

Digital fixation: the law and economics of a fixed e-book price

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Fifteen OECD countries, ten of which EU members, have regulation for fixing the price of printed books. At least eight of these have extended such regulation to e-books. This article investigates the cultural and economic arguments as well as the legal context concerning a fixed price for e-books and deals with the question of how the arguments for and against retail price maintenance for e-books should be weighted in the light of the evidence. It concludes that while the evidence in defence of a fixed price for printed books is slim at best, the case for a fixed price for e-books is weaker still while the legal acceptability within EU law is disputable. Against this background, introducing a fixed price for e-books is ill-advised.

Keywords: retail price maintenance; fixed book price; e-books; agency pricing

Introduction

In many Western countries, books have been subject to price fixing, or more generally *retail price maintenance* (RPM), since as early as 1829 (IPA 2014). Usually, RPM originated from agreements between publishers and booksellers but over the years, such agreements have been replaced by legislation in many countries.

Laws or agreements concerning fixed book prices are usually motivated from the observation that 'books are different' since they have a special cultural and educational value, which justifies promoting the production, diversity, wide availability and consumption of quality books and promoting readership. Along with other policy instruments such as a reduced VAT rate for books and prizes or grants for authors, fixed book prices are often considered to be a means to these ends, as it would help small bookshops to survive and allow both bookshops and publishers to cross-subsidise between commercially more and less attractive titles. For instance, the Net Book Agreement in the UK was motivated by the argument that without price fixing, retail competition would lead to fewer and less well-equipped bookshops, resulting in fewer titles published and smaller print runs, causing books to become more expensive (Dearnley and Feather 2002). Similarly, fixed book price legislation was introduced in The Netherlands to create conditions for a broad and diverse supply of books in the long term, available through a geographically wide network of bookstores with a broad collection in stock (Kamerstukken II 2002/03, p. 1). Other countries had similar motivations (OECD 2012, note 82).

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With the advent of e-books, countries with a fixed price for print are faced with the question of whether to extend existing legislation to e-books: do the same cultural policy arguments and legal considerations apply? An extra angle was added to this debate by the rise and fall of agency pricing for e-books between 2010 and 2013: in response to Amazon's aggressive pricing strategy to gain market share, the six largest publishing multinationals in co-operation with Apple adopted the 'agency model', in which retailers receive a percentage of the retail price set by the publisher. Publishers feared that low prices would erode consumers' perception of the value of books, cannibalise print sales and lead to a downward pressure on wholesale prices. Amazon resisted the agency model initially, but yielded after a few months. Thus, agency pricing operated without sector-specific legislation and echoed the price fixing arrangements for printed books of the distant past, with the difference that it was introduced unilaterally by publishers against a dominant retailer rather than in agreement with booksellers as was common in the past. After the European Commission and the US Department of Justice had started antitrust investigations, the publishers settled and abandoned agency pricing (European Commission 2013, De los Santos and Wildenbeest 2014).

This article investigates the cultural and economic arguments as well as the legal context concerning a fixed price for e-books and studies how the arguments for and against RPM for books in general and e-books in particular should be weighted in the light of the evidence. While there is a large economic literature on RPM and a substantial number of studies on fixed prices for printed books, an analysis of fixed prices for e-books is lacking. This article is aimed at filling this gap. To this end, it first reviews the economic analysis of RPM and the evidence supporting it. Subsequently, it sketches the current situation concerning fixed prices for printed books and e-books within the OECD and the cultural policy motivations and economic arguments for fixed book prices. After that, the relevant economic characteristics of the book publishing industry and some figures on the emerging e-book market are outlined. Since the arguments for and analysis of a fixed price for print and e-books are largely generic and interact, this article then analyses the arguments for fixing printed book prices and the evidence supporting these arguments. The ensuing section investigates their applicability to e-books and briefly discusses the acceptability of a fixed price for e-books under EU law. It is concluded that while the evidence in defence of a fixed price for printed books is slim at best, the case for a fixed price for e-books is weaker still while the legal acceptability within EU law is disputable.

The economics of retail price maintenance

Unless specified differently, RPM is used here to refer to a fixed price in the consumer market, which does not allow for any upward or downward deviations. Some authors use 'minimum RPM' for price floors and 'maximum RPM' for price ceilings. In general, these will have very different effects on the market outcome.

Judging from the historical use of RPM, books do not seem so different after all. Mathewson and Winter (1998, p. 59) observe that 'RPM is the most important vertical restraint in terms of both the frequency of use and the number of legal cases generated.' It used to be common in a wide range of markets such as clothing, jewellery, sports equipment, electronic appliances and cars, and estimates of

the percentage of retail sales under RPM range from 4 to 10% in the US in the 1950s, to 25% or more in the UK and Canada in the 1960s.

Manufacturer's perspective

Economic analysis of RPM starts with the observation that in a perfectly competitive market, a manufacturer would not prefer RPM. Demand is usually higher if prices are lower, and price competition in the retail market normally leads to lower prices and increases sales, which increases a manufacturer's profit if wholesale prices are not affected by competition.

