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## 7 Net impacts and policy implications

### Key points

- The PIRs provide benefits to publishers, authors and also printers, but impose costs on consumers and the broader economy. These effects stem principally from the protected higher prices of many books.
- While most of the direct benefits and costs are offsetting, there are ramifications for community wellbeing.
  - PIRs make a contribution to the ‘unpriced’ cultural and related benefits for the community from some local writing and publishing activity.
  - However, the restrictions have efficiency costs and cause a transfer of income from Australian consumers to overseas authors and publishers.
- The current PIR regime is unnecessarily costly for consumers, restricts the commercial operations of booksellers and is not a well targeted mechanism for supporting cultural externalities. Reform is necessary.
- In the discussion draft, the Commission proposed that territorial protection be time-limited to 12 months duration.
  - Many participants considered that the proposal would create distortions between different genres of books. Some thought that it would be of insufficient impact to generate significant price and efficiency benefits, whereas others thought it would have much the same effect as full abolition of PIRs.
- Having considered industry feedback and undertaken further analysis, the Commission is recommending that the PIR provisions be repealed. As part of this change:
  - Industry should be given three years notice to facilitate adjustment.
  - Current subsidies for encouraging Australian writing and publishing should be reviewed immediately, and any changes implemented prior to the repeal of the PIRs. The new arrangements should be reviewed after five years.
  - To assist in monitoring the impact of these changes, the ABS should undertake a revised version of its 2003-04 industry and market surveys as soon as possible and update them prior to the five year review.
- Other reform options, including amendments to the 7/90 day rule and price caps, also offer benefits relative to the status quo, but there would be larger net benefits from more robust reform.

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The terms of reference ask the Commission to examine options for reform to the Parallel Import Restrictions (PIRs) and to consider any transitional arrangements that should accompany reform, should it be warranted. This chapter first summarises the benefits and costs of the PIRs, highlighting the key effects relevant for policy, and then explores potential reform options, before setting out the preferred approach.

## 7.1 The PIR balance sheet

Restrictions on competition will typically have impacts on the quality, availability and prices of the goods or services concerned.

However, in the case of the restrictions on the parallel importation of books, there do not appear to be major quality or availability issues. The latter was a problem prior to the introduction of the 30 day release and 7/90 day resupply rules in 1991. But with those changes and the emergence of global internet purchasing and distribution systems, timely availability of books is now much less of a concern.

Most of the key impacts of the PIRs therefore stem from their effects on book prices.

### *Price effects*

Drawing on a range of quantitative and qualitative evidence, the Commission has concluded that, while price differentials between Australia and overseas sources of supply vary over time and across market segments, at times the effects on prices are likely to be substantial. As detailed in chapter 4, without the PIRs there would be opportunities for Australian booksellers to obtain editions of current list trade titles from the UK and US markets that are cheaper than in Australia, in some cases substantially so. Although the scope is less clear, downward price pressure could also arise from other sources:

- some books — particularly educational texts — could potentially be imported from Asia at substantially lower prices, and Asia might also come to serve as a source of some trade books in the future.
- low cost ‘remainders’ could be imported from the UK, US and other markets.

### *Offsetting impacts*

Stemming from their price-raising effects, the PIRs assist activity and employment in the local books industry in several ways. As detailed in chapter 5:

- By protecting higher monetary returns from rights trading and local publishing activity, the PIRs enable publishers to increase their publishing portfolio and obtain some economies of scope and scale.

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- In lessening import competition, PIRs provide greater certainty for local publishers and authors in investing resources in the production and creation of particular titles.
  - The 30 day rule encourages the timely publication of foreign authored books in Australia, and there is greater demand for local book printing in Australia.

However, the higher prices for books that underpin these benefits are ultimately paid for principally by consumers and there are attendant effects on activity and employment elsewhere in the economy. Without the PIRs and the upward pressure on book prices they have sustained, enhanced consumer spending power could have translated into additional demand for other goods and services, generating employment and business opportunities in other sectors. Further, the expansion of the books production industries over recent decades has attracted and held productive resources, notably skilled labour and capital, that have thereby been unavailable for use in other industries. The upshot will have been reduced growth in employment and output in other parts of the economy.

In reflecting the two sides of the ‘price raising coin’, the preceding benefits and costs are largely offsetting, although they do have distributional consequences. In effect, they involve a transfer of income between different groups and sectors in the community, benefiting book producers primarily at the expense of consumers.

As well as the effects discussed above, the PIRs also have some benefits and costs that do not ‘balance out’.

### *Cultural externalities*

On the credit side of the ledger, as a consequence of increased local publishing activity and thereby a greater volume of locally authored books, there is greater portrayal of Australian events and stories through Australian eyes. While not readily quantifiable, the Commission considers that books and literature on the whole provide a range of benefits to Australians, including cultural and educational benefits, and that Australian literature has some particular benefits in these regards.

