

# CULTURAL VAT ON BOOKS

An Evaluation of the three first years

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A report from the Swedish Booksellers Association and  
The Swedish Publishers' Association

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# 1. Introduction

By Dag Klackenberg and Jonas Modig

When we published our report a year ago, about the development of the Swedish book industry from 1973 to 2003, we wanted to describe an unusually dynamic period, which was covered by the statistics that celebrated its 30th anniversary. It was also a period characterized by three decades of free pricing, and almost as many years with the highest VAT on books in the world. We thought that we saw a period of change towards a stronger, more modernized, and commercially more professional industry. We also started to see the first welcome effects of the VAT reduction, something we had fought for for many years.

In December 2002 the Swedish parliament decided to lower the VAT on books and related products from 25 per cent, which is still the standard VAT level, to 6 per cent. The new VAT rate is applicable to printed matters, cassettes, and other media which present books in spoken form, as well as products aimed at the blind and at people with other reading disabilities.

We base the evaluation of the first three years of reduced VAT rate on a positive and hopeful attitude. For this we have good grounds. Our colleagues in most countries face a more sluggish market. In countries which still uphold a system of fixed pricing, a lot of energy is spent on trying to stop the free book trade, which is starting to move across the borders in an increasingly international market. At the same time in Sweden we can see the positive effects of the VAT reduction which we predicted. Publishers, booksellers and others, not least the book buyers, have enthusiastically embraced the stimulus brought about by the lower tax.

The book industry has for a long time been described as operating in a mature market, which sooner or later would have to stand back for new phenomena in the dynamic media world. This judgment today seems premature. The first three years with cultural VAT affirms the conviction that books face a good future in Sweden.

Still, this report is dominated by the fundamentally critical analysis of the monitoring of the price development, which is carried out by The Council for Official Statistics (Statistiska Centralbyrån, hereafter SCB). The monitoring is part of the task set out for the Book Price Commission, appointed by the government. Their sixth and latest report is meant to be delivered in February, 2005. SCB's measurements so far claims that the VAT reduction has meant a corresponding lowering of the price consumers pay for fiction and children's books, but they find the price change for non-fiction not satisfactory.

Dan Ahlmark, economist and a book industry specialist, shows how SCB, despite careful and complex planning, makes mistakes which lead to errors and incorrect conclusions. This part of the report is not easily digested, but readers who take the time to penetrate these problems, will find that the criticism has a solid basis.

Why this preoccupation with criticism of the results of SCB's monitoring? The differences between their conclusions and our own are not particularly great. The Book Price Commission in their reports usually point out that the industry fulfils its promise to pass the VAT reduction on to book buyers.

It is our firm belief that the enhanced analysis of the industry which has been brought about by our own efforts, must be carried on and must be developed further. This must be done using methods which we believe in. Leaving the way SCB measures prices unchallenged would be perceived as our accepting their methods. For future analysis and investigations this would be detrimental.

The differences of opinion are explained by the lack of understanding of the dynamics of the book business. The problem is comparability: how do you compare the books on the market this year with last year's? They are never exactly the same products. It should not come as a surprise that the VAT reduction has an effect on quality. Simply put, space has been created for producing more expensive and better books. It seems evident that SCB have not managed, or rather not wanted, to realise the importance of taking these dynamic effects into account.

If SCB fail to accept this objection we must ask what the expectations – from the politicians – were, regarding the reduction, and how the promises made by the industry were interpreted. We promised not to use the tax cut to increase our gross margins, but to pass the reduction on to the customers. This we stand by, and we emphatically claim that we have kept that promise. We never promised, however, to publish the same books year after year, so that prices could be easily measured. On the contrary, it seems only natural that our production should evolve when better conditions are offered. To say that this is not a way for customers to benefit from the lower VAT is simply not credible.