Telser (1960) describes two main motivations for manufacturers to adopt RPM, the anti-competitive 'cartel argument' and the pro-competitive 'service argument'. The cartel argument explains why manufacturers may adopt fixed retail prices. If a cartel of manufacturers aims at raising wholesale prices, it will be tempting for any member to lower his price secretly and increase output. RPM is a relatively efficient way to monitor compliance to the cartel agreement.¹ A second anti-competitive argument is related to foreclosure, where profit margins for retailers ensured by RPM convince retailers not to supply a competitor's products (see Lafontaine and Slade (2008) for a discussion).

For the service argument, one needs to assume that the quantity sold at the retail level increases with the level of service or sales effort offered. The detrimental effect that retail price competition could have in such cases is most easily understood in relation to free-riding: without RPM, consumers can shop around for service and afterwards buy the product at the store that offers the lowest price and the lowest service. This enables discounters to free-ride on the service delivered by others and forces high-service retailers to reduce their service levels as well. RPM encourages retailers to compete on the service provided, and if the sensitivity of demand to service is substantial, RPM may increase prices, service levels, sales and profits. Telser argues that this service argument can only apply to 'branded products that are unfamiliar to the mass of consumers' (Telser 1960, p. 95). Obviously, free-riding by discounters on the service provided by high-service stores is potentially aggravated by Internet sales.

An additional – arguably pro-competitive – motivation for RPM in case both manufacturing and retail are highly concentrated, is the 'double marginalisation' or 'double mark-up' problem (Spengler 1950). If the manufacturer and the retailer both set profit-maximising prices without co-ordination, the resulting retail price will be higher than it would be if there was one vertically integrated monopolist. Consequently, both the manufacturer and the retailer have lower profits, whereas consumer surplus is also reduced. In such a case, co-ordination to set retail prices at a monopoly level leads to lower prices and is beneficial for manufacturers, retailers, and consumer. However, price floors are not needed to solve the double marginalisation problem; the use of price ceilings suffices. An alternative solution would be to set the wholesale price at marginal costs and charge retailers a fixed franchise fee.

Mathewson and Winter (1998) observe that RPM occurs for products such as clothing, books, candy et cetera, which have high search costs compared to the price differences across retailers and hence do not seem to be prone to free-riding on high service levels. They extend the service argument to include the effect of RPM on the number of outlets for a product, which may increase demand as well,

and review several more subtle mechanisms suggested by various authors, in which RPM may be efficient even without any free-riding on service. Such mechanisms are related to differences in taste between consumers, high service as a signal of product quality or luxuriousness (Marvel and McCafferty 1984), and the effect of RPM on inventory. The latter is studied in Deneckere *et al.* (1996, 1997) in a model with demand uncertainty in which discounters minimise their inventory to reduce costs. RPM can then support larger inventories and sales and may or may not increase consumer welfare. Other modelling approaches such as Rey and Tirole (1986), Rey and Vergé (2004), Schulz (2007), Foros *et al.* (2007) reveal that, depending on differences in the structure of the market and of demand, almost any outcome is possible: RPM may or may not lead to higher prices and service levels and the effect on social welfare differs.

Retailer's perspective

An additional motivation for retailers to implement RPM is also anti-competitive. RPM can serve for a cartel of retailers to co-ordinate their prices. Given a fixed wholesale price (which would result from effective competition between manufacturers), this enables them to increase their profits by keeping retail prices artificially high. A related effect of RPM initiated by a cartel of retailers is that it delays entry by discounters by making it less attractive for them to enter because they can gain market share less quickly. Once discounters gain relevance and market share, RPM becomes less attractive for a manufacturer (Mathewson and Winter 1998).

Another situation in which retailers profit from RPM is when manufacturers compete for scarce retailer shelf space (Shaffer 1991). Through RPM, manufacturers can commit to a large profit margin for retailers, which can convince them to dedicate shelf space to the product.

Empirical evidence

In theoretical models, both pro-competitive and anti-competitive motivations for and outcomes of RPM are possible, depending on subtle characteristics of market structure and demand. Therefore, it is impossible to draw a general conclusion about the impact of any instance of RPM on social welfare: looking at the evidence is the obvious thing to do. Overstreet (1983) gives a review of the empirical studies evaluating the effects of RPM that existed at the time. He notes that in the greater part of the empirical work, a price increase due to RPM was observed. However, this does not prove RPM to be anti-competitive in these cases, since a combined increase of prices and service levels, inventory or outlets, may increase total demand and enhance consumer surplus and total welfare. Studies of the effects on the quantities sold are scarce and inconclusive. All in all, Overstreet concludes that RPM has been used in both efficient and anti-competitive ways and that various explanations of its use are required.

Ippolito (1991) reviews all RPM cases reported in the US between 1975 and 1982 and concludes that collusion is the primary explanation in less than 15%. Mostly, service-enhancing and sales-enhancing theories are a more plausible explanation. Similar conclusions are drawn in reviews of empirical articles by Mathewson and Winter (1998), Cooper *et al.* (2005) and by Lafontaine and Slade

(2008). Thus, the evidence suggests using a case-by-case rule of reason approach to RPM, instead of illegality per se.²

Kretschmer (2014) develops criteria to tell pro-competitive and anti-competitive use of RPM apart, solely based on the available empirical evidence. He discusses screening criteria for presumptive legality or illegality proposed by other authors. These are typically related to a high market share/market power of the manufacturer, a high adoption rate or RPM in the market, and dealer initiation – all of which are considered indicators for anti-competitive use of RPM. The use of RPM by new firms to launch new products or to enter the market, in particular if such products benefit from a high level of sales service, is often considered acceptable, as is an output increase as a result of RPM. However, such criteria could lead to the rejection of instances of pro-competitive RPM or the acceptance of anti-competitive instances. Moreover, Kretschmer notes that the relevance of dealer initiation is not backed by empirical evidence. He proposes a sequential investigation rule, based on questions concerning the concentration in the manufacturing market and the market share of the individual manufacturer applying RPM, the adoption rate of RPM, dealer concentration and product complexity. Depending on the answers to these questions, RPM is most likely to be pro-competitive or anti-competitive.

