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## 4 Price and assistance effects

### Key points

- There are many substitutes for titles published in Australia. Thus, the market for any one title, or even for Australian-authored titles more generally, is not ‘closed’.
- By assisting publishers to segment international markets, PIRs potentially facilitate international price discrimination, which can lead to higher prices in individual countries.
- To the extent that PIRs raise book prices, they provide assistance to copyright holders, which will have flow-on effects to others in the books industry. The greater the price effect, the greater the assistance (and vice versa).
- The assistance provided by PIRs will fluctuate over time, increasing as the local industry’s competitiveness declines, and decreasing as its competitiveness improves. Changes in exchange rates can have significant effects in this regard.
- A range of evidence suggests that the repeal of the PIRs would lead to material downward pressure on prices in at least some market segments:
  - Price comparisons suggest that prices in Australia for some titles are from time to time higher than the price of those titles in the UK and the US. In many instances, the price difference is substantial.
  - Were PIRs removed, 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.
  - Were the PIRs removed, very low cost ‘remainders’ could be imported from the UK, the US and other markets.
  - Experience in other sectors supports the view that repealing the PIRs would likely put downward pressure on book prices in Australia, as do the book producers’ own predictions of contraction were the PIRs to be removed.

The study’s terms of reference indicate that the operation of the Parallel Import Restrictions (PIRs) potentially results in higher book prices, and also state that views differ on whether they cause ‘significantly higher prices’ for Australian consumers, compared to those in overseas markets.

Submissions to this study presented a range of views, and some evidence, on this matter. Many authors, publishers and others in the books sector maintained that book prices in Australia are often lower than those in major overseas markets, and

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that removing the PIRs would see little if any reduction in prices. Other participants, including some major book retailers, argued that prices should fall significantly were the PIRs to be removed.

To the extent that the restrictions do result in higher prices in the Australian market, they would effectively provide assistance to local book producers, similar in some respects to the effects of tariffs, quotas and other import restrictions that protect some other industries. This would be consistent with the view — expressed by many in the books sector — that removing the restrictions would cause the local book production industry to contract.

However, ascertaining the extent of any price effects ensuing from the PIRs is not straight-forward. In the first instance, determining the effects of removing the PIRs requires an understanding of the potential sources of books that might be amenable to parallel importation. Even where this is clear, data and methodological issues often bedevil attempts to compare book prices in different countries in a way that sheds light on the effects of PIRs.

With these difficulties in mind, this chapter examines:

- how the restrictions could assist copyright holders, by helping them to segment world markets and engage in international price discrimination
- what the available evidence is able to reveal about the PIRs' impact on book prices in Australia.

## **4.1 How PIRs potentially result in higher book prices and assist copyright holders**

### **What affects the price of books?**

The prices charged for different titles and editions reflect the interplay of many factors:

- These include the cost of creating, producing and supplying books, including the drafting and editing of manuscripts and purchasing of rights, design work, printing and binding, marketing, freight and distribution, and the costs that publishers incur when they provide books on a 'sale-or-return' basis to retailers.
- Factors at the retail level include: the level of competition among booksellers, which can influence the retail mark-up on the prices charged by publishers; the retailing strategies adopted by different booksellers, such as the level of sales service provided and whether they offer particular titles as deeply discounted 'loss-leaders' to lure customers through the doors; and any taxes due on the sale.

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- Factors on the demand side include consumers' income levels, preferences for different genres, authors and titles, and the availability and price of close substitutes for the books in which consumers are interested.

In regard to the availability of substitutes, any individual title published in Australia faces competition from a range of sources. These include rival titles in the same genre, whether locally-produced or imported, and foreign editions of the same title available from foreign on-line booksellers. Also, rather than buying a particular title new, consumers can obtain it from a library or second-hand bookstore. The upshot is that the market for books in Australia, including for those titles published in Australia, is by no means fully 'closed'.

However, the extent to which alternative sources of books constrain the price of particular titles on the Australian market depends on how close a substitute they are in the consumer's eyes, and on their price. Anything that increases the price of these substitutes — or excludes them from the market altogether — will provide more room for a publisher to correspondingly raise the price of its titles.

### **Direct effects on the price of books protected by the restrictions**

As noted in chapter 3, the immediate effect of PIRs is to insulate book titles published in Australia from import competition. In the absence of PIRs, local booksellers or book buying groups could source legally-produced foreign editions of that title from whichever international supplier had the lowest cost or best value-for-money edition. This competitive threat would pressure the local publisher to lower the price of its own edition *if*, after taking into account taxes and freight etc:

- an 'equivalent' edition (defined in box 4.1) of a title was available at a lower cost from abroad and/or
- a different edition of the title, that represented 'better value' (also see box 4.1), was available from abroad.

But when shielded from this potential source of direct competition, a publisher can charge booksellers a price which is above the cost of an equivalent foreign edition, certain in the knowledge that it cannot be undercut by such an edition.

In effect, PIRs support the segmentation of world book markets, assisting publishers to charge different prices for the same or a similar product in different countries. Although sometimes the publishing rights to a book are sold as 'world rights', often they are split up and sold separately for particular markets, or sub-groups of markets. For example, in the case of English-language books, separate publishing rights might be sold for the United States (US), the United Kingdom (UK), Australia and/or other key Commonwealth countries, and 'the rest of the world' (including Asia,

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#### Box 4.1 **Comparing different editions**

Titles may be published in a number of editions, both within the one country and across countries. Editions may vary in terms of paper quality, size, cover material and sometimes content.