We have not made any promises regarding changes of reading habits. Current studies give no reason to worry about the development of book reading in Sweden. The political ambition, using the VAT reduction to bring about changes in reading habits, even among adults who never read books to become book readers, should not meet with too great expectations. Experts agree that the Book Price Commission is not appointed for long enough to register any such changes. The Commission says so itself in its reports. Debating these (uncalled for) expectations therefore seems rather meaningless. Still, some already maintain that the reform is a failure on this count. It is hard to believe that anybody had expected that the tax cut would within three years make a significant number of readers out of non-readers.

It is our firm belief that the reduced VAT is a complete success, and that everybody has benefited from it, not least book buyers. We do not hesitate to maintain that the industry has fulfilled its promise to pass the tax reduction on to book buyers. It will soon be hard to understand that the tax levied on books was ever anything other than the cultural tax, which applies to other areas of cultural life.

## 2. Developments for publishers

By Jonas Modig

### Background

The reduction of the VAT on goods and services in the cultural sector from 25 to 6 per cent meant a dramatic lowering of the costs for books. Since it applied to all trade books it changed the market conditions immediately. The impact compares only to the introduction of free book prices in 1970. But in reality it took many years before market conditions were really affected.

The abolishing of fixed prices was decided already in 1965, so the industry had several years to prepare for the transition. More important, by a series of trade agreements, market conditions changed only step by step, and it is not until the past few years that the book industry has done away with the restrictions which emanated from before 1970.

The slow change from a fixed to a free price system is indicative of an industry that is dependent on far-sightedness and patiently developed strategies. It is therefore of special interest to try to gauge the effects of a change which is unequivocal, forceful, broad and quickly implemented. The VAT reform has met with a lot of interest also internationally, and any analysis and documentation that we can produce to describe the effects will be of importance even outside Sweden.

### Dynamic effects

It should be kept in mind that changed pricing, which has been focused on for political reasons, is for publishers only one of several interesting factors. More diverse, and in the long term more interesting, are the dynamic effects caused by improved economic conditions. These will be seen in more varied publishing, in breadth and in type of books; in the structure and number of publishers; in renewal of channels between publishers and book buyers; and in the relations between authors and publishers. We can already see that the number of small publishing houses has increased, thereby broadening the supply of general literature.

These dynamic effects make the monitoring of price changes more difficult. This difficulty has been a recurrent theme in the analysis of the industry's development, and in the political discussions about book market conditions.

It is important when trying to establish the market effects of the VAT reduction, to estimate the general economic state of the industry. The shifts in state of the book trade do not follow the changes in the whole economy. There are indications of the opposite, i.e. that the book industry benefits from a weaker general economy, since consumers have a tendency to switch from more expensive goods and services to for example books. But the pattern is not unambiguous. A deep recession will affect books as well, but with a certain time lag, and a strong economy will have positive effects on book selling.

### The favourable trend

When the VAT was reduced the book industry already experienced a positive trend. According to statistics, the members of the Publishers Association increased their sales in 1999 by 4 per cent, in 2000 by 1 per cent, and in 2001 by 9 per cent. Altogether a period of good development, especially since the general economy was considerably weaker.

Keeping this in mind, the sales increases after January 2002 are even more heartening. Thus the publishers sales increased by 14 per cent in 2002, only to stay at that level in 2003, and to rise another per cent or two in 2004. Sales to booksellers have increased more than the sales to book clubs, which, due to structural difficulties, have shown a weaker development over several years.

Publishers' sales of new titles and backlist rose by 1 million copies in 2002 compared to 2001, and by another 4 million copies in 2003. The members of the PA sold over 40 million copies in 2003, which is the highest number ever recorded.

This strong sales development has also meant increasing income for authors, since the major part of their earnings come from royalties.

### Positive publicity

For people in the book industry these figures are hardly surprising. In fact they correspond very well to the estimates and analyses we produced as part of the campaign to have the VAT reduced. What is known about the price elasticity for books, and our evaluation of other factors, indicated a development very similar to what we now see actually happening.

The positive publicity that books have received, as one effect of the lower VAT, has probably played an important role. Books in general and paperbacks especially have become trendier, and the price reduction has strengthened this tendency even further. It could be argued that this has coincided with a cooling perspective of the IT-revolution, prompted by the bursting of the IT-bubble. The rapid development of new media slowed down, and traditional media regained their positions.