Fixed book prices: practice and policy motivations

Fixed book prices in the OECD

In the bulk of the literature on RPM cited above, its application in the book market is ignored. Schulz (2007), however, stresses the remarkable situation that in Germany RPM has been mandatory in the book trade since 2002, while it is forbidden per se for all other sectors. This situation is similar in many other countries that have a fixed book price. Presently, 15 OECD countries have regulation for fixing the price of printed books (see Table 1), commonly mandated by legislation as competition policy would no longer allow for a business agreement to fix book prices (OECD 2012). The fixed price for printed books typically lasts 18–24 months after a book is published, but in Slovenia its duration is only 6 months and in Norway it can be 4–16 months, depending in the moment of publication. In the Netherlands, publishers can adapt the fixed price every six months. Most countries with a fixed book price allow limited discounts for the general public, at book fairs or for schools and libraries (IPA 2014).

Fixed book prices are by no means a remnant of the past. Slovenia, for instance, introduced a fixed book price law only in 2014, Israel in 2013, while in Poland, the Polish Chamber of Books has drafted a bill only recently and is currently lobbying to have it adopted. Quebec (Canada), Hungary and Denmark have recently had discussions on whether a fixed price for books should be (re)introduced (IPA 2014). Meanwhile, other countries have repealed existing price fixing agreements, often prompted by competition policy: Sweden, Finland and Australia in the 1970s, the UK and Ireland in 1995, Switzerland in 1999 and Hungary in 2007 (OECD 2012, IPA 2014). Ten of the countries with a fixed book price in Table 1 are EU members, despite RPM being a hard-core restriction under the Block Exemption Regulation. The European Commission does not favour fixed book price laws, but accepts them as long as they do not hinder cross-border trade between member states (European Commission 2002).

Table 1. Fixed prices for printed books and e-books in OECD countries per 1 January 2015.

| RPM for printed books | RPM for e-books? | No RPM for books |
|-----------------------|------------------|------------------|
| Austria | Yes | Australia |
| France | Yes | Belgium |
| Germany | Yes | Canada |
| Greece | Yes | Czech Republic |
| Korea | Yes | Denmark |
| Norway | Yes | Estonia |
| Slovenia | Yes | Finland |
| Spain | Yes | Hungary |
| Italy | No | Iceland |
| Japan | No | Ireland |
| Netherlands | No | New Zealand |
| Portugal | No | Poland |
| Luxembourg | N/A | Slovak Republic |
| Mexico | N/A | Sweden |
| Israel | N/A | Switzerland |
| | | Turkey |
| | | United Kingdom |
| | | United States |

Sources: Compiled based on IPA (2014), OECD (2012), Kurschus (2015), http://www.buchmesse.de/en/international/book_markets/, http://www.boekenvak.be/sites/default/files/EBF_surveyfixedfreeprices_112010.pdf. No information available for Chile.

Table 1 shows that at least eight OECD countries with a fixed price for printed books currently have a fixed price for e-books as well. Italy, Japan, the Netherlands and Portugal chose not to extend RPM regulation to e-books. No country is known to have RPM regulation for e-books but not for print – but while it lasted the agency model could be seen as a publisher-initiated version of this.

Policy motivations

As was indicated in the introduction, there are several interlinked cultural policy motivations for fixed book prices. In general, policymakers aim to promote the diversity and wide availability of books, as well as their consumption and readership.³ The arguments that link these policy objectives to a fixed price for books generally refer to printed books. Proponents of fixed book prices fear that price competition between booksellers would drive smaller, independent, specialist or niche booksellers out of business, to the benefit of large chains, discounters and supermarkets that focus on bestsellers only. This would force other booksellers and publishers also to focus on bestsellers, leading to a reduction in the variety of books published and on stock in bookstores as well as reduced accessibility of books, in particular in remote areas. A fixed price, it is argued, enables publishers and booksellers to cross-subsidise low-selling but culturally important titles with the profits made on bestsellers. Moreover, a guaranteed profit margin can convince booksellers to stock books that have an uncertain sales potential.

Arguments against a fixed retail price for books mostly originate from competition policy: by reducing competition between booksellers, RPM is believed to lead to artificially high retail prices and supra-normal profits at the expense of

consumers. In addition, fixed book prices may be opposed for equity reasons, since to the extent that cross-subsidies between titles occur, they may on average cause a cross-subsidy from low-income bestseller readers to high-income readers of specialist books (e.g. see Canoy *et al.* 2006).

