

**EUROPEAN MASTER IN LAW AND ECONOMICS**

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**FIXED BOOK PRICES AND THEIR IMPACT ON MEXICANS' READING HABITS**

Master Thesis by

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## **AUTHORSHIP DECLARATION**

I hereby declare and confirm that this thesis is entirely the result of my own work except where otherwise indicated. I acknowledge the supervision and guidance I have received from professor Roger Van Den Bergh. This thesis is not used as part of any other examination and has not yet been published.

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18 August 2014

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## INTRODUCTION

Knowledge and cultural treasures are preserved in books and disseminated through reading. Reading habits have been considered essential to safeguard the individual's autonomy and dignity, as well as a necessary condition for a society's economic, social and democratic development.<sup>1</sup> However, most Mexicans have very low engagement with books, in spite of a high literacy rate.<sup>2</sup>

As an attempt to solve this problem, on 2008 the Mexican Congress enacted the Law for the Promotion of Reading and Books (hereinafter, the "Law"). It imposes a unique price on books, fixed by the publisher or importer (hereinafter referred jointly as "publisher"), for their retail sales within national territory. Its dispositions were justified in cultural terms: facilitate equitable access to a wider variety of books in order to promote reading habits among the population. The Law is inspired by similar legislation in Europe, which has been in force for over a century allegedly with successful results.

Nevertheless, neither the Congress nor the Supreme Court carried out a proper analysis of Retail Price Maintenance ("RPM") as a tool to promote culture. They suggest a trade-off between competition in the book industry and ease of access to culture, which they hold as dogma. They argue that price competition is the reason why reading and culture have not

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<sup>1</sup> See *Resolution A/RES/54/122*, dated 20 January 2000, from the General Assembly of the United Nations. See also Organization for Economic Cooperation and Development ("OECD"), *Program for International Student Assessment ("PISA"), Reading, mathematical and scientific literacy*, Paris, 2000.

<sup>2</sup> Statistics from the National Institute of Statistics and Geography ("INEGI") show that the literacy rate has increased in Mexico during the past 50 years, and more than 90% of the population is able to read. However, studies carried on by the OECD indicate that Mexicans have a low understanding of the texts they read (*reading literacy*) and a low reading engagement. *Reading engagement* is measured by: (i) time usually spent by students reading for enjoyment each day; (ii) the diversity and content of their readings; and (iii) the students' reading interest and attitudes.

Indeed, in 2000, Mexico ranked lowest in reading literacy, being the one with the highest proportion of students below Level 1, and scored the lowest reading engagement index from the OECD countries evaluated. Sources: OECD, *Reading for Change: results and engagement across countries: results from PISA 2000* and *Knowledge and Skills for Life: first results from the OECD Program for International Student Assessment 2000*.

developed properly in Mexico, and assume that by restricting it the demand of books will automatically increase.

The purpose of my research is to redress the deficiencies of the discussion in Mexico regarding the constitutionality of the Law. I analyze the different effects that Fixed Book Prices (hereinafter, “FBP”) may have in the market to determine whether they are an effective tool in guaranteeing the constitutional right of access to culture. The first chapter of my research will explain the main contents of the Law, the logic behind it, and an assessment of its constitutionality. I will continue by illustrating the European experience on FBP. The third chapter introduces a general discussion on RPM, and the theoretical effects of FBP. The fourth chapter focuses on the situation in Mexico and presents data that serves as indicator of the possible effects of the Law. Finally, I will lay out my conclusions.

## **A. THE LAW FOR THE PROMOTION OF READING AND BOOKS IN MEXICO**

### **I. BACKGROUND**

On April 2005, Senator Tomás Vazquez proposed the enactment of a new version of the Law, trying to enrich the content of the one in force since 2000.<sup>3</sup> Based on similar European legislation, the proposal introduced the notion of a unique retail price for books as a tool to incentivize bookstores to compete in non-price factors. Indeed, the proposal deems discounts as the cause of concentration of supply in few selling points and the reduction of titles available in the market. Thus, by allegedly reinforcing the chains of production and distribution, it considers FBP to be an adequate tool to improve the dissemination of books, attain equitable access to them, and promote reading habits among the population.

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<sup>3</sup> The proposal and all the documents that were part of its legislative procedure are available in Spanish at: [http://www.diputados.gob.mx/LeyesBiblio/proceso/lx/106\\_DOE\\_24jul08.pdf](http://www.diputados.gob.mx/LeyesBiblio/proceso/lx/106_DOE_24jul08.pdf).

When reviewing the proposal, the Federal Competition Commission (hereinafter, the “FCC”)<sup>4</sup> highlighted its anticompetitive effects by equaling FBP to an absolute monopolistic practice that would incentive publishers to guarantee their profit margins through higher prices; impair dynamic efficiency and innovation in the market; and cause harm to consumers. Nevertheless, despite the FCC’s recommendations against FBP, the proposal was approved by the Congress on April 2006. The discussion carried on by Deputies and Senators regarding its costs and benefits was rather superficial: it was mainly based on what the Mexican poet Gabriel Zaid wrote once about FBP,<sup>5</sup> and on the assumption that if the European experience has been successful it should also work for Mexico.

The Law was sent for review to President Vicente Fox; however, on September 2006, he sent it back to the Congress without his approval. Following the FCC’s arguments, he deemed that a restriction to competition in the retail market was not justified and it would affect its current efficiency. Therefore, in his opinion, the proposed measure would result incongruous with the guarantee to free competition enshrined within article 28 of the Constitution. It was until April 2008, now under President Felipe Calderón’s administration, that the Law was revised again by the Congress. Fox’s observations were dismissed under the argument that the Law would not have anticompetitive effects, and was justified both by the international tendency on FBP and the public interest in promoting reading. Consequently, the Law was enacted on July 2008 without any modification.

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<sup>4</sup> See file PRES-10-096-2005-104, dated 6 October 2005, issued by FCC. Available in Spanish at: <http://www.cfc.gob.mx:8080/cfcresoluciones/Docs/Mercados%20Regulados/V2/7/1382538.pdf#search=libro>.

<sup>5</sup> Gabriel Zaid, *Librerías y precio fijo*, Letras Libres, August 2005. Available in Spanish at: <http://www.letraslibres.com/revista/convivio/librerias-y-precio-fijo>.

## **II. CONTENT OF THE LAW**

The dispositions of Law are deemed to be of public interest<sup>6</sup> and mainly have the purpose to: promote reading; encourage and stimulate publishing, distribution and commercialization of books; encourage and stimulate the establishment and development of bookstores, libraries, and other public and private spaces for reading and distribution of books; and make books equally accessible within national territory, to increase their availability and bring them closer to readers.<sup>7</sup>

According to the Law,<sup>8</sup> the publisher shall freely determine the retail price of its books, which will be unique. Retailers must apply only the unique retail price, without any modification. The Law is applicable for all printed books that are sold within Mexico, regardless if they are imported or produced nationally, during the first 18 months after their publication. The only exception are purchases that, for their own ends, excluding resale, are carried on by the State, the libraries that offer public services and loans, and educational, professional or research institutions.

## **III. CONSTITUTIONALITY ASSESSMENT OF THE LAW**

### **1. Constitutional guarantees involved**

In Mexico, all constitutional guarantees enjoy the same hierarchy. However, neither of them is absolute: one could be limited up to the extent it serves to guarantee the exercise of the other. The Law involves two guarantees that allegedly conflict each other: culture and competition.

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<sup>6</sup> Article 1 of the Law.

<sup>7</sup> Article 4 of the Law.

<sup>8</sup> Articles 22 to 26 of the Law.

Article 4 of the Constitution enshrines the right for every person “to access and enjoy cultural goods”, and imposes the State the obligation to “promote the means to spread and develop culture”. The Supreme Court has failed to interpret the scope of this right or the State’s obligation. It could be argued that the larger the amount and variety of books available, and the easier it is for people to access and enjoy them, the better the State complies with this disposition. However, I consider that the preference implied by the Congress and the Supreme Court towards the purchase of “culturally valuable” books at traditional bookstores lacks legal support.

Furthermore, article 28 forbids any act that, in whatever manner, may prevent competition among economic agents, or compel consumers to pay exaggerated prices.<sup>9</sup> The Federal Law on Economic Competition (“FLEC”), which regulates article 28 more into detail, establishes that the purpose of competition law is the prevention and elimination of restrictions against the efficient functioning of markets.<sup>10</sup> The FLEC addresses RPM as a monopolistic practice which allows efficiency defenses: it will not be illegal if its overall effect is positive in consumers’ welfare.<sup>11</sup> Nevertheless, if RPM is ordered by law, the only way to challenge its compliance with national competition policy is through an analysis by the Supreme Court.

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<sup>9</sup> The term “exaggerated prices” has not been interpreted neither by the FCC nor the Supreme Court. However, for purposes of this research, it will be understood as the price that would be set by a monopolist.

<sup>10</sup> Article 2 of the FLEC.

<sup>11</sup> According to articles 54 and 55 of the FLEC, RPM would only be anticompetitive if it has the purpose or effect to unduly displace economic agents from the market or prevent their entrance to it; the economic agent who performs it has substantial power in the relevant market, and there are no efficiencies that derive from it that might counterbalance its negative effects.

## **2. Supreme Court's analysis**

On 2009, two companies<sup>12</sup> submitted *amparos*<sup>13</sup> to the Supreme Court challenging the constitutionality of the Law, arguing its dispositions violated their right of free competition. The first *amparo* was discussed in 2011; the second, in 2013, just followed the considerations established by the former.

When the first *amparo* was reviewed by the Supreme Court, it analyzed whether the Law created a conflict between the two constitutional rights at stake and, if so, how they could be balanced. According to the resolution, the Law is constitutional: not only does it not limit competition on the market, but on the contrary, serves to strengthen it; and it protects the public interest by enhancing constitutionally valid cultural objectives. It parts from the consideration that traditional bookstores face unfair and disloyal competition by large retailers, which are able to extract a higher margin from publishers and, consequently, grant more discounts to consumers. Thus, FBP are seen as a mechanism to protect them from disappearing from the market by promoting equitable competition, based on assortment and services.

A majority of six Justices voted in favor of the resolution and the Law's constitutionality. They highlighted the importance of reading and recognized books as a cultural good whose distribution must be promoted by the State. In their opinion, FBP would intensify the supply in the country through an increase in the availability of a large variety of books, the expansion of the bookstores' network, and the decentralization of the market. They considered that, by doing so, reading habits would be promoted and, thus, the Law's culture-enhancing effects would cause a positive result on social welfare.

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<sup>12</sup> The first company was Costco, a discount retailer club that has a small book department selling mostly bestsellers (file 2261/2009). The second was Porrúa, a publishing and bookstore company (file 2266/2009).

<sup>13</sup> The *amparo* is a constitutional remedy for the protection of citizens' human rights and guarantees against State abuses.

Moreover, these Justices estimated that, even if the Law's cultural effect was not attained, it is not anticompetitive: State intervention is required to ensure the efficiency of a market in which intellectual property rights prevent competition; it precludes the monopolization of sales by large retailers at the expense of small bookstores; and prices would be fixed by publishers considering the market condition and their costs, seeking to bring their products to the highest possible number of consumers. Nevertheless, these Justices failed to explain how FBP incentivize the creation of bookstores and why it cannot be done under a free market or through less restrictive State interventions. They state that the purpose of the Law is not to offer cheaper books, but they disregard how an increase in prices could be counterproductive to enhance demand. Hence, their analysis of necessity and proportionality of the Law was incomplete.

The five justices who voted against the resolution project considered the Law violates the right of free competition and, therefore, should be declared unconstitutional regardless of its impact in culture. In their opinion, article 28 requires prices to be subject to market forces and the authority cannot empower private parties to fix them. They deemed price fixing, by its own nature, prevents competition, which otherwise would guarantee better goods and services, at better prices, to consumers. However, these Justices overlooked any potential pro-competitive effects economic theory usually attributes to RPM; just as President Fox and the FCC did before, they regarded RPM as a hard-core restriction.

Additionally, even under the assumption that FBP are not anti-competitive, these Justices doubted they would incentivize reading. On the contrary, they believe the Law would be counterproductive given the sensibility of books' demand and the differences in distribution costs along the country. In particular, they affirmed that publishers lack incentives to fix low prices; discounts would facilitate an increase on the amount books sold;

and a unique price would not favor the creation of a more extensive network of bookstores.<sup>14</sup> Thus, in their opinion, the Law failed to achieve its alleged cultural benefits.

## **B. THE EUROPEAN EXPERIENCE**

As explained before, the Law was inspired by the European experience. FBP have its origins in the 19<sup>th</sup> century, in the form of business agreements that were justified under cultural grounds: allegedly being able to increase the diversity and availability of books in the market. Germany was one the pioneers of the system: all members of the *Börsenverein* (the association of publishers and retailers) were obliged to accept fixed prices. Soon, other European countries began to follow the German example: France, the United Kingdom, and Sweden, just to name a few.

