "industry". In fact control from having a "differentiated" product may simply arise from the possibility that consumers are not aware of good substitutes.

Take the drug marketing practices for instance. The Senate Committee Hearings on the pharmaceutical industry¹⁶ revealed that the manufacturers engage in the practice of deliberately making generic names for new drugs very difficult to remember (long chemical names obviously meant to discourage doctors from using them) and selling them under easily remembered brand names. The whole promotional program is directed at making the doctor prescribe the brand instead of the generic name.

As if this was not enough, the pharmaceutical industry also lobbied for the passage of an amendment to the Fair Trade laws in each state making it a criminal offense for druggists to substitute other brands for the one prescribed by the doctor even if the pharmacist knows them to be chemically identical!

¹⁶See U.S., Congress, Senate, Committee on the Judiciary, Administered Prices, Drugs, 87th Congress, 1st session, 1961 (Washington, D.C., U.S. Government Printing Office, 1962) p. 174.

A monopolistic position implies in turn "greater independence in price determination."¹⁷ With regards to the importance of branding in conferring pricing independence to the firm, not much can be said except that a host of other factors must first be considered. Obviously the price will depend on the competitive conditions, industry practices, i.e. collusion, introduction of new substitutes, etc. A strong consumer franchise also may be relevant within a narrow price range only. Cigarette manufacturers, for instance, have learned to their dismay that no matter how much they advertised smokers shift to new brands once prices are raised by more than a few cents per pack.¹⁸

Branding is also considered the means by which producers can control their markets "through to the final consumer". Selling a well known brand enables them to dictate to distributors minimum resale prices and to restrict them to certain market territories. We shall see more of these in our chapter on restrictive trade practices.

Comparison of the "social" and "private" functions of trade-marking points to a very significant issue which may profitably be

¹⁷Phelps and Westings, op.cit., p. 92.

¹⁸For an exhaustive study of price policies in this industry see William Nicholls, Price Policies in the Cigarette Industry (Nashville, The Vanderbilt University Press, 1951) especially Chapter X, pp. 127-136.

raised up before we leave the subject temporarily. That is, the conflict that arises when trademarks are employed for purposes outside the intent of the law. Talking about the protection given by trademark law, Chamberlin says "A producer has no right to exclude others from manufacturing and selling the same product, even the 'identical' product. He can claim protection only against anyone forging his name, and it seems to be the theory of the law that he be protected only in this respect Legal cases and textbooks agree that the function of the trademark is to show origin, to identify. The question is, where does identification leave off and differentiation begin? There would be mere identification, without further differentiation of product, in the case of two competing goods, identical in every respect - as to color, shape and design, labels, marks and names, everything except only an inconspicuous identification mark or name and the address of the producer. Obviously "protection" which went no further than this would have no economic value to the producer, for it would mean no more to the buyer than does the slip found in a container (and which identifies perfectly), "Packed by No. 23." Except where the buyer deals directly with the seller, as in retail trade, and where personal relations therefore enter in, origin is of absolutely no significance to him except as it indicates quality. The purchaser of "Lux" probably does not even know that it is made by Lever Brothers Company, to say nothing of caring whether it is or not. The name stands for a certain quality,

a certain product, not a certain producer, and to permit only one producer to use the name is to grant him a monopoly to this product. The law does vastly more than to identify."¹⁹

C. THE THEORY OF PATENTS AND TRADEMARKS

Why is there a need to study trademarks separately from patents? Are not the effects of trademark protection similar if not identical with those of patent protection?

There are, to be sure, some similarities between patents and trademarks. From the standpoint of competition, both represent barriers to entry and hence are related to monopolistic conditions. Both involve protection of industrial property - patents are supposed to stimulate research, while trademarks are supposed to stimulate greater attention to quality maintenance and improvements. Both offer inducement to risk capital - patents on the capital necessary for research and development, while trademarks are on the capital necessary for advertising and sales promotion. And finally, both involve questions of welfare and rejection of static efficiency as an ideal for public policy.

These are very strong similarities which are in fact very well recognized throughout this paper. But there are also some basic

¹⁹See Appendix E in Chamberlin's classic book, The Theory of Monopolistic Competition, (Cambridge, Harvard University Press, 1946). He devotes a brief but comprehensive analysis of the economic implication of trademark protection in this Appendix Chapter.

differences which justify separate treatment of trademark protection from patent protection. Among these reasons are:

(1) Trademarks affect demand primarily whereas patents affect supply. We cannot approach the issues involved with trademark protection through consideration of cost curves except in as far as it leads to greater selling costs. But even here we are on more solid grounds when working on effects upon elasticity of demand than on the shape of the cost curves.

(2) Inventions on new ideas about a process or a product are scarce commodities often obtainable at a very high price (research costs). Trademarks, on the other hand, are available to all at hardly any cost, limited only by their imagination.

(3) Patents involve different questions of economic efficiency from trademarks.

If we are to use the theory of patents in analyzing the economic consequences of trademark protection we shall be faced with the problem of overlooking the consumer and concentrating mainly on production. As we shall find later, the consumer is a very important determinant of the consequences of trademark protection.

Another danger lies in overlooking the relation of the manufacturer with the distributive trades. As we shall show in Chapter IV, trademarks play a very significant role in the balance of power between manufacturers on the one hand and the distributive trades on

the other.

Suffice it to say therefore that there are compelling reasons for treating trademark protection separately, although we do not deny the many similarities between them. Perhaps this will become more clear as we advance through the paper.

CHAPTER II

TRADEMARKS AND THE EFFICIENCY OF INFORMATION

A. INFORMATION FROM TRADEMARKS

In our introduction of the subject we made reference to a relationship between trademark protection and consumption. We shall here elaborate on the nature of and the reasons for this relationship.

Let us define consumption as the sum of all activities directed towards the purchase and use of goods and services. It includes activities in the form of "search" (a term borrowed from Stigler)²⁰ by the consumer for specific goods and qualities which in his evaluation can give him the highest satisfaction given his limited budget. The "search" activity involves the acquisition of information about product choices, product qualities and prices, and their availabilities.

Sufficient and correct information is obviously a vital element in the "search". If the consumer is to maximize his satisfaction within the limits of his budget he must find not only the most suitable combination of goods and services but, given the variety of brands available for each type of commodity, also the most suitable brand.

²⁰ See G. Stigler, "The Economics of Information", Journal of Political Economy, June 1961, p. 213-25.

Evaluation of brand suitability naturally requires appropriate information on substitutabilities and complementarities, on prices and corresponding qualities, and on availability. In the case of the most suitable combination of goods and services, the choice depends primarily upon certain basic necessities although the income level, customs, education and other factors undoubtedly have substantial influence. In other words, the goods that make up the combination at any given time for any given individual is fairly set. Information required for arriving at the most suitable combination is more or less well defined ranging from prices to specific uses, and its veracity is easily tested.

But the choice of a brand for each specific commodity is seldom if ever set by basic needs²¹ and is therefore largely or totally (depending upon the commodity) influenced by external elements the most important of which is advertising. In making his decision, the consumer is often confronted with the problem of distinguishing between "hidden" qualities or estimating the value of not too obvious quality differences. Dependence of the consumer upon relevant and accurate information is therefore much more evident in this type of choice than in that for the most suitable combination of goods.²²

²¹We do not intend to go into the psychological questions of what constitute "basic" needs. The point being stressed is that for most consumption "ends" there are usually a number of brands which can serve the purpose.

²²Note that we use the word "accurate" here not in the sense of being "objectively" precise, but more in the sense of being consistent with the expectation of the consumer. For instance, we may consider as accurate the information that "Veto" deodorant checks perspiration odour all day if the consumer feels that it does when she uses it.

It is in this particular regard that trademark protection derives its direct economic significance. Trademarks serve as "storehouses" of information about products and thus play a critical role in the consumer's choice of the most suitable product. All advertising messages are in a sense stored in the brand and it is upon the brand that consumer loyalty can be harnessed.²³

What kinds of information may be obtained by the consumer from trademarks?

There are several possibilities depending upon the consumer's experience, his ability and education, the amount and effectiveness of advertising and promotions by the trademark owner, the type of product, the length of time it has been in the market, and the make up of the trademark itself.

Consider the case of a typical grocery shopper at the point of purchase. She is confronted by a number of brands from which to

²³We may note here the difference between a trademark and a tradename. A trademark is directly associated with the product (must be attached to it physically). It is often linked to the wants satisfied by the product. A tradename on the other hand may not be attached to the product at all and often not known by consumers. A trademark can also be used to differentiate between qualities of products produced by the same firm. Tradenames obviously cannot. Finally tradenames may be generic or descriptive names while trademarks cannot be any of these. Note that trademarks do not mean symbols only - they can also be names as long as they are not generic. See M. Greenhut, "Free Entry and Trade Mark - Tradename Protection", Southern Economic Journal, 1959, p. 170-181.

choose. If she had tried some particular brands before they may remind her of specific qualities, the degree of her satisfaction or dissatisfaction, their reliability, their prices, their quantities, the stores where they are available, and other related information.

If the brands have not yet been tried, they may remind her automatically of some advertising messages which explain their qualities, where they can be purchased, and sometimes their alleged popularity among consumers. More evident is the information about the name of the manufacturer and the country or region of origin. If the brand is used on other product lines some of which she may have already tried, it may remind her of desirable or undesirable qualities which are probably present in the yet untried product line.²⁴

So far we have listed ten types of information which may be obtained by the shopper from the trademark. They are product qualities, prices, quantities, availability, name of manufacturer (wholesaler or retailer), country or region of origin, reliability, service connected

²⁴One of the reasons given for carrying only one brand of auto parts is that "Brand stands for the kind of service, help, the quality of the line, and the ease in installation to which the dealer has become accustomed." See Brian Dixon, "Price Determination and Marketing Management", Bureau of Business Research School of Business Administration, University of Michigan, Ann Arbor, 1960, p. 49.

with the product purchased, popularity among consumers, and relation to other product lines. These are important product data "symbolized" by the trademark in the consumer's mind.²⁵

The amount of information each individual buyer is able to draw out from a name or mark obviously depends upon his ability to identify and assess specific qualities. The name IBM will certainly be more meaningful to an electronics engineer than to a lawyer. The level of education, acquired skills, and memory affect the information content of trademarks to individual consumers.

The type of product is also an important consideration. It is evident that industrial buyers are more conscious of technical specifications of their requirements than of the brand of products offered. Where product differentiation has little room to play, such, as in secondary industries, due to greater perceptiveness of buyers, brands may not connote distinctive qualities.

To summarize, trademarks provide consumers with several types of information about products. They store information accumulated from experience and advertising, and thereby help the consumer in his

²⁵A brand name, according to some marketing experts, "is a complex symbol that represents a variety of ideas and attributes. It tells the consumers many things: not only by the way it sounds (and its literal meaning if it has one) but, more important, via the body of associations it has built up and acquired as a public object over a period of time." See Gardner and Levy, op.cit., p. 35.

"search" for the suitable product. Since in facilitating this "search" the consumer is better able to match his purchases to his preferences, trademarks serve to make more efficiency the activity of consumption.

But will trademarks contain sufficient and accurate information without legal protection? Or to put it less speculatively, do trademarks given legal protection, impart accurate information? Needless to say these questions must be answered before we can determine whether trademarks help or prevent the consumer from maximizing his satisfaction from consumption.

Note that accurate here merely means consistent from the standpoint of the consumer.²⁶ A major source of difficulty in determining whether information is accurate or inaccurate is the fact that some claims cannot be objectively tested. Consider for instance the image projected for the Marlboro brand of cigarettes. Advertising messages claim that it is the brand preferred by strong, rugged men. Or the case of the hair spray that offers women that long awaited romantic experience (perhaps in more colloquial term, a "happening"). The accuracy of information carried by the brand in the consumer's mind is of course impossible to test, even if it should be considered worthwhile to establish.

Hence any evaluation of the accuracy of information must be

²⁶See supra. p. 20 footnote 22.

limited to those types of information whose accuracy can be determined. These include information on prices, quantities, some measurable qualities, and availability.

B. A MEASURE OF EFFECIENCY OF INFORMATION

The approach we use in relating trademark protection with the accuracy, or "efficiency", of information is to consider the possibility of measuring the latter under two situations - one where protection is granted and the other, where it is absent. In the second situation various assumptions will have to be made as to possible implications of abolishing legal protection on trademark use.

We may measure such efficiency by determining the variability of prices, quantities, some qualities and availability. Thus in the case of price, the greater the variation from one store to another or from one date to another, the lower the effeciency of price information contained in the brand.

Similarly the greater the variability of brand quality the lower the effeciency of quality information from a brand. Variability in quality may be in use of brands, geographic or temporal. If products are identical, use of different trademarks result in misinformation. On the other hand, use of the same trademark where products

are not identical may also result in confusion or misinformation.²⁷

Consumers may similarly be misinformed when the same brand of product has different qualities from time to time and from place to place. Variability through time may be the result of poor quality control, deliberate quality changes entailed in competition, changes in the prices or availability of raw materials, or technological improvements.

Consumers who have been patronizing a given brand of a product may be misinformed if quality deteriorates while no acknowledgment of such a change is made; or *inversely*, if the quality is improved and the brand image is maintained or changes disproportionately. Where the product possesses "hidden qualities" such changes may occur frequently.²⁸

Quantity changes obviously affect the efficiency of information in a parallel manner although they would be much more easy to detect in the case of most products, particularly those consumed regularly, than changes in quality.

²⁷We may illustrate this with actual cases. General Foods marketed two physically different types of coffee, one for the institution trade - restaurants, hospitals, schools - the other for household use. Both were sold under the same brand name of "Maxwell House". On the other hand, the Le Galion firm in France sells the same perfume under the brandnames Lanvin and Le Galion. The same may be said of Longines and Wittnauer watches.

²⁸See *infra* p. 98 for reasons why product quality may be deliberately deteriorated due to competition.