The book publishing industry and the emerging e-book market

For an economic analysis of a fixed book price against the background of the policy motivations summarised above, it is useful to outline the relevant economic characteristics of the book publishing industry. The production of books traditionally comes with high fixed costs and low marginal costs. This entails economies of scale when publishing a single title and economies of scope when publishing a portfolio of titles. Digital printing technologies have reduced the economies of scale for printed books significantly. In theory however, e-books experience even stronger economies of scale due to negligible marginal costs. In practice the effect is the opposite because of the much lower capital investment required for production of e-books, and disintermediation through self-publishing thrives since their advent (Waldfogel and Reimers 2015).

Another feature which stimulates concentration in the book publishing industry is the fact that some authors and books become very popular and others fail, while success is very hard to predict in advance. Caves (2000) coined this as the ‘nobody knows principle’. It is commonly countered by pooling risks in larger portfolios. Combined with the reputation publishers can build, these characteristics naturally bring about concentration in the book publishing industry. All in all, the market structure typically consists of a handful of large publishers, some of which are international players, and a fringe of many small independent publishers that are often less commercially motivated (Wikström and Johansson 2013). Globally, there are six internationally dominant conglomerates, 300–400 medium-sized publishers and over 80 thousand small publishers or self-publishers. The top-fifty publishers together have 80% market share (OECD 2012).

Different books are imperfect substitutes even if sometimes they are close substitutes. Normally, this leads to monopolistic competition, which may cause too little or too much variety (Canoy *et al.* 2006).

Most books have a short commercial life cycle. For the Netherlands it was concluded that around 2010, an average book generates more than half of its turnover in the first year after publication and about three quarters in the first two years (Poort *et al.* 2012, p. 33). This implies that mandatory price fixing for typically 18–24 months lasts throughout the commercial life of most new titles.

At the retail level, economies of scale may stem from the ‘love for variety’. Consumers visiting a physical or online bookstore for a certain book, may end up buying an alternative book or several books that match their interests. While ‘love for variety’ applies to both printed books and e-books, there is an opposite force driving the optimum scale of brick and mortar retailers of printed books down, which is the highly skewed distribution of turnover in the book market.⁴ To the extent that it is predictable which books will sell well by the time they reach bookstores, this implies that the marginal revenues of extra square feet of store space for books will often quickly drop below their marginal costs or the marginal revenues of a coffee corner or of selling stationary instead of books.

There are several relevant differences between the markets for printed books and e-books. First, a consumer needs a complementary device for reading an e-book. E-readers or tablet computers are most commonly used for this purpose. Different devices use different file types and with these come consumer lock-in and compatibility issues: Amazon has developed apps for reading e-books in its proprietary AZW format on iOS and Android devices, but Amazon's Kindle e-readers cannot read e-books in the common ePub format (OECD 2012). Conversion tools are available on the Internet, which limit the switching costs for consumers who want to use different devices or buy e-books from different platforms. Nevertheless, retail concentration is much higher for e-books than for print. In the US, Amazon was initially responsible for more than 90% of all e-book sales. By the end of 2013, Amazon's market share was still around 65% (De los Santos and Wildenbeest 2014).

From a consumer perspective, e-books have both advantages and disadvantages compared to print (Poort *et al.* 2012, pp. 54–61). Portability of large numbers of books is an advantage, in particular when the user is travelling or for reference purposes. Ease of purchase – combined with instant delivery – is another advantage. Other features of e-books are primarily of interest for non-fiction books: searchability, the possibility of including external links and multimedia extensions, and of providing updates as well as the option to buy individual chapters of a book, which is useful for travel guides for instance. Disadvantages of e-books in comparison to print are reduced oversight when browsing through a book, reduced ease of lending books to friends and the fact that e-readers on the beach or at the poolside are more vulnerable to theft and damage. These pros and cons can help understand why many consumers use printed books and e-books alongside each other.

E-books have existed since the 1970s, but have only gained economic relevance after the launch of e-readers and tablet computers from 2006 onwards (OECD 2012). Currently, e-books are most popular for fiction. Since in most countries e-books have a substantially lower price than print, market shares for e-books in terms of revenues are lower than in terms of copies sold. Systematic, internationally comparable data for the e-book market are unavailable and different sources differ even when reporting for the same country. Yet it is beyond doubt that e-book adoption is highest in the US, where turnover from e-books amounted to about 19% of industry revenues in 2013. Although this market share was 50% or more in some segments and for some publishers and retailers, total e-book revenues stagnated in 2013 and in the first half of 2014. The UK comes in second, with a 2013 market share for e-books of 15%, followed at some distance by countries such as Denmark (5%), the Netherlands (4.7%), Germany (3.9%), and Spain (3–5%), France (1.5–2.3%) and Sweden (1%). Overall, e-books account for only 3% of book sales in Europe (Wischenbart *et al.* 2014).

Increasingly, e-books are not just sold per copy but offered in flat rate subscriptions, similar to streaming music and video services such as Spotify and Netflix. After several smaller competitors, Amazon launched *Kindle Unlimited* in 2014 which allows customers unlimited access to a library of 700 thousand titles for \$ 9.99 per month. Since its launch this service has been made available in the UK, Germany and some other European countries (Wischenbart *et al.* 2014, Chapter 16). Readfy seems to be the first to offer a library of 35 thousand e-books free of charge in an add-sponsored model in Germany, Austria and Switzerland.