The system of FBP started to change as competition policy developed more strongly in the continent. At that time, RPM was considered a hard-core violation, so countries needed to regulate FBP as a way to exempt them from competition policy.<sup>15</sup> For example, Germany's competition law from 1958 allowed publishing houses to fix retail prices under mutual contracts. As consequence, the *Sammelrevers* were created, covering a number of individual

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<sup>14</sup> **Justice Luna:** "I believe [discounts] are an incentive for people to be able to acquire more books, but I do not understand what can be incentivized when there is a unique price that totally and absolutely forbids rebates [...] For me it is illogical to think this will promote culture. [...] On the contrary, I believe it discourages it because they will purchase solely the books they are obliged to purchase, but will not have the possibility to purchase the books they would like, and that otherwise could obtain at a more accessible price".

**Justice Silva:** "Competition in retail prices benefits regular purchasers, by having access to lower prices, and occasional purchasers with a more elastic demand, favoring the development and consolidation of reading habits among those people less interested in it. Consequently, the possibility of granting discounts in book prices is a direct way to support and promote reading [...] State's obligation to guarantee the access to culture, from my point of view, cannot materialize through public policies that violate explicit constitutional prohibitions [...] there can be, and there are, other policies that can guarantee the same goal of cultural diffusion without restricting free competition and without causing a detriment to consumers".

<sup>15</sup> Afterwards, this criterion change. According to the Guidelines on Vertical Restraints (2010/C 130/01) adopted by the European Commission ("EC"), RPM would continue to be presumed to fall within Article 101(1), but the presumption could be rebuttable under an efficiency defense.

price-fixing contracts<sup>16</sup> signed between each publisher and its final vendors. Despite not being forced to fix prices, almost all publishers in Germany were doing it.<sup>17</sup>

Similarly, in United Kingdom, the Net Book Agreement (“NBA”) was subject to both the Restrictive Trade Practices Act and the Resale Prices Act after its review by the Restrictive Practices Court in 1962. Back then, the Court determined the NBA was not against the public interest and, on the contrary, without it there would be a contraction of the industry: in particular, a decline in the number of stockholding booksellers; a rise in the price of books; and a decline in the number of titles published.<sup>18</sup>

Later on, it was considered that FBP and their benefits for consumers should not depend on the whim of those part of the business agreements. Therefore, the number of countries with business agreements began diminishing as they switched for laws on FBP. For instance, France’s *loi Lang*, from 1981, empowered publishers to decide the retail price of books and prohibit bookstores from selling them with a discount of more than 5% of the fixed price. As of Germany, the contractual price fixing system was challenged for its cross-border effects with Austria and Switzerland. The EC investigated the issue and accepted the German system as long as its effects remained national;<sup>19</sup> still, on 2002, Germany replaced it by a mandatory law to ensure its application.

Norway is one of the few countries in Europe where book prices are still fixed through business agreements. Nevertheless, on 2005, an agreement between the Norwegian Booksellers Association and the Norwegian Publisher Association substantially limited the

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<sup>16</sup> *i.e.* the publisher decides whether to fix prices or not for each book. As a result, intra-brand price competition was limited in some books but not in others.

<sup>17</sup> See: Sich V., *The system of fixed book prices in Germany*, German publishers and booksellers association, 2004, available online at: <http://www.tau.ac.il/~nirziv/FixedBookPricesinGermany1.pdf>.

<sup>18</sup> For an account of the defense of the NBA before the Restrictive Practices Court, please refer to Barker, R.E. and Davies, G.R., *Books are Different*, London, Macmillan, 1966.

<sup>19</sup> European Commission, *Commission accepts undertaking in competition proceedings regarding German book price fixing*, press release IP/02/461, 2002.

scope of FBP. The Norwegian Competition Authority evaluated its effects on 2008 and concluded that, for example, the new agreement has not only led to greater output, but to a greater variety of book titles sold and to lower prices, as well.<sup>20</sup>

Only a small minority of countries have repealed the system and moved to free prices: Sweden, Finland and the United Kingdom. Instead of restricting competition, these countries instituted other State measures to favor the book market: reduced VAT for books; support systems for authors; or subsidies for small-scale books' production. Moreover, they incentivize reading through educational policies. So far, they are still convinced that liberalization has been a success;<sup>21</sup> nevertheless, countries with FBP are also convinced of the opposite view:

“Two contributions, in particular, stood out. Sweden reported that in 1981 they abolished RPM for books and the outcome was wonderful for the publishing businesses because the booksellers have become more specialized, they've differentiated themselves, the price of books has gone down and there are many more publications than there used to be, and so on. The next contribution was from France which reported that in 1981 they imposed RPM on books, and the outcome was wonderful since the number of booksellers has not diminished and there were more books available since, as a result of the huge margins, the retailers work hard to push books and to do all kind of good things for the publishers”.<sup>22</sup>

European legislation on FBP has been subject to constant debate and analysis over time.<sup>23</sup> However, no conclusive result has been reached so far: there is no convincing support

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<sup>20</sup> Norwegian Competition Authority, *The development of sales in the book industry from 2004 to 2007*, Report 1/2008, 2008.

<sup>21</sup> The effects after NBA's abolition have been discussed at more extent in English language than those in Sweden and Finland. See: Dearnley, J. and Feather, J., *The UK bookselling trade without resale price maintenance: an overview of change 1995-2001*, Publishing Research Quarterly, 17(4), 2002, pp. 16-31; and Fishwick, F. and Fitzsimmons, S., *Effects of the abandonment of the Net Book Agreement*, Cranfield School of Management, 1998.

<sup>22</sup> OECD, *Policy roundtables: resale price maintenance*, DAF/COMP(2008)37, 2008, p. 277.

<sup>23</sup> For an analysis of the Dutch case, see Van Der Ploeg, F., *Beyond the dogma of the fixed book price agreement*, Journal of Cultural Economics, 28, 2004, pp. 1-20. The Finish case has been discussed in Stockmann, D., *Free or fixed prices on books: patterns of book pricing in Europe*, European Institute for Communication and Culture, 11(4), 2004, pp. 49-64. As of the case of Germany, please refer to Bittlingmayer,

that either of those pricing systems is superior to the other, even as a mean of cultural policy. Theoretically, there are strong arguments on both sides and it is difficult to predict which effect will prevail. Empirically, despite FBP being in force for decades, there has not been a systematical analysis of the book market in Europe.<sup>24</sup> Indeed, there are so many factors at stake and the data available is insufficient, so it is difficult to establish any causal effect by looking at before and after experiences or cross-country comparisons.<sup>25</sup> Consequently, it seems rhetoric also dominates the discussion in Europe.

## C. ECONOMIC RATIONALE BEHIND THE LAW

### I. OVERVIEW ON RETAIL PRICE MAINTENANCE

RPM is a type of vertical restraint in which a manufacturer imposes restrictions to its distributors on the price they can charge when selling the goods to final consumers. Originally, it was deemed as a *per se* violation to competition law: the United States Supreme Court considered its economic effects were indistinguishable from those of a naked horizontal price fixing by a cartel.<sup>26</sup> However, the Chicago School criticized this view, highlighting the advantages of RPM to overcome market failures in distributional services.

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G., *Resale price maintenance in the book trade with an application to Germany*, Journal of Institutional and Theoretical Economics, 144(5), 1998, pp. 789-812; and to Beck, J., *Fixed, focal, fair? Book prices under optional resale price maintenance*, Social Science Research Center Berlin, Markets and Political Economy, working paper SP II 2004-15, 2004.

<sup>24</sup>One of the few empirical analysis on FBP in Europe is Bernhamou, F., *et. al.*, *Réglementer le prix des livres: quels effets sur le bien-être du consommateur? Une analyse empirique sur les années 2000 en Europe*, LVIII<sup>e</sup> congrès de l'AFSE, Paris, 2009. Here, the authors compare book prices and quantities between the 12 European countries they analyze and conclude that FBP has a positive effect on consumers' welfare: price does not increase significantly and is correlated with a larger diversity in books published.

<sup>25</sup>For example, Fjeldstad performed a comparative study on the Nordic countries (Norway has FBP; Denmark a hybrid system; and Sweden and Finland had FBP and later switched to free prices) and concluded "one should be careful to argue that fixed book prices lead to one development and free prices to the opposite. One system does not seem to be superior to the other". Indeed, it is not clear up to what extent the differences in results derive from different price systems, differences between the Nordic countries, or differences in the economic situation during the period. Fjeldstad, A., *Å sette pris på bøker i ein del europeiske land*, Report 24, Norsk Kulturråd, 2001, Oslo.

<sup>26</sup>*Dr. Miles Medical Co. v. John D. Park and Sons*, 220 U.S. 373, 1911. *Albrecht v. Herald Co.*, 390 U.S. 145, 1968.

Consequently, the United States Supreme Court began narrowing previous precedents until, in 2007, held that RPM could be either procompetitive or anticompetitive and, therefore, must be judged under the rule of reason on a case-by-case basis.<sup>27</sup>

The anticompetitive effects that might derive from RPM could be summarized as follows: facilitate cartel behavior among suppliers or retailers;<sup>28</sup> soften competition in interlocking relationships;<sup>29</sup> lead to an appreciable increase on prices in the relevant product market; solve the commitment problem of a monopolist; and lead to the foreclosure of competing suppliers and innovative retailers. However, whether these effects will be displayed would depend on market conditions: mainly, concentration in the upstream market; high barriers to entry; limited innovation; and lack of countervailing buyer power. Generally speaking, there seems to be broad recognition that RPM would have substantial negative effects on welfare if inter-brand competition is not vigorous.

As of the procompetitive effects of RPM, two main arguments have been developed by the Chicago School: double marginalization,<sup>30</sup> and the free-riding problem.<sup>31</sup> The first explains the rationale behind a maximum RPM: both consumers' surplus and manufacturers' and retailers' joint profits are higher than without the RPM, and retailers can still compete with each other with prices below the maximum.<sup>32</sup> On the other hand, minimum RPM is

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<sup>27</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 2007.

<sup>28</sup> On the manufacturer's cartel hypothesis, see: Tesler, L., *Why should manufacturers want fair trade*, Journal of Law and Economics, 1960, pp. 86-105; and McLaughlin, A., *An economic analysis of resale price maintenance*, Ph.D. Dissertation, University of California at Los Angeles, 1970. On the retailer's cartel hypothesis, see: Ippolito, P., *Resale price maintenance: economic evidence from litigation*, Journal of Law and Economics, 1988, pp. 263-294; and Shaffer, G., *Slotting allowances and resale price maintenance: a comparison of facilitating practices*, Rand Journal of Economics, 1991, pp. 120-135.

<sup>29</sup> See Rey, P. and Vergé T., *Resale price maintenance and interlocking relationships*, Journal of Industrial Economics, 58(4), 2010, pp. 928-961.

<sup>30</sup> See Spengler, J. J., *Vertical Integration and Antitrust Policy*, Journal of Political Economy, 50(4), 1950, pp. 347-352.

<sup>31</sup> See Tesler, L., *Why should manufacturers want fair trade?*, Journal of Law and Economics, 1960, pp. 86-105.

<sup>32</sup> In practice, however, price ceilings have arisen in another set of circumstances which are not explained by considerations of double marginalization. For example, see *R. v. Nova Scotia Pharmaceutical Society* (1992), 93 D.L.R. (4th) 36 (S.C.C.). This can be explained by the excess capacity theorem of monopolistic competition: under certain circumstances consumers would be better off with negotiated price ceilings that cap revenues and

usually explained by the free riding problem: it prevents retailers from reaping the benefits of expenses incurred by others, giving them incentives to incur those expenses and provide presale services valued by both manufacturer and consumers.<sup>33</sup>

The procompetitive effects of price floors have been more controversial than price ceilings<sup>34</sup> since they prevent consumers to acquire goods at lower prices. Nevertheless, they are commonly used and considered beneficial when the demand of a good depends on more than just price and, even in the absence of free riding, manufacturers cannot rely entirely on retailer competition for the provision of additional services. In principle, by protecting a certain margin of rent for retailers, minimum RPM ensures those services whose provision would otherwise be costly to monitor and subject to potential moral hazard.<sup>35</sup> Thus, minimum RPM would create incentives for retailers to increase their number and spread their locations;<sup>36</sup> guarantee the availability of the product;<sup>37</sup> provide information to consumers; reduce shopping time;<sup>38</sup> increase sales efforts;<sup>39</sup> and create and safeguard a reputation of quality.<sup>40</sup>

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lead to a thinner retail network. Mathewson, F. and Winter, R., *The law and economics of resale price maintenance*, Review of Industrial Organization, 1998, pp. 57–84.