Can we then arrive at a conclusion regarding trademark protection and the efficiency of information by comparing two situations - where protection is present and where it is absent - on the basis of variability of prices, qualities or quantities? We may re-state this in the form of a testable hypothesis: Prices (and qualities or quantities) are less variable when there is trademark protection than when such protection is absent. This, we hope, will help establish or refute the contention that trademark protection, by facilitating the "search" adds to the efficiency of information.

A simple test is conceivable. From cross sectional or time series data on particular brand prices (qualities or quantities) we can derive a mean price, a mean quality (i.e. tensile strength), or a mean quantity, and represent the measure of variability by the value of the standard deviation. The larger the standard deviation, the greater the variability and therefore the less efficient the trademark is as an information medium.

But what data can be used for the situation where trademark protection is absent? (Situations with modified form of protection can initially be overlooked for the sake of simplicity.)

There is no period of relevance when protection over trademarks was lifted.²⁹ One alternative, of course, is to compare

²⁹ Note that even during the olden times trademarks were protected by the guilds. See Rogers, *op.cit.*, p. 43. In the German and Italian trade guilds of the Middle Ages, as in France, the use of marks was usually compulsory; the member was not only permitted but was compelled to use his mark, so as to strengthen the hold of the guild upon the trade.

situations in two countries - one with protection and the other without. But this alternative is plagued with both theoretical and practical difficulties. Even if there are communist countries where trademark laws do not exist,³⁰ constance of price and quality may simply be due to the existence of a state monopolist, and comparison is really meaningless.

Another alternative is to make an assumption about the possible effect of eliminating trademark protection, such as for instance, the discouragement and reduction in advertising. This assumption, as we shall argue later,³¹ is quite valid since the risk of investing in brand advertising will greatly increase as non-owners of the brand find that they are free to cash-in on the goodwill earned by the advertiser.

³⁰Trademarks and trademark laws do exist in Communist countries. See Koust Katzarov, "The New Structure of Protection in Industrial Property in Eastern Europe", Journal of the Patent Office Society, Vol. XLII, No. 9, pp. 596-620. The author thinks that modification in the original trademark laws of Eastern European countries do not represent essential differences with regard to the fundamental principles of Western laws on the subject. See also R. Watson, "Soviet Law on Inventions and Patents", Journal of the Patent Office Society, Vol. XLII, pp. 48-49.

³¹See infra p. 38

Assuming therefore that this will take place, the test then becomes one of comparing price, quality or quantity variability of two brands advertised in different degrees - one more and the other less heavily advertised. The problem is now reduced to testing the hypothesis: Prices (or qualities or quantities) are less variable the greater the advertising expenditure.

On the question of prices we may briefly mention here the prevalence of resale price maintenance in some industries, a practice which we shall deal with in Chapter III. As the name suggests, the practice consists of curtailing price competition among distributors. The producer usually sets a minimum retail price to be followed by all distributors of his brand. But resale price maintenance, it is argued, is only possible when the manufacturer has a heavily advertised brand. In other words due to this practice we may expect greater price uniformity and high advertising expenditures to be closely correlated in certain types of products.

What about quality?

Can standardization of quality be related to the level of advertising expenditures?

We are here faced with a much more complex problem on account of the number of variables which affect quality standardization or

more precisely quality control.³² There are four reasons why firms would have interest in quality control, namely:

(1) the quality of the firm's product is subject to minimum standards set by a public regulatory body, i.e. Foods and Drugs Administration;

(2) consumers are capable of detecting quality changes;

(3) it is necessary for competing with other firms in the industry; and

(4) it is necessary to safeguard a monopoly position.

Ethical drugs are subject to very strict quality controls both by the manufacturers and public authorities for obvious reasons. The hazard to health and life of unstandardized drugs is too great to leave to private initiative and the competitive motive the responsibility for maintaining quality standards.

But in the majority of consumer products the motivating force stems primarily from the market. Where consumers are sufficiently sensitive to quality changes, the maintenance of quality may be a critical factor in one's share of the market. In such cases huge advertising outlays will not be spent on products subject to wide variations of

³²Note that we are here talking about qualities the standardization of which requires constant attention and control, such as the chemical composition of drugs as opposed to produce of agriculture, like wheat.

quality since the goodwill earned through the years can be easily lost because of one defective unit.

If this observation is true then one can expect highly advertised products to be less variable, at least in the downward direction, in quality than less advertised products. For it stands to reason that firms which maintain quality purely on account of competitive motives will only incur heavy advertising expenditures when they can make sure that quality can be maintained. But can we say that this is true of all products?

Obviously not. Chemicals, for instance, are hardly advertised relative to consumer products in general but there is little doubt that they are subjected to the same if not greater quality control. Quality improvements are also likely to cause greater advertising expenditures although they represent, in fact, product variations. Indeed most advertisements are about "new", "improved" and "more powerful" product properties!

Variations in the downward direction, or deterioration, of quality then seems to be the only relevant data if we are to test this relationship between trademarking and quality maintenance. Moreover comparisons need to be restricted to products in the class on account of the difficulties mentioned above (i.e. chemicals). These of course substantially limit the conclusions that can be made about the contribution of trademarking to the efficiency of

information.

To summarize briefly, trademarks serve as vehicles of market information. In supplying this information they may facilitate the consumer's "search" for the suitable product and hence contribute to the efficiency of consumption. This will depend upon the accuracy of the information derived by the consumers.

Conceptually the accuracy of this information can be tested by measuring the variability of the data about the product - e.g. quality, prices, quantity, etc. But we have seen that this entails both practical and theoretical difficulties which will make conclusions therefrom highly tenuous and of limited value.

CHAPTER III
TRADEMARKS AND COMPETITION

The second economic issue we have proposed to consider is the impact of trademark protection upon the efficiency with which resources are allocated in production. This brings us to the question of its effects upon competition, or more specifically to its effects on competitive structure and behavior.

I. TRADEMARKS IN ECONOMIC THEORY

Trademarks have been generally viewed as a major source of product differentiation. One of the earliest references to them in economic literature was made by Sraffa who pointed out that in distinguishing products of the same class from each other, they served as obstacles to the free play of competition since they led to the "absence of indifference between the different producers."³³

The most significant treatment of the subject is found in Chamberlin's Theory of Monopolistic Competition where trademarks

³³See P. Sraffa, "The Laws of Returns Under Competitive Conditions", Economic Journal, December 1926, p. 542.

are cited as one of the principal reasons for rejecting the highly unrealistic assumption of "product homogeneity" in economic theory.³⁴ He mentions a number of well known brands to illustrate the extent of product differentiation accomplished through their use and to point out the monopolistic elements this implied.

Chamberlin argues that the protection of trademarks amounts to protection of monopoly. If imitation is allowed no profits above the competitive level can be earned in the long-run. Since imitation leads to more standardized goods, buyers would have no basis for discrimination. Imitation will thus tend to bid away monopoly profits.

But with protection, according to Chamberlin, such profits do not tend to be eliminated because as he says "they are due not to the imperfection of competition, in that system does not adjust itself promptly to new conditions, they are due to the permanent imperfection (if such it must be called) that it never adjusts itself at all - the law prevents it."³⁵

But permanent imperfection is obviously an overstatement of the law's restrictive effects. There is ample evidence to show that

³⁴See Chamberlin, op.cit., Chapter IV.

³⁵Ibid., See Appendix E p. 270.

many brands which used to occupy dominant positions in the market have lost their positions because of the appearance of superior substitutes, more aggressive competitors, or changes in consumer tastes. Consider for example what happened to such brands as Ivory Soap or Gestetner copying machines. Clearly adjustments do take place even with the existence of trademark protection although they take other forms aside from imitation of the brand.

An abundant crop of books and articles following Chamberlin's work on monopolistic competition theory explored the many implications of product differentiation upon traditional models of competition and monopoly.³⁶ However, except for a few casual remarks about trademarks, little or no specific attention has been devoted to studying the economic implications of trademark protection to our knowledge.

II. TRADEMARK PROTECTION AND THE CONDITIONS OF ENTRY

In his classic study on barriers to entry, Bain reached the conclusion that "great entry barriers are more frequently attributable to product differentiation than to scale economies in production and

³⁶The list of these books and articles is too long to mention here. Chamberlin's bibliography in the later editions of his book (*ibid.*) provides a complete list.

distribution."³⁷ Without raising the thorny question of just how much of product differentiation can be explained by the mere use of trademarks, it is difficult to make any assessment of the latter's importance in competition. From the theoretical standpoint, the use of trademarks seems to indicate only an indirect relation with entry barriers.

Perhaps it would be useful to start with some definitions. A product is differentiated from others of the same general class as long as consumers think it is different. In other words differentiation is a subjective phenomenon, not an objective one. Gasoline brands, for instance, are differentiated no matter if they are chemically identical, as long as the buyers consider them different from each other.

Some have found it useful to distinguish between different forms of differentiation as either vertical, horizontal, or innovational. Vertical differences are those connected with higher and lower qualities of a good. A higher quality good has attributes which are held to be superior by virtually all buyers and the cost of supplying the product is greater. Horizontal differences are those about which there is no clear agreement - different people would rank dissimilar qualities in different orders, and cost differences, if any, are only incidental. Innovational differences are those connected with changes considered by most or all buyers as improvements

³⁷Joe Bain, Barriers to New Competition (Cambridge: Harvard University Press, 1956).

and superior in spite of whatever additional cost is involved. They represent replacement of the old quality by the new.³⁸

Bain does not make these distinctions but it is clear from his study that the important element in differentiation is the amount of advertising used to convince consumers of the existence of differences. He says;

"The single most important basis of product differentiation on the consumer good category is apparently advertising. Substantial differences in design or functional capacity of the product appear important only in a distinct minority of cases - automobiles, quality fountain pens, and in a lesser degree, rubber tires."³⁹

How are trademarks relevant to advertising?

The use of trademarks (branding) and advertising are complementary activities. Branding, according to Telser, "is essential to the maintenance of the stock of knowledge about goods ..." while advertising "adds to the stock of knowledge about products. ... Without these (branding) the knowledge gained in each instance could not be effectively used on subsequent occasions. Sellers must keep their identity and the identity of the goods they sell before the public so as to capture the benefit of goodwill from prior experience."⁴⁰

³⁸See L. Abbott, "Vertical Equilibrium Under Pure Quality Competition", American Economic Review 1953, pp. 826-45.

³⁹Bain, op.cit., p.142.

⁴⁰See Lester Telser, "Supply and Demand for Advertising Messages", American Economic Review, May 1966, pp. 462-464.

The real significance of trademarks on this question lies in the protection that accompanies them.⁴¹ In the absence of trademark protection it is difficult to conceive of the use of advertising as taking a major role in product differentiation. Trademark protection guarantees that the returns on investment in advertising accrues solely to the firm. Without such protection the risk to investment in advertising would probably be too high to justify any substantial outlay. In the words of Chamberlin, "the wastes of advertising, about which economists have so often complained, would be reduced, for no one could afford to build up goodwill by this means, only to see it vanish through the unimpeded entrance of competitors."⁴²

What consequences can be expected to follow from the discouragement of advertising? To answer this question it may be useful to first understand some of the economic effects of advertising. Bain's authoritative study showed that advertising leads to the

⁴¹See Ralph Brown, "Advertising and the Public Interest: Legal Protection of Trade Symbols." Yale Law Journal, Vol. 57 (1948). According to Brown the trade symbol is the vehicle of both informative and persuasive advertising and hence, "protection of the former carries with it protection of the latter," p.1165.

⁴²See Chamberlin, op.cit., p. 274.

erection of high barriers to entry through its effects on product differentiation. Essentially this means that the consumer loyalty to the advertising firm's brand makes it difficult for potential competitors to enter the market. The disadvantage may consist of higher selling costs or of having to sell their products at lower prices, or of both.

For the potential entrants these disadvantages will vary depending on whether there are economies or diseconomies to large scale production and selling. There may for instance be diseconomies to large scale sales promotion. This would suggest that the entrants should simply choose to enter at the reduced scale at which product differentiation disadvantage is minimized. But if that scale happens to be sub-optimal from a production-distribution standpoint, the entrants will be forced to compromise by selecting a scale which minimizes the aggregate of production scale economy and product differentiation disadvantages.⁴³

The possibility also exists where economies of large-scale sales promotion are encountered. Such economies occur for the entrants if their gross disadvantage in lower prices plus higher selling costs per unit decreases as their scale increases through some range, when promotional outlays of their rivals are unchanged. Such a condition might result when at a given price sales would increase more than proportionately to the sales promotion budget in the

⁴³See Bain, op.cit., p. 114.

latter become large enough to support either heavy advertising in national media or a nationwide distributive system. But Bain expressed some skepticism about the existence of significant economies of this sort for entrants.⁴⁴

Of course this analysis applies to situations where potential entrants could offer only technically similar products. Those industries characterized by fast technological changes will most likely have potential entrants carrying genuine product innovations. As Johns correctly points out, it is very likely that any initial disadvantage in selling costs will be short-lived when buyers are quick to realize the superiority of the products of new firms in the industry.⁴⁵

In any event advertising does affect the conditions of entry into an industry by putting the potential entrants at a disadvantage in terms of higher selling costs or lower prices which they need to charge. The seriousness of the disadvantage depends on whether economies or diseconomies of scale to production and sales promotions are met, the scales at which they are met, the comparative quality of products the entrants can offer, the competitive policy of

⁴⁴Bain, op.cit. p.116.

⁴⁵B. Johns, "Barriers to Entry in a Dynamic Setting", Journal of Industrial Economics, 1962, p.55.

established firms, and the possibilities for entering the market under established trademarks.⁴⁶

Going back to our original question, would we now expect to have greater freedom of entry if advertising were reduced? In as much as advertising is the single most important basis of product differentiation in consumer goods industries, and product differentiation the most frequent explanation for great barriers to entry, the reduction in advertising, assuming other things constant, would result in greater freedom of entry, particularly in consumer goods industries.

How is this relevant to trademark protection? The answer is obvious by now. If advertising depends upon trademark protection as a necessary condition then the latter's removal or weakening may be expected to reduce product differentiation and the obstacles to entry it helps create.

