



**Australian Government**  
**Productivity Commission**

# Restrictions on the Parallel Importation of Books

Supplement to  
Research Report

September 2009



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## About this supplement

On 3 September 2009, the Australian Publishers Association (APA) released a paper commenting on the Productivity Commission's recent report: *Restrictions on the Parallel Importation of Books*. The paper was commissioned by the APA and prepared by two European academic economists, Professors Oswin Maurer and Markus Walzl.

The stated aim of the Maurer/Walzl paper (henceforth: the paper) is 'to investigate the extent to which the Commission's report resembles 'best practice' in its theoretical and empirical analysis of the economic and societal impact of parallel import restrictions (PIRs) and the corresponding policy recommendations' (p. 4). The paper's authors interpret the Commission's recommendation to repeal the PIRs as being reliant on four 'central claims' (p. 2), relating to:

- international price differentials
- the impact of repealing the PIRs on prices
- the link between lower prices and productivity and consumer wellbeing
- policy mechanisms for addressing the cultural externalities of books.

The authors then examine whether the claims can be substantiated by the material in the Commission's report (henceforth: the report). In broad terms, the paper contends that:

[T]he report provides an insufficient basis for policy reform as it does not collect the information about the relevant market that is necessary for an evaluation of the status quo and the economic impact of alternative policy proposals. (p. 2)

Many of the technical issues discussed in the paper were not raised by the APA (or other participants) either in initial submissions to the Commission's study or in responses to the draft report, and were not addressed directly or in much detail in the Commission's final report.

Accordingly, this supplement is being released to set out the Commission's views on the merits and policy relevance of the main arguments in the Maurer/Walzl paper. In short, the supplement points out that:

- while the report's findings in the four areas mentioned above each added weight to the case for repealing the PIRs, the Commission's recommendations are not reliant on the four 'central claims' as interpreted by the paper's authors
- the Commission's findings were based on more extensive analysis than the paper acknowledged

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- various analyses said by the paper to be missing from the report are unnecessary for the policy assessment task the Commission faced
  - the paper characterises parts of the report inaccurately, and exhibits an imperfect grasp of the practical requirements for sound policy advising.

In this context, and contrary to the views expressed in the Maurer/Walzl paper, policy advising should not be paralysed by the inability to unequivocally exclude counter-hypotheses or to quantify all impacts on net welfare. Of course, robust quantification to the extent practical, together with related evidence and sound judgment, provide greater surety on the merits of particular policy reforms. This robust but differentiated approach to policy advising is exemplified in the Commission's work over several decades.

Overall, while some issues raised by the paper arguably could have been covered at more length in the report, the Commission does not see the paper as justifying any fundamental revision to the analysis in the report, or to any change in its policy recommendations.

## **Pricing issues**

According to the paper's authors (p. 2), the first two 'central claims' upon which the report's recommendations rely are that:

- 1 There exists a significant price differential for substitutable editions of a book sold in Australia and in other countries such as the US and the UK as a result of PIRs in Australia.
- 2 Repealing PIRs will induce significant downward pressure on book prices.

### *Gauging price differentials*

The paper (p. 10) contends that the first claim is 'not supported by the material in the report in a satisfactory way as the analysis lacks proper statistical hypothesis tests, a coherent discussion and estimation of currency risk and proper quantification of potential gains from the reform.'

The Commission's conclusions regarding international price differentials and the domestic price impacts of the PIRs were based on a wide range of evidence. This included the Commission's own, extensive, quantitative price comparisons, which clearly demonstrated some substantial price gaps between Australian and US and UK prices for books. It also included price comparisons submitted by participants

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and earlier work by the Prices Surveillance Authority and the Australian Competition and Consumer Commission (ACCC).

Recognising the limitations of international price comparisons for determining the price impacts of PIRs, the Commission also buttressed its judgments by drawing on other evidence — not acknowledged in the paper — including:

- qualitative statements about price differentials and data on freight costs supplied by book industry participants (p. 4.11)
- statements by some book producers that removal of the PIRs would result in greater imports of cheap books, and the assessment of most book producers that removal of the PIRs would cause the local industry to contract (for example, pp. 4.18 and 5.4).
- research on the effects of reform episodes in other markets, and of trade liberalisation and competition reform generally (p. 4.21).