<sup>33</sup> However, some authors have considered that, in practice, the free-rider argument rarely applies and that a great amount of presale services cannot realistically be subject to the free-rider problem. See: Leegin, *op. cit.*, Breyer J. dissenting; and Pitofsky, G., *Why Dr. Miles Was Right*, Regulation, 8, 1984, pp. 27–30; Scherer, F. M. and D. Ross, *Industrial Market Structure and Economic Performance*, 3rd ed. Chicago: Rand McNally., 1990, pp. 551–552.

<sup>34</sup> For example, in the Guidelines on the application of Article 81(3) from 2004, the EC stated that minimum and fixed RPM, unlike maximum RPM, “generally fail to create objective economic benefits, do not benefit consumers and are unlikely to be considered indispensable to the attainment of any efficiencies created by the agreement in question”. See paragraphs 46 and 79.

<sup>35</sup> See Romano R.E., *Double moral hazard and resale price maintenance*, The RAND Journal of Economics, 25(3), 1994, pp. 455-466; and Klein, B. and Murphy, K., *Vertical restraints as contract enforcement mechanisms*, Journal of Law and Economics, 31, 1988, pp- 265-298.

<sup>36</sup> Gould, J.R., and Preston, L.E., *Resale price maintenance and retail outlets*, *Economica*, 32(127), 1965, oo. 302-312.

<sup>37</sup> In cases where the demand is uncertain, minimum RPM serves to support adequate inventories among retailers, to the benefit of the manufacturer and the consumers: preventing discounting increases the manufacturer’s profit and the total quantity actually transacted (and therefore total welfare). Deneckere, R., Marvel H., and Peck J., *Demand uncertainty, inventories, and resale price maintenance*, The Quarterly Journal of Economics, 111(3), 1996, pp. 885-913; Rey, P., and Tirole, J., *The logic of vertical restraints*, The American Economic Review, 76(5), 1986, pp. 921-939.

<sup>38</sup> Winter, R., *Vertical control and price versus non-price competition*, The Quarterly Journal of Economics, 1993, 108(1), pp. 61-76.

However, it should be considered that those arguments focus on a single manufacturer and not necessarily apply when retailers carry many brands of products; the welfare effects would depend on how sensitive consumers are to an increase in price or a decrease in service; and RPM might create a prisoner's dilemma for manufacturers that could even lead to a decrease in the quality of services.<sup>41</sup> Empirical research is still needed to clarify RPM overall effects. Some authors suggest that there is little applicability of procompetitive theories of RPM and that "a more favorable legal environment for RPM results in a loss in consumer welfare";<sup>42</sup> others identify that service and sales enhancing theories have a great potential to explain RPM.<sup>43</sup>

## II. EFFECTS OF FIXED BOOK PRICES

Books are private goods, but the knowledge in them is public and creates positive externalities. Not only do they have an intrinsic cultural value, but they also have the advantage of not existing precisely in a zero-sum relation to one another. However, being

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<sup>39</sup> RPM allows manufacturers to grant dealers a higher margin that will serve as a "payment" for his selling efforts: "A profitable opportunity for manufacturers to design distribution arrangements where retailers are compensated for supplying increased manufacturer-specific promotion services". Klein, B., *Competitive resale price maintenance in the absence of free-riding*, *Antitrust Law Journal*, 76(2), 2009, pp. 449.

However, it has been considered that it is inefficient to use RPM as a method to increase profit and, thus, achieve procompetitive promotion. Grimes, W.S., *A dynamic analysis of resale price maintenance: inefficient brand promotion, higher margins, distorted choices, and retarded retail innovation*, Southwestern Law School, Working Paper 1023, 2010, available at: [http://www.swlaw.edu/faculty/faculty\\_listing/ssrn](http://www.swlaw.edu/faculty/faculty_listing/ssrn).

<sup>40</sup> See Greening, T., *Analysis of the impact of the Florsheim Shoe case*, in R. N. Lafferty and R. H. Lande, eds, *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases*, Washington, D.C.: Federal Trade Commission, 1984; Marvel, H., and McCafferty, S., *Resale price maintenance and quality certification*, *The RAND Journal of Economics*, 15, 1984, pp. 340-359; Oster, S., *The FTC v. Levi Strauss: an analysis of the economic issues*, in R. N. Lafferty and R. H. Lande, *op. cit.*; and Van den Bergh, R.J. and Camesasca P.D., *European competition law and economics: A comparative perspective*, Intersentia Publishers, Belgium, 2001, pp. 220-222.

<sup>41</sup> Hunold, M. And Muthers, J., *Resale price maintenance and manufacturer competition for retail services*, Center for European Economic Research, Discussion Paper No. 12-028, 2012, available at SSRN: <http://ssrn.com/abstract=2043020>.

<sup>42</sup> MacKay, A. and Smith D.A., *The empirical effects of minimum resale price maintenance*, University of Chicago, 2013, available at: [http://home.uchicago.edu/~mackay/MacKay%20and%20Smith%20\(2013\)%20-%20The%20Empirical%20Effects%20of%20MRPM.pdf](http://home.uchicago.edu/~mackay/MacKay%20and%20Smith%20(2013)%20-%20The%20Empirical%20Effects%20of%20MRPM.pdf).

<sup>43</sup> Ippolito, P., *op. cit.*

experience goods, they can be subject to a “lemon problem”, which would lead both supply and demand to be insufficient.

The market of books is characterized by uncertain demand<sup>44</sup> and monopolistic competition.<sup>45</sup> This situation prevents publishers and bookshops to accurately assess risks and, therefore, calculate marginal revenues. Consequently, if they consider it is unlikely the revenue from a particular book will cover its costs, they will not be willing to offer it.<sup>46</sup> This potentially threatens the investment in original or unconventional books, and may lead to a homogeneous and concentrated supply. From a cultural point of view, this situation is undesirable.

### **1. How are FBP supposed to achieve their cultural goal?**

FBP are generally justified under the argument that books are cultural goods and not commodities; as such, they cannot be left to market forces alone. Defenders of FBP are concerned that, without them, book retailers might engage in cream-skimming: by discounting bestsellers, less demanded books and traditional bookstores would end up being displaced from the market. Thus, by restricting price competition, they will be protected; the production and distribution of a greater number and variety of books would be incentivized; and the network of bookstores would be extended and strengthened. Accordingly, it would

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<sup>44</sup> Creative industries are characterized by the “nobody knows principle” according to which demand is uncertain. In this sense, publishers and bookstores cannot assess *a priori* which book will be successful and profitable from a consumers’ preference perspective. Demand varies drastically overtime depending on changing consumers’ interests and the range of books offered in the market.

See: Caves, R.E., *Creative industries: Contracts between art and commerce*, Harvard University Press, 2000.

<sup>45</sup> Consumers acknowledge non-price differences between books. Since they do not perceive them as perfect substitutes from one another, inter-brand competition is limited. The degree of substitution between one book and other depends mostly on its style or area of discipline: Harry Potter might be a substitute of Twilight, but not of Freakonomics. See: Dixit, A.K., & Stiglitz, J.E., *Monopolistic competition and optimal product diversity*, The American Economic Review, 67, 1977, pp. 297–308.

<sup>46</sup> If the demand for a title is reduced, its average costs will be higher than the market price and will not be profitable its production.

generate a larger public utility, since consumers would have more options available and accessible.<sup>47</sup>

“[...] the system of fixed book prices promotes the availability of the cultural product ‘book’ all over the country. It ensures a dense net of distribution, a wide range of bookstores with large supply and an extraordinary cultural service [...] A lively culture of reading is promoted, too, because one can get any book one wants even in the smallest bookstore on the countryside within a very short delivery period [...] Fixed price-systems are thus a way of taking into account the specific cultural and economic character of books and giving readers access, under optimum conditions, to the widest possible supply”.<sup>48</sup>

FBP give bookstores higher and more certain mark-ups. This helps small retailers to subsist in the market by making them more profitable and preventing large retailers from abusing their economies of scale to do predatory pricing. Moreover, by having a better calculatory basis, bookstores could potentially balance their risks and minimize their expected costs by cross-subsidizing *ex-ante* between less profitable books and bestsellers, without necessarily causing an overall increase in final prices.<sup>49</sup> Consequently, FBP grant bookstores the incentive to diversify their catalogue of book titles; limit their losses; and encourage them to hold better stocked catalogues to prevent supply shortages.

Furthermore, since price stops being a relevant factor for consumers, non-price intra-brand competition needs to be strengthened. The way bookstores differentiate themselves, reach a larger number of consumers and increase their total revenue is by their location; the

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<sup>47</sup> The increase in public utility would be directly proportional to an increase in variety if we assume that all books are equally valuable. However, this does not seem to be the underlying assumption in the discourse held by the Mexican Congress and Supreme Court, who underestimate the cultural value of bestsellers and disdain retailers which focus their sales on them. Indeed, someone may consider that it would be preferable to induce people into reading Shakespeare instead of E.L. James; however, it is totally subjective where the distinction in cultural value is drawn.

<sup>48</sup> Sich V., *op. cit.*

<sup>49</sup> Backhaus, J.G. and Hansen, R., *Resale price maintenance for books in Germany and the European Union: a legal and economic analysis*, at Marciano, A., and Josselin, J.M., *From Economic to Legal Competition: New Perspectives on Law and Institutions in Europe*, Edward Elgar Publishing Ltd, 2003, pp. 87-103. On this regard, the OECD points out that is “unclear how the authors can be certain that the overall price effect of the RPM system is not an increase, but just a redistribution of revenues from some titles to others”. *Policy roundtables: resale price maintenance, op. cit.*, p. 56.

diversity of books they have in inventory (including those from new authors, specialized disciplines, and not-so-popular types of literature); and the additional services they offer (for example, with educated vendors able to recommend a book). As consequence, they reduce consumers' opportunity costs of purchasing a book: it becomes easier and cheaper for consumers to find the book they are looking for.

Regarding competition among publishers, FBP do not hindered it: they still compete by the variety of book titles they introduce into the market; the royalties they pay to authors; the wholesale price they offer to bookstores; and the retail price they fix. FBP will allow them to benefit from diversification of risks, economies of scope, and cross-subsidization. Thus, FBP prevent withdrawing resources from unpopular books in favor of trend-driven publishing.

## **2. Which is the dark side of FBP?**

FBP are not a magical solution as the previous section would indicate: not only do they have anticompetitive effects, but also are neither necessary nor proportional to solve the aforementioned market failures. Thus, their net effect on welfare cannot be easily assessed.

- *Retail prices will increase*

Publishers determine both the wholesale and the retail price at which their books will be sold to and by bookstores. On one hand, they have incentives to grant bookstores high marginal revenues to increase their interest in offering the book in their catalogue and strive for its sale by guaranteeing that they will recoup their fixed costs.<sup>50</sup> On the other, publishers are also interested in maximizing their own profits.

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<sup>50</sup> It has been considered that “the manufacturer cannot get the dealer to do more without increasing the dealer’s margin”. Easterbrook, F., *Vertical agreements and the rule of reason*, Antitrust Law Journal, 53, 1984, p. 156.

Publishers enjoy a certain degree of market power that allows them to fix monopolistic prices. Faced with a unique retail price, large bookstores cannot counteract publisher's market power and prevent them from increasing it. Thus, publishers will fix the retail price at the maximum possible that increases both bookstores' and their own marginal revenues. The retail price consumers will end up paying will be higher than under a competitive scenario; particularly since bookstores cannot longer offer seasonal, volume or loyalty discounts.

The effect that an increase in books' retail price will have in the amount of books exchanged in the market will depend on the elasticity of demand. In this regard, studies have found that the demand of books is highly price and income sensitive.<sup>51</sup> This implies that FBP will cause a reduction of sales, particularly from low-income consumers. Additionally, the demand of books by those consumers with a high opportunity cost of reading may also have a higher elasticity. Thus, a policy which leads to an increase in retail prices seems incompatible with a policy that tries to increase the number of books actually purchased and to promote reading by those currently uninterested.