It is from the cultural and related value of Australian books that the prime case for government support for local publishing, and indeed for the PIRs, arises. Kate Grenville alluded to this point thus:

If we were producing socks or toasters the decline of a local industry would be of no importance except to the individuals involved. But if Australian writers can’t afford to go on writing (and Australian publishers can’t afford to publish us) then there will be many fewer books reflecting our unique Australian experience ... (sub. 2, p. 1)

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However, as discussed in chapter 6, for most books, most of their value will be reflected in the prices people are prepared to pay for them and the sorts of books that people purchase. It is the residual ‘unpriced’ component of books’ cultural value that represents a source of externalities for the community. While these may warrant government support for an industry, the chapter found that the externalities dependent on the PIRs are unlikely to be large.

Further, PIRs are not the only way of supporting culturally valuable Australian writing and publishing activity and the associated externalities. Thus, to help justify the retention of the PIRs, they must also be the most efficient and effective means of delivering this support.

Against this test, the PIRs clearly have significant limitations. First, as dealt with below, most of the assistance to copyright holders stemming from the PIRs leaks offshore, rather than supporting Australian works. Further, that part which flows to the Australian books industry is not particularly well targeted at these cultural externalities. This is because the support provided by the PIRs to local writing and publishing activity is not differentiated according to the cultural significance of the output concerned, and some of the support leaks to the printing industry rather than assisting writing and publishing. Moreover, as discussed below, it appears likely that subsidies are able to deliver assistance to Australian writing at much less cost than the PIRs.

### *Leakage of income*

On the debit side, because the PIRs raise the price of foreign-authored books as well as Australian-authored books, there is a leakage of income<sup>1</sup> from the Australian economy. As explained in chapter 4, some of the price increase realised by foreign-authored books in the local market will be ‘captured’ by the foreign author and/or publisher which created the work, and sold its rights to the Australian publisher or released the book here itself. In effect, the restrictions cause Australian consumers to pay higher prices which benefit not only Australian copyright holders but also foreign copyright holders.

As a share of the assistance provided by the PIRs, this leakage is substantial. The indicative estimates in appendix E are that, for every dollar of assistance that the PIRs provide to local authors and publishers in the trade sector, in the order of \$1.50 will flow to foreign authors and publishers. Put in more concrete terms, this suggests that for every \$10 million in support they deliver to Australian trade

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<sup>1</sup> Technically speaking, there is a leakage of ‘economic rent’ — returns earned from resources in excess of those necessary to induce the use of those resources in a particular activity. This leakage should be distinguished from ordinary payments for imports.

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authors and publishers, the PIRs cost Australians at least \$25 million, \$15 million of which flows offshore.<sup>2</sup> (Equivalent figures are not available for educational books.)

### *Economic efficiency costs*

A further debit is that PIRs create a range of ‘economic efficiency costs’. Within the books sector, the presence of the PIRs lessens the imperative to operate at ‘best practice’, which can result in inflated cost structures and other inefficiencies in parts of the supply chain. As noted in chapter 5, distribution is one area in which current arrangements may have limited the scope for efficiency gains. Further, the additional resources attracted into the books sector by the PIRs would most likely have produced a higher value output elsewhere. In this context, there is much evidence from other sectors that government interventions that artificially boost returns to particular activities usually lead to less efficient resource use overall (see, for example, PC 2005, chapter 4). And, as noted above, higher book prices, by curtailing some consumption, will have caused an associated reduction in consumer welfare.

### *Summing-up*

Based on the foregoing benefit-cost balance sheet, there is a strong case for reforming the PIRs. With the core copyright protection still in place to provide incentives for creative endeavour per se, the significant leakage of income overseas and the other efficiency costs of the restrictions mean that the PIRs would need to generate substantial external benefits to provide a net benefit overall. However, the externalities that are dependent on the PIRs are unlikely to be large and, in any case, the PIRs are a poorly targeted mechanism for supporting such externalities.

Some participants raised other issues they saw as relevant to assessing the merits of PIRs. These included regional development considerations, the policy stance in other countries, taxation issues, piracy concerns and environmental considerations. As discussed in appendix B, while a number of these matters are important in their own right, PIRs are not an appropriate vehicle for pursuing goals in these areas. Other policy mechanisms exist to address such matters, where intervention is warranted.

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<sup>2</sup> The draft recommendations were formulated on the basis of preliminary estimates of the income leakage to foreign copyright holders consequent upon the PIRs. In the Commission’s completed analysis (appendix E), the estimated leakage ratio is significantly higher than that estimated at the time of the discussion draft. This higher ratio adds weight to the view that removal of the PIRs would generate net benefits for Australia.

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Of more relevance is the concern to avoid unnecessarily disruptive adjustment in the local books industry, which would militate against any precipitate reform of the PIRs, but this is not a reason to maintain them in perpetuity. Further, some aspects of the current PIR regime, most notably the 7/90 day rule, are widely acknowledged to have not kept pace with technological change and modern supply timeframes.

## **7.2 The reform options**

The Commission has concluded that the PIRs require reform, and has identified a range of options, from minor changes within the existing PIR framework through to abolition of the restrictions.