Of course, evidence of this nature does not readily translate into quantitative estimates of changes in book prices in the Australian market that would be suitable for statistical hypothesis testing of the kind suggested by the paper.<sup>1</sup>

Nevertheless, on the basis of the totality of the evidence before it, the Commission was able to conclude that, but for the PIRs, Australian booksellers could often obtain and ship many titles at a lower cost (at times, much lower) than they are charged by local publishers. Indeed, evidence from some participants indicated that certain booksellers had at times *already* engaged in the parallel importation of cheaper books into Australia (in some cases, in breach of the current restrictions).

It should be noted that, in reaching its conclusion, the Commission was cognisant of issues such as exchange rate risk and its differential effects on firms. Thus, on page 4.22 of the report, the Commission noted that ‘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.’ Exchange rate risk is an ordinary element of natural protection and commercial practice and was raised only in this context in the few submissions that dealt with this issue.

Further, while the Commission judged that removal of the PIRs would put downward pressure on book prices, the Commission’s recommendation that the PIRs be repealed did not *rely* on that judgment, contrary to the claim in the paper.<sup>2</sup>

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<sup>1</sup> In elaborating on what types of information and evidence it believes would be required before any change to the policy status quo could be justified, the Maurer/Walzl paper calls for, among other things, ‘an econometric assessment of international price differentials that *unequivocally* rejects the hypothesis that price differentials can be explained by exchange-rate fluctuations and associated risk premia or transportation costs’ (p. 23, emphasis added).

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Accordingly, given the nature of the evidence, the difficulties there would be in subjecting it to meaningful statistical analysis, and the limited policy relevance of the tests suggested by the paper, there would have been little value in the Commission attempting to undertake such hypothesis tests (or the other analyses) suggested by the Maurer/Walzl paper.

In summary, while it is not possible to provide a definitive estimate of the effects of PIRs on book prices, or an unequivocal prediction of market-wide price movements in their absence, the evidence assembled during the study enabled the Commission to draw conclusions about those price impacts that, in its experience, are sufficiently robust for assessing the merits of policies such as PIRs.

### *PIRs, market power and prices*

While the paper acknowledges that the causal relationship between PIRs and price discrimination is well established in the economic literature, it also argues that the report did not address some possible market structure changes, arising from repeal of the PIRs, that could impact on prices. It suggested that such changes could have a range of effects on prices and assistance, stating that ‘the impact of lower prices on market structure could even reverse the direct (price decreasing) effect [of repealing the PIRs].’

The paper’s authors then put forward a range of analytical and empirical hurdles they assert must be jumped before a conclusion on the price effects of PIRs can be reached (pp. 12-13). These include the estimation of ‘cross-price elasticities’ of demand for books and an examination of the likelihood of post-reform mergers in the publishing sector. According to the paper:

An assessment of the impact of PIR on prices needs an estimation of market power in the relevant market. If market power is sufficiently large, it cannot be excluded that repealing PIR leads to a long-run increase in book prices as the result of consolidation and higher concentration of the supply side. The report does not offer such an analysis.  
(p. 2)

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<sup>2</sup> Importantly, a finding that the PIRs have no impact on book prices in Australia would not be sufficient to justify their retention. As the report noted (pp. 1.8 and 4.5), if cheaper, or otherwise better value, books were not available for importation from overseas, removal of the PIRs would have little substantive impact on the local books market, in which case the restrictions would serve no useful purpose. Alternatively, even if repeal of the PIRs were to cause the cost of books to booksellers to fall but these savings were not passed on to consumers — an outcome which the Commission’s assessment of competition in the retail market indicated was unlikely — the repeal of the PIRs would still provide benefits by, among other things, reducing the leakage of PIR assistance to foreign copyright holders (p. 5.23).