In particular for Sweden but also for The Netherlands, the low penetration of e-books may be surprising when compared to the adoption of digital music and video services and the Internet penetration in general. These figures underscore the fact that the speed of e-book adoption is not only determined by demand characteristics, but to a large extent by availability and pricing. In several countries, publishers have been hesitant to publish e-books, fearing that unauthorised file sharing would erode their revenues like it had eroded those in the music and audiovisual industries.

Nevertheless, the figures above underscore the fact that policymakers can no longer ignore e-books. With the advent of e-books, countries with a fixed price for printed books are faced with the question of whether to extend existing legislation to e-books: do the same cultural policy arguments and legal considerations apply? As was shown in Table 1, eight OECD countries extended fixed book price regulation to e-books. Four others decided to leave the price of e-books free, whereas the price of printed books is still subject to RPM. Policy makers could also consider repealing RPM laws for printed books in the light of the emergence of e-books, but there have not been any indications for such developments so far.

Economic analysis for RPM for printed books

To what extent do the economic mechanisms and evidence underlying RPM apply to printed book publishing? First, note that the policy motivations for fixed book prices are largely consistent with the anti-competitive retailer cartel argument. Fixed prices for printed books are supposed to help small, independent – and possibly inefficient – bookstores to survive and to keep discounters and supermarkets away from gaining market share rapidly. Fixed book prices are also supposed to generate higher profits, which retailers may re-invest in stocking low-selling but culturally important titles. Thus, the anti-competitive effect of a fixed price is motivated by the culturally desirable effect it may have on the survival and geographical spread of smaller bookstores and on its presumed effect on the diversity of books stocked by retailers. At the publisher level, the effect of fixed prices is also implicitly expected to be anti-competitive: publishers are expected to use additional profits they make on bestsellers thanks to the fixed price, to cross-subsidise culturally important publications that have uncertain commercial prospects.

However, it is not certain if the higher profits that bookstores and publishers are supposed to re-invest, occur in the first place. Wholesale prices are not fixed, and it depends on these prices whether retailers have a high profit margin or not. In theory, publishers may help small, independent bookshops survive by offering them a lower wholesale price than large chains, discounters or Internet stores – they could also do this without RPM – but this runs counter to the logic that larger retailers have more buying power to negotiate low wholesale prices or even to include a most-favoured-nation-clause in their agreement which precludes this. With or without RPM, small booksellers may be driven out of business. Similar question marks can be placed by the assumption that RPM raises profits for publishers which they can use to cross-subsidise low-selling publications. RPM is not a sufficient condition for softening the monopolistic competition between publishers. Nevertheless, it may facilitate coordination of the retail prices publishers set for their publications.

But even if RPM enables publishers to increase their profits, there is no guarantee they will reinvest it in a wider variety of books than they would have done

otherwise. With or without a fixed price, publishers need to invest in a wide portfolio of titles, because they are highly uncertain which will become bestsellers and which will fail. Ringstad (2004) argues that there is no indication that publishers knowingly invest in loss-making titles. They may temporarily subsidise books by authors of whom they have higher expectations for the future, or low-selling publications that improve their image. But this is business as usual. The point that cross-subsidies are not guaranteed is also stressed by Appelman (2003) and Canoy *et al.* (2006). Any opportunities for extra profits created by RPM may as well cause inefficiencies at publishers and bookstores and will be the most beneficial for offline and online booksellers with a limited number of books in stock.

An additional anti-competitive argument for RPM mentioned above is foreclosure. However, this does not apply in the book market, as booksellers generally have no exclusivity deals with publishers. Deals are made about a more prominent placement of books in the shop-window or in the store – e.g. on tables instead of on the shelf – but such deals do not qualify as foreclosure.

What about the pro-competitive motivations for RPM? Telser's (1960) service argument in combination with free-riding has been criticised for being unlikely for products with high search costs compared to differences in retail price. This criticism certainly applies to books (Schulz 2007). Moreover, as Canoy *et al.* (2006) stress, the opportunity costs of the time spent on consuming a book usually outweigh the price, which implies a relatively low price elasticity.

The applicability of the more general version of the service argument to books is also questionable. Books are no complex products, even if finding the right book may be difficult. Nor do books seem to benefit from a luxury image upheld by high prices and fancy stores. Advice by a well-informed, passionate bookseller may certainly increase sales, but the costs of providing such services are not so high that they require a profit margin guaranteed by price fixing. Besides, it can be disputed if the low-cost suggestions provided by an algorithm in an Internet store does not beat the passionate bookseller and the romantic serendipity of browsing bookshelves.

The related argument by Deneckere *et al.* (1996, 1997) that RPM can be used to mitigate the negative effect of demand uncertainty on inventory, could potentially be valid. However, the book trade has already produced an alternative solution to this by a common contractual arrangement that is less suspect from the perspective of competition policy, namely a right for booksellers to return unsold copies. Insofar as a fixed book price increases the number and geographical spread of bookstores, this may increase demand, particularly since a substantial share of books is bought on impulse or as a gift. For such purchases, availability is likely to prompt demand. However, the weight of this argument is likely to have decreased with the advent of e-books and of large Internet bookstores that offer a near infinite variety of printed books and next-day delivery.

