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Summary of Discussion of the Hearing on Competition Issues in Books and e-Books

Annex to the Summary Record of the 72nd meeting of Working Party No 2

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This document prepared by the OECD Secretariat is a detailed summary of the discussion of the Hearing on Competition Issues in Books and e-Books, held by Working Party 2 on 29 November 2021.

More documents related to this discussion can be found at
<https://www.oecd.org/daf/competition/competition-issues-in-books-and-e-books.htm>

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Summary of Discussion of the Hearing on Competition Issues in Books and e-Books

The **Chair** introduced the session by noting that the impact of digital technology in the book industry is one example of the wider issue of the relationship between competition and innovation. Unlike some disruptive innovations, e-books have not replaced consumer demand for the older product and traditional publishers continue to play an important role. Digitalisation has reduced the costs of production and distribution, but it is unclear whether this has been reflected in lower prices. The practice of resale price maintenance (RPM) that enables publishers to set the retail prices of books continues in many countries on the grounds of supporting books as cultural goods, but may also act to reduce competition and innovation in the e-book market and protect the traditional sector from disruption.

The expert speakers for the hearing were:

- **Imke Reimers**, Associate Professor of Economics, Northeastern University, United States;
- **Joost Poort**, Associate Professor, Institute for Information Law, University of Amsterdam.

Dr Reimers discussed the economics of book publishing in the digital era, drawing mostly on US data but with broader application and relevance to international markets.

She began by showing that e-books are not on course to replace physical books: after a rapid initial surge, the volume of e-books has plateaued since around 2013, while volumes of physical book sales are much higher and are rising. She offered three potential explanations: first, consumers value the physical nature of a printed book; second, printed books allow consumers to “show off” their collection (although this does not apply to all genres); and third, some consumers are deterred from e-books by the need for a complementary electronic device.

She then touched on her research on two effects of mass digitisation on the supply side. First, piracy appears to reduce sales of e-books but not those of physical books; she estimated that protection measures such as take-down notices increased e-book sales by around 10%. Second, however, digital libraries of old works that are now in the public domain increase physical sales.

Digitisation also creates opportunities for consumers by giving them more information with which to consider their purchases. Her co-authored research shows that New York Times reviews increase sales significantly, but the quantity of titles reviewed is limited. Electronic reviews and ratings on, for example, Amazon and Goodreads have a smaller effect per title, but a much larger aggregate effect on consumer welfare, since every book is rated.

Digitisation and electronic commerce have reduced the costs of publishing. Marginal costs of distribution are lower not only for e-books, which can be distributed for free, but also for physical books because of online retailing. Fixed costs are also now lower because of opportunities for self-publishing. The number of ISBNs published in the US grew fourfold between 2008 and 2012. Since then, the number of self-published physical books has continued to grow explosively while the number of self-published e-books has remained constant.

Self-publishing has also allowed traditional publishers to learn about the popularity of books and genres and hence make more efficient choices of what to publish. Dr Reimers

presented evidence that publishers are now making more accurate predictions of books' popularity, as measured in the relationship between advances offered to authors and sales of the finished book.

Iceland described findings from market research into the substitutability of audio and print books, conducted by the Icelandic Competition Authority in relation to a proposed acquisition of Iceland's largest book publisher Forlagið by the audio book and e-book company Storytel. The surveys strongly indicated that audio and print books form separate markets, since they are consumed in different ways. Few consumers reported that they would increase their purchases of audio books in response to an increase in the price of print books, or vice versa. Reasons for the limited substitutability of the two types of book include the fact that print books are often purchased as gifts, while audio books are generally purchased for their convenience in certain situations.

Norway discussed its experience with RPM. Under an exemption to Norwegian competition law, publishers and booksellers agree on the retail prices of books and the period for which prices are fixed. The goal is to allow "efficient cross-subsidisation", so that publishers can use the revenue from bestsellers to finance books with lower sales volumes, thus sustaining quality and variety of titles. The speaker focused on the duration of the fixed price. Because books are durable goods, there is scope for intertemporal price discrimination whereby the price is set highest early on to target those with a high willingness to pay, then later reduced. However, rational consumers may withhold their purchases, creating an incentive for sellers to lower the price sooner. A fixed price with a long duration is a commitment device that removes this possibility.

Two recent empirical studies have shown that the fixed price agreement in Norway supports higher prices for popular titles for a longer time period, as intended. However, a recent study fails to find documented evidence that this serves the cultural objective of ensuring that a larger number and diversity of books are published. Trends in the number of book titles published in Norway and Denmark during 2011-2016 were similar despite the fact that Denmark liberalised its book market in 2011, which does not suggest that RPM increases the number of titles being published. The fixed price model in Norway may be slowing the development of digital products. Publishers own most of the physical bookstores and therefore have an incentive to continue to promote sales of physical books rather than e-books or audio books. In addition, the fixed price agreement prevents books being offered for streaming until after the fixed price period has ended.