### The promises

One important question is obviously how well the industry has delivered on its promise to let the whole VAT reduction be reflected in its pricing. This promise was not an act of industry politics, but based on the financial analysis, upon which the argument for the reform rested. Our basic belief is that the price elasticity for books is close to -1, which means that a price reduction of 15 per cent will cause a sales increase of the same magnitude. Or in other words, customers will spend the same amount of money on books, and they will receive more for their money.

These are naturally rough estimates. Other market factors make it hard to produce an exact picture of the development. The dynamic effects, such as the growing investments in more expensive book projects, play an important role. Taking into account what members of the PA have reported, we have good reason to claim that the industry has lived up to its promises regarding price reduction, and that sales have developed in the positive direction which was forecast.

### Fiction

Looking specifically at fiction, that is often the subject for discussion in cultural politics, sales rose dramatically in 2002, and stayed on that level in 2003. The number of titles published increased in 2002, but decreased somewhat in 2003. The number of copies printed and sold grew both years.

Monitoring the price changes for fiction is less complicated than for other categories. The comparability between such factors as size, weight, binding, and paper quality over time is fairly stable. It gets more complicated if factors such as more ambitious editorial input, higher translation costs or smaller print runs should be taken into account.

Vitalizing changes of this kind have characterized the publishing of fiction during the period of lower VAT. That is hardly surprising. Publishers' wishes to experiment and to be a little more daring than usual, will immediately be seen, when the economy allows and the market is changing in the right direction. The lower VAT has no doubt made a number of publishing projects possible, which otherwise would not have been undertaken. These include translations from odd languages, new authors with different profiles and genre crossing texts.

Interest in other countries for Swedish literature has grown considerably in recent years. This has naturally stimulated publishing in Sweden as well. It has also stimulated the establishing of literary agencies, for many years common in the USA and in some European countries, but unheard of in Sweden until a couple of years ago.

Since some agents represent their authors in their relations with Swedish publishers, the question has arisen whether this affects the authors' conditions. Since the general agreement between the Swedish Publishers Association and the Swedish Writers' Union that existed for many years, was abandoned in 1996, the market became more open.

There has been no systematic study of how authors' earnings have developed, but it can safely be noted that there have been no major changes. The terms in the old general agreement forms a solid praxis. There is however no doubt, that some authors today can demand better conditions than before, with or without the aid of agents.

### Children's books

The factors of influence regarding children's books are not altogether the same as those of fiction for adults. There is a stable continuity in an active backlist, where a number of well known authors can be relaunched for new generations. And there is the unsurpassed power of new phenomena in the market, such as strong "characters" and the focusing on certain authors and successful publishing ideas.

Two examples are the Harry Potter books and the Manga publishing, which after the VAT cut have dominated the market for children's books. Harry Potter is a good example of the impressive impact books can have, thereby strengthening the position of books in relation to other media.

Much the same can be said about the enormously successful cartoons of Japanese origin, which are labelled Manga publishing. This is a new kind of publishing, so unlike the traditional that it has found a new market; and its strategy, marketing and editorial treatment are different. It is too early to tell what the long term impact of Manga might be, but it definitely proves that the room for vitalization and new concepts is in no way threatened.

Competition is fierce between publishers of children's books, profits are vulnerable, and there is little room for price increases. The positive sales development caused by lower VAT has given publishers extra resources. Some have hired new staff, and we have seen new categories of books, new formats, and more flexible pricing.

The number of children's books published increased from 1206 in 2002, to 1326 in 2003. And the number of new authors and illustrators rose from 117 in 2002, to 128 in 2003. In the preceding years the number of newcomers was about 90 annually.

Compared to fiction for adults, children's books are characterized by a greater variation in size, weight, illustrations and text volume. The editorial input also varies considerably. Hence, there are many factors which must be determined when price development is measured.