By an ‘equivalent’ edition, the Commission means an edition with essentially the same characteristics as the Australian edition, in terms of format, cover material, content and so forth. In practice, there may be variations between Australian and foreign editions, even those in the same format and binding. Sometimes, for example, there may be some differences in content — such as a forward by a local identity — or a different cover design or even title, although in broad terms the editions are equivalent.

However, often there are more substantial differences in the editions available in different markets. For example, many trade books first appear with hardback covers in the UK and the US, with smaller (A or B format) paperbacks released later in the life cycle of a title, whereas many Australian editions are printed initially as large (C format) trade paperbacks. Also, Australian-authored titles are sometimes re-edited to make changes to character and object names, spelling and expressions, particularly for the US market.

Typically, consumers will be willing to pay more for what they perceive to be a better quality format than a lower quality format, and to pay a price premium for a localised edition. But even with such differences, it is likely that the availability of a foreign edition of a particular title would provide significant price discipline on a local edition. In this sense, the issue is not simply whether ‘lower cost’ books are available abroad, but whether ‘better value’ books are available (even if, in some cases, they are more expensive than a lower quality Australian edition; or, in other cases, they are of lower quality than a more expensive Australian edition).

For analytical purposes, comparisons of equivalent editions — ‘like-with-like’ — in principle provide the best means of ascertaining price differences between markets.

Africa and the rest of Oceania). With PIRs in place to prevent ‘arbitrage’, this system assists with international price discrimination.

For PIRs to be effective in allowing a local publisher to raise the price for a particular title, two additional conditions must be met.

First, the title itself must have some ‘market power’ in the Australian market — otherwise, as alluded to above, different titles (including those not published locally and thus not directly covered by the restrictions) could take the title’s sales by being sold at a lower price, or representing better value for money. As several participants emphasised, books are not plastic buckets, where any colour will do and price is virtually all that counts. Rather, titles, even those on a similar topic, are differentiated from each other — they are only ‘imperfect’ substitutes. Even though

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numerous titles may be published, each title may be sufficiently different from others that publishers can, to an extent, exercise some market power in setting the price of the book. For some titles — those in the *Harry Potter* series, for instance — this market power will be substantial.

The second condition for PIRs to be effective in allowing a higher price is that the local demand for the title must be such that it can command a higher price in Australia (for an equivalent edition) than in at least one other territory where the title is sold. Importantly, if no lower cost foreign edition of the title was available, the PIRs of themselves would have no direct impact on the price of the Australian edition. In this case, its price (with or without PIRs) would simply reflect local market conditions.

### **How such price effects manifest as assistance to copyright holders**

To the extent that these conditions are met in practice, the PIRs allow the prices paid for books published in Australia to be higher than could otherwise be charged. This would provide a form of ‘assistance’ to copyright holders, which could manifest in a range of ways.

In the first instance, the value of higher prices would show up directly as higher profits for publishers. In the absence of any off-setting cost increases, higher book prices would directly raise the net returns from publishing books.

In practice, it is likely that publishers would face higher costs in some respects — for example in acquiring Australian rights (see immediately below) and also through incentives to use higher-cost (local) printers or fast-track delivery arrangements to meet the requirements of the 30 day rule, and thereby qualify for the protection that the PIRs provide (see chapter 5). Higher returns to publishing, in the first instance, could also induce an expansion in Australian publishing activity, which would erode any initial increase in the profitability of existing publishers, as the cost of resources used in publishing (such as editors and printers) is bid up.

Higher returns available from the sale of works published in Australia, consequent upon the price effects of the restrictions, would also be reflected in a higher value for the Australian rights of literary works. That is, aware of the potential for publishers to gain higher prices for works published and sold here, local authors should be able to command higher advances and royalties from publishers than they otherwise could. Equally, foreign copyright holders (that is, authors and/or the publishers to whom they have sold world or offshore rights for their works) would be expected to receive higher payments for the Australian rights to their titles.

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The ultimate distribution of the benefits of assistance to copyright holders would depend on the relative bargaining power of the various parties in the book industry supply chain, together with underlying market conditions. Suffice it to say that the benefits of the assistance would be shared around to some extent.

### **Nature of assistance to copyright holders flowing directly from the parallel import restrictions**

The way PIRs can assist copyright holders is similar, in some respects, to the effects of other import restrictions which apply to some other industries. Tariffs, for example, cushion domestic industries from exposure to international competitive pressure. They increase the price of competing imports and thereby provide room for local producers to lift their prices, albeit at the expense of local consumers. Likewise, PIRs also cushion domestic copyright holders from at least direct international competition (other than via online booksellers), potentially allowing them to charge higher prices for their goods in the Australian market.

As a mechanism for providing assistance, the PIRs have some features that affect their desirability relative to other means of supporting the books industry.

First, to the extent that the PIRs support higher book prices in practice, the quantum of assistance they provide to copyright holders depends on the commercial success of the title. That is, the more of a title people buy and/or the more they are willing to pay for the title, the higher the overall value of assistance. In this sense, the PIRs augment market forces. This contrasts with, for example, the provision of grants by the Australia Council (appendix F), which are not tied to the sales volume of a title.

Second, part of any price increase attained 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 published the book here itself. In effect, to the extent that PIRs result in higher prices for books more generally, the restrictions cause Australian consumers to effectively subsidise not only local holders of Australian copyright but also foreign holders of Australian copyright. (Estimates of the ratio of this ‘leakage’ to foreigners are presented in appendix E.) In contrast, with a tariff, the higher price paid by local consumers for foreign goods is offset by the tariff revenue received by the government.

Third, the quantum of assistance provided by PIRs depends on the price of the local edition compared to competing foreign editions. If the price of those competing editions exceeds the price of an (equivalent) Australian edition, then the PIRs have no price effect and afford no substantive assistance to local producers. However, if the price of a foreign edition substantially undercuts the Australian edition, the

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effective ban on the foreign edition means that the assistance provided, on a per book basis, is also substantial.