As with all reform in the economy, predicting exact outcomes is difficult. Indeed, many industry participants in this study were unsure of the likely ramifications for them of changes to the current arrangements. This suggests the need for an approach to reform that takes account of the uncertainties involved. At the same time, it is important to recognise that uncertainty does not provide a justification for policy paralysis: policy decisions often must be taken with incomplete information about the impacts, and then be monitored with a view to adjusting or refining policy settings, if necessary.

With these considerations in mind, in developing its preferred approach to reform the Commission has examined the merits of the following broad approaches:

- Option 1 — limit PIR protection to a fixed time period following publication
- Option 2 — other measures to liberalise the PIRs within the existing framework
- Option 3 — repeal the PIRs and rely on consumer demand for Australian stories and narratives, in conjunction with existing subsidies, to sustain a broadly appropriate level of local writing and publishing activity
- Option 4 — replace the support for cultural externalities provided by the PIRs with a new or amended subsidy regime.

### **Option 1 — Time limited PIRs**

In the discussion draft, the Commission recommended a package of measures, the key element of which entailed limiting the period of formal PIR protection to 12 months, rather than providing it for the full term of copyright.

In formulating this draft recommendation, the Commission was cognisant of the desirability of retaining some certainty for Australian publishers to invest in works

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by local authors, and also of the desirability of generating price pressures in parts of the market where they are most lacking. The Commission envisaged that, after five years of operation, it would be appropriate to review the measure and to explore whether more comprehensive liberalisation of PIRs was warranted.

Many participants argued that the draft recommendation would have unintended effects. On the one hand, several participants provided data showing that many titles generate the bulk of their sales after the first year of publication. They also argued that sales patterns for books vary across genres, meaning that the provision of a set period of PIR protection would distort incentives between genres. In particular, a twelve month PIR period was seen as favouring relatively short-lived ‘best seller’ titles, with much less assistance for ‘slower burn’ books, including many Australian, childrens’ and educational books. On the other hand, some participants argued that the recommendation would fail to generate the downward price effects that the Commission had intended. And some indicated that the draft proposal entailed insufficient reform to bring about any substantive change in the industry. Box 7.1 contains a selection of such comments.

The Commission notes that much of the criticism from book producers was based on the presumption that local publishers could not be competitive with overseas suppliers, or would make no effort to compete (through price, service, reliability of supply and terms of trade etc) against them, after the initial period of formal PIR protection. Thus, a number of participants expressed the view that the Commission’s proposal would render investment by local publishers worthless after a year, or that it typically requires longer to recoup the investment in a title.

However, the draft recommendation was not premised on a view that the investment in titles would be able to be fully recouped from sales made during the period of PIR protection alone. Rather, it was constructed to provide a (limited) period of protection to a publisher, and thereby provide some additional certainty of returns in that period, with returns to publishers and authors after that period depending on the ability of the local edition to be able to compete against other potential sources of supply for the title. In this respect, they would have had the benefit of a first-mover advantage. It would still be the case that publishers (and authors) would need to assess whether the prospects of a book were such that its potential lifetime returns would warrant its publication.

In putting forward the time-limited PIR model in the discussion draft, the Commission was also cognisant that the sales cycle of individual titles varies to some extent and, for instance, that sales of some authors and/or titles can build over many years and sometimes be revitalised several years after their first release.

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### Box 7.1 Some criticisms of the draft recommendation

Many book producers expressed concerns about the draft recommendation, with some suggesting that its effects might be similar to those that would flow from full abolition of the PIRs. A number also criticised what they saw as its premise. For example:

If the Commission has its way, we're to operate under a system which recognises the importance of territorial copyright, but which removes it after a year because somehow the worth of a book; the value of its ideas; the importance of it, has evaporated. (Penguin, sub. DR481, p. 5)

[T]he Commission has completely underestimated the importance of backlist to publishers (both in revenue terms, and in the initial decision to acquire, and thus, invest), and have wrongly concluded that by introducing the 12 month rule, that this will somehow diminish the effect that this will have on the Book Industry as a whole .... (Hachette, sub. DR480, p. 5)

I am not entirely opposed to a defined period of certainty for local authorship, but 12 months is nowhere near long enough to provide any incentive for publishers to take the risks involved in publishing new authors, release both hardback and trade-paperback editions followed by B-format editions or to take on the expense of picture books ... (Jacinta di Mase, sub. DR434, p. 4)

As an independent publisher, Spinifex does not expect to recoup our investment in a book or an author in the first twelve months — with rare exception, the only publishers with sufficient market clout to do this are large multinational publishers. The outcome will be a 'monoculture of the mind' dominated by high-selling, fast-pulping books of the moment. This is not the way to create an identifiable and sustainable industry. (Spinifex Press, sub. DR430, p. 1)

RHA considers a windback to one-year PIRs the equivalent of a removal, in terms of impact. (Random House Australia, sub. DR550, p. 13)

[The Commission] has also failed to understand tertiary publishing cycles and that an acceptable return on investment is not achieved in one year. (Pearson, sub. DR528, p. 1)