It may be objected that the same degree of product differentiation could just as well have been accomplished through greater emphasis upon objective differences. In such a case design protection or patent protection would be sufficient to stimulate efforts by firms

⁴⁶Hines for example alludes to the possibility that firms within the markets "... may well overestimate the probabilities of potential entry by this new kind of firm, and behave more competitively as a result." See Hines, op.cit., p.149.

to differentiate product designs and qualities.

It has not been asserted that the use of advertising implies the absence of real differences. On the contrary, we have recognized that improvements are usually accompanied by greater advertising.⁴⁷ What we assert is that the lack of protection for trademarks (and hence also for advertising) will tend to reduce differentiation based solely on advertising which Bain points out to be much more evident in the majority of cases than differences in design or functional capacity.⁴⁸

III. TRADEMARKS AND COMPETITIVE BEHAVIOR

If firm behavior can be predicted from a knowledge of management objectives, then it would be useful to begin our investigation of the effects trademark protection upon competitive behavior by considering the aims of management in using such marks. As we have seen earlier there is considerable agreement that the immediate objectives for trademarking are:⁴⁹

- (1) to facilitate selling
- (2) to have a symbol for goodwill
- (3) to inform
- (4) to identify source of the product

⁴⁹See supra, p. 8

The selling function is made easier with the use of a trademark for obvious reasons. It eliminates the need for retailers to explain product qualities to their customers and thus cuts the selling time required. We may note in this connection the real problems involved when product qualities cannot be precisely defined, or even when this is possible, the terminology required may be too technical and vague to the average consumer. Even asking the tobacconist for some blend of tobacco can be far more cumbersome than asking him for Rothman's cigarettes.

When there are diseconomies to large scale sales promotion because the market is not homogeneous (some consumers may not like the sound of the name Lifebuoy and will not buy it however much the seller advertises the brand) the seller can conveniently use a variety of brands acceptable to different consumer groups. In marketing this is a common practice called "market segmentation"⁵⁰ This perhaps explains why Procter and Gamble sells its toilet soap and detergents under a large number of brands.

A survey of large firms in the United States⁵¹ revealed that

⁵⁰See A. Roberts, "Applying the Strategy of Market Segmentation", Business Horizon, Fall 1961, pp. 65-72.

⁵¹See R.F. Lanzillotti, "Pricing Objectives in Large Companies", American Economic Review, December 1958, pp. 923-932.

aside from seeking to earn a targeted rate of return, the other objective of pricing strategy of most firms is the preservation of a certain share of the market. This is consistent with the desire for a 'quiet life' on the one hand and the oft-quoted axiom that "competition" must be met on the other.

Without stretching the relation too far it can be argued that the use of trademarks helps the firm in maintaining its share in the market. As we have seen trademarks are largely responsible for product differentiation. But product differentiation results in reducing substitutability of the brand for others, and depending on the extent to which this latter is reduced, increases the stability of the firm's market share.⁵²

Note that this entails no difficulty in considering multi-brand firms. The market share they try to safeguard may very well be the combined market for all their brands.

Once trademarks are used, of course, protection against infringement is a necessary condition for the stability of the firm's market share. In the absence of legal protection there is nothing to prevent other firms from "cashing in" on the investment of the

⁵²See study of brand loyalty by Ross Cunningham, op.cit., p. He reports, "The study indicates that a significant amount of brand loyalty to individual products does exist - more, indeed than has hitherto been realized by many marketing executives. There are many instances where 90% or more of a family's purchases have been concentrated on a single brand over three whole years."

brand owner in developing a strong consumer franchise for his product.

Consideration of developing a large network of outlets also impels producers to use and develop trademarks. The majority of small retail outlets will refuse to handle unbranded merchandise because they usually do not enable them to charge a comfortable margin. We shall discuss these in the following chapter together with the problems of controlling the distributive outlets.

IV. PRICE DISCRIMINATION AND TRADEMARK PROTECTION

In the United States several cases have been uncovered by the Federal Trade Commission where trademarking is used very effectively to support price discrimination activities.⁵³ One of the often cited cases involves the selling by Rohm & Hass of methyl methacrylate at vastly different prices to two groups of buyers.

⁵³The same pillows were marketed by American Featherbed and Pillow Co. under five brand names - "Princess", "Progress", "Washington", "Puritan" and "Ideal". They were advertised as having different grades and were sold at correspondingly different prices.

Borden Co. was charged by the FTC with violation of the Robinson Patman Act by discriminating in price between the purchases of its "private label" evaporated milk and purchasers of its nationally advertised "Borden" brand evaporated milk.

Goodyear Tire and Rubber Co. sold tires to Sears, Roebuck under the labels "All State" and "Companion" at lower prices than those sold to the rest of the trade under the labels "All Weather" and "Pathfinder". See BNA Report, op.cit., p. 56.

The company sold it under the brandnames "Luata" and "Crystalite" to manufacturers at 85 cents per pound, and as "Vermonte" and "Crystalex" to dentists at \$45 per pound.

Since price discrimination exists wherever technically similar products are sold at prices which are not proportional to the marginal costs, there is good reason to believe that the practice is fairly widespread. However, the task of determining marginal costs is so difficult that external examiners find it often impossible to substantiate their allegations. Nevertheless the conditions for practicing discrimination seem easy enough and the advantages are so considerable that it would be very surprising if only a few take advantage of it.

V. TRADEMARK LICENSING

We have so far limited our discussion of the consequences of trademark protection to the more immediate effects upon competition. We showed that not only does the law serve as a direct barrier to competitive market adjustments but also as a pre-condition for advertising and the barriers to entry that this latter often creates. In the following pages we discuss the impact of trademark protection upon competition in so far as it is used as the basis for licensing agreements between trademark owners and other parties using the trademark.

It has been claimed by some economists⁵⁴ that the trademark law sanctions licensing agreements which empower the trademark owner to control prices, quality, and market shares of licensees with a view to restricting competition. To examine the validity of this proposition we searched for concrete cases which could support it and the following analysis is made on the basis of what we have found. Needless to say we cannot, on the basis of a limited study, make any statements about the extent to which licensing agreements are used for these ends.

The main reason for this is the fact that there are no sources of information other than records of cases brought before the courts

⁵⁴ See for instance Clair Wilcox, Public Policies Toward Business, (Chicago, Irwin, 1955) pp. 172-180.

as restrictive practices. Nevertheless it would be sufficient, to prove the hypothesis, that control does exist in some cases.

A. TYING ARRANGEMENTS

Trademark owners are said to restrict competition by requiring their licensees, on the strength of their licensing agreement, to refrain from buying goods from their rivals. There are two methods by which they do this. One is called a "tying arrangement" whereby a "seller gives the buyer access to one line of the seller's goods if the buyer takes others as well." The other is called "exclusive dealing arrangements" whereby "a seller gives the buyer access to his line of goods only if the buyer agrees to take no goods from any of the seller's rivals." ⁵⁵

For the moment let us consider the first method. A tying arrangement is also said to hold when a licensor requires his licensee to purchase the latter's raw materials either from him or designated firms. There are many examples of this practice one of which involves an ice cream company which licensed some 400 other companies to prepare and sell ice cream under its brand name. The licensing agreement required that the licensees purchase their ice cream mix and toppings from suppliers designated by the licensor.

⁵⁵ See Caves, op.cit., p. 59.

When brought to court on charges of "per se" violation of the anti-trust laws, the company was acquitted on the grounds that in order "... to properly control the quality of the goods produced by 400 franchises the licensor was justified in specifying suppliers whose goods could be easily supervised." ⁵⁶

The obvious inference from the above case is that the protection of trademarks can be used very conveniently to keep out competitors or create a monopoly. This is not to say that "tying arrangements" would not be attempted in the absence of trademark protection but merely to point out that the existence of legal provisions empowering the licensor to impose on its licensees conditions that may restrict entry of competitors does amount to protection of monopoly.

Tying arrangements of this nature seem to be most feasible when one of the products involved is produced under conditions of monopoly or enjoys a large share of the market, and when there is collusion

⁵⁶ See *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964) discussed in F. Gilmore, "Quality Control Its Use and Abuse", Journal of the Patent Office Society, Sept. 1966, pp. 585-586. Similar cases include *Baker v. Summons Co.*, 307 F.2d 438, 134 USPQ 266, (1st Cir. 1962); *Switzer Bros. Inc. v. Locklin*, 297 F.2d 39 (7th Cir. 1961); *duPont v. Gelanese Corp.*, 167F. 2d 484 (CCPA 1948); *Arthur Murray, Inc. v. Horst*, 110F Supp. 678 (D. Mass. 1953) and *Morse-Starrette Products v. Steccone*, 86F Supp. 796 (N.D. Calif. 1949)

among the firms. Some of the more familiar examples of these arrangements include the licensing by the Coca Cola Co. of the United States of bottlers all over the world and the sale of IBM cards to IBM machine users.⁵⁷

B. EXCLUSIVE DEALING ARRANGEMENTS

The licensing of trademarks has been claimed to be one of the basis for exclusive dealing arrangements which as we earlier defined involves selling a line of goods on the condition that the buyer take no goods from any of the seller's rivals.⁵⁸ Examples cited to support this contention include the case of petroleum retailers who by contract must sell only one brand of petroleum products.⁵⁹

It seems to us that the evidence presented to show the role of trademark licensing in exclusive dealing arrangements is not very convincing. Our examination of the legal cases linking these two has led us to believe that exclusive dealing arrangements are largely

⁵⁷ See for instance *Coca Cola Co. v. Bennett*, 238 Fed.513 (8th Cir. 1916) or *Coca Cola Co. v. J.G. Butler & Sons*, 229 Fed. 224 (E.D. Ark. 1916). The Coca Cola Co. manufactures a syrup in Atlanta, Georgia, and supplies it to local bottlers, directly or through distributors, under contracts which require the addition of various ingredients to the syrup under detailed instructions. See also *International Business Machines Corp. vs. U.S.*, 298 U.S. 131

⁵⁸ See Gilmore, op.cit. p. 582-84.

⁵⁹ See *Standard Oil Co. v. United States*, 337 U.S. 293 (1949). Also pertinent are the cases of *Denison Mattress Factory v. Spring Air Co.*, 309 F. 2d 403 (5th Cir. 1962) and *Kellogg Co. v. National Biscuit Co.*, 71 F.2d 662 (2d Cir. 1934)

based on commercially attractive advantages found by both the licensor and the licensee in such contracts, or as in the case of gasoline retailers, the relatively large investment on equipment and fixtures shouldered by the gasoline companies.

C. MARKET SHARING THROUGH LICENSING

Market sharing has in a number of instances been accomplished and enforced with the help of trademark protection. One of the usual methods employed is to organize firms into some sort of a cartel, adopt and advertise a trademark on a large scale (for the entire market), follow product standardization rules, license each member firm to produce and sell under this trademark, and allocate sales territories to each.

One such arrangement was the "Spring Air Co.", a trademark owning corporation of 34 small bedding manufacturers. The "Spring Air" trademark was advertised on a nationwide basis and used under license by each member firm in selling its bedding products. Each manufacturer agreed in the licensing contract not to manufacture, sell, ship or deliver Spring Air trademarked products outside its assigned territory or to sell Spring Air products for resale outside the territory.⁶⁰

⁶⁰ A former member manufacturer, Denison Mattress Factory, sought to defeat Spring Air's breach of contract suit for non-payment of assessments by attacking Spring-Air territory, supplier, and price restrictions as Sherman Act violations. As its principal reason for rejecting Denison's defense of illegality, the Fifth Circuit found that the central purpose of the contract was not to stifle competition but to protect Spring Air's trademark rights. See *Denison Mattress Factory v. Spring Air Co.*, 308 F. 2d 403 (p. A-9 ATRR No. 61, 9/11/62) and an excellent collection of Anti-trust cases analyzed by the staff of the Bureau of National Affairs entitled Antitrust and Trade Regulation Today: 1967 (Washington, D.C., The Bureau of National Affairs, Inc. 1967) p.56. Similar example can be found in *White Motor Co. v. U.S.* 372 U.S. 253, 31 U.S.

The restrictive effects of such market sharing arrangements have been defended on the grounds that the latter may be the only avenue open for small manufacturers to compete with the larger ones in the industry. It has been argued that this restriction on "intra-brand competition" actually leads to stimulation of "inter-brand competition", and should therefore be sanctioned.

Much of this argument of course arises from the businessman's notion of "competition." The argument perhaps can be more appropriately stated as a case for giving small but organized firms greater power to act as oligopolistic firms and to engage other large firms in rivalry. Since this adds nothing to make the industry more competitive, but instead decreases competition, there is good reason to consider such trademark licensing agreements as restrictive.

In these market sharing agreements the basis for drawing market boundaries is usually the cost of freight. The boundary between any two licensees fall at the point where the shipping costs from their factories became equal, so that further shipment by either licensee would result in higher shipping costs than a shipment to that location by the other licensee.⁶¹

D. FOREIGN LICENSING

Restriction of competition through the help of trademark

⁶¹ See BNA, op.cit., p. 70 regarding the Sealy Corporation licensing agreements.

licensing agreements is not limited to domestic sources of supply. Competition, or more specifically "intrabrand competition " is also largely restricted by blocking the entrance of foreign suppliers into the market. Trademark licensors have been known to deny their foreign licensees the right to sell in the former's market or markets on the strength of trademark law provisions prohibiting infringement.

The extent of foreign licensing by American firms may be noted from results of a survey conducted by the Patent, Trademark and Copyright Foundation of the United States to study the characteristics and extent of foreign licensing by American firms of their patents and trademarks.