- *FBP will not necessarily induce cross-subsidization and increase variety*

Allegedly, retail prices would increase only for bestsellers, allowing a lower price for less popular books that would induce their demand and lead to an increase in variety within the market. Indeed, the logic behind the *ex-ante* cross-subsidization argument is the following:

“[...] publishers publish presumed culturally valuable titles that they know will not (or are quite unlikely to) cover their costs. These costs are covered by the profit from more popular, but less culturally valuable titles. [...] with less profit from mass-market titles due to fiercer price competition with free pricing, the publishers

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<sup>51</sup> Bittlingmayer, G., *The elasticity of demand for books, resale price maintenance and the Lerner Index*, Journal of Institutional and Theoretical Economics, 48, 1992, pp. 588–606. Rigstad, V. and Løyland, K., *The demand for books estimated by means of consumer survey data*, Journal of Cultural Economics, 30, 2006, pp. 141-155. Hjorth-Andersen, C., *A model of the Danish book market*, Journal of Cultural Economics, 24, 2000, pp. 27–43.

cannot afford to subsidize the culturally valuable titles to the same extent as with fixed pricing”.<sup>52</sup>

Nevertheless, there is neither guarantee nor strong evidence that indicates the additional profits are used for *ex-ante* cross-subsidization; and substantial *ex-post* cross-subsidization will still take place in the market of books, regardless of FBP, due to their nature of creative artwork and the “nobody knows” principle:

“Publishers do not generally publish works they anticipate will be unprofitable on the back of ‘safe risks’. They hope [...] that every book they publish will be profitable – the problem (and here lies the risk) is in knowing which will be profitable and which (possibly the majority) will not be. What does happen is that *ex post facto*, it turns out that some books have contributed to profits, others not”.<sup>53</sup>

Moreover, the cross-subsidization argument lies under the assumption that bestsellers are the ones with an inelastic demand while unsuccessful books are more elastic. It conveys that a large majority of consumers will pay higher prices so that a minority can satisfy their idiosyncratic taste by diversification in the market.<sup>54</sup> However, bestsellers can turn out to be highly-elastic due to the existence of closer substitutes,<sup>55</sup> while less-demanded books can be more inelastic if they are too specialized. Moreover, the less demanded a book is the higher the profit margin publishers and bookshops would need to collect to be willing to promote it

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<sup>52</sup> Ringstad, V., *On the cultural blessings of fixed book price. Facts or fiction?*, International Journal of Cultural Policy, 10(3), pp. 351-365.

<sup>53</sup> National Heritage Committee of the House of Commons, cited in *ibidem*, p. 357.

<sup>54</sup> “I believe the public interest would be better served by a wider distribution of a somewhat narrower range of books rather than attempting to cater for a small erudite section of the population”. Horowitz, S., *Statement to Trade Practices Tribunal*, cited in Fishwick F., *Book prices in Australia and north America*, Commission of the European Communities, Luxemburg, 1985, p. 12.

<sup>55</sup> This substitution effect may not only be by the existence of a larger amount of books within the same category, but also by higher cross-price elasticity against other cultural activities. Perhaps, if the book serves a recreational purpose, other forms of recreation may be considered substitutes from reading by consumers. A study estimating the cross-price elasticities between books, magazines and newspapers against other types of cultural goods (cinema, theater, museums, other cultural events, films, music, and magnetic media) has found that books are complements, rather than substitutes, of other cultural goods. Nevertheless, this study does not consider a segmentation of the products. Prieto-Rodríguez, J., Romero-Jordán, D., and Sanz-Sanz, J.F., *Is a tax cut on cultural goods consumption actually desirable? A microsimulation analysis applied to Spain*, Journal of Applied Public Economics, 26(4), 2005, pp. 549-575.

instead of one with high consumer loyalty.<sup>56</sup> Hence, the cross-subsidization argument would not hold anymore.

- *Small bookstores should not be, and are not, as protected as implied*

The discourse on FBP usually places a lot of emphasis on the “disloyal discounting” carried on by large retailers: they abuse their dominant position to force publishers into granting them lower prices which allows them to undercut small competitors.<sup>57</sup> Defenders of FBP consider that small bookstores must be protected against this “unfair competition”, and the way to do it is by restricting large retailers’ ability to offer lower prices. This objective is clearly paternalistic and hardly compatible with a competition policy focused on efficiency.

If publishers offered all bookstores the same commercial conditions, even the smallest one could offer discounts and the “unfairness” in the market would vanish. Yet, differentiation among bookstores may be economically justified if it derives from differences in costs and does not have exclusionary effects. For instance, competition authorities in the European Union, the United States, and Mexico have upheld uniform volume discounts as lawful, even when granted by or to a dominant firm.<sup>58</sup> However, if price cuts are selective and not justified in economic grounds, competition law should be applied to deter and punish these practices instead of fighting anti-competitive behavior by restricting competition.<sup>59</sup>

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<sup>56</sup> See: Steiner, R.L., *The evolution and applications of dual stage thinking*, Antitrust Bulletin, 49(4), 2004, pp. 877-909.

<sup>57</sup> This is present on the discussions carried on by the Mexican Congress and Supreme Court, but also by other defenders of FBP in Latin America. See: Centro Regional para el Fomento del Libro en América Latina y el Caribe, *Pensar el Libro*, 4, August 2006. In particular, the articles published by Cabanellas, A.M.; Argüelles, J.D.; Uribe, M.; Arcila Gutiérrez, P.D.; and Uribe, R. and García de la Torre, M.A. Available in Spanish at: [http://www.cerlalc.org/revista\\_precio/editorial.htm](http://www.cerlalc.org/revista_precio/editorial.htm).

<sup>58</sup> To offer a lower price as quantity increases is justified as long as the discounts reflect the lower unit costs incurred by sellers in large-volume transactions. For example, see: *British Airways Plc. v. Commission*, Case T-219/99, E.C.R. II-5917, 2003, para. 246-247; *Portugal v Commission*, Case C-163/99, E.C.R. I-2613, 2001, para. 49-53.

<sup>59</sup> In Mexico, exclusivity discounts and differences in commercial conditions are considered anticompetitive when they are carried on by dominant firms absent any efficiency defenses. See articles 54, 55 and 56, sections VIII and X, of the FLEC.

Moreover, if the discounts obtained from publishers allow large retailers to offer lower prices, this practice is not anticompetitive: it would be predatory pricing if the price they set is below their marginal or average variable costs, and as long as they can recoup the losses in the future.

Even if we do not question the desire to protect small retailers, FBP do not mean all bookstores will enjoy the same marginal revenues: while the retail price must be the same for all bookstores, the wholesale price will still vary among them. Due to their bargaining power and economies of scale, large retailers can enjoy higher marginal revenues than traditional bookstores by negotiating a lower wholesale price. The difference is that, under a FBP scheme, large retailers will no longer pass those rebates to consumers. Traditional bookstores, not being able to charge higher prices to compensate, will still have inferior marginal revenues than large retailers.

Another point that must be considered is whether the development of large retailers and unconventional distribution channels does in fact affect the sales and reduce the number of traditional bookstores. On this regard, an empirical study on the Spanish market shows that they have a positive and synergetic relationship, which has even lead to an increase in the number of bookstores and made consumers better off.<sup>60</sup> Thus, it would seem that traditional bookstores do not require any State protection to ensure their subsistence in the market.

- *Reduce incentives to expand into remote areas*

Different bookstores face different cost structures which do not necessarily derive from inefficiency, but by external factors. Costs vary drastically among locations. Supplying a

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<sup>60</sup> Hernández, A. and Jiménez, J.L., *Do supermarkets reduce the number of traditional bookshops? An empirical application to the textbook market in Spain*, Association for Cultural Economics, Working Paper AWP-02-2011, 2011.

remote area usually implies higher transportation costs and a lower quantity demanded; thus, average and variable costs will be higher than supplying a large city. Publishers set bookstores' marginal revenues regardless of these differences in costs. A margin that is profitable for a bookstore located in Mexico City might not be for a bookstore in a small community in Chiapas. By not being able to raise prices and compensate those costs, bookstores have less incentive to expand their business to remote areas.

- *Additional services may not be welfare-enhancing*

Allegedly, price competition and uncertainty in marginal revenues have deterred bookstores from providing additional services that would otherwise benefit consumers. Nevertheless, FBP would only be necessary for incentivizing their provision as long as those additional services are publisher-specific and could be subject to free riding. This may be the case of salesmen's promotional efforts and the information on books they provide thereof. However, FBP cannot prevent consumers from obtaining these services elsewhere: through the internet or at book-clubs, for example. Thus, it is not clear why a restriction to competition would be necessary or proportional to ensure these services and how does their provision impact the demand.

Moreover, most of the additional services that could be offered by bookstores are inherent to their infrastructure and internal logistics; therefore, they are neither publisher-specific nor subject to free riding. Consequently, if those services were valuable for consumers, bookstores would provide them regardless of price competition (up to the extent they serve to increase their market shares and overall profits); if they are not, then FBP is forcing consumers to subsidize unwanted services:

“In practice non-price competition may be of value to customers, some of whom will accordingly be prepared to pay higher prices for a better quality of service. The key point is that the free market will force firms to provide their quality of service as cheaply as possible and that the range of different types of services on offer will be determined by the preferences of consumers rather than of suppliers”.<sup>61</sup>

In this regard, we should evaluate how valuable are those additional services to consumers; particularly, by distinguishing their impact on marginal versus infra-marginal consumers. Indeed, not all consumers value them equally; they have different preferences on the right amount of services and prices:

“The additional customers attracted by the services must be better off as a result of the service provision. But if some of the additional receipts are derived from higher prices charged to infra-marginal customers who do not value the services, the benefits to society of the services provided need not justify their cost”.<sup>62</sup>

If infra-marginal consumers do not value them enough, and would be better off with a lower price, the provision of these additional services will have a negative effect on welfare. And if marginal consumers do not value them, the provision of these services would not lead to an increase in consumption by non-readers.

- *Incentives to innovate will be eliminated*

Under a FBP scheme, unconventional distribution channels (such as coffee-shops, supermarkets, petrol stations, or online portals) will have fewer incentives to develop:

“By stopping price competition in retailing, the practice impedes the replacement of high-cost by low-cost forms of retailing, and of less efficient by more efficient firms [...] price maintenance tends to slow down the pace of change in retail

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<sup>61</sup> Allan, W. and Curwen, P., *Competition and choice in publishing industry*, Institute of Economic Affairs, London, 1991, p. 23.

<sup>62</sup> Marvel, H.P. and McCafferty, S., *The welfare effects of resale price maintenance*, Journal of Law and Economics, 28(2), p. 370. See also: Van den Bergh, R.J. and Camesasca, P.D., *op. cit.* pp. 218-221; and Comanor, W.S., *Vertical price-fixing, vertical market restrictions, and the new antitrust policy*, Harvard Law Review, 98(5), 1985, pp. 983-1002.

markets, to delay changes in the shares of trade handled by different types of retail enterprise and to discourage the development of ‘unorthodox’ methods of retailing”.<sup>63</sup>

Their competitive advantage against bookstores is precisely low transportation and distribution costs that could allow them to offer better prices to consumers. However, their business model is not focused on books and they offer mostly bestsellers; for this reason, defenders of FBP have disdained them.<sup>64</sup> Yet, this does not seem consistent with a policy aiming to facilitate access to books in general. It would end up displacing cost-efficient retailers from the market, reducing the number of options available for consumers, and harming those who would prefer lower prices.

Moreover, by preventing price competition among retailers, FBP are restricting dynamic efficiency in the market and withdrawing the incentives to innovate. Particularly, if consumers are heterogeneous, FBP fail to give retailers the proper incentives to invest in product and service differentiation. Indeed, by restricting the ability to price discriminate, FBP will affect the development of innovative selling formats with a variety of service portfolios. As consequence, the supply available for consumers will be rather homogeneous.

“The prevention of price competition between retailers protects inefficient outlets and hinders the expansion of more efficient methods of retailing. Specialization with consequent economies of scale is hindered because its advantages cannot be exploited. The protection afforded to small-scale, high-cost traditional forms of supply tends to breed homogeneity in business psychology and skills and a resistance to experiment and change from within”.<sup>65</sup>

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<sup>63</sup> Yamey, B., *The economics of resale price maintenance*, London, Pitman, 1954, pp. 5 and 86.

<sup>64</sup> See footnote 57.

<sup>65</sup> Yamey, B., *op. cit.*, cited in Fishwick F., *op. cit.*, p. 9.

- FBP are unnecessary due to technological advances

Technological developments over time have significantly changed the paradigm in the book market. This circumstance, for example, led the United Kingdom's Restrictive Practices Court to consider FBP were not justifiable anymore and to overturn the NBA.<sup>66</sup> Certainly, technology has allowed a reduction in unit production and storage costs, improving books' profitability. It also reduces consumers' opportunity and transaction costs<sup>67</sup> and solves some information asymmetries on books before purchase.<sup>68</sup> Additionally, technology has also allowed retailers to strengthen their logistics and speed up the internal flow of books.

Nowadays the internet has become an important tool to increase accessibility not just to books in particular, but to cultural and scientific ideas in general. Moreover, it also minimizes authors' barriers to entry: blogs, for example, have become a popular way for people to spread their thoughts. Likewise, the ebook market has significantly grown, providing a substitute to print books that is easily accessible through any electronic device with internet connection: it has been estimated that most of the ebooks sales come from cannibalizing print books and only a third purely come from market expansion.<sup>69</sup> Consequently, as these technologies penetrate deeper in the country,<sup>70</sup> print books and brick-and-mortar bookstores will no longer be indispensable for people wanting to read.