Territorial copyright "lite" (as envisioned by the Productivity Commission) means that, after 12 months, all that investment becomes worthless as overseas competitors can dump cheap editions into Australia. (Australian Publishers Association, sub. DR513, p. 13)

Booksellers were also critical of the draft recommendation:

As the only truly multi-national retailer operating in Australia acting as an Independent, we have a unique position with insight into many open and closed markets of the world. ... The Draft Proposal — notwithstanding the marginal benefits to our business that it offers — realistically does little to improve the balance of power that currently exists within the Australian bookselling community. (Kinokuniya Bookstores of Australia, sub. DR288, p. 1)

The Commission's draft recommendation for 12 months protection of new titles [i.e. the fast selling 60% of book sales] fractures the market. The slow selling backlist titles comprising the remaining 40% of the market will not provide the critical mass necessary for such efficient wholesalers to open in Australia. ... The adoption of this draft report recommendation would provide no stimulus to Australian Publishers to provide the level of logistical support and service to booksellers and ultimately book consumers available in competitive open markets. (Coalition for Cheaper Books, sub. DR509, pp. 14–15)

The shift to a twelve month period of exclusive territorial copyright and an open market for backlist is a change of the same order of magnitude as opening the market entirely. ... we see no additional downward pressure on price in reducing territorial copyright to the first twelve months of release. Indeed there would be an incentive for publishers to maximise the return from their investment during that period of certainty which could have the reverse effect. (Australian Booksellers Association, sub. DR478, p. 2)

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Some of the concerns raised by authors and publishers could in theory be addressed through a longer period of PIR-protection, such as by extending the period of protection to 24 or 36 months after a title's first publication. However, such an approach could not fully remove the distortion of incentives for the publication of different books entailed in the 12 month proposal, and it would further limit the downward price pressure that the reform would generate. Thus, it would dull incentives for substantive change in the books sector.

## **Option 2 — Reform within the existing PIR framework**

The increase in competitive pressure in the books market resulting from the 1991 reforms to the PIR regime has had some important benefits for consumers, for publishers and authors, and for the wider community.

- The changes have increased the commercial imperative for publishers to provide Australian consumers with access to new globally-released books close to the time they become available in the major overseas markets.
- Though a range of factors has contributed to the growth and changing nature of the industry over the last two decades, the 1991 reforms have clearly been influential in altering the mindset of the industry, which is now much more outward looking than before.

Through this study process, the Commission has explored various options for extending the liberalisation process within the current framework of the PIRs. Were such an approach feasible, it could reduce the adverse effects of the current arrangements while retaining some of the support that PIRs provide for the cultural externalities attaching to some local publishing and writing activity. It could also avoid many of the uncertainties and transitional costs inherent in the immediate abolition of the PIRs, while leaving scope for further reform at a later date.

However, as discussed below, none of the intermediate options identified by the Commission appear both feasible and likely to deliver significant net benefits, compared to retaining the status quo or abolishing the restrictions.

### *Modifying the 30 and 90 day rules*

A number of booksellers proposed shortening the 30 day release and 7/90 day resupply rules. Several authors and publishers also supported a shortening of the 7/90 day rule, although some expressed concern at the prospect of shortening either rule — see box 7.2.

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## Box 7.2 Participant's views on shortening the 7/90 day and 30 day rules

### *90 day resupply rule*

It is widely accepted that technological and transportation developments mean that publishers generally have the capacity to respond to requests from booksellers to supply a title almost instantaneously and meet those orders in much less than 90 days. Accordingly, to maintain the pressure on Australian publishers to provide consumers with timely access to books, many participants considered that the 7/90 day rule could be tightened. For example, Collins Booksellers contended that:

The 90 day rule is archaic and redundant given consumers' access to overseas online book retailers and the dramatic increase in publisher's air freighting stock. The 90 day rule encourages trading inefficiency and higher prices from local distributors ... (sub. 230, p. 3)

Similarly, the Text Publishing Company said that the rule:

... is now irrelevant to many publisher practices and an impediment to bookseller efficiencies. (sub. 63, p. 54)

On the other hand, Black Dog Books argued that shortening the rule could impact heavily on publishers of children's books:

From our point of view, as a representative of the children's publishing industry, much of the debate has been framed around the idea of an adult work of fiction or nonfiction text printed in black and white. We are concerned, for example, that there has been an assumption that the 90 day reprint rule has been made irrelevant by changes in technology. With the high proportion of colour in children's books and the low price points, it is necessary to print children's books in China or South-east Asia, and it takes that period of time to print and import a reprint of a picture book, especially if it has unique printing features. (sub. DR479, p. 2)

### *30 day release rule*

For the most part local authors, publishers and printers strongly endorsed continuation of the 30 day rule. In this respect, Omnibus Books called for patience, pointing out the difficulties that can sometimes arise in meeting the rule:

We live in an impatient world. Waiting for a book is not something that necessarily causes financial loss of any significance ...