"Nearly one-fourth of those responding indicated that they registered all of their marks in one or more foreign countries. Another fourth registered abroad between 76 and 95% of their U.S. marks; and a third quarter registered between 25 and 75%, with most of these being at the 50% level. Less than a fifth registered under 25% and only about 10% indicated that they did not register any of their U.S. marks abroad ..." ⁵⁹

Exclusive rights are generally extended under trademark licenses, and they are generally a cause for higher royalty rates.⁶⁰ The study

⁵⁹ Results of this survey are reported in J.N. Behrman, "Licensing Abroad Under Patents, Trademarks, and Know How by U.S. Companies", The Patent, Trademark and Copyright Journal of Research and Education, Vol. 2, June 1958, No. 2, pp. 181-278. The Survey involved interviews with executives of 65 companies and questionnaires sent to 387 companies (40% replied).

⁶⁰ Ibid., p. 255.

reports that in about one-fifth of the cases, the grant of exclusivity was coupled with prohibitions against the licensee operating or selling in any other territory than his own.

There is a host of reasons cited for establishing foreign licensing agreements including returns in the form of royalties, profits of subsidiaries, cross-licensing, and currency and trade restrictions of foreign governments. But provisions in many licensing agreements suggest that reduction of potential competition is a very strong motive for the agreements.⁶¹

The restrictive effects of such agreements upon competition are believed to be quite substantial. Differences in production and managerial efficiency and in the cost of the factors of production between countries often open up opportunities for exportation of the same brand of product from the low cost to the high cost country. If not for the specific provisions in licensing agreements prohibiting such exports, there will tend to be greater price competition (intra-

⁶¹ See *ibid.*, p. 214, particularly section on Business Motives for Imposition of Restraints. Licensees may desire to restrict competition either because they wish to reduce risk - infant industry protection, their markets are too small for efficient scale production, or simply because it gives them monopoly positions. The licensor, on the other hand, may want to protect himself against creation of a strong competition from abroad, to divide territories, to earn at least royalties from markets in which he is prevented from, or is unable (financially) to exploit, to control sales volume and prices of products sold by the licensee (because of advantages of discriminatory pricing or because of pressure from either the licensee or the government of the licensee).

brand) in the market.⁶²

One of the specific forms in which restrictive provisions have taken shape is the market sharing agreements by international cartels. The procedure is described somewhat as follows "... a trademark is advertised throughout the world and each cartel member is granted the exclusive right to use it in his own territory. If a member oversteps his market boundary, he is driven back by an infringement suit."⁶³

Needless to say protection from "intra-brand" competition does not free the firm from competition from other brands. Each local manufacturer still has to contend with the competition from producers of other brands in the same industry. Hence the restraining effects of market sharing agreements are limited by competition in the local market. If the product is not highly differentiated, and in the absence of collusion with domestic competitors, the price set by the licensee for the product will depend more on competitive conditions at home, than on any "brand" monopoly enjoyed.

⁶² In Canada the clamour for reform of the trademark now is partly based on the charge that drug prices are high because, among other things, local manufacturers are protected by it from imports of the same brands from low cost producing countries.

⁶³ See Clair Wilcox, *op.cit.*, p. 172-75 for a brief but comprehensive treatment of restrictive practices arising from the trademark law. Examples of trademarks used in the establishment of regional monopolies through division of the market are Mimeograph, Merck, Tunken, American Bosch, S.K.F., Mazda, New Jersey Zinc, and Electric Storage Battery.

E. EXCLUSIVE DISTRIBUTORSHIP UNDER TRADEMARK LICENSING

A large variety of complex arrangements characterize the system of distributing goods from the factories to the consumers. One of them is the practice of restricting the sale of goods to a single outlet in each market territory, or what is widely known as exclusive distributorship. Exclusive distributorship is a common feature in the selling of most industrial products and a considerable number of consumer goods, especially of the durable type.

The reasons for its predominance in the selling of industrial goods are often inherent in such products, namely, the need for specialized knowledge in selling, and the offer of specialized servicing after sale, such as for example the case of most electrical and mechanical equipments. These are of course, important economic reasons as well. The size of the market (relative to the volume and costs of merchandise) may justify the use of only one outlet. Thus for example farm tractors are usually sold by exclusive distributors.

In the realm of consumer goods (except durable such as cars, refrigerators and the like) many of these complications do not arise. Drugstores as well as supermarkets for instance could easily handle the selling of detergents since no technical services are connected with their sale and capital requirement is miniscule. But exclusivity nonetheless characterize the selling of many consumer items and the reasons are sometimes traceable to trademark licensing agreements.

In the previous sections we discussed how some restrictive practices such as tying arrangements, price discrimination, and market sharing have been employed with the help of trademark licensing agreements to restrict entry to the "top" level of the vertical structure of supply (or distribution), namely, the producing sector. Here we have a trade practice restricting entry into the distributive trades through the use of trademark licensing agreements.

The most common form in which exclusive distributorship through licensing occurs is that for imported goods. A local distributor receives authorization from a foreign supplier to register and/or use the latter's trademark in his country. The foreign supplier usually requires that the local distributor advertise and promote the trademark in return for which he agrees not to deliver contract merchandise, either directly or indirectly, to other persons in the latter's assigned territory.⁶⁴

The registration of the trademark in the name of the local distributor (or in some instances in the name of the foreign supplier) empowers him to prevent other distributors from importing the same brand of product into the domestic market. In effect this amounts to a legal restraint upon intra-brand competition for the imported product and hence constitutes a formidable barrier to entry of other distributors.

⁶⁴ See Chapter on Exclusion and Discrimination in Wilcox, op.cit., pp. 1748ff.

F. RESALE PRICE MAINTENANCE

Curtailling intra-brand competition may also be accomplished through the practice of fixing a minimum price that wholesalers or retailers may charge for one's product. The objective is to prevent price cutting by some retailers or wholesalers. As is often the case, a strong association of retailers may pressure the manufacturers to protect their margins by withdrawing supplies of the product from price cutting retailers. Or the manufacturer himself, seeing the advantage of sheltering small high-cost retailers in order to have a more widespread network of outlets, may institute the control arrangements.

Resale price maintenance has a long and interesting history in the United States. It has been a widespread practice in the drug, cosmetic, toilet goods, liquor, gasoline and bookselling fields, and more occasionally in the sale of household appliances, sporting goods, foods, clothing, rubber products, radios and tobacco.⁶⁵ Concealed under the name of Fair Trade Acts, resale price maintenance was allowed in all except two states of the Union and the District of Columbia. "By virtue of a single contract between the owner of a

⁶⁵ See Report of Federal Trade Commission, Resale Price Maintenance, (Washington, U.S. Govt. 1945). The number of product fields may however be misleading. The above items do not add up to more than 10 percent, by value, of the products sold at retail in the United States. See Wilcox, op.cit., p.423.

trademark and the purchaser of the trademarked article, the resale price and price for hundreds and perhaps thousands of wholesalers and retailers can be fixed."⁶⁶

The importance of trademarks in such price fixing arrangements lies again in the area of enforcement. To discipline price cutters the manufacturer has to be in a position to control the supply of his brands. According to Yamey, no manufacturer of an unbranded staple line⁶⁷ had this power. In the model statute drafted by the National Association of Retail Druggists, which has been used as the basis for Fair Trade Laws in many states, the power to fix prices was confined to the owner of a trademark and to distributors to whom he delegates authority.

It is interesting how the courts defended such price fixing practices on grounds that goodwill of the trademark owner will be

⁶⁶According to Wilcox "the statutes legalizing resale price maintenance were whipped through the legislatures at breakneck speed. There is no record of hearings having been held in forty states. There is no transcript of hearings available in any state.", op.cit. p. 416-419.

⁶⁷"The attitude of the legitimate trade towards proprietary articles," says Yamey, "tended to become ambivalent. On the one hand the retailer saw in them a threat to the value of skill and experience in retailing and a direct means of intensified competition. On the other hand, branded goods offered prospects of securely enforced minimum retail prices because each manufacturer was in a position to control the supply of his brands to retailers and so to discipline price cutters by withholding suppliers." See B.S. Yamey, Economies of Resale Price Maintenance, (London: Pittman & Sons Ltd., 1954) p.527.

impaired by price cutting of some firms. According to a Court Justice explaining his decision "the manufacturer had made a substantial investment in advertising his brand and the goodwill thus acquired was a species of property that belonged to him. When he made a sale he parted with his products, but not with his goodwill. When distributors cut his prices, they impaired his goodwill and thus inflicted damage on his property."⁶⁹

⁶⁹See S. Timberg, "Trademarks Monopoly and the Restraint of Competition", Law and Contemporary Problems, Vol. 14, 1949, pp. 322-34.

CHAPTER IV
TRADEMARK PROTECTION AND DISTRIBUTION

Distribution is seldom treated separately from production since economic theories relating to the latter apply equally to the former. Cost functions and revenue functions in the distributive trades indicate no essential differences from those in production so that from the standpoint of explaining the determination of supply no great advantage is felt to be added by complicating the analysis with a distinction between the two.

But the subject of our study requires us to leave pure theory for the moment and to return to the more realistic setting where supply is actually affected by a host of influences "tucked under" the smooth curves of cost schedules. Some such influences can be traced back to the efficiency with which goods are brought from the factories to the consumer's table and their relative share in the final cost of the product is significant enough to warrant much closer attention than is ordinarily given them.⁷⁰

⁷⁰ One of the most recent studies prepared by Harold Barger for the National Bureau of Economic Research indicates that the marketing mark-up in the United States is 37 per cent of the retail value, about 8 per cent of which is value added by wholesalers. While this includes transportation cost, Barger indicates that more complete coverage would raise distribution mark-up in the United States from the minimum of 37 percent to something less than 50 percent. See Harold Barger, Distribution's Place in the American Economy Since 1869. (Princeton: Princeton University Press, 1955), p. 25.

We have shown in the previous chapter how trademark protection has been used to restrict competition in manufacturing and the distributive trades. In some cases it served to block entry into a profitable market and in others, to put a lower limit to price competition. In all these cases trademark protection indirectly contributed to the structure of competition both in the manufacturing and in the distributive trades sector, and hence to that extent affected very significantly the efficiency with which resources are allocated in our economy.

We turn now to another aspect of the structural effects of trademark protection - the relative strength it contributes to manufacturers vis-a-vis the distributive trades, and see how this indirectly leads to certain competitive conditions in each sector. It is also hoped that by looking at this aspect it would be possible to predict some structural changes which would likely take place once trademark protection is abolished.

A. VERTICAL CONFLICT IN DISTRIBUTION

Our modern economy is characterized by a variety of complex arrangements by which goods are passed on from the hands of the manufacturers to those of consumers. Between these two, one may find wholesalers, jobbers, brokers, wholesaler-retailers, and ordinary retailers. Their functions vary from the complicated job of advertising, product development and warehousing undertaken by some

wholesalers, to that of retailing, undertaken by large numbers of small stores.

The important point in these arrangements that we wish to bring out is the fact that by the mere existence of these intermediaries decisions regarding the product, its price, its promotion and market can be made by parties whose interests conflict with those of the manufacturers. This conflict of interests is often on many grounds but our primary interest here is on the sharing of monopoly profits by the manufacturers with members of the distributive trades. The stronger the retailers are vis-a-vis the manufacturer, the greater the mark-ups they can insist on charging (or the greater discount they can ask) for the product, and hence the greater the pressure on the manufacturer to reduce his prices to the distributive trades.

The relative bargaining strengths of manufacturers and distributors depend on a number of factors, among the most important of which are: (1) possession of a patent; (2) possession of a well-advertised trademark and goodwill; (3) collusive agreements among manufacturers, or among distributors; (4) size and sales organization, or (5) some combination of these.

The manufacturer of a new, technically superior product has the advantage of dealing with eager retailers. If the manufacturer has a patent, he becomes virtually a monopolist and retailers wishing to carry his product would be more easily led to accept his terms.

They may see a number of advantages in carrying the product such as faster turnover, customer-drawing power of such an item in their stores, and prestige, which justify small margin for the line.

Or strength may arise from collusive agreements to support or protect profits. Manufacturers, for instance, have been known to fix prices and act as a large monopolist. Here too, the retailers are left without any alternative. At the other extreme, we may have collusive agreements among retailers who may force the manufacturers to fix minimum resale prices and thereby protect their margins against price-cutting retailers.⁷¹

When such agreements do not exist, size of the firm (manufacturer or distributor, as the case may be) is also an important determinant of bargaining strength. A large wholesaler with nationwide distribution facilities is more likely to obtain higher discounts from the manufacturer than a small wholesaler. Since size is often a characteristic of well-managed, established firms, there is greater reason for a manufacturer to prefer such wholesalers from others even if he has to sell his products at a lower margin of profit and leave the wholesalers to add any mark-up they (wholesalers) desire.

Our main concern here is the advantage derived from having a well-advertised trademarked product. There is good reason to think that many firms derive their bargaining strength from possession of

⁷¹ Such agreements are prevalent and have as a matter of fact, received official blessings with the enactment of Fair Trade laws in almost all states of the union. The association of druggists which spearheaded the move to legalize resale price maintenance provides an excellent illustration.

well-known trademarks which facilitate retail selling and compel retailers to carry them.⁷²

In the previous chapters we have seen how trademarks are actually being used by manufacturers to control the selling and pricing activities of their retailers. Through licensing agreements manufacturers owning widely advertised trademarks are able to limit the retailer's source of supply to themselves as in exclusive dealing arrangements. Similarly, they are able to confine the sales of wholesalers to certain territories and types of markets, as in market-sharing arrangements.

We have also discussed the role of trademarks in resale price maintenance. Here the manufacturer can discipline price cutters by threatening them with a halt in supply of his well-known trademarked product. But this presents a seemingly paradoxical situation. If the manufacturer is, in fact, not eager to maintain prices because this implies a limitation to his potential volume of sales, is he not in effect acting merely to protect the interests of retailers?⁷³

⁷² Imagine how many potential customers will be lost by a soda fountain that does not carry Coca Cola as a standard line, or a drugstore that does not sell Bayer Aspirin!

⁷³ This may be the case when there is a relatively high price elasticity of demand for the product. Lower retail prices will then generate a more than proportionate increase in sales.