This level of assistance for copyright holders, resulting from PIRs, is tempered by competition from foreign online book retailers (most notably Amazon), which exposes Australian rights holders to international pricing pressure, at least to some extent. However, the price impact of this competition is a matter of some debate (see chapter 5). The upshot is that the assistance provided by PIRs will fluctuate over time, particularly with changes in exchange rates and also with other cost factors that affect the competitiveness of books produced in Australia relative to those produced abroad.

### **Indirect price and assistance effects on other books**

The foregoing indicates how PIRs can protect the price of titles published in Australia when better value editions could otherwise be imported from abroad. Higher prices provide a form of assistance to producers of those books.

PIRs may also provide some assistance to the producers of other categories of books sold in Australia, but the mechanism by which they do so is less direct.

One of these categories is books published in Australia that are not sold overseas. PIRs do not directly affect the price of these books because, without versions overseas that could be imported into Australia to compete with the local edition, publishers can price the local edition at whatever the local market will bear, taking into account the availability and price of other titles on the market with which they compete. However, to the extent that PIRs can enable a higher Australian price for rival books that are also sold overseas, this is likely to provide some room for publishers to increase the price of their ‘local market only’ books too. In turn, this would represent a form of assistance to local producers.

Another category of books whose price is not directly affected by PIRs are those foreign-authored books that are not published in Australia. Booksellers are able to import these books at any time from the lowest cost or best value source they can identify and deal with. The restrictions might still have some indirect impact on the local price of these books insofar as they raise the general price level of books in Australia. This would provide some room for individual booksellers to price imported books at higher levels too, although competition between booksellers might be expected to reduce their capacity to do so.

However, it is possible that, in fully restricting a major part of the market, Australia’s PIRs have reduced the incentives for the establishment of lower cost supply options that could otherwise have serviced the still fully open (non-PIR

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protected) part of the market. If that is the case, it would increase the likelihood that the restrictions have put upward pressure on prices across the whole of the market, rather than only on those titles that are technically eligible for PIR protection.

## 4.2 Evidence on the price effects

While the PIRs potentially raise the prices of books published in Australia, assessing the actual magnitude of any such price effect is not straight-forward. To start with, it requires an understanding of the foreign sources from which book imports might be feasible in the absence of PIRs. Even where this is clear, the next issue is whether books could be sourced from these markets at sufficiently attractive prices to make them competitive with locally produced books.

Many previous studies of PIRs have relied on comparisons of prices in Australia with those in other, developed, English-speaking markets, particularly the UK and the US. Participants in this study also provided such comparisons, and the Commission has augmented these with its own analysis.

Even so, gaining a clear indication of the effects of PIRs through such analyses is difficult. In the first instance, significant methodological hurdles arise in attempting to undertake valid comparisons:

- There are various complexities in ensuring comparison of like-with-like. These include how best to make allowance for cross-country differences in formats, cultural re-editing, rates of tax levied on books and typical discounts to recommended retail prices; as well as how to account for freight costs which will depend on the source country, freight mode and freight volumes, and whether books are provided on a sale-or-return or firm sale basis.
- The outcomes of international price comparisons are significantly affected by movements in the exchange rate. To mitigate the sensitivity of the results to the exchange rate requires comparisons at several points in time.

In the second instance, the results of price comparisons between current list books in the US, the UK and Australia, even if robust methodologically, cannot provide a precise indication of the price impacts of PIRs. This is especially the case as book prices in these countries are, *prima facie*, themselves inflated by PIRs. Although some current list books might be parallel imported from these countries in the absence of PIRs in Australia, the cost at which such books might be procured for shipping to the Australian market could be less than the cost of those books when sold in their home markets. Further, some books might be sourced from elsewhere at a lower cost, such as from other western economies or from Asia. And remainders from any

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country, including the UK and the US, could also offer a much cheaper source of books, including of broadly like-for-like editions, at least for some titles.

In interpreting the results of price comparisons, it is also important to recognise that, even if and when the *average* price of books in Australia is less than the average in other markets, PIRs may still have price impacts by preventing the importation of *some* titles that are available more cheaply from abroad. Thus, there is a need to consider the variability in price gaps for books in different countries; not just comparative average price levels.

For all these reasons, while price comparisons may in some circumstances shed light on the effects on PIRs, or the potential effects of their repeal, they need to be interpreted carefully and, ideally, assessments of these matters will draw on a range of evidence and indicators. With these considerations in mind, this section explores what the available evidence is able to reveal about the PIRs' impact on book prices in Australia.

## **Prices of trade books**

### *The PSA/ACCC studies*

The Australian Competition and Consumer Commission (ACCC) and, before it, the Prices Surveillance Authority (PSA) undertook a range of surveys of 'current list' (as distinct from remaindered) book prices for the period from 1989 to 2001. These included: a survey of the recommended retail prices (RRPs) in publishers' catalogues for the UK, the US, Australian and Canadian markets; surveys of bestsellers in the UK, the US and Australia; and a survey of prices of medical texts in those countries.

The lack of extensive electronic datasets on book sales at the time of these surveys restricted the sample sizes, types of price data and methodological approaches that could readily be used in the studies. The comparisons were based on RRP in different countries, and often sought to account for differences in the format of books in different markets, and to adjust for the effects of differential tax arrangements applying to books in different countries.

The studies revealed that, while the price of books was often higher in Australia than in the UK and the US, these price differences varied over time. In particular, the ACCC found that, in three of the four years to 2001-02, the price of bestselling paperback fiction books was lower in Australia than in the UK (see appendix D).