The Norwegian Competition Authority has argued for RPM to be replaced by direct measures to support the same cultural objectives. It recommends that there should be lower prices on bestsellers, direct support to authors, and more flexible pricing that can adapt to a digital future including audio books and e-books.

The Chair turned to **Denmark**, where RPM was weakened after 2000 and abolished in 2011. Before 2000, there was both bookstore and publisher exclusivity, so that books were only sold in dedicated bookstores, which could only stock titles from publishers who fixed prices. The industry argued that this was necessary to promote a diversity of titles given the small size of the Danish language area, and to support the existence of bookstores to act as a showcase for books and offer guidance to consumers.

The Danish Competition Authority removed bookstore exclusivity in 2000 and made price-setting by publishers optional in 2001. In 2006 it decided that publishers could only fix prices for 10% of all new titles, and that RPM would be fully removed in 2011.

A study in 2013 found that book prices fell by about 5% in real terms since 2000 while published first editions grew by around 40%, creating an annual consumer gain of around 10 euros per head of adult population.

The speaker then presented updated data on new titles published, units sold, prices, and number of bookstores. The numbers of fiction titles published as print books has continued to rise. In particular, the number of titles of Danish origin published in print has almost doubled since 2009. In addition, digital titles have grown up alongside print. Total units sold were around 50% higher in 2019 than in 2001. Digital sales overtook print in 2020, partly reflecting the effect of lockdown during Covid-19. Book prices are more difficult to analyse because of the heterogeneity of the product. There is some indication that real book prices fell between 2011 and 2016 but have risen since. The number of dedicated bookstores, including online stores, has fallen by around 30% since 2001 but the overall number of physical outlets selling books (including e.g. supermarkets) has risen. The fall in dedicated physical bookstores is in line with general retail sector trends, while online sellers provide a wide selection.

Physical bookstores remain the most popular outlet for buying books. Almost 25% of Danish adults subscribe to a book streaming service. Overall reading habits have been stable for the last ten years.

Overall, the speaker characterised the liberalisation of the Danish book market as a success story, with stable reading habits despite competition from other forms of leisure and entertainment, more titles being published, good consumer access to books, and market development in response to consumer demand for new forms of reading.

The Chair gave the floor to **Germany**, where the current system of RPM was introduced in 2002 and remains in force. Books are subject to an exemption from vertical price fixing on the grounds that fixed book prices are considered indispensable for protecting books as a cultural asset. The German Book Price Fixing Act prohibits price competition in book retail with the aim of ensuring the availability of a wide range of books for the general public through a large number of retailers. Publishers are obliged to set a price for the sale of each book, which retailers must observe. The system has unanimous political support.

The speaker presented some statistics regarding the German book market in 2020. Physical bookstores remain the largest sales channel for books with a share of 42% by value even in the first year of the pandemic. Online sales have risen to 24%, with the fastest growth observed among local online bookstores. E-book sales are rising but remain low at around 6% of total sales.

A report by the Monopolies Commission in 2018 argued that the economic effects of price fixing were unclear and that a conclusive justification for the system was impossible to establish. There have also been subsequent reports on the economics and legal position of price maintenance, commissioned by the industry. All studies confirm that the national system results in increased demand for a wider range of titles, a high level of service, low average book prices (but higher prices for bestsellers), and a guarantee of market access for small publishers and unknown authors.

Dr Poort gave a presentation on the rationale for intervention in book markets, its extension to e-book markets, and finally digital piracy.

Two key characteristics of books potentially justify intervention from an economic perspective. The first is that books are entertainment products with significant economies of scale. Thus, for example, diseconomies of scale in the case of small language areas can justify intervention. Secondly, books are also cultural goods that are considered to have positive externalities, which can warrant economic intervention to promote their creation, distribution and consumption. This could include instruments such as author grants, low VAT, public libraries and possibly RPM. Intervention in book markets is sometimes criticised, however, as tending to benefit more educated and higher income groups

disproportionately, and because evidence for the effectiveness and efficiency of intervention is often poor, particularly in the case of RPM.

RPM enables the monitoring of a cartel agreement and can therefore lead to higher prices, but may be also welfare-enhancing for consumers if sales are positively affected by service levels, sales effort and number of outlets. Theoretical economic models do not provide a clear answer regarding the desirability of RPM since the effects on prices, service levels and total welfare depend on the parameters of the model. Empirical evidence suggests that RPM often leads to higher prices, but this could nevertheless improve welfare if it leads to higher service levels.