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Again, the Commission does not accept the paper’s assertion that policy analysts must estimate the market structure after the policy change, and undertake the associated analytical exercises nominated by the paper, before it can be reasonably concluded that repealing the PIRs would create downwards pressure on prices. Clearly, were it possible to undertake such exercises with sufficient accuracy, such estimates may enhance the certainty attaching to the findings of a policy review. However, while the paper may be correct in stating that some of the abnormal outcomes about which it theorises ‘cannot be excluded’, the Commission judged that it could reasonably proceed without the detailed examination envisaged by the paper, on two bases.

First, the Commission did not find any prima facie evidence of significant abuse of market power, other than that related to the restrictive practices arising from the PIRs themselves.<sup>3</sup> Indeed, the concerns of local book publishers about the effects of abolishing the PIRs appeared to relate mainly to the prospective loss of their own market power in the face of increased competition from imports; not about possible increases in the abuse of market power of other members of the industry.

Second, even if market concentration issues or abuses of market power were at some stage to prove significant (due to factors other than the existence of the PIRs), the appropriate policy response would not be to restrict parallel imports but to utilise the measures provided in the trade practices legislation and administered by the ACCC. The paper (p. 12) acknowledges that ‘predatory activity and similar abusive practices may be sanctioned according to competition law’, but offers the proposition that PIRs might still be retained on such grounds. In the Commission’s view, such a proposition rests on a very tenuous string of conditions. As an approach to policy it diverges significantly from best practice — which would be to address such activity directly, should it arise, rather than to retain a monopoly to counter the effects of some anti-competitive practices that may well not eventuate.

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<sup>3</sup> It should be noted that the Maurer/Walzl paper, on page 17, claimed that box 5.6 and appendix E of the report indicate that copyright holders do possess market power and that the relevant market offers scope for abusive practices. However, neither the box nor the appendix provide evidence of there being market power in the books sector *that is not dependent on the PIRs*. Nor do the box or the appendix provide evidence of ‘considerable concentration of market power’ in the sector as the paper earlier (p. 14) asserts.

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## Economic efficiency impacts

According to the paper's authors, the third 'central claim' of the report is that 'lower book prices increase consumer wellbeing and enhance domestic productivity' (p. 2). The paper's authors recognise that such claims are straight-forward for certain products and markets, but argue that particular characteristics of the books market — including the differentiated nature of book titles and the presumed scope to exercise market power — mean that such outcomes cannot be guaranteed to follow repeal of the PIRs. In turn, the paper argues that additional analysis would be required to sustain the central claim above. Thus, for example, the authors argue that:

The report does not estimate the preferences of consumers (ie the responsiveness of demand on price changes) and acknowledges that existing studies are not conclusive. As a result, the impact of repealing PIR on the portfolio of books written and published in Australia cannot be estimated by the report. This estimation, however, would be necessary in order to assess the effect of repealing PIR on consumer rents, productivity and welfare. (p. 3)

The report, in fact, identified three broad ways in which 'economic efficiency' and thus 'welfare' could be improved by the repeal of the PIRs. These are through consumer wellbeing and improved productivity within the books sector (as mentioned by the paper), and through improved resource allocation between different sectors of the economy (not mentioned).

Further, the report's recommendations were not reliant on the 'central claim' alluded to above. Indeed, the substantial leakage of assistance provided by the PIRs offshore (box 1), together with the availability of more efficient mechanisms to assist Australian writing (see next section), meant that, even if the PIRs generated no net efficiency costs, it would be appropriate to recommend their repeal.

While some of the theoretical possibilities discussed in the paper again 'cannot be excluded' without definitive evidence, the Commission considers that in the main they are sufficiently unlikely, and/or of insufficient consequence from a policy analysis viewpoint, to have warranted any specific investigation. For example, as indicated earlier, the Commission sees little scope for local publishers to exercise broad market power in the absence of PIRs. However, were the repeal of PIRs to lead to greater abuse of market power as hypothesised by the paper, this would again be appropriately addressed through application of trade practices provisions.