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However, based on the full results of its studies, the ACCC concluded that Australian consumers had paid significantly more for books than their counterparts in the UK and the US for most of the period covered by its surveys:

Inquiries by the ACCC consistently showed that Australian prices were substantially higher than in the UK and the US until the mid-1990s. Up to the date of the last study in 2001 at least, the surveys suggested that though some titles were priced competitively with comparable overseas markets, there were large differences in respect of other titles. As such, the ACCC concluded that there were substantial consumer benefits that could be realised if the restrictions were removed. (ACCC, sub. 260, p. 11)

### *Participants' comparisons of Australian and US/UK current list prices*

During the current study, several participants — including booksellers' groups, several publishers and the Australian Society of Authors — submitted their own comparisons of prices in Australia, the UK and the US. The comparisons are described in appendix D.

The findings and conclusions that participants drew from their comparisons varied. For example:

- In comparisons with UK and US prices for around 10 bestseller titles at around the end of 2008, the Australian Publishers Association (sub. 244) found that the Australian price was occasionally the most expensive among the three countries, and more often was the least expensive.
- In comparing the prices of 11 international bestselling titles at the end 2008, the Coalition for Cheaper Books (sub. 218, p. 7) found that 'in almost all cases, Australian recommended retail prices are substantially more than the UK or US'.
- Hachette Australia (sub. 232) found that around three quarters of its 20 top selling titles were cheaper in RRP terms in Australia than in the US, with only one quarter more expensive, and that all of its titles were cheaper than could be obtained from Amazon when freight of \$15 per book was included.
- Leading Edge Books (sub. 254, p. 8) concluded on the basis of its comparison of 16 bestselling titles in Australia, the UK and the US that '... the retention of territorial copyright does not cause Australian consumers to pay a higher price for books.'

Taken at face value, the comparisons suggest that prices of many titles in Australia can be competitive with, or lower than, the price of UK or US editions. At the same time, the comparisons — including some of those submitted by participants opposed to the removal of PIRs — suggest that there are also titles available at lower cost in the UK and the US.

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However, the comparisons had a number of aspects in common that, taken together, inevitably weaken the level of confidence that attaches to the results as a basis for understanding the price effects of PIRs:

- Each study examined only a small number of bestselling books, and many focused on comparing the price across countries for the first-release format. As Australian first release books are often C format trade paperbacks whereas those in the UK and the US are often hardbacks, the comparisons were not always on a like-with-like (that is, equivalent edition) basis.
- Most of the comparisons relied on RRP. To the extent that discounting practices vary across countries, comparisons based on RRP may give a misleading indication of retail price differentials between the different markets.
- There were also variations in the way in which prices were adjusted to reflect freight costs and other factors. Some grossed up the overseas price by 30 per cent to account for freight, for instance. Readings and Gleebooks (sub. 226) stated that their freight costs (plus statutory charges) could be as high as 40 per cent of the cost of a book, but that for bulk orders of books from overseas — as would potentially be a more frequent scenario in the absence of PIRs — this share could be as little as 10 per cent. Likewise, the Coalition for Cheaper Books (sub. DR509) indicated that the cost of air freighting books from the UK and the US to Hong Kong represented less than 20 per cent of the wholesale price of the books supplied to Hong Kong — implying that it would be a smaller share of the retail price — and that the same freight charges would apply for books shipped directly to Australia.
- As the comparisons were undertaken for book prices at a similar, single point in time, they cannot reveal trends and shifts in price differentials over time. For assessing the merits of PIRs, it is their effect over time that is of most relevance. In this context, participants' comparisons were undertaken following the fall in the Australian dollar in 2008, which would be expected to reduce the level of Australian prices compared to those abroad. Indeed, Readings and Gleebooks (sub. 226, p. 3) noted that '... last June when the Australian dollar was strong against the US dollar many overseas originated books were significantly more expensive in Australia'. On the same matter, albeit from a different perspective, John Wiley & Sons said:

... there has been widespread over-pricing (particularly during the recent period of a strong Australian dollar, when we heard anecdotally that we were one of only a very small group of publishers to reduce the price of our imported trade titles as the Australian dollar strengthened against the US dollar and the pound) ... (sub. 169, p. 1)
- A broader limitation is that, as mentioned above, it is not possible to conclude solely from comparisons of prices of current list books in these countries what the effects of removing Australia's PIRs would be.

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### *The Commission's comparisons of Australian and US/UK current list prices*

While aware of the inherent limitations of price comparisons, the Commission has undertaken extensive comparisons for this study to help explore what such exercises can reveal. Its comparisons drew on the comprehensive data contained in The Nielsen Company's BookScan database for 2007-08, and the first 11 months of 2008-09, for top 5000 editions (in sales terms) in Australia, the UK and the US.

The Commission undertook three types of comparisons:

- 1) The first compared the RRP's of books in the different countries, matched by title, author, format and publication date to generate 'like-with-like' comparisons.
- 2) The second, a variant of the first, used the BookScan point-of-sale price data for Australia and the UK, rather than the RRP data.
- 3) The third eschewed the like-with-like approach and compared the cheapest priced edition of particular titles in each market.

The Commission used a conservative approach in matching titles and editions from the different datasets.<sup>1</sup> While this reduced the sample size, particularly for the like-with-like comparisons, it also limited the risk of inappropriate matches. Even so, the sample size for the comparisons was over 300 and 900 matches in each year for the Australia-US and Australia-UK like-with-like comparisons, respectively, and over 1200 matches for the lowest-cost comparisons with both countries. The Commission also conducted sensitivity analyses of the results, in particular to examine the effects of exchange rates on measured price differences between the countries. The methodology used, and detailed results, are discussed in appendix D.