## Non-fiction

Few people outside the book industry realise how vital non-fiction is to publishing. The category is very wide, and it includes rapidly produced books on current affairs as well as handbooks which require years of production and heavy investments. Academic and professional books are included, as are cook books and gardening books. The levels of ambition differ, and target groups are very diverse. Therefore sales channels are many and varied. The publishing of non-fiction is not easily grasped, and any statement about characteristics, price development or state of business should be carefully expressed.

According to statistics produced by the Swedish Publishers Association the number of non-fiction titles published decreased for several years in the late 1990's and early 2000's. After 2001 the publishing has risen again, as has the number of copies printed and sold.

Calculating the costs for non-fiction titles is often more complicated than for books of other categories. The costs for editorial work and for production are sometimes so high that it takes several years to recover them. Thus, the risks may be great, and failures can be very costly, but then again, a success can be beneficial for many years.

It is quite obvious that the lowered VAT has been positive for the sales of non-fiction. This is especially true for students who buy text-books, usually a very price sensitive segment. Publishers catering to this market segment have used their newly won resources to hire more staff and to launch books in new formats, better bindings and with digital inclusions. The number of new authors has grown, and the level of ambition in editorial work has risen.

Correspondingly the general trade non-fiction publishing has developed in several ways. The indigenous publishing of books on nature, cook books and hand books has increased supplanting international co-productions. These books are more expensive to produce, but it results in books which are better suited for the Swedish market, providing better quality and enriching the national book culture.

The lower VAT has given publishers the opportunity to take on bolder initiatives, bigger and more long-term projects, greater width and variation in target groups and special interests. A number of richly illustrated biographies and works of popular science and history have been produced. Advanced series of publications in special subject areas such as philosophy and psychology have been enhanced and strengthened. Many of these projects have been undertaken by small publishers.

## School books

The market for school books differs greatly from the market for general trade books. Most school books are sold directly to the schools, and no longer through the book stores. The editorial work may be similar to that for trade books, but the different market conditions leads to fundamental differences in calculation, planning and financing. This is born out in the substantial differences in sales development. The stretched economy in most local authorities has been a direct threat to school book purchases, and for the past few years the trend has been negative.

It should be noted that the VAT reduction has no effect what so ever on the school book market, since VAT is not a cost for the local authorities.

Text-books for university studies have more in common with general trade books. The students buy their books themselves, usually in the book stores. Publishing is primarily done by a few specialised publishers, but is also undertaken by some general trade publishers.

The student organisations lobbied actively for a VAT reduction, and it is obvious that the effect has been very positive for this price sensitive customer group. The tax decrease is seen by publishers as remedy for the damages caused by piracy, which for many years has been a problem, especially in this market segment.

## 3. Retailers

By P Jonas Sjögren

The annual sale in February is a vitamin injection for the Swedish book trade. In the same vein the lowering of the VAT on books from 25 to 6 percent can be said to have been a virtual doping shot. From one day to the next, book prices were lowered by 15 percent. This led to a sales increase of 20 percent or more. Sales have since stayed on that level or risen further.

### Planning

Since the actual decision by the parliament was taken less than a month before it comes into effect, the book trade had to start planning for the change before it was decided. The bookstore chains and the big department stores agreed on procedure, such as mark down and the colour of price stickers.

There were, however, some problems related to the sale in February. The sale catalogues are printed in October and November, and the decision was formally taken in December. Some booksellers printed the new prices in their catalogues, while others used the old, higher, prices, and gave their customers the reduction when they paid. Apart from this, the transition does not seem to have caused any real problems.

### Marketing

Media assisted the book trade in informing the public about the price change. The struggle for lower VAT, which was fought for several years, received a lot of media attention. It was therefore only natural that press, radio and TV also covered what actually happened after the decision was taken.

All personnel in the stores were informed about the change during December. After January 1 customers were informed using folders and store signs. There was also joint advertising in newspapers and on TV.