Lastly, it was already mentioned that instead of a fixed price, a price ceiling or a franchise fee would suffice to remedy the double mark-up problem. The situation in the UK after the Net Book Agreement resembles this, as most publishers print a recommended retail price on the back cover, which in practice serves as a price ceiling.

It can be concluded that anti-competitive arguments are the most obvious motivation for fixed book prices. This conclusion also matches the outcome of the empirically based sequential investigation rule developed by Kretschmer (2014),

when assuming a fairly high concentration rate of the publishing market and a high adoption rate of RPM. It is also in line with the common – albeit empirically unsupported – critical appraisal of dealer initiation of any RPM scheme.⁵ This anti-competitive nature of a fixed book price is paired with noble intentions about what should be done with the ensuing profits. There is, however, no guarantee that such surpluses are indeed created, and if they occur, that they will be re-invested in line with the policy objectives.

The empirical evidence about the effects of a fixed book price is limited. As was discussed, the welfare effects of RPM are generally hard to determine, since indicators such as a price increase have ambiguous consequences. But even partial evidence – e.g. the effect of a fixed book price on title production, the number of bookstores, and readership – is scarce. An important reason for this are the very large differences in book production and reading behaviour between countries (Canoy *et al.* 2006), which may depend on factors such as the language area, cultural differences, income levels and cultural policy other than RPM. This implies that the effect of a fixed book price can hardly be tested in a cross-sectional country comparison. Nor can the effect of an unchanged policy be determined by monitoring developments over time in a single country. The best way to find empirical evidence about the effect of a fixed book price, is studying the effect of policy changes in country case studies or by using a panel data-set of countries over time. Ideally, this panel data-set contains countries that introduced or repealed a fixed book price over the measurement period. If not, conclusions may be based on diverging developments between countries with and countries without a fixed book price.

Canoy *et al.* (2006) perform this kind of panel study, using data for 20 countries in the years 1975–1999. They explain the annual number of new titles relative to the population of each country by developments in GDP per capita, education levels and whether or not countries have a fixed book price. A fixed book price appears to have no effect. In a second model for only seven countries in the years 1990–1999, a negative effect of a fixed price on title production is found when allowing for country-specific random effects.

This outcome is purely determined by the suspension of the Net Book Agreement (NBA) in the UK in 1995, which was motivated by the material changes in the production costs and the length of production runs in printing as well as by structural changes in retailing, i.e. the emergence of large chains of retailers. By this time, the Publishers Association had decided it could no longer defend the NBA (Utton 2000). Dearnley and Feather (2002) study the changes in the British book trade since 1995. They find indications for a decrease in the number of independent bookstores but a relative increase in the retail space devoted to books. Like Canoy *et al.* (2006), they see no indications for a decrease in the number of published titles. A sharp increase in the *recommended* retail price of books was observed shortly after suspension of the NBA, but the aim of this was to give booksellers room for discounting. They conclude that ‘there is little compelling evidence that the abrogation of RPM in 1995 intrinsically harmed the UK bookselling trade’.

Fishwick (2001 cited Ringstad 2004) reaches similar conclusions. Bestsellers have gained from discounting while non-mass-market books have become more expensive. Bearing in mind the equity concern with fixed book prices phrased above, this implies that on average, high-income customers, whose demand is fairly inelastic, ended up paying more while low-income groups pay less and buy more.

Title production has increased after a brief dip in 1997. Fishwick (2008), however, studies retail price developments between 1996 and 2007 in more detail and concludes that book prices have in fact increased more than general inflation, when correcting for changes in the mix of books purchased. During the same period, book prices in Germany and France appear to have increased less. Fishwick explains this remarkable outcome by pointing at an increase of the recommended retail price set by publishers, to compensate for much bigger discounts given to powerful retailers.

Løyland and Ringstad (2012) and Ringstad (2004) contrast this outcome with price and sales developments in Finland, Sweden, Norway and Denmark, which do not reveal any correlation with fixed book prices at all. In addition, Løyland and Ringstad (2012) study the effects of the partial liberalisation of the Norwegian fixed book price system in 2005, which reduced the duration of the fixed price, allows for a maximum discount of 12.5% in all sales channels during that period (instead of a maximum discount of 25% exclusively for book clubs before), and repealed the exclusive right for bookstores to sell schoolbooks. The authors conclude that prices are slightly lower than they would have been without the partial liberalisation, even though this effect is short-term and concentrated on bestsellers. Bookstores in rural areas experience a negative impact of losing their exclusive right to sell schoolbooks. The number of titles published appears to be slightly higher, particularly in crime and entertainment literature.

Fixed prices for e-books

Economic analysis

It was concluded that the anti-competitive argument for RPM – to raise profits for publishers and retailers – is the most likely motivation for fixed book prices. These profits are commonly justified by the aim of maintaining a geographically wide network of well-stocked bookstores and a wide variety of books published, but it is uncertain to what extent such profits occur and are indeed re-invested. For e-books, all retailer-related arguments lose their direct relevance. The Internet provides access to any e-bookstore anywhere, so there can be no public interest associated with a geographically wide network of e-bookstores.