Even with these extensive data, methodological variety and safeguards, a number of specific aspects of the approach adopted mean that caution is needed in interpreting the results of the comparisons. Among other things, the comparisons based on RRP

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<sup>1</sup> For this final report, the Commission expanded the sample size for its US like-with-like comparisons, from 230 to 347 (for 2007-08), by matching editions listed as 'trade paperbacks' in the US BookScan database with those labelled as B formats in the Australian database. There can be some size and quality differences between these books but, in general, they are sufficiently comparable in the Commission's view to be included in the like-with-like comparisons.

The Commission also considered matching editions labelled as 'mass market paperbacks' in the US BookScan database with those labelled as A formats in the Australian database. Inclusion of these matches would increase the average price gap on a like-with-like basis from 35 per cent to 48 per cent in 2007-08. These formats are of similar dimensions, although the US mass market paperbacks tend to be printed on lower quality paper and have a lower quality appearance. While there is a case for their inclusion in the like-with-like comparisons (possibly with an adjustment to reflect quality differences), the Commission has taken a more conservative approach and omitted these matches.

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data suffer the inherent limitations of such exercises (see above). While the use of the BookScan point-of-sale price data potentially overcomes this problem, comparisons based on such data are susceptible to their own biases — for example, they do not account for the influence on average prices of the sale of books through different retail channels (appendix D). Also, while making allowance for the levying of GST on books in Australia, the Commission has not sought to adjust retail prices to reflect differences in freight costs.

For this and a range of other reasons, the results of these comparisons are at best an indication of differences between the retail prices of books in the different countries; they do not, of themselves, attempt to indicate the price at which the books sold in other countries *could* have been sold in Australia.

### *Results for 2007-08*

The results suggest that, in 2007-08, and recognising Australia's high exchange rate at this time, trade titles in Australia were somewhat more expensive than editions available in the UK, and markedly more expensive than those available in the US:

- 1) The RRPs of matched editions in Australia were on average 9 per cent higher than the RRP of like editions in the UK, and 35 per cent higher than the RRP of like editions in the US.
- 2) The average selling price (ASP) of matched editions in Australia was on average 18 per cent higher than the ASP of like editions in the UK. (Data on ASPs are not available for the US market.)
- 3) The price of the cheapest Australian edition of matched titles was on average 13 per cent higher (on an RRP basis) and 22 per cent higher (on an ASP basis) than the cheapest edition of the titles in the UK, and over 50 per cent higher (on an RRP basis) than the cheapest edition of the titles in the US.

There was some variability within these general trends. In particular, for around one-sixth of titles in the Australia-UK like-with-like comparison, the Australian RRP exceeded the UK RRP by at least 25 per cent. And for one-fifth of titles in the Australia-US comparison, the Australian price exceeded the US price by at least 50 per cent.

The Australian price also undercut the foreign price in some cases. For example, the Australian RRP was lower than the US RRP for like editions of matched titles in 5 per cent of cases, and lower than the UK RRP in 20 per cent of cases.

The above estimates relate only to one time period, in this case the financial year immediately prior to the recent fall in the value of the Australian dollar. As the

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Commission noted in the discussion draft, Australia's exchange rate was relatively strong against the US dollar in 2007-08. When the Australian dollar is weaker, the price differences between Australia and the US would be expected to be smaller.

### *Results for 2008-09*

For this final report, the Commission extended its analysis to cover data for the first 11 months of 2008-09: that is, for the period when the Australian dollar was much lower against the US dollar (though a little higher against the UK pound). This period also covers the time for which most participants undertook price comparisons.

As expected, the estimated price difference between Australia and the US was much narrower in 2008-09, although, reflecting the variability in prices around the average, the results still contained many titles that were markedly more expensive in Australia compared to the US:

- The RRP of matched editions in Australia was on average 12 per cent higher than the RRP of like editions in the US, with the difference exceeding 25 per cent for more than a one-sixth of the titles.
- The RRP of the cheapest edition of matched titles available in Australia was on average around 27 per cent higher than the cheapest edition of those same titles in the US. The price difference exceeded 50 per cent in one-quarter of the cases.

For the like-with-like comparisons with the UK:

- On an RRP basis, the price of matched editions in Australia was on average 12 per cent higher than the price of editions in the UK. The price difference exceeded 25 per cent in one-quarter of the cases.
- On an ASP basis, the price of matched editions in Australia was on average 25 per cent higher than in the UK. The price difference exceeded 40 per cent in more than one-quarter of the cases.

The price of the cheapest edition of matched titles available in Australia was on average around 13 per cent (RRP) and 27 per cent (ASP) higher than the cheapest edition of those same titles in the UK. In around one-quarter of the cases, the price gap exceeded 30 per cent (RRP) and 45 per cent (ASP).

### *Prices in other 'open' markets*

The Coalition for Cheaper Books cited the experience of Dymock's in the Hong Kong market as an example of the prices at which booksellers can obtain trade books in an open market.<sup>2</sup> The Coalition's submissions indicated that Dymock's

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Hong Kong store can source equivalent editions of books for 30 to 35 per cent less, on average, than can its Australian stores. It noted that, even if Dymock's were forced to trans-ship books to Australia via Hong Kong, the cost reduction to its Australian stores would remain close to 20 per cent (see box 4.3).

**Box 4.3 Dymock's Hong Kong wholesale price comparisons**

In its initial submission, the Coalition for Cheaper Books (sub. 218) reported a comparison of the best cost price for Dymocks in Australia to the best cost price for Dymocks in Hong Kong, for a selection of 11 international bestselling titles. The comparison entailed the same edition of each book, sourced from the same multinational publisher, and adjusted for the GST paid on Australian sales. The Coalition stated that, on average, the wholesale price was 35 per cent less in Hong Kong (although, as noted in the discussion draft, the initial submission did not indicate at what price the titles could be landed and sold in Australia).