As we recognized earlier, resale price maintenance may be practiced upon the initiative of retailers in collusive agreement. In such a situation it is the retailers who have the strength vis-a-vis the manufacturers. Here there will be a tendency to extort and share a monopoly price for the product which may be based on the elasticity of demand for it in the 'private' market of the average retailer. Needless to say this will tend to increase the gross profits of retailing.⁷⁴

But price maintenance may be practiced to accomplish the aims of producers. These aims may include: (1) to stimulate entry into the retail business; or (2) to protect their reputation and goodwill.

The manufacturer may find it necessary in order to increase his sales to have a larger number of small retailers in the territory. By maintaining a high minimum price level or allowing a larger mark-up to be charged by retailers, the manufacturer encourages entry of more firms into the retailing of his particular product. At the

⁷⁴ Henry Smith in his study of retail distribution problems. See Retail Distribution A Critical Analysis (2nd ed. London: Oxford University Press, 1948) says, :It (resale price maintenance) will, except where a deliberate policy of excluding the inefficient has been followed by strong producers, tend to make the position of the retailer a little more monopolistic, and to make the reaction of the retail market to falling wholesale prices a little slower." p1201.

same time he is able to limit the size of each firm to its profit maximizing output at the maintained resale price.⁷⁵

Increasing the retail margin through the use of resale price maintenance is also employed to encourage existing retailers to push the price-maintaining producer's products. The Report of the Lord Chancellor's Committee on Restraint of Trade⁷⁶ noted that "... the manufacturer has the alternative of relying upon advertising to create the demand for his products (in which case he may be able to get his output retailed on a comparatively narrow retail margin) or relying upon the retailer to push his goods (in which case a relatively wide margin must be allowed)." Also the producer may seek to maintain dealers (inefficient) in low volume areas thus leading to an increase in prices because of distribution costs.

Where the producer has a well advertised trademarked product, not maintaining resale prices at levels which yield a comfortable minimum mark-up for retailers may lead to the elimination of all but the most efficient retailers. If, as we pointed out earlier,⁷⁷

⁷⁵Note the difference between the demand conditions facing the firm in perfect competition and with resale price maintenance. In the former, the firm is not able to sell any quantity above the prevailing competitive price. In the latter, the firm may, depending upon its competitive position in its 'private market,' price above the minimum resale price fixed by the manufacturer. The size limitation is to expansion of sales when the firm decides to price below the minimum. Since the producer will stop supplying it with the given trademarked product once it prices below the limit, it can only expand sales until all its stocks are exhausted.

⁷⁶Committee on Restraints of Trade, Restraint of Trade (London: H.M. Stationary Office, 1931).

⁷⁷See supra, p.

the trademark has received such consumer acceptance that every retailer must carry it, the producer may even be able to force the retailers to handle the line which does not cover the cost of retailing it. Thus retail firms which are inefficient will be forced to leave from this product's market. Where handling a complete line is critical for the retailer, the effect of not carrying one brand may even prejudice the whole store.

The protection of reputation and goodwill is often used as an argument by producers to fix prices.⁷⁸ Some producers advertise their brands at certain prices and if retailers sell it at lower prices they complain that goodwill will be lost as a consequence. To the extent that producers are able to justify maintaining resale prices on this argument it helps strengthen the position of the manufacturer vis-a-vis the retailers.

Hence resale price maintenance together with exclusive dealing, and market sharing arrangements are some of the forms in which manufacturers are able to control the terms in which their trademarked products are sold to final consumers, and to influence the competitive structure in the distributive trades. In as much as trade-

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See U.S. Congress, Hearings before the temporary National Economic Committee, 78th Congress Part S-A "Federal Trade Commission Report on Monopolistic Practices in Industries." (Washington, D.C., U.S. Government Printing Office, 1939). Also J.L. Brown, "Trends in Resale Price Maintenance", Comparative Law Series (New Series), Vol. I, No. 2 (Feb. 1938) p. 37.

mark protection helps perpetuate such practices, it thereby contributes to the bargaining position of the producer. Needless to say, this bargaining strength is measured by the producers' ability to share less of his monopoly profits with the retailers in the final analysis.

We may illustrate this sharing of profits graphically by assuming that the producer considers as his demand schedule the "final" demand of consumers for his product, that is, the aggregate of demand schedules for the product facing the retailers. The producer enjoys some measure of monopoly because he sells a well differentiated brand, and has earned consumer loyalty for his brand. In the graph below, Fig. I, he maximizes profits by selling

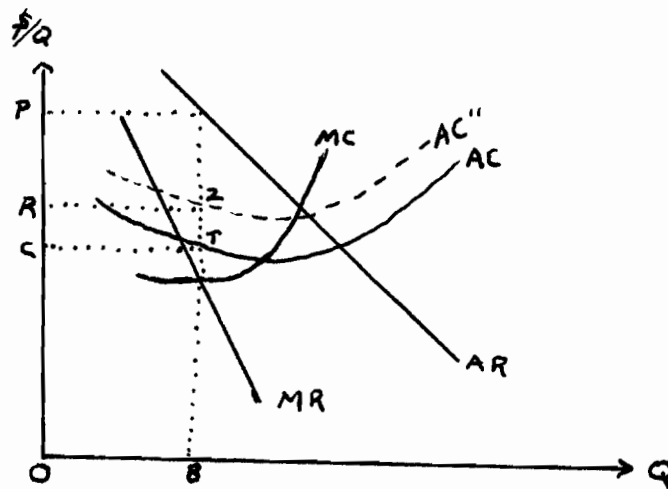


Figure I

quantity OB at the price OP. He earns a monopoly profit represented by the area of CPMT. Average cost, AC, includes production and selling costs of the producer alone. If AR represents the 'final' demand for his product, we may also include the cost of distribution, or more specifically, of retailing by adding the gross retail margin to the average cost of the manufacturer. Assuming that this margin is the same whatever quantity is sold, we will have a corrected average cost, AC'', above AC.

The producer now suffers a reduction in his monopoly profits by the amount of the gross margin X quantity sold, or the area CRZT. Depending on his strength, this profit "shared" can be large or small.

The retailers on the other hand may be earning profits or incurring a loss depending on a number of circumstances. Note that "profit sharing" here does not imply that the retailer is actually earning some profits, although the greater the area of CRZT, the more likely it is that he is earning profits, everything else remaining constant.

It is difficult to illustrate in a similar graphic fashion the situation of the retailer. One of the biggest problems here is to determine the cost of retailing the particular brand of product of any given manufacturer since fixed and variable costs of

the retailer are difficult to allocate to products and even more to brands of products. Consider, for instance, the thousands of items carried by supermarkets or any corner grocery store. Also consider the fact that some retail services are not capable of exact measurement.⁷⁹

The difficulty of analysis in the case of retailers also springs from the fact that the margin on one brand of product may be totally unrelated to its contribution to overall profits of the retailer. As we mentioned earlier some brands have the power of 'luring' customers into a store. This explains why some retailers will be willing to carry them even at very, very small margins. Some sort of "shadow pricing" may be more useful than the margin in indicating the profitability of a line to a retailer.

From the standpoint of the vertical conflict of interest, some simple conclusions can be drawn. The stronger the producer is relative to the distributive trades, the lesser the profits he would be willing to share with them in the form of margins. Since a strong trademark for the producer's product confers on him this advantage over retailers, we would expect producers of well-known and

⁷⁹ Convenience and pleasant surroundings, for instance, are services which cannot be measured and allocated to individual products.

accepted branded products to share less of their monopoly profits with retailers than producers of unknown brands.

B. IMPACT OF ABOLISHING TRADEMARK PROTECTION ON THE
DISTRIBUTION SYSTEM

Legislation to protect proprietary rights to trademarks is premised on the assumption that in its absence imitation of labels will take place to the detriment of their owners and the consumers. Damage to trademark owners consists of endangering their exclusive rights to exploit the goodwill earned by their products and/or their advertising and promotions. Damage to the welfare of consumers is assumed to be the confusion that will arise as to the source of products.

In economics, this imitation of labels, or more popularly termed "poaching" is nothing but the form in which competitive adjustments will tend to take place, in the absence of barriers, upon the stimulus of above-normal profits earned by a well-known trademarked good. The trademark law is, in fact, preventing such adjustments from taking place, not only momentarily, by permanently.

We need not dwell here on the inconsistency of public policy towards competition. Suffice it to say that in the absence of legal protection there will be a tendency for more resources to be allocated into the production of such a differentiated product when

more than normal profits are earned. On economic grounds therefore, there is validity to the assumption that imitation will take place if legal protection to trademarks is not provided except when only normal profits are earned in the absence of protection.

Our concern at this point is to analyze the probable impact on the distribution system of removing this legal obstacle to competitive adjustments. How will it affect the position of the manufacturer in his relations with the distributive trades? How will it affect the use of trademarks? The role of the distributive trades?

If our conclusions regarding the role of trademark protection in conferring control of the distribution system in the hands of the producers are correct, then the consequences of abolishing this protection suggest themselves. In the first place the reduction in brand advertising as a consequence of higher risks to such investment will tend to weaken the producer's ability to differentiate his products from the rest in the industry. Secondly, and as a consequence of the above, the producers will tend to become more dependent on the distributive trades to 'push' their products. And finally, this dependence on the distributive trades will very likely increase the use of 'private' (or distributor's) trademarks.

Returns to investment in advertising and sales promotion are

often said to take the form of incremental sales for each additional dollar of advertising expenditure. With trademark protection such returns will accrue to the firm advertising his trademarked product since use of the trademark by other 'non-registered' firms⁸⁰ is prohibited by the law. Without trademark protection there is no more guarantee that returns will accrue to those firms which advertise. In fact greater net returns (profits) will accrue to those firms which merely imitate advertised labels since they do not incur advertising expenditures. This will obviously discourage firms from advertising and thereby reduce product differentiation through it.⁸¹

But to reduce advertising and product differentiation for the producer's trademark is to weaken his ability to influence retailers to carry his line of products without the offer of lower wholesale prices (or what amounts to the same thing, offering higher discounts). In effect, in order to influence the sales of his products, a producer must rely on the cooperation of his retailers. This cooperation, of course, is bought at a price (lower prices to

⁸⁰There are, as we have earlier discussed, registered users or licensees.

⁸¹If firms which do not advertise have the same production costs as those firms which do, they can even derive the latter out of the market by under-pricing them. This is possible because they have, by definition, less selling costs.

distributive trades) which would vary depending on expectations regarding turnover. The lower the expected turnover the higher the mark-up retailers would want to charge and therefore the greater the pressure on producers to offer their products at lower wholesale prices. Some producers have the alternative of undertaking the distribution themselves.⁸² They may elect to open up retail outlets and sell directly to their consumers. Others may arrange to sell on a 'consignment' basis with special stores so that retailers need not worry about financing inventories. But for the greater part of consumer goods this method of distribution is inefficient and not feasible for many manufacturing firms. Products such as common daily necessities must be sold through a large network of outlets since it would otherwise entail tremendous inconvenience to consumers.⁸³ Also, the capital outlay and management requirements for handling its own selling directly to consumers are often out of the reach of producers. At the same time the function of distribution can be handled far more effectively and efficiently by distributors than by the producers.

⁸²This is feasible in some durable consumer good industries such as household electrical appliances, or automobiles, where many producers offer a large assortment of models and styles, and for the purchase of which most consumers will be willing to make special trips to the outlet.

⁸³Imagine if everytime one needs to buy a pack of cigarettes he must go to a specialized dealer downtown!

Hence in the absence of trademark protection, the reduction of advertising and promotion of trademarks will lead to a serious weakening of the producer's position vis-a-vis the distributive trades. The producer loses the basis for his control over retail prices (hence retail margins), market territories, and other conditions of selling when his brand is not legally protected and widely advertised. This is a consequence well recognized in the field of marketing when the producer fails to promote his trademark.⁸⁴

Finally we come to the third consequence, namely, the increase in the use of "private labels", another term to designate retailers' or wholesalers' brands. Private labels serve the same function of informing consumers regarding qualities, sources, prices, availability, etcetera, with one difference, they are under the control of the distributive trades rather than manufacturers, and are owned and developed by them.

This difference becomes a very crucial one under conditions where no legal barrier to "poaching" or imitation of labels exist. The possibility of being able to pass off imitation labels (manufacturer's) through the distributive trades is high when the latter do not share "responsibility" for the brand. In fact where

⁸⁴One of the advantages of promoting a brand is to avoid "being" at the mercy of distributors," and to enable the manufacturer "to control his market through to the final consumer." See supra p. 14

the "imitation" is very successful (or accurate) and is being sold at much lower wholesale prices to retailers, it would be profitable for the retail firm to carry the "imitation" rather than the original. From the standpoint of identifying product, a "gap" exists between the manufacturer and the consumer which allows the competitive adjustments (imitation) to take place in the absence of legal protection. This gap however, does not exist in the case of private labels. The distributive trades which are "responsible" for the brand are selling directly to the consumers. In such a situation legal protection becomes superfluous since the danger of confusing the buyer as to the source of the product does not arise.⁸⁵

This advantage of private labelling does not, of course, imply that producers will sell their goods under private labels in their eagerness to avoid confusing the public. The point being made here is that, assuming trademarks play as large a role in consumer purchasing decisions as we attribute to it, the decrease in brand promotions (through advertising) as a consequence of removing protection will most likely lead retailers to adopt their own labels.

⁸⁵Usually the "private label" is the name of the store itself. Note that the question of "source" of the product is not quite as simple as that. Even with private labels confusion may arise as to the identity of the processor or manufacturer. But so also with manufacturers' brands. Perhaps to be accurate they need to state sources of various materials used in manufacture. But this leads to absurdity.

There are obviously "private" advantages to the distributors in the use of private labels. Just as brandnames or marks of manufacturers enable them to rise above the "dead level" of competition because their products become differentiated, private labels also permit some measure of monopoly position to the distributive trades. They earn consumer loyalty for the store, not to the producer.