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<sup>66</sup> Utton, M.A., *Books are not different after all: observations on the formal ending of the Net Book Agreement in the UK*, International Journal of the Economics of Business, 7(1), 2000, pp. 115-126.

<sup>67</sup> For instance, online stores have spread the availability of books and reduced transaction costs for their exchange.

<sup>68</sup> It has become easier for consumers to access information on the content and recommendations of books, as well as to locate the nearest place where the book is available.

<sup>69</sup> Li, H., *The impact of ebooks on print book sales: cannibalization and market expansion*, University of Pennsylvania, 2013. Available at: [https://bepp.wharton.upenn.edu/bepp/assets/File/HuiLi\\_ebook\\_Feb15.pdf](https://bepp.wharton.upenn.edu/bepp/assets/File/HuiLi_ebook_Feb15.pdf).

<sup>70</sup> However, penetration is quite low in Mexico. According to statistics from OECD, by December 2013, Mexico ranked the lowest from the 34-country group in wireless broadband subscriptions per 100 inhabitants and the second lowest in fixed broadband. Source: <http://www.oecd.org/sti/ict/broadband>.

- FBP do not lead to an increase in demand

FBP in Mexico have an additional objective not present in the European discourse: to promote reading habits among the population by an increase in supply. Theoretically, an increase in supply leads to a decrease in price that *ceteris paribus* increases the quantity that a consumer demands of a good. Yet, even if we assume that FBP in fact increase supply, it is not clear that price will consequentially decrease and, hence, it will not necessarily translate into an increase in the quantity of books demanded. Indeed, the publisher will fix the retail prices based on their *ex ante* estimations of the market; however, he will be reluctant to change it afterwards and adjust it to the real market conditions.<sup>71</sup> Considering that books are price-elastic, an increase in price will hardly increase the quantity of books demanded. Additionally, other variables are also relevant to determine demand, but FBP do not address them: the preferences of the consumer; its income; and the prices of substitute and complementary goods. Thus, it is incomprehensible how FBP would serve to promote reading.

#### **D. ANALYSIS OF THE MEXICAN CASE**

The Law seeks to ensure that (i) a larger quantity and diversity of books becomes available (*i.e.* published and distributed); (ii) those books are accessible for people through an extensive and non-concentrated network of bookstores and libraries; and (iii) Mexicans increase and diversify their reading habits. Within this chapter I will attempt to observe how those three indicators have changed overtime as a proxy of the Law's impact.

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<sup>71</sup> If the costs from changing a price are high then they will remain unchanged. FBP increases this cost because the publisher will need to report it to a government commission, register the new price, and ensure all retailers apply it. Sticky prices can be both privately efficient and socially inefficient. Mankiw, N.G., *Small menu costs and large business cycles: a macroeconomic model of monopoly*, *The Quarterly Journal of Economics*, 100(2), 1985, pp. 529-537. Moreover, the principle of loss aversion can also explain publishers' reluctance to decrease prices. Kahneman, D., and Tversky, A., *Choices, Values and Frames*, Cambridge University Press, 2000.

However, even after this analysis it is not possible to draw a decisive conclusion on the Law's effectiveness: the data available are limited and not fully reliable; the book market is too complex and is impacted by many independent variables; and is difficult to establish a direct link between the Law and any quantitative changes that the book market may have displayed overtime. Additionally, we would need to evaluate if the Law has been enforced since its enactment, considering that it lacks sanctions in case of non-compliance. Thus, a more detailed investigation would be required to have a better assessment.

## **I. AVAILABILITY**

This analysis is based in data reported by the National Chamber of the Mexican Publishing Industry on 2013.<sup>72</sup> I was not able to access neither more detailed reports nor historical data on the publishing industry that could allow me to carry out a better analysis.

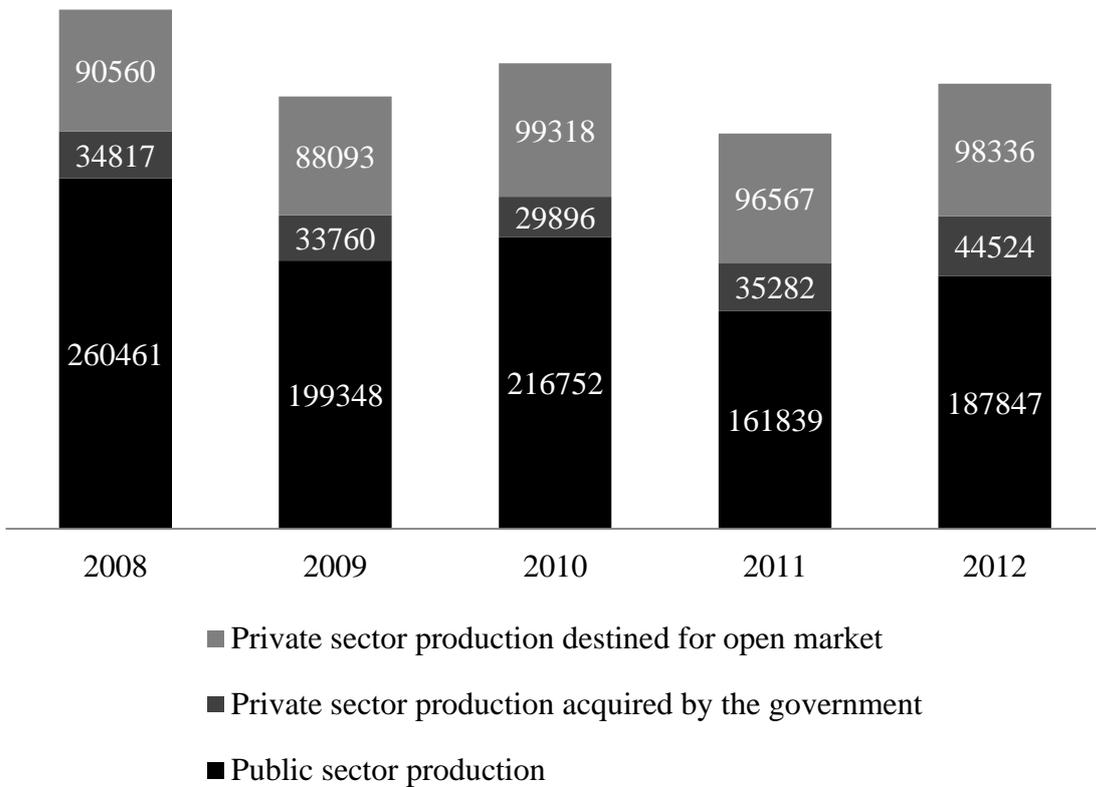
### **1. Books produced**

The number of books produced from 2008 to 2012 has slightly decreased. However, more than 50% corresponds to books either produced or to be acquired by the government, and are out of the scope of the Law. The number of units produced by the private sector and destined to be sold in the open market has not varied significantly over time: it increased by 7.9% from 2008 to 2012.

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<sup>72</sup> Available in Spanish at: <http://www.caniem.org/archivos/estadistica/Indicadoresbooklet2012.pdf>.

### Number of books produced in Mexico



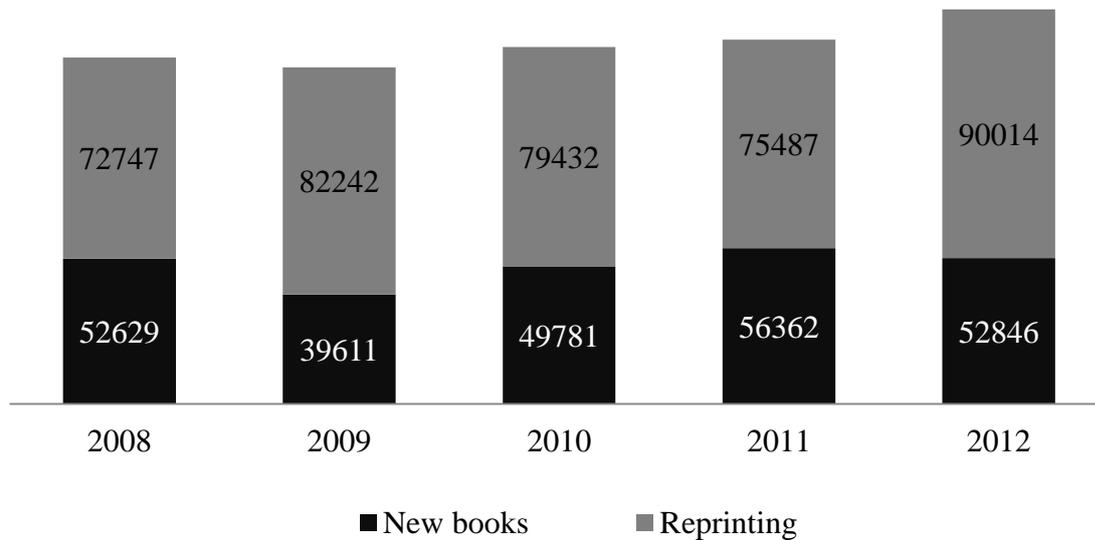
The impact of these numbers depends on the population of the country. According to the INEGI, the population in Mexico that is able to read grew 10.8% from 2005 to 2010, reporting a total of 89,599,459 individuals on the latter year.<sup>73</sup> On the other hand, the total production of books suffered from a 14.3% decrease, from 385,838 units in 2008 to 330,707 in 2012. This indicates that there is a clear insufficiency of books available, at least for 2010: one book per every 259 inhabitants; or one per every 902 inhabitants if we just consider books destined for the open market.

The aforementioned numbers refer both to reprinted books and new publications. Nevertheless, the Law is only applicable to books within the first 18 months of their publication as a tool to incentive that new books are published. Thus, it is relevant to

<sup>73</sup> Since the population census is carried on every 5 years, there is no official data available for more recent years.

distinguish between both types of books and focus on how the production of new books has changed after the Law.

**Number of books produced by the private sector, including both open market and government acquisitions**

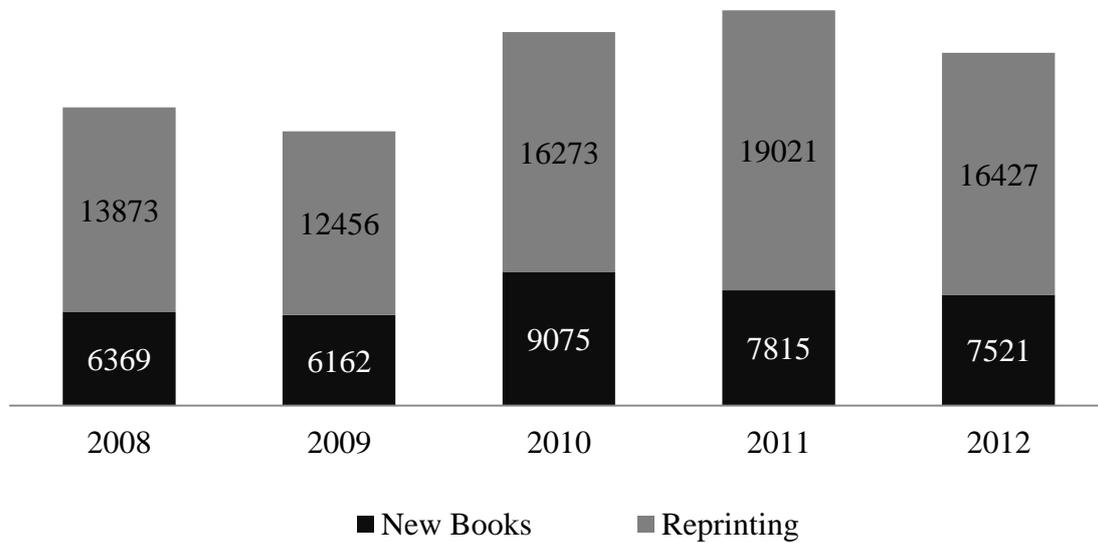


On this regard, the data show that production of books by the private sector has displayed a minor but consistent upwards tendency: the number of units increased by 12.2% from 2008 to 2012. Yet, that increase mostly corresponds to reprints. The amount of new books has maintained over time, and their proportion in the total production has slightly decreased: from 42% of the total of books produced in 2008, to 37% in 2012.

Data on the different titles that have been produced can serve as a proxy to assess their diversity.<sup>74</sup> However, this data is insufficient to reflect changes on the production of unpopular books as compared to bestsellers that could allow assessing the applicability of the cross-subsidy argument.

<sup>74</sup> Authors generally view diversity depending on the number of book titles offered. See: Caves, R.E., *op. cit.*; Cowen, T., *Creative destruction: How globalization is changing the world's culture*. Princeton, Princeton University Press, 2002; Van der Ploeg, F., *op. cit.*; and Canoy, M., Van Ours, J.C., and Van der Ploeg, F., *The economics of books*, CESifo Working Paper 1414, 2005, available at: <http://SSRN.com/abstract=668861>.

