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The hidden effect of the 'gray market' on global trade

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Jerry Haar

At an estimated $10 trillion, the global black market is the world's fastest growing economy and is only rivaled in total value by America's $14 trillion GDP.

However, while countries are increasingly cracking down on the black market, the "gray market" has not received much attention — mainly because it is not illegal. Nonetheless, it does have serious, negative effects on global trade, even though certain groups of consumers may benefit.

Gray markets, also known as parallel markets, are where goods are sold legally but outside of the manufacturer's authorized trading channels. These markets can often involve the import and sale of goods that are genuine but intended for foreign markets, allowing them to be sold at lower prices than the same products sold through official channels. Nations are concerned about gray markets because they cause tax revenue loss and undermine local businesses.

The gray market works in a number of ways. One is retail arbitrage. Retailers take advantage of price differences in various markets by buying products from lower-priced regions and selling them in higher-priced regions. For example, a retailer might buy branded goods intended for sale in one country and resell them in another country where prices are higher. In this retail arbitrage play, a reseller of German medical equipment responsible for the Argentine market diverts 15 percent of his stock to resellers in Brazil where supply is short and where the Argentine exporter can mark up the price by 20 percent and gain on the exchange rate as well, given that the Brazilian currency, the real, is stronger than the Argentine peso.

In another example, unauthorized resellers (individuals or companies) purchase products from authorized distributors or retailers and resell them without permission from the manufacturer. This is common in electronics, luxury goods and pharmaceuticals. Overseas purchases are another example; small businesses purchase goods directly from overseas suppliers where prices are lower, then resell them locally. This bypasses the local authorized distribution network.

Finally, manufacturers or authorized dealers sometimes sell excess inventory, such as appliances, to third parties who then sell these products through unauthorized channels. These third parties can offer lower prices as they acquired the goods at discounted rates. These various methods show how the gray market operates by exploiting price discrepancies, distribution inefficiencies and regulatory differences across regions.

What drives gray markets? First is the prevalence in high-demand electronics and pharmaceuticals where products are often imported and sold through channels not authorized by the original manufacture. Second is the effect of economic conditions where official products may be unaffordable for a large portion of the population, driving consumers towards the gray market for more accessible prices. Third is weakness in regulatory frameworks and enforcement. Fourth is the explosion of e-commerce, facilitating the expansion of gray markets as online platforms make it easier for unauthorized sellers to reach consumers directly.

Given this state of play, what recourse do countries have to combat the gray market? Customs enforcement is essential to prevent the unauthorized import of goods destined for gray markets. This can include stricter enforcement of existing import laws and more rigorous inspections of goods entering the country. Increased intellectual property rights enforcement and more vigorous regulation of the e-commerce marketplace are also required.

As for the brands themselves, they must resort to stricter controls over their distribution chains, offering warranties only on products sold through authorized dealers, and educating consumers about the risks of purchasing from unauthorized sources. Information sharing and deployment of tracking technologies such as RFID tags and QR codes can also go far in helping identify and shut down gray market channels.

For the vast majority of producers like Tommy Hilfiger, Adidas, Coach and Sonos, throwing in the towel is not an option. Taking on the gray market is a campaign that is being waged now and will continue for years to come.

Jerry Haar is a visiting scholar at the University of Oxford, a professor of business at Florida International University and a fellow at the Woodrow Wilson Center and the Council on Competitiveness.