Another advantage of private labelling lies in the area of costs. Product costs are reduced because retailers can obtain their merchandise from small processors or manufacturers who charge less for their services than those with established brands. Distribution costs are reduced since usually transportation is more direct from the small private label packer to the retailer and there is no longer need for a warehouse system to serve small accounts.⁸⁶ Centralized purchasing for private label products often eliminated the need for a sales force otherwise supported by producers' brands. And finally, selling costs are reduced because the proximity of the consumer eliminate the need for advertising, mailers, etc. to promote the brand.⁸⁷

⁸⁶ This was necessary in the case of advertised producer's brands. Among the advantages of private labels are (1) product differentiation tends to become store differentiation, (2) Threat of underpricing by competitors on the same brands is minimized, (3) Better margins can be obtained from private labels. R. Zimmerman, "The Third Revolution in Food Distribution", Report of 28th Boston Conference on Distribution (Boston: Retail Trade Board, 1956) pp. 74-77.

⁸⁷ Ibid., p. 131.

Some broad changes in the system of distribution also make it convenient for retailers to use their own private labels. In the food distribution system, for instance, today's tendency toward "one stop shopping" transfers the attention from the item to the store. "The Supermarket," according to the National Commission on Food Marketing,⁸⁸ offers a large and diverse package of services. After the consumer has selected the store offering the best 'package' and after she has driven to that store, the specific identity of an individual item is of secondary importance."

In short, the conditions suitable for the wide use of private labelling are present. With the abolition of trademark protection, the problems involved in promoting manufacturers' trademarks and the consequent strengthening of the position of distributors vis-a-vis the producers lead us to conclude that private labels will most likely increase in significance in distribution.

Note however that the adoption of private labels and their development involves the assumption of responsibility over a number of functions which previously did not concern the average retailer. In adopting a private label the retailer or wholesaler must take the responsibility for (1) definition of the product, (2) quality control, (3) physical movement from production to the distribution

⁸⁸See National Commission on Food Marketing, Organization and Competition in Food Retailing, Technical Study No. 7 (Washington D.C., U.S. Government Printing Office, 1966) p. 130.

warehouse, (4) merchandising of the product from label design to point of sale displays and occasional advertising.

Clearly the small retailers are not in a position to shoulder all these responsibilities since the smallest stores carry at least a few hundred items of merchandise. Only the large integrated wholesaler-retailer firms have the management sophistication, financial capability, and physical facilities to engage in private labelling. Private labelling has, in fact, been initiated primarily by large chains about 30 years ago and is presently practiced also by voluntary group wholesalers, cooperative competitors and independent wholesalers. ⁸⁹

Will the advantages of private labelling, once legal protection is removed, lead to greater integration of supply? A priori one would be inclined to conclude that integration will tend to increase. Past trends in retail integration have shown that this can be accomplished without too much difficulty. At the same time the increase in integration has made survival very difficult for independent small retailers as evidenced by the number of small shops

⁸⁹Voluntary group wholesalers and cooperative competitors are affiliated retailers, the former assembled by wholesalers and the latter by independent retailers. In varying degrees, the supply houses for these groups provide group merchandising, advertising, store location, store layout, financing, retail accounting, store supervisor, private labels, et cetera. See *Ibid.*, pp. 25 and 132-133. Retail chains sold about half their total volume of frozen vegetables, frozen fruit juice, bakery products and dairy products under their own labels.

which were forced to close up during the peak of the chain-store movement.⁹⁰

C. ABOLITION OF TRADEMARK PROTECTION AND THE MARKET STRUCTURE

If our conclusions regarding the consequences of abolishing trademark protection are valid, then there are bound to be some serious repercussions upon the market structure in both the manufacturing and the distribution levels of supply. We will consider here the question as to whether abolition of trademark protection leads to more competitive conditions in the suppliers' (manufacturers') level and to less competitive conditions in the distributive trades.

Product differentiation is a major element of market structure. How will the removal of trademark protection affect product differentiation? Our analysis in Chapter III suggests the answer. Brand advertising which is a major cause of product differentiation will be discouraged on account of the risk involved for the advertiser. Depending on the relative significance of other factors, e.g. quality differences, patents, etc., in differentiating the product from others in the industry, such discouragement of advertising will decrease product differentiation.

⁹⁰The number of grocery stores operated by single-store firms dropped by more than 130,000 between 1948 and 1963. Stores with annual sales less than \$5,000 dropped 86%. See Ibid., p.165.

Reduction in product differentiation in turn may result in facilitating the entry of new firms into the trade.⁹¹ Since the evidence shows that "great barriers to entry are more frequently attributable to product differentiation than to scale economies in production and distribution," considerable improvement in the condition of entry can be expected with the removal of trademark protection. As far as manufacturers brands are concerned, this "improvement" will, all other things constant, lead to greater competition in the manufacturing level.

But improvement of entry conditions also comes from another source. The adoption by the distributive trades of private labels opens the way to small manufacturers and processors which are able to offer lower wholesale prices for specified products. Such entrants need not overcome the barrier of high selling costs since they can contract to sell all their products to distributors under the latter's brand.⁹²

If private labelling, in making entry of small manufacturers easier, leads to greater competition among manufacturers, what are its effects on the structure of competition in the distributive trades?

⁹¹ Improving conditions of entry is only probable because there are other factors - economies of scale and absolute cost advantages - which determine conditions of entry. See Bain, *op.cit.*

⁹² See staff report to the Federal Trade Commission, Economic Inquiry into Food Marketing, Part II, (Washington: U.S. Govt. Printing Office, December 1962) pp. 41-42. Comparative market structures of suppliers with their own brands and those with private brands seem to bear this out. According to the report, "The manufacturer of packer-brand products is relatively more concentrated (the top 8 control 66 percent of sales) than the manufacturers of private brand products (the top 8 control 44 percent of sales)."

The record of retailing in the United States does not provide a determinate answer to this question. We know however, that private labelling has been initiated by the large chains which assumed the integrated functions of wholesaling and retailing. We know also that where they occur, manufacturers pack under private labels only for very large distributors and retail organizations. Very little however is known about the consequences of private labelling on market structures.

But 'a priori' there is no great difficulty in analyzing the structural changes that private labelling requires. If the abolition of trademark protection leads to reduced promotion and advertising of manufacturers' brands, and greater use of private labels, then small retailers will be put at a serious disadvantage.⁹³ If these small firms do not organize into associations or chains and adopt their own labels; they must compete on the basis of price with the large chains and supermarkets. Previously their existence depended on

⁹³ One of the arguments against government labelling in the hearings of the Boren Committee is that it will weaken the efficiency of the brand name as a guide to consumer buying. It is then argued that, as a consequence, the position of the independent retailer will be jeopardized because he relies heavily on brand name merchandise to maintain his clientele in the face of price competition from the chains. See U.S. Congress, Hearings before subcommittee, Committee on Interstate and Foreign Commerce, Pursuant to H.R. Res. 98, 78th Congress, 1st Session, Parts 1 and 2 (1943). These hearings will be referred to as the Boren Committee Hearings (Washington: U.S. Government Printing Office: 1943.)

carrying well-advertised manufacturers' brands, specialty items, and having convenient store locations. The 'convenience' basis for their existence is fast being usurped by the tendency towards "one-stop" shopping in large supermarkets. Abolition of trademark protection will remove the first basis - well-advertised brands of merchandise. These small stores may then end up as "specialty stores."

Competition on the basis of price is also unlikely to be in favour of the small retail store. Not only do large supermarkets have the advantage of the trend towards "one-stop shopping" where 'price specials' have proven very effective,⁹² they also have considerable cost advantages. The cost advantages are due to economies of scale in retailing, discriminatory prices obtained from manufacturers on account of centralized purchasing, and specifically with regards to private labelling, the economies accruing from combining several warehouses in a single firm and moving items in large volumes from their source of production.⁹³

Hence, abolition of trademark protection will lead to greater concentration in the distributive trades, given our assumptions.

⁹²Price specials are temporary low prices used very conveniently and effectively by large stores to implement promotion through pricing a "mix of merchandise". Since these stores carry several thousands of items, few buyers can determine whether or not price for the whole "bundle of groceries" is cheaper in this store than in others.

⁹³See chapter on Economies of Scale in Food Retailing, National Commission on Food Marketing, op.cit., pp. 139-152.

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CHAPTER V

COSTS AND BENEFITS OF TRADEMARK PROTECTION

It is clear from the existence of legal protection to proprietary labels that perfect competition does not enjoy the primacy in social valuations that would justify our evaluation of its consequences purely on the basis of the implications upon competitive conditions. Disregarding non-economic considerations for the moment, it is also clear that little agreement exists as to the desirability of pursuing perfectly competitive markets as a public policy objective once dynamic assumptions are included.⁹⁶ When a conflict between growth and efficiency arises, present economic models fall short of providing a satisfactory reason for choosing one instead of the other.

If we are to provide a more complete and realistic evaluation of the economic consequences of trademark protection we need to

⁹⁶"... As concerns dynamic efficiency," says Scitovsky, "Perfect competition is far from being a model of perfection; and that the response of a perfectly competitive industry to changing conditions compares unfavorably with that of an industry controlled by a monopolist, or a state official in charge of planning, "See Tibor Scitovsky, Welfare and Competition, (Chicago, Irwin, 1951) p. 365.

employ a different criteria for desirable public policy objectives and a different framework for analysis. These criteria must include measures of consumer welfare such as the desire for variety, for quality goods, and protection against deception and all hazards to life and health. For these objectives, the cost and benefit approach offers a more suitable framework for analysis. It considers projects (or policy proposals) as economic choices between alternatives, and compares the costs and benefits of each with the help of well-known propositions in welfare economics and other branches of economics. The aim, whenever possible, is to determine which alternative "maximizes the present value of all benefits less that of all costs, subject to specified constraints."

I. ALLEGED BENEFITS OF TRADEMARK PROTECTION

The right to be protected against imitators of one's brand has been traditionally regarded as necessary not only because of the common persuasion that the right to good will is a basic human right but also because it is believed that protection yields beneficial results to society. As the Association of National Advertisers puts it, "... history proves (that the free, competitive system of trademarked goods) is the best guarantee yet devised for freedom of choice for the consumers ..."

See A.R. Prest and R. Turvey, "Cost-Benefit Analysis: A Survey," in Surveys of Economic Theory, Vol. III, (New York: St. Martin's Press 1966) pp. 157-158.

See testimony of George S. McMillan, Secretary, Association of National Advertisers, Inc., Boren Committee Hearings, op.cit., p. 202, 207.

Our discussion of the role of trademarks in market information still remains to be completed with a consideration of its benefits and costs to society. Is there a cheaper means of conveying information to consumer regarding properties of a product? What, if any, are the advantages of using trademarks over those in using alternative vehicles of information?

The question of product variety is again an extension of a previous discussion of trademark effects on the amount of product differentiation. Consumer welfare is enhanced by the existence of a wider range of choice or product alternatives. Does trademark protection lead to greater variety of consumer goods?

Finally there are the social benefits that can be derived from greater quality control in production. Assuming that little incentive will characterize markets once trademark protection is removed, is the price society pays for the incentive given by trademark protection commensurate with the benefits derived.

These are the issues that we intend to investigate in this chapter. We begin with an analysis of the "alleged" benefits of trademark protection to society in this section and then proceed with an analysis of the costs. Needless to say the variables in this problem do not yield to dollar-price-cost valuations so that in some

sense the cost-benefit approach with its quantitative definitiveness cannot really be accomplished. But where the issues are inherently qualitative, "spurious accuracy" is more of a disadvantage than a help for making choices. Hence we shall proceed to attempt an identification and evaluation of the benefits and costs of trademark protection even in the absence of quantitative measurements. Let us here look at the alleged benefits.

A. BETTER INFORMED MARKETS

We have discussed in Chapter II the kinds of information provided both directly and indirectly by trademarks. Briefly it may be recalled that trademarks usually indicate the distinctive properties of the product, its price, availability, popularity, source, and reliability. Indirectly trademarks involve all the information supplied by advertising.

We also argued that to the extent that trademarks supply consistent information to consumers, they facilitate the "search" for the suitable brand and hence enhance the efficiency of consumption. From this observation we may extend the discussion and ask whether these are the type of information which consumers need to be able to maximize their satisfaction from consumption.

In the minds of many economists the answer is no. Talking about brand advertising A.P. Lerner claims that "most of it has the effect of stressing partly or wholly imaginary differences

between goods ..."⁹⁹ Meade says that "In the real world a large part of the expenditure on advertisement is undertaken ... without in fact giving consumers any greater knowledge ... all such expenditure is a waste due to monopolistic conditions in the sale of commodities."¹⁰⁰

But Chamberlin disagrees. He thinks that the stress on "technical information" about the product and its uses presented with "zero emotional appeal" has been greatly overdone. This kind of information, he agrees, is of course useful and desirable but "it is not the only kind people want. They are perhaps more interested in knowing that a famous movie star smokes a certain brand of cigarette than in knowing what the cigarette is made of; and both are information People must want this kind of advertising; if they did not, it would soon be known, and something else would replace it."¹⁰¹

Chamberlin himself suggested a test as to whether this information is wanted by consumers. He refers to the possibility of selling this information separate from the product at a price sufficient to cover the cost of supplying it. For example,

⁹⁹ See A.P. Lerner, Economics of Control (New York: MacMillan Co., 1944), p. 43.

¹⁰⁰ See James Meade, Economic Analysis and Policy, New York: Oxford University Press, 1946), p. 166.

¹⁰¹ See Edward Chamberlin, Towards A More General Theory of Value, (New York: Oxford University Press, 1957), p. 146.

we may sell the Sears, Roebuck catalogues instead of distributing them free. He adds that "it would probably be a best seller."¹⁰²

The differences in opinion obviously arise from different assumptions about the consumer. Whereas Lerner and Meade assumes him to be a cold, rational economic agent, Chamberlin takes the more realistic case where he is subject to emotional and sometimes pathological impulses. If "consumer sovereignty" is to be accepted as a measure of greater social welfare, then we are inclined to agree with Chamberlin. If not, then the position on the superiority of "technical information" has greater weight, justifying re-examination of public policy on trademarks and advertising.¹⁰³

Assuming that both types of information are desired by the consumer, can they be provided by other devices aside from trademarks (and accompanying advertising) at a lower social cost? Clearly this involves a number of questions. First are these other devices which can provide the same information? Are they equally efficient? and how do they compare with trademarks from the standpoint of social cost?