**Number of different titles produced by the private sector,  
including both open market and government acquisitions**

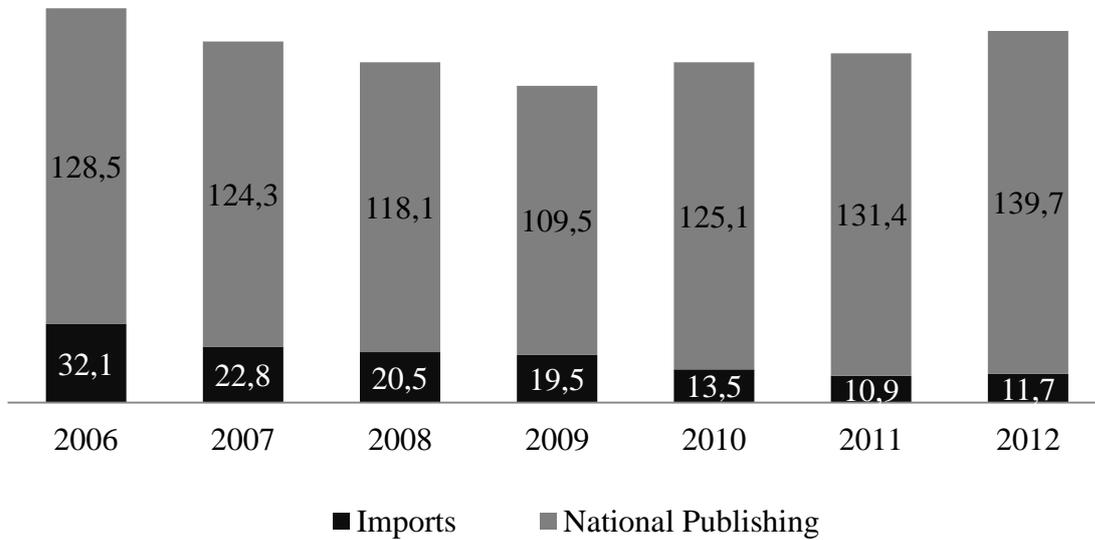


Here, there is no clear upwards tendency as in the case of the amount of books produced. In fact, the production of different titles has actually gone downwards from 2011 to 2012. Moreover, new titles have remained at 31% of the total production.

**2. Books sold**

The amount of books that have been sold decreased importantly from 2006 to 2009. The tendency reverted since 2010, but the total amount is still inferior to the one before. While the increases in sales are related to government acquisitions, the decreases correspond to a loss in market share of imported books against national publishing.

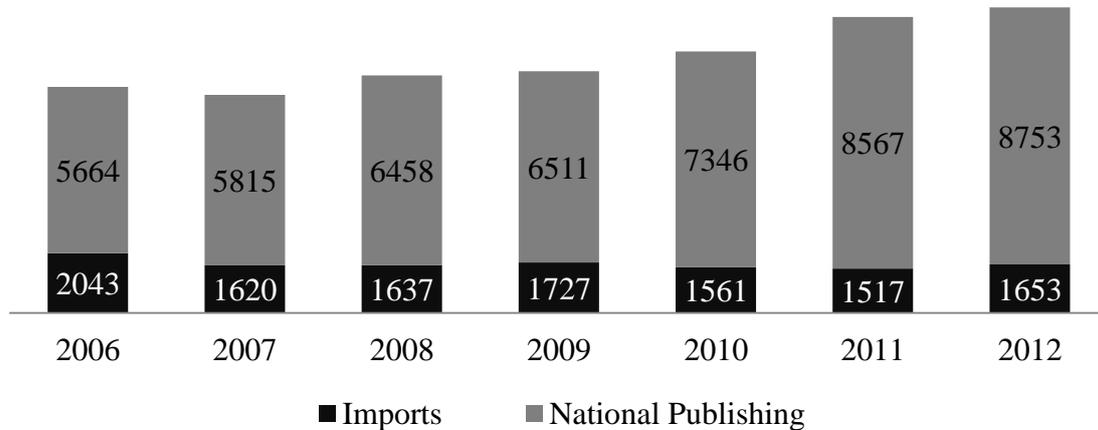
### Millions of units sold by the private sector



Indeed, imported books corresponded to 20% of the market in 2006, while for 2012 they only represented 8%. The Law is applicable to both imported and national books; moreover, books are not subject to import taxes. Thus, we could fairly assume that this decrease does not relate to legal barriers against imports. It is worth noting that a large proportion of the books sold correspond to books for elementary and secondary education: just in 2012, these books represented 42.9% of the total sales in terms of volume, while literature books represented only 5.9%.

If we look at sales from the value point of view, instead of the volume, the “V” shape of the previous graph disappears and we appreciate a constant increase, particularly regarding national publishing. This could indicate a raise in prices: indeed, the total sales value increased from 2006 to 2012 by 2,699 million pesos even though the amount of units sold during that time-lapse decreased by 9.2 million units. However, other macroeconomic factors, such as inflation, should be considered.

### Millions of pesos billed for sales by the private sector



The following chart illustrates how the number of books sold is spread along the different distribution channels. For private consumption in Mexico, bookstores are the most important channel to acquire books, while supermarkets and departmental stores follow from the distance.

### Thousands of books sold by the private sector per distribution channel

Distribution Channels	2006	2007	2008	2009	2010	2011	2012	
							#	%
Government	60,347	46,619	48,140	44,142	46,496	49,512	59,349	39.2
Bookstores	42,045	42,084	41,705	40,468	39,999	40,345	39,408	26.0
Schools	11,681	12,789	9,822	9,722	12,476	13,512	17,974	11.9
Exports	16,085	14,991	14,894	11,545	15,466	14,951	13,428	8.9
Supermarkets and Departmental Stores	12,731	12,747	11,013	11,926	10,611	8,393	9,549	6.3
Own outlets	2,431	1,825	2,240	1,908	3,870	4,494	4,311	2.8
Book fairs	2,539	991	1,094	1,131	1,170	1,032	1,413	0.9
Private companies	2,254	3,710	2,972	3,152	2,426	3,761	907	0.6
Direct sales	1,946	1,658	1,378	1,329	1,226	1,181	148	0.1
Others	7,544	8,715	5,431	3,680	4,867	5,158	4,930	3.3
<b>Total</b>	<b>160,603</b>	<b>147,129</b>	<b>138,689</b>	<b>129,003</b>	<b>138,607</b>	<b>142,339</b>	<b>151,417</b>	<b>100</b>

Unconventional distribution channels have not managed to penetrate in the market. On the contrary, it seems that they have been losing strength overtime: supermarkets and departmental stores had a 7.9% share in 2006 but for 2012 they just occupied 6.3% of the market, while bookstores have maintained their share during the same period.

## **II. ACCESSIBILITY**

The Law has the intention not only to increase the number of bookstores in the country, but also to decentralize it. Indeed, one of the main concerns highlighted within its statement of intent is that bookstores are mostly present in Mexico City, while the population in other locations does not have access to them. The Law is not seeking to enhance unconventional distribution channels and these represent a small percentage of the distribution channels to which publishers sell their books; consequently, they will be out of my evaluation. This analysis is based on data for December 2006 and November 2013 reported by the National Council for Culture and Arts (“Conaculta”).<sup>75</sup>

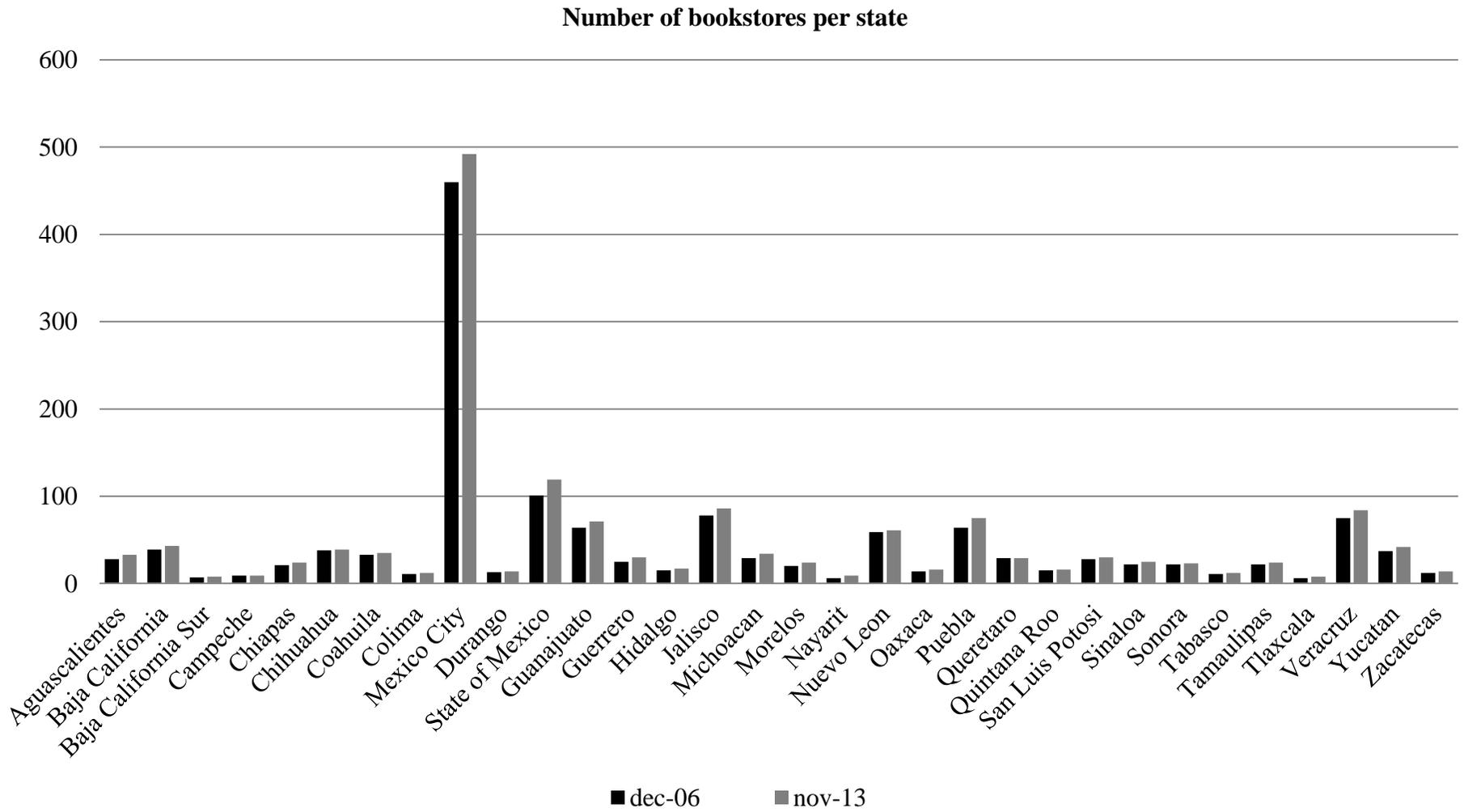
Moreover, I will take a look into data on public libraries.<sup>76</sup> Even though FBP do not impact them directly, the Law allegedly aims to promote them as well. If the ultimate goal of the Law is to promote reading, it should not really matter whether people purchase the books or just borrow them. In Sweden, for example, the government has preferred to focus its efforts in the development of libraries rather than protecting bookstores by restricting competition. Indeed, investing in libraries could be a better mechanism to approach books towards readers in those locations where it is not profitable to establish a bookstore.