Moreover, since retailers do not have to keep costly stocks of e-books or rent expensive floor space to shelve them, there are no cost-related impediments for any e-bookstore to offer the full collection of e-books, once they have developed the infrastructure to sell them. In many countries (e.g. the Netherlands, Flanders and a number of Scandinavian countries), booksellers have created a joint electronic platform for selling e-books, in some cases joining forces with publishers. Individual specialist shops and larger chains of booksellers are trying to develop the local market for e-books together to achieve the kind of scale needed to compete with Google, Apple and Amazon. Thus, cross-subsidisation between titles at the retailer level and the preservation of a geographically wide network of bookstores are irrelevant for e-books. Along with this, pro-competitive arguments for RPM related to inventory (Deneckere *et al.* 1996, 1997) and shelf space (Shaffer 1991) lose relevance insofar as they have ever had any in relation to books. Nor does the argument that the proximity of bookstores could increase the sales of books bought on impulse or as a gift apply to e-books.

The argument could yet be made that a fixed price for e-books helps a wide network of bookstores for print to survive in a market which is gradually shifting to e-books. Thanks to a fixed e-book price, they may acquire some market share for e-books as well, which helps them to survive for print. This argument requires a new kind of cross-subsidisation: from e-books to print. Again, it is most uncertain if the according profits on e-books will be made and if a cross-subsidy will really occur. Moreover, with the increasing adoption of e-books and the ubiquitous availability of e-bookstores 24/7, the justification for government intervention to safeguard a geographically wide network of well-stocked bookstores also loses strength. A fixed e-book price will not contribute to the accessibility of books but may only marginally and temporarily improve the geographical spread of bookstores by stalling the adoption speed of e-books in general and offering bookstores slightly better chances to acquire a share of the e-book market.

For publishers, pro-competitive arguments related to sales services, retailer inventory and shelf space apply even less than for printed books, and double marginalisation problems can be solved differently. Hence, publishers' motivations for fixed e-book prices are also anti-competitive in the sense that they are geared towards raising their profits, at the expense of retailers or consumers. This conclusion matches the outcome of Kretschmer's (2014) empirically based sequential investigation rule, when a fairly high concentration rate of the publishing market and a high adoption rate of RPM are assumed. In the US, agency pricing was indeed used to raise retail prices significantly: when it was adopted, prices for best-sellers rose by more than 40%, which motivated the Department of Justice to file a lawsuit. After agency pricing was abandoned, e-book prices for the relevant titles decreased by 18% at Amazon and by 8% at Barnes & Noble (De los Santos and Wildenbeest 2014). Again, one can hope but not be certain that any additional profits resulting from fixed prices are used to cross-subsidise commercially less attractive titles, and so far no sound evidence has been found to base this hope on. Shareholders, for one, would rather receive such profits in the shape of dividend payments.

Obviously, publishers can have an interest in a diverse and fragmented retail market, in which there is little buying power. It strengthens their bargaining position, and fixed prices can contribute to this. However, a single publisher taking the RPM route does not add much, which can explain why publishers coordinated the introduction of agency pricing in 2010. A diverse and fragmented retail market serves like a collective good that benefits all publishers and to which they all contribute by observing RPM. In some cases, individual publishers might be better off if *everyone else* observes RPM, but they will not – for example, when marketing a long awaited sequel to a bestseller.

Against this background, bear in mind that there are many more opportunities for publishers and retailers to sidestep RPM legislation for e-books than for print. First, they can decide to lend or stream e-books next to selling them, for instance in subscription models like *Kindle Unlimited*. Second, they can enhance e-books with external sources, sound or video. With such additions, they normally no longer fall under the legal definition of an e-book, since a clear demarcation between e-books and other electronic services would become tricky or even impossible. Third, schoolbooks, academic books and other non-fiction may be sold per chapter and updates may be sold at lower costs, which also creates a puzzle for RPM legislation. Given these options, a publisher can decide for himself whether or not

to have specific titles fall entirely under the fixed price regimen. As long as legislators do not wish to forbid such innovative practices,⁶ complying with RPM legislation for e-books would basically become optional for publishers and in particular for bestsellers, they may decide not to.

*Legal context*⁷

As with printed books, European law does not rule out legislation for fixed e-book prices in principle. That said, price fixing laws will be subject to stricter review in the case of e-books, in part owing to their nature: e-books are a service, whereas paper books are a good. Introducing a fixed price presents even more of a legal challenge when the free movement of services is at stake. Whereas there is some room for the imposition of restrictions on the trade of *goods* in the domestic market, even if supplied from abroad (i.e. in the case of not allowed forms of circumvention), a similar restriction on *services* would give rise to significantly bigger problems.

This issue was the main focus of the debate in France, when it introduced a fixed price for e-books. Under the French Act, suppliers who have their corporate seat in France are required to charge a fixed price for books, so anyone offering books for sale to buyers in France must apply the fixed price. This means that suppliers established outside of France (e.g. Amazon) are also bound to charge fixed prices. It is this extraterritorial criterion – no exception being made for EU/EEA countries – that makes the proposal vulnerable. In this particular case the European Commission started an investigation (as became clear from the French Parliamentary documents), but this did not result in a formal procedure.