In its supplementary submission (sub. DR509), the Coalition submitted data for a further 32 books, and included information on the freight costs to Australia. The data indicated that the landed price of the books in Hong Kong was on average almost 30 per cent less than the best local cost available in Australia. The Coalition stated that the freight cost from the UK and US is the same for Australia and Hong Kong, implying that the books could be landed here (in the absence of PIRs) at the same price as they are landed in Hong Kong. The Coalition further stated:

Even were Dymocks to trans-ship the basket of books from Hong Kong to Sydney, the additional cost [would still leave the basket] 18.72% cheaper. ... Dymocks advises that on occasion, they have purchased books for Australia through Hong Kong but in very small volumes. They have not purchased any product direct from international publishers as the closed market in Australia prevents them from doing so and thus offering comparable prices to their Hong Kong Stores. (pp. 3–4)

Taken at face value, the data provided by the Coalition suggests that substantial reductions in prices could eventuate were Australia to remove its PIRs. However, the Commission notes that, in these circumstances, foreign publishers would not necessarily supply Australian retailers at the wholesale prices they currently offer to booksellers in 'cheaper' countries. In the absence of PIRs, foreign publishers are just as likely to want to engage in price discrimination as at present. Whether they could do so effectively would depend in part on the level of competition they would face from other suppliers of titles they stock, including from publishers or wholesalers in other countries (and wholesalers in their own country).

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<sup>2</sup> New Zealand is technically also an open market, but in practice it operates largely as part of a collective 'ANZ' market, with little parallel importing. Retail prices in New Zealand are not significantly different from those prevailing in Australia (appendix C).

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### *Sourcing books directly from Asia*

Beyond the specific case of Hong Kong, the Commission received differing views during the study on the prospects and impacts of Asia as a source of supply to the Australian trade market were PIRs to be removed.

On the one hand, John Wiley & Sons argued that Asia could, in the absence of PIRs, become a source of cheap books for Australia via the emergence of Asian wholesalers offering appropriate terms and conditions for the Australian market:

Currently we are not aware of any wholesalers in Asia that offer a sufficiently quick and reliable service, with the desired trading terms (particularly the right to return over-stocks), to make them an immediate threat if the 30/90 day provisions were removed. However, given the potential market size that Australia would present in these circumstances, we believe that one or more wholesalers would soon set up in Asia (and offer the required trade terms) and represent an attractive source of supply to booksellers in Australia. (John Wiley & Sons, sub. 169, p. 2)

The Australian Society of Authors (sub. 70, p. 4) argued that, without PIR protection, Australian booksellers could also negotiate bulk, discounted sales at low royalty rates, or buy from cheaper English-language markets such as India. In discussions with the Commission, Michael Moynahan (CEO of HarperCollins Australia and, until recently, the Managing Director of Random House India) indicated that it is possible that a wholesaler might establish in Australia which would source some stock from the Indian market and/or other Asian markets, and that some large Australian booksellers might also be able to source some stock directly from these markets.

On the other hand, Mr Moynahan also indicated that, while India has a sizeable English-language market with a number of (multinational and domestic) publishers and wholesalers, it is unlikely that, in the absence of PIRs, they would at present be able to offer a reliable and comprehensive supply of books to the Australian market. He also indicated that, while the prices of many books published in India are often very low (in part to compete against pirated editions, which are rife in that country), the prices of some 'western' titles in India are not substantially less than their UK and US prices. Similarly, REDgroup retail said:

Our experience gained from working in both the Asian and New Zealand markets is that: ... [w]e do not see any immediate likelihood of efficient alternative supply channels being available from Asia that would fulfil an Australian bookseller's broad backlist stock needs with a compelling cost and margin offer, taking into account factors such as freight to store and markdown on unsold stock. (sub. DR471, p. 2)

Hachette Australia (sub. DR480, p. 4) went further and argued that the notion that wholesalers in Asia might emerge to put downward pressure on prices in Australia is

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‘pure fantasy’, due in part to the nature of the Asia book market, including differences in Asian and Australian tastes in books.

The Commission accepts that, particularly in the short term, Asia may not be able to offer a competitive and comprehensive supply of (legally-produced<sup>3</sup>) books to the Australian market, which in turn implies that any pricing pressure from this source, were the PIRs to be removed, could be limited. However, on the evidence before it, the Commission cannot rule out the possibility that Australian booksellers or wholesalers would be able to source at least some trade titles at a relatively low cost from Asia in the absence of PIRs, and particularly as these markets develop over time.

### *Remainders*

‘Remainders’ are printed copies of titles that generally have failed to find significant acceptance in a particular market and/or which have had print runs greater than demand. To avoid the costs of storing or pulping the books, and to recoup some of their investment, publishers typically sell them to specialist remainder wholesalers at very low prices. This practice occurs in all countries, although the time at which a particular title is remaindered in different countries may vary depending largely on its date of initial release and subsequent popularity.

Where titles are remaindered overseas ahead of the date at which they are remaindered in Australia, the ability to parallel import the remaindered edition could substantially reduce the price of these titles on the Australian market. Based on figures provided by Spinifex Press, the price reduction to Australian consumers could be in the order of 90 per cent:

A book published in Australia and selling for \$24.95 might be published in a much larger print run in North America, but doesn’t completely sell out and so it is remaindered to the highest bidder (in the USA 25c is a high bid for remainders). It could easily be dumped on the Australian market where the author is better known and sold at \$3.<sup>4</sup> (sub. 61, p. 4)

While remainders are already a feature of the Australian book market, some local publishers argued that the relaxation of PIRs could lead to a deluge of such inexpensive books in Australia, in particular for titles published in the UK and the US (box 4.4).