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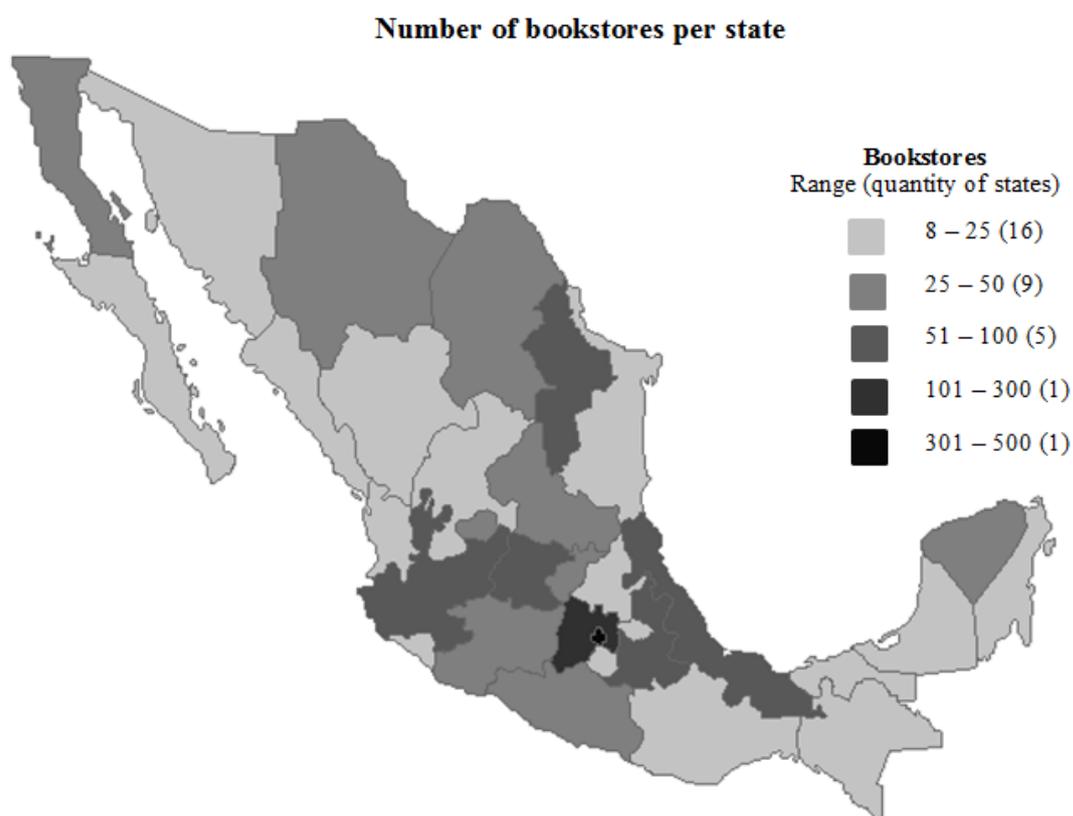
<sup>75</sup> The statistics are available at: <http://sic.conaculta.gob.mx>.

<sup>76</sup> Statistics for 2006 and 2011, reported by INEGI, available at: <http://www3.inegi.org.mx/sistemas/biinegi/#A>.

**1. Bookstores**



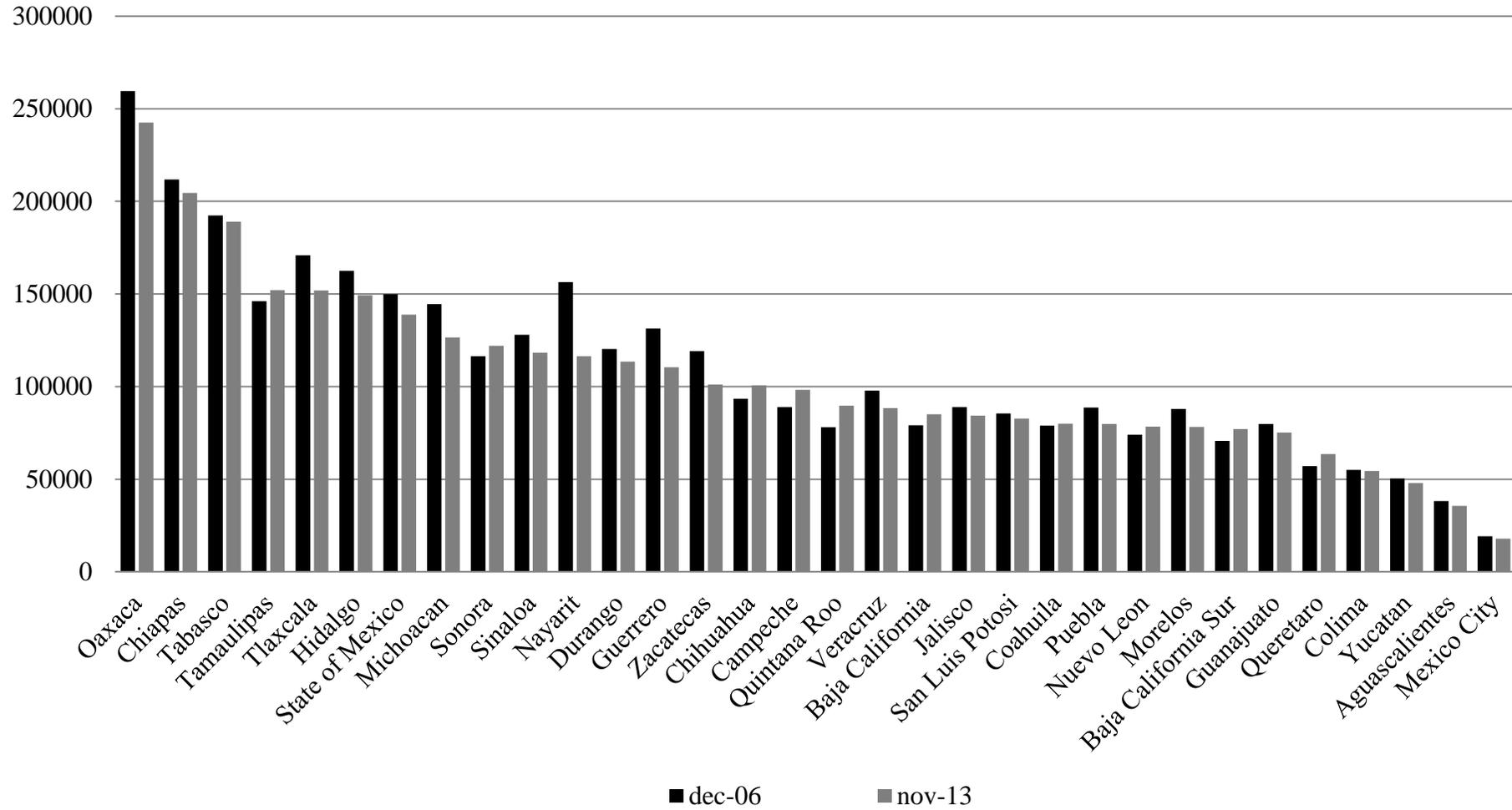
The total number of bookstores has increased by 9.3%: from 1,413 in 2006 to 1,558 in 2013. However, it must be highlighted that there are no accessible data on the number of books and titles available per bookstore. Moreover, as it can be appreciated from the previous graph, they are still centralized: 492 are located in Mexico City, representing 31.58% of the total; followed by 119 bookstores in the State of Mexico, representing 7.63%. These two states have been also the ones which show a larger increase over time: 32 additional libraries in Mexico City and 18 in the State of Mexico.



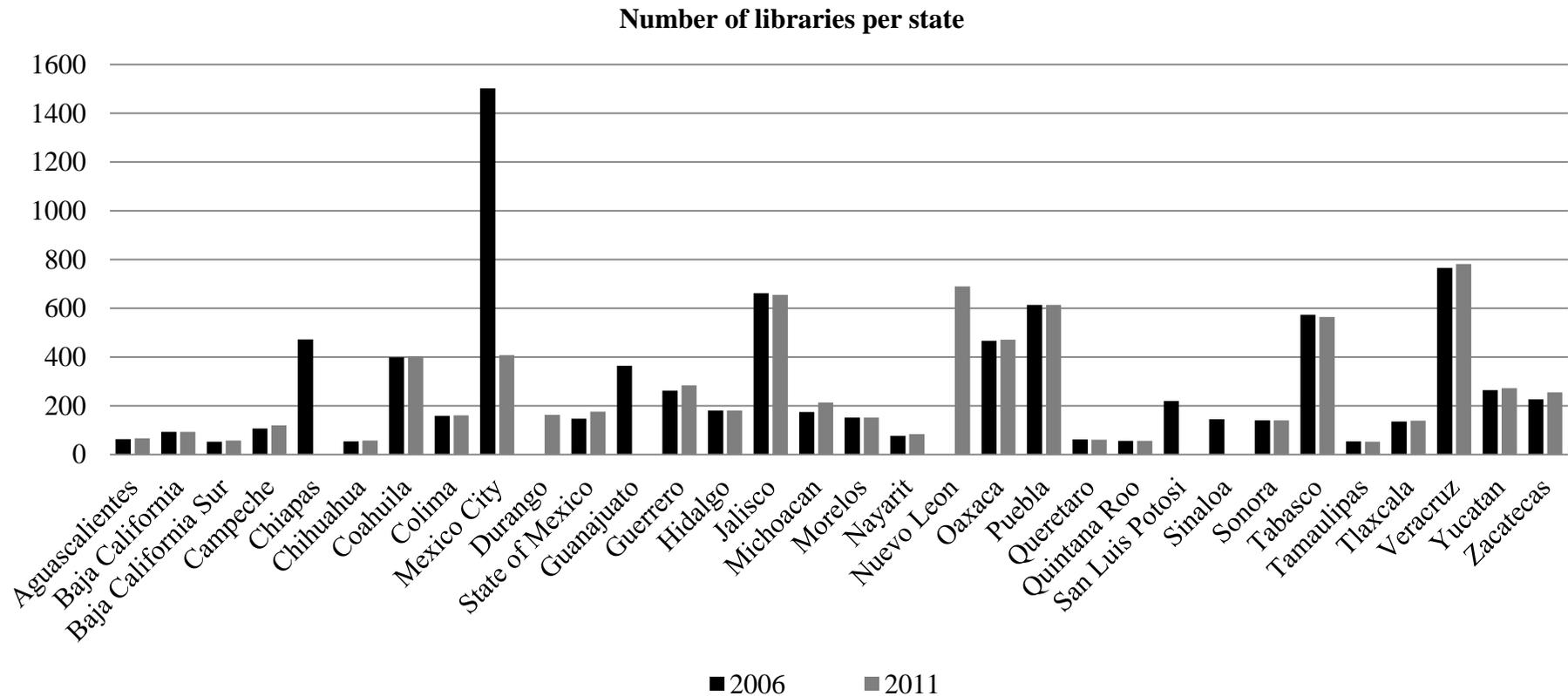
In the national scale, there are 72,103 inhabitants per bookstore,<sup>77</sup> and only 55.23% of the total population lives in a municipality with at least one bookstore. Even though Mexico City has a high density of population, it is also the one which reports the lowest number of inhabitants per bookstore, with 19,178 in 2006 and 17,903 in 2013. The State of Mexico, in the other hand, is now ranked as the 7<sup>th</sup> state with more inhabitants per bookstore: 149,853 in 2006 and 138,922 in 2013.

<sup>77</sup> Considering a national population of 112,336,538 inhabitants, as reported by INEGI on 2010.

### Inhabitants per bookstore

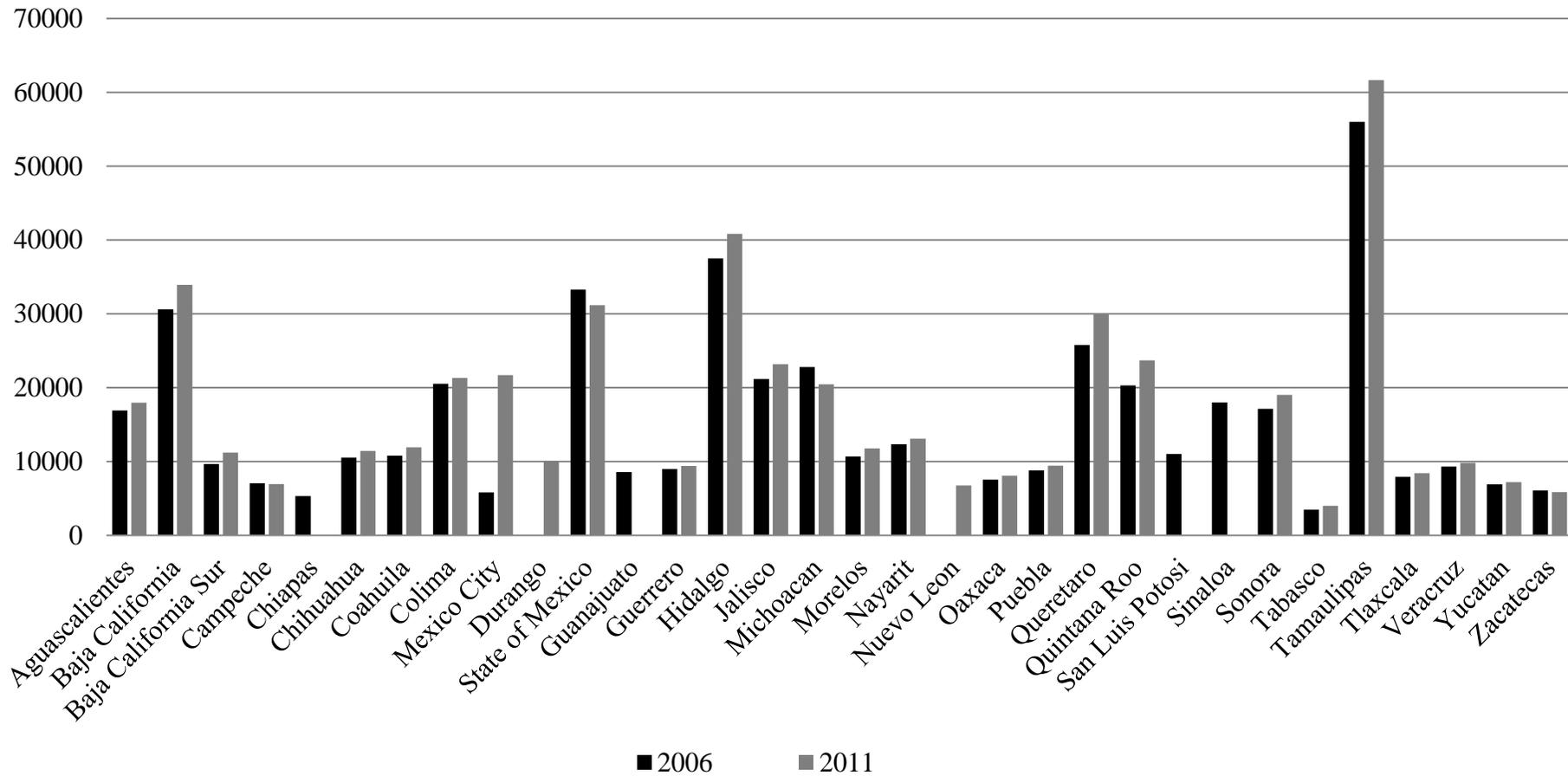


## 2. Libraries



\* There is no available data for Durango and Nuevo Leon on 2006; and for Chiapas, San Luis Potosí and Sinaloa on 2011. The number of public libraries for Guanajuato in 2011 is zero.