Currently I have a contract with an American publisher for a very famous US author's anxiously awaited new title. This has been delayed many times for reasons known only to the author but we are now faced with the US publisher delaying the supply of files to us because they have been unable to make the work ready by the agreed deadlines. The book will now arrive in a bookstore in the USA ahead of ours purely because the US publisher can print faster than we can. We will have to work overtime to enjoy the benefit of our territorial copyright, and that is with the 30 day rule intact. Without the benefit of this protection I would have no logical reason to publish this author in an Australian edition. (sub. 173, p. 2)

However, some booksellers suggested that the 30 day rule could also be shortened. For instance, the Australian Booksellers Association argued:

... within any regulations the ABA contends that maximising speed of supply is paramount for consumers. The ABA proffers a blanket 7 day rule within those regulations supplemented by the capacity for publishers to exhaust copyright if they are not compliant with the speed of supply provisions. (sub. 172, p. 8)

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A shortening of the 30 day and 7/90 day rules would increase the scope for parallel importation if books were not made available to booksellers in a timely fashion. This would reinforce the reforms introduced in 1991.

However, a shortening of these rules, and the 7/90 day rule in particular, would represent little more than regulatory catch up with the reduction in supply timeframes made possible by technological and transportation developments. Moreover, to the extent that local publishers complied with the shorter timeframes, there would be no additional competitive pressure on book prices. And, in any case, the Commission notes that where books are published in Australia outside the formal 30 day period, publishers appear able to encourage booksellers to treat them as if they are PIR-protected. Thus, shortening the rule may have little practical effect.

#### *Limiting PIR protection to Australian-authored books*

The option of limiting the restrictions to books authored by Australians — as distinct from published in Australia — was raised in some of the early inquiries into the PIRs. Prima facie, it would provide a simple solution to the objective of reducing book prices in Australia and reducing the leakage of income abroad, while preserving some support, above that provided by an open market, for Australian-authored books.

However, while considered a ‘live’ option at the time of those early reviews, advice from the Office of International Law within the Attorney General’s Department confirms that it can now been ruled out as a generalised approach by a clause in the *Australia-US Free Trade Agreement*, which requires equivalent national treatment for Australian and US citizens in laws concerning copyright protections. The Office advised that it may in any case also breach the agreement on *Trade-Related Aspects of Intellectual Property* as well as the *Berne Convention for the Protection of Literary and Artistic Works*.

Similarly, the Office of International Law indicated that the key element of the Reedings and Gleebook’s proposal for PIR protection to be restricted to ‘Australian versions’ of books (box 7.3) would run foul of the same international treaties.

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### Box 7.3 An 'Australian version' PIR

As an alternative to shortening the 30 day and 7/90 day rules, the joint submission from Readings and Gleebooks (sub. 226, pp. 8–9) proposed an arrangement that would effectively remove the need for these requirements. The key features of their 'Australian version' PIR are as follows:

- Protection for a work would be established by the publication of an 'Australian edition' of the work, and could be obtained at any time.
- Until publication of an Australian version, any legal edition of a work could be imported.
- If the Australian version of a title became unavailable for any reason, any legal edition could be imported until the Australian version was available again.
- Competing editions could be imported at the request of a customer in a reasonable quantity (including multiple copies for book clubs, libraries etc.).
- Booksellers could list alternative editions and their prices but not stock them where an Australian edition was available.

Readings and Gleebooks went on to argue that:

The above features would introduce clarity to the current legislation ... The need for the 30/90 day rule is done away with. There is a real incentive for publishers to keep Australian booksellers informed about publishing programs, publish as close to original publishing date as possible, and to keep titles in stock. The ability to list alternative editions introduces some transparency to the way books are priced in this market. (sub. 226, p. 9)

### *A price-cap arrangement*

Drawing on the PIR regime applying in Canada (box 7.4), the Australian Booksellers Association (subs. 172, DR478) and some other booksellers advocated the introduction of a price-cap scheme which would limit the amount by which the Australian prices of titles protected by PIRs could exceed those of foreign editions in overseas markets, in order to maintain their protection. Although noting that in Canada the price cap only applies to imported books, REDgroup Retail argued in its submission that:

A requirement for both domestic and imported editions to meet a maximum pricing differential with foreign editions would subject more books in the Australian market to ... competitive pricing pressure. Australian booksellers would have an ability to shop elsewhere for stock if faced with an inefficient local supplier. (sub. 175, p. 4)

In principle, such a system would preserve the scope for the prices of PIR-protected books to be lower in Australia than overseas, while limiting any upside difference.

REDgroup Retail noted in its original submission (sub. 175, p. 2) that the goal of such a scheme was to balance a range of performance and overseas parity pricing

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#### **Box 7.4 Canadian book pricing laws**

Like Australia, Canada restricts the parallel importation of books if certain requirements are met by local suppliers. Protection under the Canadian Book Importation Regulations 1999 differs between a 'Canadian edition' of a book, and an imported book that has a Canadian exclusive distribution arrangement.