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<sup>3</sup> Some participants expressed a concern that removal of the PIRs could lead to an increase of pirated copies of works from some Asian markets. This matter is discussed in appendix B.

<sup>4</sup> While the availability of imported remainders offers significant price savings for Australian consumers, they may also cause a reduction in the total royalties received by authors, depending on whether they supplant sales locally. The impact of remaindering on Australian authors’ royalties is discussed in chapter 5.

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#### Box 4.4 Selected participants' comments on remainders

Participants provided varying views about the nature of remainders and the extent to which their parallel importation might generate lower book prices in Australia:

The US publishing model is all about oversupply and overproduction where return rates for most trade publishers are 40/50% range. PIR has been the only roadblock to the US or UK freely remainder dumping into Australia. The 12 month proposal [in the discussion draft] opens this floodgate, compounded by the US financial crisis and the stock piling of a maximum volume of inventory where author advances need to be recouped which means the maximum flood of bargain basement books into Australia. (Macmillan Publishers Australia, sub. DR506, p. 2)

[Remaindering is not] restricted to the last few copies of books that are at the end of their life, or failed titles that have no life left in them, as the Coalition for Cheaper Books would have us believe. Books are remaindered for a number of reasons, including over-printing, making way for a new format at a new price that might appeal better to the intended market and higher than anticipated returns. ... Overseas dumping of remainders is uncontrollable and potentially hugely damaging and this market is very appealing for USA and UK sellers, as it is a long way from their home market. (Murdoch Books, sub. DR387, p. 2)

Remainders principally derive from end of line and marginal titles, which have either failed, or not sold to their expectation. Generally speaking, if an international book has failed, or is overstocked in one market, it will fail, or be overstocked, in all markets. By definition, this means the title is marginal, and there is limited or no demand, and it is not being stocked by booksellers of any variety. This does not now, nor will it in the future, create downward pressure on the price of author brands, from where the majority of backlist sales derive. Hachette contends that remainders may increase, but because of the nature of those remainders, they will not place downward pressure on backlist prices. (Hachette Australia, sub. DR480, p. 3)

We do not believe that the opportunity to import remaindered books would necessarily have a downward effect on prices. By definition the availability of specific titles as remainders is finite and their impact would be temporary rather than long term. Our experience as booksellers is that consumers see remainders as opportunistic or impulse purchases. Remainders are already available to booksellers ... so it is hard to see remainders having a significant (if any) dampening effect on prices. (Readings/Gleebooks, sub. DR474, p. 1)

Overseas evidence suggests that the availability of remainders as a lower priced source of books is limited to back list and niche titles. For example, in New Zealand, the LECG (2007) study found that parallel importing (including importing of remaindered books) has mainly occurred in these segments of the market. Although remainders may principally derive from end of line and marginal titles, Text Publishing stated:

Remainders would generally enter the market some time after a book has been published here and would have their greatest impact on backlist titles, which might be selling well for a number of reasons: simply because demand has grown, or because a film based on the book is screening or because the book has been placed on school courses. (sub. 63, pp. 41–42)

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However, a number of book industry participants saw the price impacts of remainders as being limited principally to the titles themselves; they did not see parallel imports of remainders as providing a significant source of pressure on current list book prices more generally (box 4.4).

### **Prices of educational books**

Price comparisons contained in submissions, despite the limitations noted earlier, indicated that educational books for sale in Australia are much cheaper than in the US. For example:

- Cengage Learning Australia compared the RRP (including GST) of the top 10 textbooks sold in Australia with the price on Amazon — finding that, on average, the price in Australia was around 30 per cent less than the Amazon price. It concluded that the ‘pricing of local (tertiary) products also indicates a highly competitive environment compared to pricing in the US and Canada for similar products’ (sub. 52, p. 8).
- John Wiley & Sons (sub. 169) also compared the RRP in Australia (including GST) to the US list price of their top 20 selling US-higher education titles. Wiley concluded that a US textbook is around 30 per cent cheaper in Australia than in the US.
- The Australian Publishers Association compared the October 2008 RRP (excluding GST) of 40 bestselling US textbooks sold in Australia with the price on Amazon, concluding that the Australian textbook prices were on average 33 per cent less than the US price. (sub. 244, p. 42)

The comparisons were all based on an exchange rate of around 70 US cents to the Australian dollar. Presumably, the differences between the price of textbooks in the two countries would be narrower when the Australian dollar was stronger.

Textbooks are far cheaper in Asian markets. Graeme Connelly — who is the head of the Campus Booksellers’ Association — noted a significant difference between the price of textbooks in Australia and those in Asia:

Currently a textbook that might cost US\$100 in the U.S. but might sell in Australia for A\$85 (significantly cheaper given current exchange rate) but nowhere near as cheap as in Asia (circa) A\$35. (sub. 60, p. 3)

John Wiley & Sons indicated that ‘the differential pricing in these (developing nation) markets is heavily subsidised by the US, UK and Australian pricing models.’ (sub. 169, p. 10).

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This evidence supports the notion that educational publishers practise international price discrimination, with the highest prices in the US where income levels are typically also highest, somewhat lower prices in Australia and much lower prices in Asian markets.