¹⁰²Ibid., p. 147.

¹⁰³We need not venture into the controversy regarding this doctrine of consumer sovereignty. For a full discussion see the American Economic Review, Papers and Proceedings, May 1962, which contains Tibor Scitovsky, "On the Principle of Consumer Sovereignty", Jerome Rothenberg, "Consumers Sovereignty Revisited and the Hospitality of Freedom of Choice", and the discussions with Abram Bergson, Stanislaw Wellisz and William Baumol.

There are several ways in which information regarding properties of a product can be communicated to the consumer through the use of labels. We know of four possible devices which have already been tried, namely: (1) trademarks, (2) information labelling, (3) grade labelling and (4) certifications of quality. We have seen what trademarks are. The others need to be explained.

An informative label is a marking or a statement on the product which passes on to the consumer "test data" about its quality, leaving the consumers to draw their own conclusions as to the values to assign to the commodity. For example, one large department store gave the following information regarding its muslin sheets and pillow cases: "These sheets and pillow cases are made from a good quality of cotton. They conform to the following specifications: construction of cloth wrap 168; filling 72; equals 140 threads to the square inch. Breaking strength - not less than 70 pounds in the wrap and filling direction. Shrinkage wrap not more than 5 percent - filling not more than 2-1/2 percent; weight less than 4.6 ounces per square yard."

Grade labelling is a phrase or symbol attached to the commodity stating a "qualitative judgement" of relative superiority or inferiority in a graduated scale. For example, canned goods in a large food chain were marked "Grade A", "Grade B", or "Grade C."

Finally, certifications of quality are phrases on the

product label which indicate that the product meets certain standards specified by the certifying organization. Note that certification of quality are similarly protected by the trademark law.

These information devices have been used by individual manufacturers and distributors, government regulatory agencies, trade associations, technical and professional societies, and consumer groups. Their use by these groups except for the first two has however been very limited in certain industries or certain periods.¹⁰⁴

These are the known alternatives to trademarks used by individual manufacturers and distributors in order to inform consumers. Each of them have advantages and disadvantages in their use relative to trademarks. The question now is whether market information could be accomplished just as efficiently and at a lower cost (from the social standpoint) with the use of any of these alternatives.

For the supply of "technical information" about the product it is obvious that these three alternatives can be superior to trademarks. The simple reason for this is that the information

¹⁰⁴During the war, the government provided or supervised the use of such devices through the Office of Price Administration, the National Bureau of Standards; the Federal Trade Commission, the Department of Agriculture and many other agencies. In the private sector, some of the principal technical and professional societies doing standards work are the American Standards Association, the American Society for Testing Materials, the American Home Economics Association, the Society of Automotive Engineers, the American Institute of Electrical Engineers, and the Illuminating Engineering Society. Consumers "Union and Consumers" Research are the principal consumers' organizations testing and rating commodities. See S.P. Kaidonovsky and Alice Edwards, Consumer Standards, TNEC Monograph 24, (Washington, U.S. Government Printing Office, 1941)

they supply is the product of scientific research and tests conducted by technically competent people using scientific equipment. There will be less likelihood of bias as long as they do not represent specific vested interests aside from that of the consumer. This is an important condition which once violated makes them all inferior to trademarks. Note also that they must be based on commonly accepted quality standards that reflect the uniform results of agreed methods of technical research.¹⁰⁵ This suggests very strongly that they cannot be achieved without government action, at least in formulating and defining quality standards. The reason for this is because the conveying of understandable information about comparative worth of commodities requires a "balancing of the interests of producers, distributors, and consumers ... it is primarily a regulatory, not a technical problem."¹⁰⁶

¹⁰⁵Experience during the war in the use of informative and grade labelling by government agencies is very enlightening. Informative labelling, for instance, must carry terminology which can be understood by consumers and uniformly used by all producers, otherwise they will only confuse consumers. Grading must also be uniform for all producers otherwise it is not useful for comparing products sold by different people. Certification marks also affords no basis for comparative product evaluation unless there is agreement on the quality standards used.

¹⁰⁶See Carl A. Auerbach, "Quality Standards, Informative Labelling, and Grade Labelling as Guides to Consumer Buying," Journal of Law and Contemporary Problems, Spring 1949, p. 364-365.

What about the non-technical type of information supplied by advertising? It is widely feared that the use of government formulated grading system will eliminate brand advertising. Commenting on the proposed extension of government grade labelling after the war, the Association of National Advertisers charged "... if grade labelling goes through ... national advertising by manufacturers is going to fold up ..."¹⁰⁷ Upon closer inspection it would seem unjustified to expect such a gloomy end to advertising. Quality standards formulated will in most cases be minimum standards so that there will always be the opportunity to inform the consumer by advertising that products of a certain manufacturer are better than minimum quality. But it does mean that "persuasive" advertising would be weakened as consumers gain experience with the new guides to buying."¹⁰⁸

B. GREATER PRODUCT VARIETY

Variety is a much cherished characteristic of our capitalist economy. Many believe that it reflects the greater capacity of a free enterprise system to respond to the differences and vagaries of consumer tastes. Greater adaptation of product qualities to consumer requirements and tastes no doubt increases consumer satisfaction from consumption.

¹⁰⁷ Testimony of G. McMillan, Secretary, Association of National Advertisers, Inc., Boren Committee Report, op.cit., p.

¹⁰⁸ Auerbach, op.cit., p. 381.

The state of "informedness" of consumers is an important determinant of variety. According to Scitovsky the variety of tastes in an 'informed' market gives rise to a variety of products, each of which fills a special need and caters to a different taste. But where buyers are ignorant, their inability to "develop a personal taste" or lack of awareness of the particular qualities which would serve their needs will lead to similarity of products competing in the market.¹⁰⁹ Producers can differentiate their products only at the sacrifices of economies of scale and will do so only if they cannot convince buyers that differences exist. Where buyers are uninformed however, producers will "seldom find it profitable to enlighten (their) customers about their special requirements and the possibility of catering to their special requirements."¹¹⁰ In such markets competing products tend to be differentiated merely by name or trademark, and other unessential features.

Hence trademarks play an important role in giving commodities "fictitious" individuality in uninformed markets. This however could hardly be considered as socially beneficial unless consumers can be shown to desire it. If advertising expenditure is often based on the rule of thumb that it should be a certain percentage of sales, - what about the information value of advertising encouraged by trademark protection? Also the informative value of advertising

¹⁰⁹ See T. Scitovsky, op.cit., p. 398.

¹¹⁰ Ibid., p. 399.

can easily be recognised regardless of welfare criteria.¹¹²

Doesn't advertising lead to better informed markets?

Scitovsky would rather switch this operation around and say that better informed markets give rise to more informative advertising. In expert, informed markets, advertising is limited in scope; but what advertising there is tends to be factual and informative and thus contributes to keeping the market informed ... (while) in the uninformed market, the buyer is all equipped to make a rational comparison among competing offers; as a result, he is usually unable even to demand the right kind of information. The seller therefore has no incentive to supply information that would facilitate comparisons.¹¹³

So far we have said that far from inducing "real" product differentiation, trademarks are even the evidence of its absence. There is really no reason "a priori" to think that trademarks lead to greater "real" differentiation. Trademark protection is concerned with a communication function separate from the activity of inventing and developing new products. Whereas patent protection may be argued

¹¹²With of course one exception - A welfare criterion based on profitability of the advertising agencies.

¹¹³Scitovsky, op.cit., p. 402.

to stimulate the latter activity, no such case can be made for trademark protection.

Finally we may note that greater variety of products as a criterion of social welfare is not self-evident. As long as or whenever economies of scale are present the demand for greater variety can only be satisfied at the cost of producing below the "ideal" output, the lowest point on one long-run average cost curve. This represents an inefficient allocation of resources since "excess capacity" exists. In order to show its contribution to social welfare, it must be shown that the loss of satisfaction from a more standardized product is greater than the gain through producing more units.¹¹⁴

C. GREATER QUALITY CONTROL

Our discussion of some restrictive trade practices reveal that they have often been justified on the grounds that only through such agreements can proper supervision over the quality of the trademarked product be exercised. Concern over the necessity for maintaining quality seems to be one of the responsibilities trademark owners have taken upon themselves. "Individual businessmen", according to Chamberlin, "constantly set standards for their products or services Typically, a trademarked product is carefully

¹¹⁴See E. Chamberlin, "Product Heterogeneity and Public Policy", American Economic Review, May 1950, p. 89.

defined and its quality scrupulously maintained so that buyers will get exactly what they have come to expect."¹¹⁵

Note that this type of quality control is different from that enforced in some industries by a government body, such as the Foods and Drugs Administration. The latter is concerned with setting minimum standards to insure against products that may be dangerous to life and health. Quality control accompanying trademarking, on the other hand, is more of a competitive necessity guarding against loss of consumer patronage and market share.¹¹⁶

The social benefits arising from this form of quality control are not as clear as those derived from the work of such bodies as the Foods and Drugs Administration. We need to investigate the nature of economic influences bearing upon product quality in order to see what would otherwise be the case if trademarks are not present.

In his article, "The Product As An Economic Variable",¹¹⁷ Chamberlin discusses the "phenomenon of product deterioration". He

¹¹⁵ See Chamberlin, Towards A More General Theory of Value, op.cit., p. 123.

¹¹⁶ This is for instance, evident from the "consumer orientation" of product determination. See recommendations for determining product attributes in Alfred Kuehn and Ralph Day, "Strategy of Product Quality", Harvard Business Review, Nov. - Dec., 1962, pp. 113-144.

notes that profit maximization may often require such things as "planned obsolescence (so that there will be repeat demand for a manufacturer's product) or cost reductions that deteriorate product quality (in small enough changes which escape detection by consumers). Quality deterioration will take place until a limit set by technological considerations is reached.

To what extent in real life are products determined in this way? In the absence of quality controls enforced by either the government, private firms, or other voluntary groups, the presumption that would seem to be established is that quality deterioration is typical since the two main conditions of (a) profit maximization and (b) imperfect knowledge are widespread. With quality controls and trademarks "in their role of guarantors of quality"¹¹⁶ a strong countervailing force is released halting the tendency towards quality deterioration.

Borden offers empirical evidence from his study of the effects of advertising¹¹⁷ that quality controls are instituted by private firms for profit reasons. Differing from Chamberlin's explanation, he says "While brands are not necessarily a guarantee of uniformity of product quality, the desire of businessmen to profit from continued

¹¹⁶ Ibid., p.136.

¹¹⁷ See Neil Borden, "Findings of the Harvard Study on the Economic Effects of Advertising", Journal of Marketing, VI (1941-42 Proceedings) pp. 89-99.

patronage usually has led them to maintain quality."¹¹⁸

To understand the reason for this apparent contradiction we need to recall Scitovsky's distinction between informed and uninformed markets. Obviously Chamberlin's theory about quality deterioration makes sense once applied to the uninformed market. At the same time Borden may be talking about a market where buyers are able to decipher small quality changes so that in order to retain their customers businessmen must be especially careful about quality standards.

To sum up, the role of trademarks in quality maintenance is not as clear as we would have expected. Where the market is informed, quality controls will likely be very strict in order to remain in business. Where the market is not informed, trademarks become significant as a deterrent to quality deterioration following efforts to reduce costs.

The next question is to evaluate the efficiency of trademarks, in this connection, with possible alternatives. We may consider the government as the main alternative body for supervising quality maintenance for the same reasons as we have cited in the section on information above. And for this we have the benefit of the Soviet experience with government inspection and quality control operations.

¹¹⁸Ibid., p.

Goldman in his article "Product Differentiation and the Soviet Experience"¹¹⁹ observes that the Soviets have resorted "to a series of legal arrangements, the purpose of which is to individualize the activities of firms which produce and sell goods. Wherever it is physically possible it is obligatory that the firm indentify itself on the good or packaging with a "production mark."

He claims that with government supervision the number of minimum standards set tends to increase as the degree of fabrication grows. To quote an example he gives, "As some of the consumer groups have discovered, the higher the degree of fabrication, the more difficult is the standardization and grading. For example, assume that the government tries to set a standard for radios. They might require that all radios have a minimum of three tubes if experience seems to indicate that radio with two tubes fail to operate properly. Now that the manufacturer cannot reduce his costs by eliminating one of the tubes, he may try to "cut another corner" by attaching a four foot electric cord instead of a seven foot cord. Obviously the solution here is to establish a standard for tubes, cords, ad infinitum."¹²⁰

This example has been included in order to underscore the difficulties with setting minimum standards as products pass more

¹¹⁹See Marshall Goldman, Product Differentiation and the Soviet Experience, Journal of Political Economy, 1960, pp. 3492ff.

¹²⁰Ibid., p. 352.

and more stages of fabrication. It is not a fair example however if it is used to condemn government inspection and quality control 'in toto'. Surely some of the reasons for the difficulty in the Soviet system are the facts that production goals are set primarily in quantitative terms, and as Goldman explains, many markets can be characterized as sellers' markets. We are inclined to believe that similar results need not take place if the government supervises quality controls in a free enterprise system. Nevertheless it is interesting to note that production marks are used in the Soviet Union to help quality control.¹²¹

¹²¹See the report by R.C. Watson, U.S. Commissioner of Patents, on "Soviet Law on Inventions and Patents", Journal of the Patent Office Society, Vol. 43, No. 1, January 1961, pp. 48 and 49. The law deals first with so-called "production" or "factory marks". Each industrial concern or establishment, except those which are specifically exempted, is required to place on the article, or on the container or label, a statement of the name and location of the concern; the name of the organization of which it is a part, and a statement of the grade of the goods. This label is not a trademark although a trademark may be embodied in it The concern may use a trademark for the purpose of distinguishing the articles. Trademarks may be "graphic images, original names, special combinations of letters, numerals or words, original packaging, etc. An establishment dealing with goods produced by others may be permitted to have a trademark of its own. But licensing of trademarks is not permitted, although collective trademarks may be used by the constituent units of associations. The owner of a registered trademark may sue to stop an unlawful use and to recover damages. Importation of infringing articles is also prohibited; but foreigners may register their trademarks in the U.S.S.R. provided their home country permits registration of trademarks of Soviet citizens and enterprises.