A 'Canadian edition' is an edition published in Canada under a separate rights agreement. This is similar to the way Australian publishers mostly operate – purchasing the 'Australian rights' to a foreign authored book, and then releasing an edition for the Australian market. An 'imported book' is one that is physically brought into Canada and released by an exclusive distributor.

Imported books in Canada must meet a number of service and price requirements in order to maintain parallel importation protection. If a book is imported into Canada from the United States, the imported book must be supplied at a price no greater than the US list price (converted to Canadian dollars at the current exchange rate), plus 10 per cent of the price after conversion, less any applicable discounts. If a book is imported from any other country then the same requirements apply, except that the allowable price difference is 15 per cent. If the Canadian price exceeds the allowable margin, then a bookseller may parallel import the title.

Authors, publishers and exclusive distributors are able to enforce their copyright against breaches of the parallel importation laws by booksellers through a range of civil enforcement provisions, including injunctions to prevent further breaches, and possible financial compensation for lost profits.

requirements against the guarantee of turnover through Australian publishers. An Australian publisher whose titles met the requirements of the system would be assured of the Australian sales of those titles. This would alleviate some of the concerns raised by many publishers in their submissions, who have argued that publishing is a portfolio business, where the revenue from profitable titles supports the infrastructure costs that enable them to publish more marginal titles. And it would do so while limiting the scope for the importation of culturally re-edited foreign editions of Australian works, which might occur to some extent in the absence of PIRs.

At the same time, there are some important differences between Canada and Australia that would affect the working of the model. For example, Canada's close proximity to the US means that US publishers, rather than separately publishing a US-authored title in Canada, may instead add supply for the Canadian market onto a US print run, and then send those physical books over the border. Thus, for US authored titles, Canadians are much more likely to have the actual US version of the book supplied in their domestic market, rather than a 'Canadian edition'. In

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comparison to Canadian publishers, Australian publishers have greater ‘natural protection’ from import competition from the US.

Issues to be answered in devising a price-cap PIR scheme for Australia would include:

- to which titles the price-cap arrangements would apply — for example, only those for which an Australian publisher had purchased the Australian rights, or also those supplied under a local distribution agreement
- what is the allowable percentage by which Australian prices could exceed the foreign wholesale price in order to maintain PIR protection, and how this might vary from country to country
- how the arrangements would take account of variations in book format, particularly if the first available Australian format (such as a C format release) is not available anywhere else in the world
- whether and how the arrangements would take account of changes in exchange rates (for example, to add pricing pressure to local publishers when the Australian dollar is low) and the availability of remaindered versions of books overseas available for potential import at very low prices.

In responding to some of these potential issues, Malcolm Neil (CEO, Australian Booksellers Association) noted that the Canadian price-cap scheme was the result of industry negotiation on the optimal balance of these issues between publishers and booksellers. Mr Neil advised that similar negotiations would be required amongst Australian market participants (pers. comm., 31 May 2009).

The approach has not been embraced by all industry participants. The Australian Publishers Association observed that such requirements would take regulatory intrusion in the books market to a new and undesirable level:

The Canadian system is an example of a much more regulated environment, which seeks to replace competition within a copyright sector with a much more onerous set of price controls and other interventions. (sub. 244, p. 54)

Nor is it clear that a price-cap approach would deliver significant net benefits, compared to more robust reform options. Firstly, a price-cap scheme could lead to ‘focal point’ pricing by publishers, where the price of most books would be set at just below the cap, in order to retain exclusive rights over them. While this may reduce the price of some books, it could at times also increase the price of others. Secondly, rules to limit the impact of remainders may deny booksellers and consumers some significant opportunities for savings. Thirdly, as alluded to above, any such scheme would involve administrative complexity, particularly in relation to the question of equivalent formats and the variability of pricing across individual transactions (for example, due to the quantity ordered, or pre-existing commercial

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relationships). And finally, to the extent that such a scheme continued to provide assistance to copyright holders, the assistance would not be differentiated according to the cultural value of different books and a significant proportion of it would continue to leak offshore.

### *A package of measures?*

Were the PIRs to be retained broadly in their current form, there would be merit in tightening at least the 90 day resupply rule. While the Commission recognises that demand for books can be difficult to predict, that printing ‘slots’ are not always available at short notice, and that off-shore printing can require longer lead times than printing undertaken locally, it does not consider that such difficulties warrant the retention of measures that significantly impede booksellers from offering a continuous supply of books that their customers want (and that their local competitors may still have in stock). On balance, the Commission considers that tightening the rule would most practically be achieved by modifying the time periods in the existing provisions. Recognising the arbitrary nature of the timeframes involved, the 7 day element could be modified to the end of the next business day, and the 90 day element could be reduced to one week.

The Commission also sees merit in the Gleebooks and Readings proposals (box 7.3) under which:

- booksellers could list alternative editions and their prices, but not stock them where an Australian PIR-protected edition was available
- alternative editions could be imported at the request of a customer in a ‘reasonable’ quantity (including multiple copies for book clubs, libraries etc.).