There was some disagreement among participants about the extent to which textbooks could be imported from Asia were Australia's PIRs to be repealed. Peter Donohue (sub. DR273) argued that educational publishers do not currently rely on the 30 day rule<sup>5</sup> and that, were the importation of textbooks from Asia to occur, global educational publishers would inhibit it very effectively by refusing to supply Asian-based wholesalers out of their Asian subsidiary companies any quantities in excess of identified Asian course needs. Pearson Australia (sub. DR528, p. 1), on the other hand, argued that there would be sufficient market opportunity to support the importation of textbooks from Asia.

It should be recognised that, were parallel importation from Asia to become feasible, the price at which textbooks are currently available in Asia would not necessarily remain at its present level. In this respect, the International Publishers Association (IPA) argued that 'without territoriality, international publishers will stop creating low price editions to be sold in developing countries, as these low price editions risk being imported to — and hence harming — economically stronger markets' (sub. 242, p. 3).

The Commission agrees with the IPA insofar as it would expect international publishers to make substantial adjustments to their pricing and publication strategies were the major English-speaking markets of the US and UK to repeal their PIRs. However, were Australia to repeal its PIRs alone, in practice, publishers would have incentives to respond by effectively setting prices adjusted for developing countries and Australia. This could result in the prices in Australia declining somewhat and the prices in Asian markets rising somewhat, with the final price points ostensibly depending on the relative importance of the sub markets and the extent of natural protection between them, for example that provided by freight costs.

In turn, this suggests that substantially lower prices for some educational books in Australia may be possible, notwithstanding some erosion of current differentials were local booksellers to seek a 'sale or return' condition from Asian suppliers. That said, as John Wiley & Sons noted (sub. 169), many books for primary and secondary school are specially developed for the Australian (and possibly New Zealand) curriculum. This suggests that, if the PIRs were removed, any downwards

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<sup>5</sup> As noted in chapter 5, the Commission's assessment is that many books that are not technically PIR-protected are presently treated by booksellers as if they are. This partly reflects the difficulties of ascertaining whether particular titles have met the 30 day rule, together with the ability of publishers to leverage their relationship with booksellers to discourage parallel importation.

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pressure on prices would most likely be seen in the market for tertiary and professional books rather than primary and secondary school books.

### **Indirect evidence on price effects**

The price effects of the removal of PIRs in other markets may provide some indication of the price effects of the PIRs on the Australian book market. In this context, New Zealand lifted its blanket ban on the parallel importation of books in May 1998, and Australia lifted its restrictions on parallel importation of sound recordings in Australia in July 1998. These reform episodes and their effects are discussed in appendix C. The evidence suggests that the Australian reforms led to a marked reduction in the prices of CDs, although the effect of the New Zealand reforms on book prices, if any, is less clear. However, as noted in appendix C, these markets differ from the Australian books market in some respects, and there is some contention about the effects of the reform episodes. This means that care is needed in drawing implications from these reform episodes for the current study.

Beyond evidence of the effects of PIRs specifically, the more general experience with trade liberalisation and competition reform in Australia indicates that removing impediments to competition typically generates a range of pressures for price reductions. The experience in other sectors is that even just the threat of additional competition can generate incentives for local suppliers to align prices more closely with costs, and to search for efficiencies in their production processes and supply chains (see, for example, PC 2005, chapter 4). While it is not possible to predict in advance the precise form such efficiencies might take, as discussed in chapter 5, in the absence of PIRs there may be opportunities for cost savings in the distribution and production of books.

The contention of many in the books industry, that the sector would contract and that Australian rights would diminish in value were the PIRs removed (see chapter 5), is also *prima facie* an acknowledgement that the PIRs do result in higher book prices in Australia than would otherwise be the case in their absence. Were better value books not able to be imported from overseas, then removal of the PIRs would have little substantive impact on the industry.

## **4.3 Interpreting the evidence**

Based on the various strands of evidence set out in the chapter, it is the Commission's judgment that Australia's PIRs put material upward pressure on book prices. The magnitude of the effect will vary over time and across book genres, but at times will be substantial.

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The Commission recognises the inherent limitations of price comparisons but, in conjunction with the other evidence presented in this chapter, the results of the Commission's extensive comparisons leave little doubt that, but for the PIRs, Australian booksellers could have obtained and shipped many titles to Australia in 2007-08 for substantially less than they were charged by Australian publishers. And while currency movements in 2008-09 have reduced the price differences between Australia and the US, the evidence suggests that there would have remained opportunities to source various titles from the UK or the US for less than the prices charged by Australian publishers. (Of course, were PIRs not in place, in practice local publishers would no doubt be more attentive to the price of competing foreign editions in such circumstances when setting their terms and prices.)

As the Commission noted in the discussion draft (and as many participants emphasised in their post-draft submissions), when the Australian dollar is relatively weak against other currencies, average price differences will be small or may even reverse in direction. That is, it is possible that the *average* price of trade books in Australia will in some years be lower than the *average* price of equivalent editions in the UK and/or the US.

However, given the wide spread of prices around the average, and the availability at times of cheaper formats overseas, there are still likely to be opportunities in such periods to source some current list trade books at a lower cost from the UK or the US (and/or for booksellers to use this prospect to obtain more competitive terms from local publishers). Furthermore, with commercial scale importing, many firms would adopt hedging strategies to moderate the impact of currency fluctuations, as is the case for other product importing.

In the absence of PIRs, downwards price pressure could also arise from other sources, including from Asian markets and through the availability of remainders overseas. However, the evidence available to the Commission does not allow it to gauge with great precision the extent to which these additional, prospective sources of parallel imports would engender price pressure in the Australian book market, additional to that provided by competition from UK and US suppliers of current list books.

The upward price pressure of PIRs on book prices has a range of effects on the books sector and the economy more broadly. These effects, and the corollary consequences from the repeal of PIRs, are explored in Chapter 5.