There was a pedagogical problem, since many people are not very good at math, especially using per cent. Why did a lowering of the VAT rate from 25 to 6 per cent on the net prices lead to a price reduction of 15 per cent (and not 19) on the retail price? The question caused some misunderstandings, but as store personnel were prepared, this was no big problem.

### The price reduction and its effects

The Minister for Culture had previously declared that she was worried that not all of the lower VAT would be passed on to the Swedish book buyers. Representatives for all sorts of retailers firmly stated that they reduced their prices corresponding to the VAT reduction, or more.

Everybody realised that the trade and its pricing would be closely observed. It would therefore have been foolish not to fully reduce prices. The bad will would otherwise have been devastating. Furthermore the increased competition in the book trade, with aggressive pricing by the internet bookstores, made it commercially impossible not to pass on the whole tax cut to book buyers. The increased sales meant increased gross profit for retailers, without their having to incur extra costs.

All retailers claim that during 2002 their sales increased by 20 per cent or more compared to 2001. This compares very well to publishers' figures. Publishers sales to retailers rose by over 19 per cent in 2002. Many Swedish booksellers do not use the calendar year as their fiscal year. But if sales for 2002 and 2003 are compared to 2001, you find that over this period booksellers, according to their official financial statements, increased sales by at least 20 per cent compared to 2001. It should be kept in mind that many Swedish booksellers sell stationery and office supplies, the sales of which have decreased for most booksellers due to fierce competition from online enterprises. This indicates that the actual increase in book sales was even higher than 20 per cent in 2002.

During the autumn of 2001 some booksellers were afraid that the planned reduction of the VAT on books would hurt Christmas sales. These misgivings proved false. The sales increase in 2002 is thus based on quite solid sales for 2001.

The sales increase in 2002 was not equal for all categories of books.

Akademibokhandeln, which operate some 20 campus stores, experienced a greater increase in sales of text-books than of general trade books. Bokia on the other hand claim that children's books increased the most. Others maintain that it was primarily books in the higher price ranges which sold better in 2002.

Everyone involved agrees that the sales of paperbacks were not much helped by the lower VAT. The growth in paperback sales has been remarkable for the past decade. The reduced VAT will help keep prices at an attractively low level for another few years, according to representatives for both retailers and wholesalers of paperbacks.

One of the political goals related to the VAT decision was that consumer groups which have before been poor book buyers, and poor readers, would find books more attractive. This goal cannot be said to have been attained. To representatives of the industry this comes as no surprise. They claimed already before the decision was taken, that it would take more than a couple of years, and further measures than the reduced VAT, for books to find new buyers and new readers.

Booksellers point out that changing consumer behaviour is not easy, and that the desired effect on customer structure will take longer to accomplish.

### Profitability

The great growth in sales caused by the lowered VAT has led to increased profitability for booksellers. Sales increased while the gross margin stayed virtually intact. Thus profit in SEK rose. For general trade books the gross margin is about 45 per cent. For the typical trade bookstore almost half the sales increase therefore directly boosted profits. For textbooks the gross profit margin is slimmer, why the profit improvement was not as drastic. The same can be said about the internet bookstores which operate at a considerably lower gross margin.

The sales increase in no way forced booksellers to incur extra costs. But obviously the strengthened gross margin made it possible for some to spend more and still see their profit rise. Some stores have hired more personnel, while others say that the investments made in new technology have not led to the redundancies they normally would have had.

According to the trade magazine Svensk Bokhandel, booksellers' profits increased by 3,4 and 4 per cent in 2002 and 2003 compared to 2001.

One reason why profits have not risen as much as sales growth is that booksellers' investments have also risen. During the early 1990's booksellers made very small investments in their stores. That began to change at the turn of the millennium, and the past few years booksellers have increased their spending even further on shelf systems and computers.

#### New bookstores

From 1978 until 2001 the number of members in the Swedish Booksellers Association has decreased or stayed the same every year. In 2002 however the association accepted 10 new members, and in 2003 24 new members were admitted. All of these are not new stores, but it is a clear indication that the lowered VAT on books has caused a changing trend in the number of bookstores in Sweden.