There would also be merit in allowing booksellers to formally aggregate single customer orders for books from abroad, as proposed in the discussion draft.

The Commission sees less of a case for tinkering with the 30 day release rule. While the rule can in some instances cause local booksellers to lose some sales to overseas online booksellers, the practical effect of tightening the rule on prices would, as noted above, be quite limited, although doing so could cause some (costly) adjustments to production and shipping arrangements, particularly in cases where off-shore printing is involved.

A price-cap scheme could potentially deliver greater benefits, although these would depend crucially on the details of the scheme’s design. Were the current regime to be retained, there would be a case for considering adoption of such a scheme, whether alone or in conjunction with the other changes nominated above.

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### **Option 3 — Abolition of the PIRs**

There are strong arguments for the full abolition of PIRs. While Australia derives considerable cultural benefits from local publishing and writing activity, the externalities dependent on the PIRs are unlikely to be large. Yet it is the externalities — and not the overall cultural value of the outputs of the local books industry — which provide the rationale for government assistance.

Australian governments already provide direct financial support to local authors and publishers in recognition of the cultural benefits that some of that activity generates (chapter 3) and the bulk of locally authored and published works — namely those for which separate foreign rights have not been sold and foreign editions published — would face little or no direct threat by parallel imports in the absence of the PIRs. Further, as discussed below, subsidies could more efficiently deliver support for the books sector, in recognition of the cultural externalities it generates, were such support deemed necessary in the absence of PIRs. Given this, the question arises as to whether the PIRs should immediately be abolished.

While having merit, abolition could, by itself, entail some material costs and risks. Though the benefits of reforms persist over the long term, such adjustment costs must be factored into the reform calculus (see PC 2000).

In line with reforms in other industries, this implies that consideration would need to be given to the provision of assistance or a period of forward notice, to allow the industry to adjust to the change.

### **Option 4 — Subsidies for Australian works**

Direct subsidies to publishers or authors can provide support for cultural externalities, to the extent that such support is necessary. Compared to PIRs, subsidies have a number of in-principle attractions.

- Notionally at least, subsidies can be better linked than PIRs to the perceived level and nature of the cultural externalities meriting support.
- Subsidy support can also be more easily limited to Australian publishers or authors, thereby avoiding or reducing the substantial leakage of support overseas that occurs under PIRs.
- In being funded from taxation revenue, subsidy support is transparent and its magnitude readily apparent. And it is drawn from across the community in keeping with the broadly-based nature of the cultural externalities.

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However, there is clearly considerable opposition amongst authors and some publishers to this approach, with a common concern being that it would remove their apparent self sufficiency and instead make them dependent on payments from the budgetary process. For example, Tim Winton contended:

People like myself appreciate the support of government, but like anybody else we prefer to make our living by getting fair recompense for our labour in a marketplace that's productive, fair and sustainable. (sub. 204, p. 14)

Katharine England argued:

A move from a flourishing, if protected industry back to the support of local culture through handouts seems a very retrograde step indeed. (sub. 137, p. 2)

And even more strongly, the Australian Literary Agents' Association said it was:

... very concerned by the suggestion in the Issues Paper that perhaps subsidies could 'provide similar benefits for Australian authors/publishers as the parallel import restrictions'. The very notion that a successful, energetic and efficient industry would be disbanded and funded by the taxpayer is bizarre ... (sub. 124, p. 11)

However, as alluded to above, the choice in this context is not between allowing an industry to thrive on its commercial merits or turning it into a constituency of mendicants. Rather, it is a choice between explicit taxpayer support for the cultural externalities associated with Australian publishing and writing or a private, implicit, tax on book consumers, underpinned by the PIRs. That choice should be dictated by the intrinsic advantages and disadvantages of the two forms of support.

A further objection raised by authors is the potential vulnerability of subsidy support to short term fiscal policies. In this regard, Thomas Keneally contended that a subsidy of sufficient magnitude to replace the PIRs:

... is unlikely to be politically viable, guaranteed or permanent. Would such a subsidy survive economic downturns, razor gangs, changes of policy and of government? (sub. 16, p. 7)

Similarly, Kate Grenville argued:

There are issues of supply — government funds will never be enough to support all the writers or books that deserve to be supported, and in any case, such funds would be dependent on the vagaries of government policy and budgets. (sub. 68, p. 4)

However, periodic scrutiny of subsidies to ensure they remain relevant and appropriate is clearly desirable. And alternative mechanisms can and should be subject to similar scrutiny — as the frequent reviews of the PIRs over the last two decades illustrate.

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Further, the subsidy approach cannot be quickly dismissed as a step into the unknown. As noted, support is already provided to the industry in this way — including through grants by the Australia Council for the Arts (see box F.1 in appendix F). Also, the subsidy approach has been used in other countries, most notably in Canada where substantial sums are paid under the long-standing Book Publishing Industry Development Program (box F.4).