### Inhabitants per library



\* There is no available data for Durango and Nuevo Leon on 2006; and for Chiapas, San Luis Potosí and Sinaloa on 2011. The number of public libraries for Guanajuato in 2011 is zero.

Regarding the number of public libraries in the country, it has decreased by 14.7%: from 8,636 in 2006 to 7,363 in 2011. In particular, 10 out of 32 states have either maintained or diminished it. From those, Mexico City shows the more drastic change, with a reduction of 1,094 libraries. On the other hand, Michoacán reports the highest increase, with 39 additional libraries. There does not seem to be a correlation between the number of libraries and the number of bookstores per state. For example, Tabasco ranks at the lower end in number of bookstores in the country, but ranks fourth in public libraries (564 in 2011); the State of Mexico and Guanajuato show the opposite tendency. Nuevo León, Jalisco and Puebla report the highest amount in public libraries: 690, 655 and 613, respectively. After Mexico City and the State of Mexico, these are the states with the highest amount of bookstores.

There were 15,257 inhabitants per library in the country for 2011. Tamaulipas has the highest amount, with 61,670, while Tabasco reports the lowest with 3,939. Strangely enough, both of these states ranked among the highest number of inhabitants per bookstores. Once again, the data does not indicate any sign of correlation between these two variables.

### **III. READING HABITS**

The following analysis is based in data obtained from the National Reading Survey from 2006; the National Survey on Cultural Habits, Practices and Consumption from 2010;<sup>78</sup> and the National Reading Survey from 2012.<sup>79</sup> These studies use different methodologies and samples; thus, a comparison between the results reported by both needs to be observed with caution. Moreover, they also suffer from non-sampling errors due to the subjectivity of respondents.

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<sup>78</sup> Both of these surveys were elaborated by Conaculta and are available in Spanish at: [http://sic.conaculta.gob.mx/publicaciones\\_sic.php](http://sic.conaculta.gob.mx/publicaciones_sic.php).

<sup>79</sup> Elaborated by the Mexican Foundation for the Promotion of Reading. Available in Spanish at: <http://issuu.com/politicaspUBLICAS/docs/enl2012>.

## **1. How much do Mexicans read?**

Mexicans had low reading engagement before the Law was enacted, and it was supposed to incentivize them to read more. Ideally, if we take a look into before and after data on the number of readers in Mexico, and the amount of books read by them, we should be able to observe an increase. Yet, the number of respondents who identified themselves as readers decreased from 56.4% in 2006 to 46.2% in 2012. Moreover, the estimated average of 2.9 books read per year stayed the same from 2006 to 2012. An increase in reading engagement is positively correlated with reading literacy rates;<sup>80</sup> however, in 2012, Mexico scored 424 in PISA's reading literacy test, compared to the 422 from 2006.<sup>81</sup>

Preliminarily, these results suggest that the Law has not served to incentivize non-readers to start reading. In general, Mexicans are not reading more and are not able to understand better what they are reading. Actually, in both surveys, a higher proportion of respondents perceived they read less than before: 40% in 2006 and 43% in 2012. Respondents attribute it to lack of time, dislike for reading, preference towards other recreational activities, laziness, and expensive prices of books.

## **2. Who are the Mexican readers?**

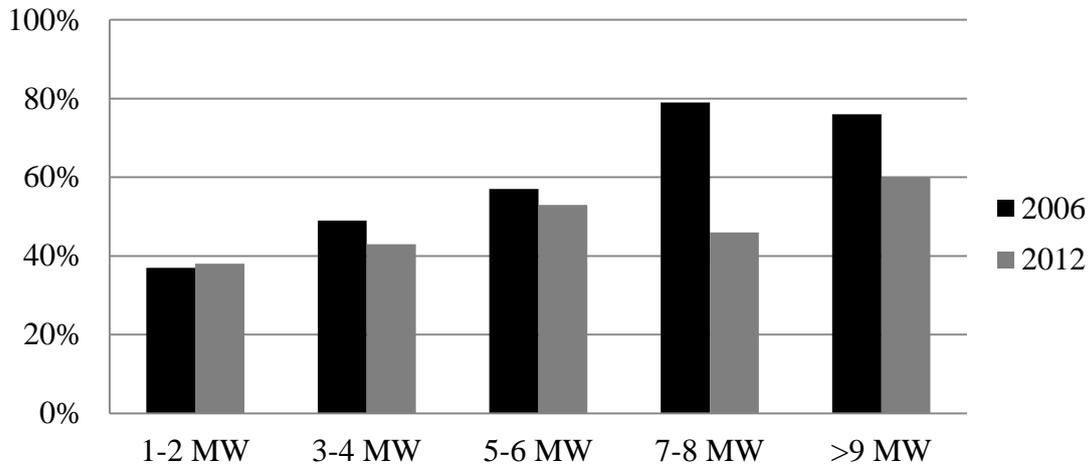
The data reflects a consistent positive correlation between socioeconomic and education levels, and reading habits (number, diversity, and frequency of books read).

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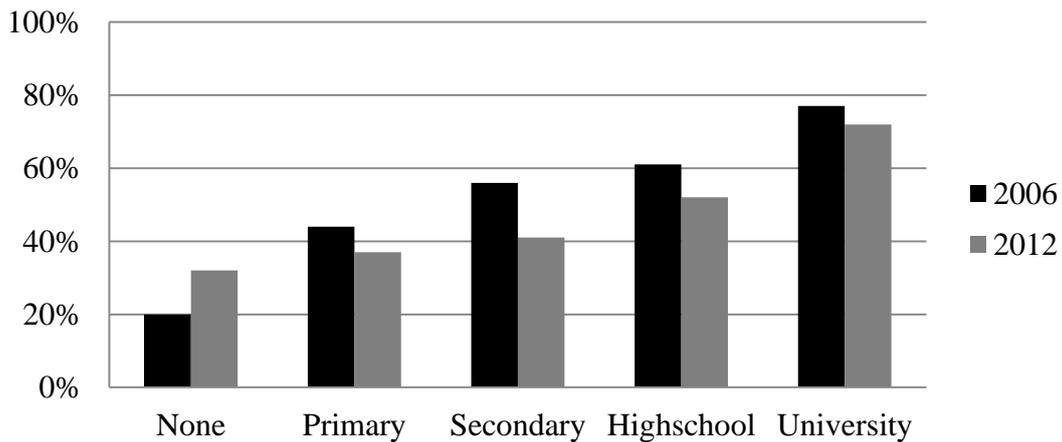
<sup>80</sup> See footnote 2.

<sup>81</sup> Results available at: <http://www.oecd.org/pisa/keyfindings/pisa-2012-results.htm>.

**Percentage of respondents who identified themselves as readers, by the amount of minimum wages (“MW”) they earn**



**Percentage of respondents who identified themselves as readers, by their education level**



This correlation is not only present in the national results, but also when evaluating reading habits by region. Indeed, the higher percentages of readers in the country were located at the three largest cities: Mexico City, Guadalajara, and Monterrey. On the contrary, the south and central-western regions were characterized by low percentages of readers. These regions include states (such as Michoacán, Chiapas, Oaxaca, and Guerrero) that have constantly reported high poverty rates and low education indexes.

Correlation does not necessarily imply causation. However, this suggests that books are perceived as luxury goods; consequently, an increase in prices may have undesired effects in

reading habits. Additionally, it highlights the importance of considering the social conditions that promote reading. Certainly, little does it help to bring books closer to people that are not able to see the value in them and lack the basic skills to comprehend them. If a high percentage of the population is excluded from education, employment and economic development, it is hard to expect them to have reading as their priority.<sup>82</sup> Thus, policies intended to increase the standard of living and the quality of education could have a positive effect in reading habits, without it being necessary to restrict competition in the book market.

### **3. How do Mexicans obtain the books they read?**

The surveys from 2006 and 2010 indicate a consistent preference towards purchasing books, mostly at bookstores. Indeed, the usage of other distribution channels<sup>83</sup> as means to access books is extremely low. It would be worth to analyze why unconventional distributors have not penetrated in the market: is it due to a preference for consumers towards the additional services offered at bookstores? However, this may suggest that unconventional distributors hardly threaten the existence of bookstores in the market.

A majority of respondents declared not having bought any book during the previous year: 54% in 2006 and 79% in 2010. When asked to explain why, respondents from 2010 attributed it to “dislike towards reading”, “lack of money”, “being uninterested in purchasing books”, “lack of time”, and “preference to access the books by other means”. Again, these explanations do not match the potential solutions offered by the Law.

Regarding other means for accessing books, both surveys indicate people mostly borrow them from friends and family. Less than a third of the respondents reported reading

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<sup>82</sup> For example, PISA 2012 reports that Mexico has the third lowest school coverage from the countries evaluated.

<sup>83</sup> The most common ones are book fairs, supermarket and departmental stores, and street stands. Nearly 1% purchase books through the internet.

books from a library. Once again, the usage of libraries shows a clear positive correlation with socioeconomic and education levels of the respondents. It suggests that those who access books at a library do not do it because they cannot afford to purchase them. The majority of respondents who have not visited a library explained it is because they “do not have time” or “do not like reading”.

## **E. CONCLUSIONS**

The Law was enacted and ruled as constitutional under the consideration that its dispositions were not anticompetitive, that it would serve to decentralize and enhance the book market, and ultimately promote reading habits in Mexico. However, the analysis done by the Congress and the Supreme Court was rather superficial and biased. Certainly, FBP’s welfare effects are ambiguous and their evaluation cannot be taken lightly. Even in Europe, despite having been discussed for over a century, a consensus on which pricing system is preferable has not yet been reached.

Firstly, the nature of the product itself limits inter-brand competition and makes supra-competitive prices highly probable under an RPM scenario. Furthermore, FBP do impose a restriction on intra-brand competition, by limiting it to non-price factors, without providing a direct solution to information asymmetries. Yet, these effects should be outweighed against potential benefits FBP might display in the market: mainly, an increase in the quantity and diversity of books available, and the strengthening of the network of bookstores. The overall impact FBP would have in the market depends on a multiplicity of variables which were not evaluated in the Mexican discourse: for instance, books’ price and income sensibility; consumers’ valuation of additional services; bookstores’ cost structures; substitutability with

other cultural goods and distribution channels; the role of innovation and technological developments; and the general social conditions.

A preliminary evaluation of the data suggests that FBP have not had the desired effect in the market. From the supply perspective, the quantity and diversity of books produced and sold has relatively maintained over time; bookstores remain centralized; and the number of books and bookstores available per inhabitant continues to be high. Moreover, even assuming that FBP would have had a positive effect on the supply of books, it is not clear how that would translate into an increase in demand. On the contrary, the data indicates that less people identify themselves as readers; the number of average books read per year is still the same as in 2006; and the results from PISA's reading literacy test have barely changed. Additionally, the analyzed surveys show that consumers' lack of reading habits is not attributable to accessibility and availability of books, but rather correlated to low education levels.

These results have to be read with caution, and no causal effect can be drawn. Nonetheless, they suggest that FBP are not an effective tool in guaranteeing the right of access to culture. Therefore, the restrictions in competition they impose cannot be justified under constitutional terms. The promotion of reading habits is a praiseworthy goal, but a more *ad hoc* solution, which does not contravene the right to free competition, is required for its achievement.