D. QUALITY IMPROVEMENTS WITH TRADEMARKED GOODS

What about improving quality? Does trademarking encourage quality competition?

In his book "Quality and Competition", Abbott remarks "When competing products are dissimilar, identifying brand labels are a prerequisite of efficient quality competition. If brand names were abolished in an attempt to eliminate the monopoloid elements of goodwill and brand preferences, quality competition would be substantially lessened."¹²²

The question of "quality improvement" is a particularly thorny one for economics. The problem is that from economic principles alone it is impossible to determine what would pass for quality improvement and what would not. Most economists insist on the "objective" evidence of improvement (technically determined), but others like Chamberlin and Sherrard¹²³ argue that the "subjective qualities" are also valid forms of improvement.¹²⁴

¹²²See Lawrence Abbott, Quality and Competition (New York: Columbia University Press, 1955) p.198.

¹²³See this particularly provoking article by Alfred Sherrard, "Advertising, Product Variation and the Limits of Economics", Journal of Political Economy, April 1951.

¹²⁴This is a much discussed point in the case against the pharmaceutical industry. The industry has been charged with claiming as improvements "molecular manipulations" which actually do not constitute any real change in effectiveness of the products. Critics claim that huge amounts of resources are wasted in merely "differentiating" products from well known inventions, while too little is used in basic research. See, Administered Prices, Drugs, op.cit., pp. 114-137.

Scitovsky's distinction between "informed" and "uninformed" markets again seems to be important here. It is logical to expect that the incentive for competing on the basis of "real" improvements is stronger when buyers are knowledgeable (i.e. industrial buyers) than when they are not. Hence the important variable is not trademark (since it is used in almost all types of goods) but the "informedness" of buyers or markets. Note the condition which predicates Abbott's statement - when competing products are dissimilar. Trademarks do play a role in information, however, but as we have pointed out in our discussion the information they provide is often times not of the "technical" variety but borders on the "emotional." Hence instead of contributing to more 'rational' buyers they may in fact serve to distract consumer's attention from the technical properties of products.¹²⁵

II. THE SOCIAL COSTS OF TRADEMARK PROTECTION

The term social costs refers to a variety of cost elements. For the purposes of our investigation it covers certain "social opportunity costs", that is, those cost elements which take the form of wastes or inefficiencies of various kinds. For instance, we ask: What are the economic wasters arising from "fictitious" product differentiation? How inefficiently are economic resources allocated

¹²⁵Attention is diverted from the weight, the quality, and the price of the article, to the size, shape, and color of the package in which it is housed. See C. Wilcox, "Brand Names, Quality and Price", Annals of the American Academy of Social Sciences, May, 1934, p. 81.

on account of the monopolistic elements existing due to trademark use? What is the relative cost of using alternative information devices?

It is clear that a complete evaluation of public policy on trademarks requires that these questions be adequately answered for only then can we determine the desirability of trademark protection from the social standpoint. But as we have alluded to a number of times in the paper these questions involve a formidable problem for analysis - that is, the lack of suitable criteria for determining what would constitute "waste" or "inefficiency" once we recognize "dynamic" considerations and agree to a more realistic picture of consumers. If we agree with Marx and Schumpeter that the essential characteristic of capitalistic reality is change and innovations, then certain restraints of trade assume the character of protective rather than necessarily anti-social devices.¹²⁶ With regards to the consumer, the debate on the usefulness of rationality as an assumption for his welfare has been shown to rob us of a criterion with which to evaluate information.

We shall not attempt to pass over these problems in order to present the semblance of a complete evaluation. To do so will be to dismiss the real problems confronting public policy decision-

¹²⁶According to Schumpeter restraints of trade tend to substitute 'automatized progress' with a much more even rate of change and adjustment. See Capitalism, Socialism and Democracy (New York: Harper Torchbooks, 1962)

makers which we have laboriously presented. Instead we shall proceed to investigate the dimensions of these problems and raise questions which should guide those who are in a position to pass judgement on the appropriate economic ends.

A. COST OF GREATER VARIETY

From a purely production standpoint, economics indicate an important problem with greater product variety. The problem lies in the fact that mass production economies require less variety than would be suggested by demand conditions. Standardization, according to Mrs. Robinson, "makes for economies in production, so that the fewer varieties of commodities offered, the greater the bulk of stuff that can be produced with given resources."¹²⁷

Does trademark protection lead to product variety that prevent attainment of economies in production?

We have earlier noted that where the market consists of well-informed buyers, trademark protection will very likely lead to greater "real" product differentiation. But where the market consists of ignorant buyers, product differentiation will tend to take the form of "fancied" differences suggested by distinctive packaging or advertising.

¹²⁷ See Joan Robinson, Exercise in Economic Analysis (London: MacMillan & Co., 1965) p. 211.

It is clear then that the latter form of differentiation will in most cases not affect economies in production. Only where real (or objective) differentiation follows would economics in production be affected adversely since it involves producing physically dissimilar products and marketing facilities.

But subjective or "fancied" differentiation is not entirely unrelated to inefficiencies of a similar nature. In this connection we may mention the existence of economies in promotions (i.e. advertising) arising from the "cumulative nature of the results of advertising expenditures and greater specialization in this activity."¹²⁸ Hence we would expect that each dollar spent on advertising will be more effective the fewer are the brands advertised. The price of greater variety, whether of products or of brands, is the saving foregone in not operating at the most efficient level. Economic resources spread too thinly on many brands are, from the standpoint of efficiency in information alone, used inefficiently.

The likelihood of such inefficiency is heightened by the fact that in some instances the optimum scale for sales promotion

¹²⁸ On the economies of scale in advertising see K.S. Palda, "The Measurement of Cumulative Advertising Effects", Journal of Business, April 1965.

may exceed the best or optimum scale for production and distribution.¹²⁹
 It is likely that firms, under such conditions, will seek to operate at some level larger than the optimum from the standpoint of production and distribution but sub-optimal from the standpoint of sales promotion economies.

From this source of inefficiency in what we have considered the area of information, we may then turn to a much debated issue of inefficiency in production arising from the monopolistic implications of product differentiation.

The problem revolves around the theory that in a monopolistically competitive market, such as one characterized by differentiated products, a typical firm attains long-run equilibrium at a scale of operation which requires a plant size smaller than what is socially "optimal." This latter, known as the "ideal output", gives rise to the short-run average cost curve that is tangent to the long-run average cost curve at the latter's minimum point.¹³⁰

¹²⁹This possibility was raised by Bain in connection with barriers to entry arising from product differentiation. He claims that when this occurs the barrier to entry is increased since the entrant firm will tend to come at a larger scale than otherwise by reason of selling economies. See Bain, op.cit., Chapter on product differentiation.

¹³⁰See R.K. Kahn, "Some Notes on Ideal Output", Economic Journal, Vol. XLV (1935) pp. 1-35; R.F. Harrod, "Doctrines of Imperfect Competition", Quarterly Journal of Economics, Vol. XLIX (1934-35) pp. 442-70, and J.M. Cassels "Excess Capacity and Monopolistic Competition", Quarterly Journal of Economics, Vol. LI (1936-37) pp. 426-43. Recent discussions on the subject include Alex Hunter, "Product Differentiation and Welfare Economics" Quarterly Journal of Economics, Vol. LXIX (1955) pp. 533-62; and a short review in C.E. Ferguson, Microeconomic Theory (Homewood, Ill., Irwin, 1966) pp. 260-64.

In the diagram below, the "ideal" plant size gives rise to a short run average cost curve represented by SAC_1 which is tangent to the long run average cost curve at the minimum points of both curves. OQM is the "ideal output" from the social standpoint.

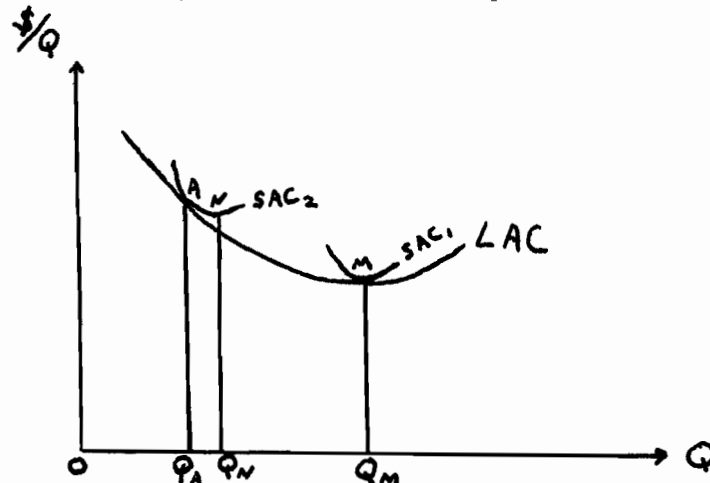


Figure II

From the standpoint of the firm facing a downward sloping demand curve, long run-equilibrium may occur at an output corresponding to OQA with a plant size represented by a short-run average cost like SAC_2 . There is then some sort of a negative excess capacity since the monopolistically competitive firm does not employ enough of society's resources to attain minimum unit cost.

The point being raised is that where products are differentiated, the "tilting" of the demand curve as a consequence, makes it more profitable for firms (they are in long-run equilibrium) to produce an output lower than the "ideal". Hence there is misallocation of economic resources.

The controversy with regards to this problem, is long and much of it irrelevant to our main interest.¹³¹ Essentially, he asked whether the output corresponding to the minimum long-run average cost is correctly considered the socially ideal output. He argued that if "differences" is considered just like any other quality which entails costs, then the "ideal output" may be to the left of the minimum long-run average cost.¹³²

The question serves to point out the inadequacy of present economic constructs to handle the problem of the social cost of greater variety or product heterogeneity. If product differentiation can be shown to be part of what the consumer considers to be his economic welfare, then the departure from the "ideal output" cannot rightly be considered an inefficiency in resource allocation. But for public policy purposes, even to have shown this is not enough. One would still be faced with the question of how much differentiation is desired.

¹³¹See E. Chamberlin, "Product Heterogeneity and Public Policy", op.cit., p. 89.

¹³²Hicks seems sympathetic to this view when he argued for the use of Marshall's surplus as a general rule for the application of welfare principles to imperfect competition instead of his marginal conditions. The latter called for equality between price and long-run marginal cost. See J.R. Hicks, "Foundations of Welfare Economics" Economic Journal, 1939, p. 710.

CONCLUSIONS

This study has attempted to present a comprehensive view of the main economic issues arising from the present public policy on the use of trademarks. It provided an evaluation of the significance of the trademark law to consumer information, advertising and product differentiation activities, competitive behavior and market structure in the manufacturing and the distributive trades, and the distribution of profits between these two sectors. We may briefly summarize our main observations and conclusions as follows:

(1) Trademarks serve as important sources of information about products, often regarding qualities not subject to any form of measurement or readily understandable description. The determination of the contribution of such information to the efficiency of the consumer's "search" for a suitable product is met with both theoretical and practical difficulties to empirical tests, and with questions involving value judgement.

(2) The restriction of competition is a frequent consequence of trademark use. Evidence has been provided to show how trademark protection is being used to block the access of other manufacturers to distribution outlets through tying arrangements; to restrict "intra-brand" competition through exclusive distributorship and resale price maintenance; and to enforce international market sharing agreements, by pre-empting a market.

Removal of protection will very likely lead to much less brand advertising and other forms of product differentiation since there would be no more guarantee that the returns to investment in such activities will accrue to the firm advertising.

(3) Price discrimination is very successfully and simply carried out with the help of different trademarks.

(4) Conflict of interests between producers and distributors arises from, among other things, the sharing of profits. A strong manufacturer's brand often enables the manufacturer to dictate retail prices, hence also the retailer's margin. A lower limit to the retail margin may be set by the manufacturer as in retail price maintenance, or an upper limit as in some forms of exclusive distributorship arrangements.

(5) The use of distributor's brands favors large wholesale-retail firms and organizations and its substitution for manufacturers' brands is likely to lead to greater concentration in the distributive trades, while making conditions of entry into the manufacturing area easier for the small firms.

(6) From the standpoint of social costs and benefits, the case for trademarks, as opposed to other product information devices like grade or informative labelling, depends upon a number of conditions: a) whether or not the alternatives carry "generally understandable" terminology used "uniformly" by all producers; b) whether or not sufficient agreement on quality standards exists to serve as the basis for comparative product evaluation; and c) even assuming that the above conditions are obtaining, there is the further question as to which type of information is more

relevant to the information requirements of the consumers - "technical" information with "zero emotional appeal" or "persuasive" information. But this brings us to the doorstep of the still unsettled controversy regarding consumer sovereignty.

(7) There is no reason "a priori" to think that trademarks lead to greater "real" product differentiation. Trademarks often serve to give commodities "fictitious individuality" in uninformed markets. Also, greater product variety as an index of social welfare is not self-evident.

(8) The use of trademarks appears to countervail the tendency to reduce costs through deterioration of product quality. But on the whole Scitovsky's distinction between informed and uninformed markets seems to be more relevant to the question of quality improvements. In well informed markets, there is greater evidence of competition through quality improvements than in less informed markets.

(9) Proliferation of trademarks may serve to confuse rather than inform.

(10) Differentiation of the "fancied" or subjective variety is not entirely free of the inefficiencies which accompany real differentiation. Whereas real differentiation may prevent the firm from realizing economies of scale since it involves production of physically dissimilar products using different production facilities, fancied differentiation introduces the problem arising from the existence of economies of scale in promotions. Each dollar of advertising up to a certain point may be more effective when spent on one rather than many trademarks.

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