It is also important to recognise that subsidies can take various forms. A number of participants, while welcoming any government support provided for literature, were critical of the ‘beauty contest’ model, wherein a panel of assessors decide which works warrant grants and which do not. However, subsidy funding can also be allocated on the basis of more objective, pre-determined criteria. Moreover, a sales-based subsidy, for example, would likely mimic many of the incentives (for the publishing of Australian works) of the PIRs.

Subsidies are used in a number of markets to address externalities, and the Commission can see no valid ‘a priori’ argument as to why public support for the externalities associated with Australian writing should not also take this form.

That said, a range of design issues can bear on the efficiency and effectiveness of subsidy arrangements. To assist in assessing the practical merits of the subsidy approach, the Commission canvassed some of these in the discussion draft. Appendix F expands that work, highlighting some design options that would need to be considered in maximising the cultural externalities generated by a subsidy scheme while rendering it practically workable and administratively efficient.

While detailed analysis would be required to determine the most efficient and effective means of delivering subsidies for Australian works, such subsidies should be able to be administered at a reasonably low cost. For example, the major component of the Canadian scheme disbursed around A\$30 million to publishers in 2007-08, with administration costs of around A\$1 million (equivalent to 3 per cent of the entitlements). This compares favourably to the PIRs, for which indicative estimates (appendix E) are that 60 per cent of the assistance for copyright holders provided via higher trade book prices leaks offshore, and a further amount supports the local printing industry.

Although this suggests that subsidies are potentially a much more cost-effective mechanism for assisting local works than the PIRs, two considerations militate against recommending the adoption of subsidies *as a replacement* for the assistance provided by PIRs. First, given that there is uncertainty about the magnitude of the price raising impact of the PIRs, setting an appropriate subsidy rate to replicate the assistance provided by PIRs would be problematic. Second, implementing a new subsidy regime would in some senses validate ongoing support for cultural

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externalities beyond that provided through other funding programs. However, as indicated earlier, the external benefits dependent on the PIRs are unlikely to be large. This suggests that significant additional support may not be warranted, at least insofar as the objective is to cater for cultural externalities (as distinct from assisting local publishing or printing activities).

### **7.3 The Commission's preferred approach**

Reform of the current arrangements is clearly desirable, to address: the upward pressure on book prices; the restrictions imposed on the commercial decisions of booksellers; and the poor targeting of assistance to the cultural externalities generated by some Australian works, including the leakage of much of its value offshore.

Whereas the draft recommendation was for the partial liberalisation of the PIRs, the Commission's further analysis suggests that, of the viable options, full liberalisation combined with appropriate subsidy arrangements would proffer greater net benefits. Other 'intermediate' reform options, such as shortening the 7/90 day rule and the introduction of price-capping arrangements, could also have some net benefits, but they are unlikely to be as significant.

Accordingly, the Commission recommends that the government terminate the PIRs, with three years forward notice to be provided to allow the industry to plan for, and begin adjusting to, the new environment.

It also recommends that, when announcing this change, the government initiate a review of the totality of financial assistance for Australian writing and publishing. This will provide an opportunity to consider more closely the efficacy of existing arrangements and whether they might be improved. Among other things, it would be appropriate to examine the case for changing some of the current subsidies to more directly support outputs that generate cultural externalities (appendix F).

While the Commission judges that these reforms would generate net benefits for Australia as a whole, the specific impact on Australian publishing would depend on the extent to which local publishers could supply local booksellers with books desired by Australian consumers at a price and terms competitive with foreign sources of supply. Similarly, the impact on local book printers would depend largely on their competitiveness relative to alternative sources of supply. In both cases, the industries have a degree of natural protection in their favour.

As set out in chapter 5, the Commission would expect abolition of the PIRs, of itself, to result in some contraction or slowing in the growth in the book production industry, and/or reductions in the income levels of some of those in the industry. Similar

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effects have occurred in several other industries where the government has removed import protections or restrictions on competition, at least in the years immediately following those reforms.

However, the extent of the pending contraction has often been overstated by those in sectors facing reform. Indeed, at the time of the 1991 reforms to the PIRs, the book industry itself was initially very cautious, with some sounding warnings about the impending impacts. Although those concerns may have been genuinely held, they did not prove to be warranted, and the industry has grown substantially over the intervening period. Similarly, while removal of the PIRs should see an increase in imported books where these represent better value, the Commission expects that most Australian publishers, including the major publishing houses, would generally adapt to the new regime, that Australian stories and content will continue to be demanded and that talented and marketable Australian authors would continue to be widely published.

In this context, it is not clear that any reductions in the growth of publishing in Australia from its current base, that would result from abolition of the PIRs, would be sufficient to entail a significant foregoing of cultural externalities. And in regard to those externalities, there would be continuing and potentially more effective subsidy support.

Nevertheless, there inevitably remains some uncertainty about how the structure of the industry would change following the abolition of PIRs and any modification to the current subsidy arrangements, and how this would affect the cultural externalities the industry generates. Accordingly, the Commission recommends that the industry's assistance be reviewed again five years after the abolition of the PIRs. To assist in this review, the ABS should revise and update its 2003-04 surveys on the books industry and market, and update them again prior to the later review.