The question therefore remains as to whether RPM for e-books is compatible with European law: whereas standard case law offers the possibility of counteracting classic evasion of the law (selling from abroad with the sole purpose of sidestepping national regulations), generic supply, which includes supplying domestic markets, should remain possible. Similar restrictions on the provision of services have proven to be untenable. Stricter national rules would put such international suppliers at a competitive advantage compared with players that focus exclusively on the national market. Should these suppliers face a situation where publishers refuse to supply them (in an effort to enforce domestic price fixing indirectly), this would quickly meet with objections arising from national and/or European competition law, based in part on the requirement of proportionality.

To the extent that agency pricing *could* offer an alternative in the digital arena, this model may not operate outside the limits of competition law, by which RPM is a hard-core restriction in the EU under the Block Exemption Regulation. Price setting by the manufacturer (principal) is accepted in agency agreements, however, as the agent does not become the owner of the good (OJ No. C130, Art. 47). A defining criterion for such agency relation is that the agent bears no financial or commercial risk to the contract concluded or negotiated, but even if these criteria are met, an agency relation may not be used to facilitate collusion (OJ No. C130, Art. 12–21). In 2011, the European Commission formally opened antitrust proceedings against the publishers who had adopted agency pricing, resulting in a settlement to abandon agency pricing.

Conclusion

While economists have increasingly accepted pro-competitive motivations for RPM since the 1980s, the motivations for book prices remain predominantly anti-competitive. Nevertheless, fifteen OECD countries currently have regulation for fixing the price of printed books, and at least eight of these have extended such regulation to e-books. Pro-competitive motivations do not seem to apply, and fixed book prices are willingly accepted by legislators to soften competition between retailers and possibly also between publishers. This is typically justified by beneficial effects the ensuing profits are believed to have on the preservation of a geographically wide network of well-stocked bookstores and a diverse supply of titles. There is, however, no guarantee that such surpluses are indeed created and if they occur, that they are re-invested in line with the policy objectives. The empirical evidence in defence of a fixed price for printed books is slim at best and there is no clear indication of any favourable effect of fixed price regimens on title production or the number of bookstores. The most promising way to find more conclusive empirical evidence about the effect of a fixed printed book price is studying a panel data-set which contains countries that introduced or repealed a fixed book price over the measurement period.

Focused on e-books, the economic analysis showed that the case for fixed prices is weaker still. Combined with the legal concerns that can be raised under EU law, this makes a fixed price for e-books ill-advised. For e-books, all retailer-related arguments lose their direct relevance: cross-subsidisation between titles at the retailer level and the preservation of a geographically wide network of bookstores are irrelevant to e-books. The argument could yet be made that a fixed price for e-books helps bookstores *for printed books* to survive, but this argument requires a new kind of cross-subsidisation, from e-books to print. Again, it is uncertain if the according profits on e-books will be made and if a cross-subsidy will really occur. A fixed e-book price will not contribute to the accessibility of books but may only marginally and temporarily improve the geographical spread of bookstores by stalling the adoption speed of e-books in general. Pro-competitive arguments for RPM related to sales services, retailer inventory and shelf space apply even less for e-books than for print.

Publishers' motivations for fixed e-book prices are also anti-competitive: they are geared towards raising their profits, at the expense of retailers or consumers. One can only hope but not be certain that any additional profits resulting from fixed prices are used to cross-subsidise commercially less attractive titles, and so far no sound evidence has been presented to base this hope on. The most compelling argument for a fixed price for e-books is related to its contribution to a diverse and fragmented retail market, in which there is little buying power. One may call this the anti-Amazon argument. However, it seems to be an oxymoron to allow publishers to fix retail prices in order to improve competition. Instead, general competition law should prevent Amazon from abusing a dominant position as an e-book retailer. As regards the other policy objectives legislators may pursue with fixed book prices, such as to increase the production and consumption of works of literature and the accessibility of books in less urbanized regions, instruments such as a reduced VAT rate for books, prizes or grants for authors or subsidies for digitising the back catalogue seem more effective, more efficient and legally less controversial.

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Notes

1. Jullien and Rey (2007) give a formal model of RPM used to support collusion between manufacturers.
2. In line with this, the US Supreme Court adopted a ‘rule of reason’ approach in the Leegin Decision, favouring a case-by-case analysis (Leegin Decision 2007). Until then, RPM had been per se illegal in the US with only a few acceptable defences.
3. Canoy *et al.* (2006) observe that governments do not want to tie themselves down to specific targets for introducing a fixed price in terms of the desired number of books published or the number of bookstores.
4. In the Netherlands in 2010, 13% of all available titles generated 90% of turnover, and the average turnover from titles with revenues exceeding €1000 was over 50 times higher than that of the other titles (Poort *et al.* 2012, p. 32).
5. Dearnley and Feather (2002) note that ‘the initial impetus for RPM came from booksellers, not publishers’. Likewise, booksellers are the most fervent supporters of the fixed book price in the Netherlands (e.g. KVB 2014). However, in some countries there is broad support for fixed book prices among both publishers and retailers.
6. In January 2015, the French Minister of Culture announced that subscription services such as Kindle Unlimited were illegal as they violate the fixed price law (see: <http://publishingperspectives.com/2015/02/bad-news-for-kindle-unlimited-in-france/>).
7. For a more extensive legal analysis, see Section 2.2 in Poort *et al.* (2012)

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