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### Box 1 Leakage of PIR assistance abroad

In the report, the Commission found that the PIRs cause a significant leakage of economic rent from Australian consumers to foreign copyright holders. While not disputing that such leakage occurs, the authors of the paper stated:

... the report does not provide sufficient data as to estimate the actual leakage of assistance because the substitutability of protected and unprotected books is poorly understood. If ... the corresponding cross-price elasticity is high, PIRs also provide considerable assistance to copyright holders of unprotected titles. The report lacks a quantitative assessment of this effect. (p. 19)

While the Commission did not seek to estimate cross-price elasticities, it did develop an indicative, base-line estimate of the share of assistance that leaks offshore, suitable for policy analysis, by using (intentionally conservative) assumptions of the price effect on unprotected books. Specifically, it was assumed that all books by Australian authors received the same level of assistance as protected books, while all unprotected books by foreign authors received no assistance. As explained in appendix E, the effect of these assumptions is to understate the share of the leakage to foreigners. Even with these assumptions, the Commission estimated that, for every dollar of assistance that accrues to copyright holders due to the PIRs, in the order of one-and-a-half dollars flows to foreign copyright holders.

The Commission rejects the paper's suggestion, made on page 11, that 'the claim the bulk of assistance leaks offshore relies on the presumption that indirect price effects are not too strong'. The result holds for any realistic value that might be given to the indirect price effects of PIRs on unprotected books.

### Financial assistance for cultural externalities

According to the paper, the fourth 'central claim' on which the report's recommendations rely is that 'Financial assistance should be provided to internalize the cultural externality of creative writing, but a revised system of grants and subsidies is better suited to target creative writing of high societal value than financial assistance as provided by PIRs.' (p. 2). The paper proceeds to argue that:

With its recommendation to substitute financial assistance as provided by the PIR through a revised system of grants and subsidies, the report implicitly assumes that committee based decision making is generally more effective than market based aggregation of consumer preferences in targeting the cultural externality. The report does not offer any theoretical or empirical justification for this claim. (p. 3)

However, the very reason that there is an economic argument for government assistance to cater for cultural 'externalities' is that consumers' purchasing decisions do not take adequate account of these broader benefits to society. Consumer demand principally reflects the benefits, whether cultural or other, that

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consumers themselves expect to obtain from books; it does not ‘target’ the cultural value of books, let alone the external component of that cultural value.

In supporting subsidies for Australian books, the Commission judged that the cultural externalities associated with those books were sufficient to justify some government assistance. That is, contrary to the sentiment in the APA’s media release issued with the Maurer/Walzl paper, the Commission did not recommend a free market in books — that is, a market without government intervention.

Nevertheless, the report did not conclude that a committee-based approach should necessarily be used to allocating direct financial assistance for cultural purposes. In discussing some alternatives to PIRs for providing such assistance, the report (in appendix F) set out three models for providing direct subsidies. While the first involves committee-based decision making, the second entails only the targeting of particular genres, and the third is a pure, sales-based subsidy for Australian works which would, in effect, reward those books in line with market demand for them. The report indicated that it would be a matter for further review to judge which form of direct financial assistance would be the most appropriate approach for assisting Australian writing, taking into account such matters as accuracy of targeting, objectivity and administrative simplicity.

While the Commission did not recommend a particular form of direct financial support, it judged that some sort of direct support would be clearly preferable to the PIRs for providing the assistance that is warranted for Australian writing. In doing so, the Commission pointed out that the administrative costs of direct financial assistance schemes for books can be 10 per cent or less of the assistance provided, whereas the leakage of assistance to foreign copyright holders associated with the PIRs was estimated to be in the order of 60 per cent (pp. F.10-11). It also pointed out that there is absolutely no ‘targeting’ of assistance to the cultural value of different books under the PIR scheme — all protected books are assisted irrespective of their cultural merit.

In view of these findings, and the fact that the Commission did not recommend that financial assistance be provided as a *substitute* for the PIRs, the Commission does not accept the suggestion in the paper, at page 19, that it might be necessary to determine the nature of any revision to current financial assistance arrangements before determining whether the PIRs should be repealed.

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## References

Australian Publishers Association 2009, 'Productivity Commission report found wanting', Media Release, 3 September.

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