In print book markets, RPM aims to promote access to books by shielding small independent booksellers from price competition on bestsellers by large players and discounters. It also aims to promote diverse titles by cross-subsidisation between commercially more attractive and less attractive titles, at both the publisher and retailer level. It is questionable, however, whether this ex ante cross-subsidisation in fact occurs.

If e-books are considered as a separate market, most of the traditional economic arguments for RPM do not apply since the digital channel does not raise issues of accessibility and proximity, compensation for stock disadvantages of smaller stores, or cross-subsidisation at retail level.

Arguments in favour of RPM for e-books instead relate to the interaction with the market for print books, namely that a low price of e-books erodes prices of print books, and that RPM for e-books helps bookstores generate profitable digital sales that cross-subsidise their selling of print books. However, since such “e-to-p” cross-subsidisation involves higher prices and slower development of the digital sector, it should therefore be asked whether such measures improve readership and consumer access or merely assist booksellers themselves.

RPM on e-books can benefit publishers as a group by promoting a fragmented retail market. Individually, however, publishers often have an incentive to circumvent RPM if they have a bestseller on their hands. Such circumvention is easier for e-books than for print books and can take the form of lending, streaming or audio-visual enhancement so that the product no longer falls under the definition of a book. Enforcement of RPM by banning bundling or all-you-can-eat subscriptions would stall innovation.

Lastly, Dr Poort presented some findings on book piracy from the Global Online Piracy Study, a survey of consumers in 13 countries across different types of content. The survey found that books are much more resilient to digitisation than audio-visual content, and the share of digital sales in total book sales is therefore small. Book piracy decreased slightly between 2014 and 2017 in most countries, but by less than it did for audio-visual content, reflecting the growth of services such as Spotify and Netflix. In the Netherlands around 8% of the population had obtained a pirated book in the previous year. Piracy was increasing among older and more educated people.

Summarising, Dr Poort said that while there are valid welfare economic arguments for intervention in books markets, the evidence in favour of RPM is slim for print books, and even more so for e-books. Focused alternative instruments may be more efficient and less controversial than price maintenance. Piracy of books is not decreasing in the same way as it is for music and video content offered by companies such as Spotify and Netflix, and the cost of piracy in terms of displaced sales is higher in the case of books due to time budget constraints. Innovation and flat rate bundling of books could reduce piracy.

The Chair turned to **Switzerland** as an example of a relatively small, multilingual jurisdiction.

In 2007 the Supreme Court upheld a decision to ban the operation in Switzerland of the RPM agreement between publishers and libraries concerning books in German established in 2002. The cartel was finally abolished in May 2007, as both the competition authority and the Swiss courts and government had made it clear that they did not want such a cartel and that book prices should be subject to competition in Switzerland. In the meantime a parliamentary initiative to introduce RPM legislation similar to that in France and Germany was rejected following a popular vote in March 2012. A new parliamentary initiative to regulate prices of books as cultural goods was brought forward in 2021 but subsequently withdrawn.

In a separate case, in 2013 the Swiss Competition Commission sanctioned ten diffusers/distributors of French books, most of which were subsidiaries of French distributors, for preventing Swiss booksellers from sourcing lower-priced parallel imports from France through exclusivity clauses with French publishers. The decision is currently being appealed at federal level. This case was very important for the Competition Commission since it embodies the fight against the isolation of the Swiss market, which makes the country expensive.

A delegate from the Antitrust Division of the **United States** Department of Justice discussed the DoJ's Apple e-books case. He clarified that the views he would express were his own and not necessarily those of the DoJ.

He started by describing the actors and motivations in the events that led to the case. Amazon was trying to drive adoption of its Kindle e-book platform, and so wanted to sell e-books at a low price. Publishers disliked this price point, which they feared would lower consumers' willingness to pay for print books. In 2010 Apple introduced its iPad platform, which functioned as an e-book reader among other things. Not wishing to engage in price competition with Amazon to drive adoption, it proposed to publishers that they would have control of the retail price on the Apple platform (so-called "agency model") provided they guaranteed that the book would not be available at a lower price on any other platform. This meant that publishers would need to secure a similar arrangement with Amazon in order to control the retail price on Kindle. By co-ordinating their approach to Amazon, the publishers were able to achieve this outcome. As a result, there was a sharp increase in the price of e-books from these publishers, as shown in one of the trial exhibits that the speaker presented.

While the case concerned anti-competitive co-ordination between Apple and the publishers rather than the pros and cons of RPM, it showed that RPM and, in this case, a shift to the agency model clearly affects the price of e-books.

The **Chair** thanked the participants and closed the hearing.