At the same time the department stores and hypermarkets have sold more books, and books have become available in stores which did not sell books at all before. Sales over the internet have also risen dramatically. There is no question that the lower VAT have made books easier to come by for the Swedish book buyers.

#### Public subsidies

The increased profitability caused by the reduced VAT came as no surprise. The government and parliament were so convinced of this change that they already in 2002 decided to cut subsidies which have previously been handed to (some) booksellers.

The subsidies which still existed in 2000 were: subsidies for establishing new stores, for renovation and for take over; subsidies to small bookstores for investing in information technology; and subsidies to booksellers in small towns to invest in stock. These subsidies required booksellers to pay at least a third of costs themselves. In 2000 the subsidies were about SEK 10 million. A small amount of money, but very important to those booksellers who received subsidies.

There is no question that the lower VAT has meant increased profits for booksellers. It may be questioned, however, if the increase has benefited booksellers in towns and villages too small for the big chains to even think of establishing new stores.

## 4. Book clubs

By Jonas Modig

### Background

The strong development for book clubs in Sweden in the 1970's can be explained by several factors. The publishing industry was recovering from a crisis which was at its deepest around 1970. This called for thorough changes in publishing, company structure and work organisation, affecting marketing, editorial work, and cost control. In 1970 fixed pricing was abolished and this paved the way for taking advantage of the possibilities offered in a free market.

The new book clubs, such as Månadens Bok, Bonniers Bokklubb and Bra Böcker, were strongly determined to forcefully renew the channel. Since the traditional booksellers adapted more slowly to the changed market conditions, the book clubs gained an advantage which gave them rapidly increased market share until the early 1980's. The period of expansion had ended, and in a market which was saturated from the clubs' point of view, new possibilities opened up for the booksellers to take back some of what they had lost.

### The international trend

At the same time as the book club market in Sweden stagnated, this development could be seen in other countries as well. It was most apparent in the USA, but leading clubs in Europe lost ground as well. The book club offers became more specialized in profile and structure.

In the other Nordic countries however the clubs retained a strong influence on the sales of attractive new titles. In both Denmark and Norway, which by trade agreements have kept fixed prices, this has led to grave conflicts between the booksellers and the publisher owned book clubs. The booksellers do not accept that new titles, which have great sales potential, are sold at lower prices to club members, than what booksellers are forced by the publishers to charge.

### The Swedish book clubs

The development during the 1970's and 80's gave the book clubs a strong position in the Swedish book market, even by international standards. It has become more difficult to recruit new members, and measures to nurse existing members have been developed. The new possibilities, offered by new technology to better meet with members' wishes, have somewhat offset the difficulties in recruiting new members. No new clubs offering a wider range of books have been launched in recent years. The new clubs which have started cater to very special needs. These clubs are often operated by specialized publishers, and the clubs can be seen as another sales channel.

### Book clubs and the reduced VAT

Book clubs in Sweden are publisher owned, and very systematically built. Therefore the possibilities to plan and follow up centrally made decisions related to the VAT reduction are very good. A few observations:

### **Lower prices**

Centrally taken decisions about total and unconditional price reduction across the board seem to have been executed. Some clubs reduced the price of their main selections even more. This has led to a discussion within the Book Price Commission regarding whether each title or each volume should be measured. The Commission has claimed that each title, no matter how big the print run, must be assigned equal weight, while the book trade representatives have pointed out that this is not how other price-product calculations are computed. Frequency and volume must be considered, when the effect of price changes at consumer level are calculated.

The extra reduction on main selections was not made in order to get away with a smaller reduction on other titles. The book clubs pass this examination no matter how you calculate it. The focus on main selections was a marketing decision, to forcefully demonstrate what advantages their members could look forward to.

### **Title selection**

The book clubs have essential knowledge about their markets, such as which books are the members interested in; what are they prepared to pay; which special offers appeal to them; how to present books; the desired layout of the member magazine. These variables change constantly and they are being analyzed continually.

Naturally, a great variety of possibilities is advantageous, and the clubs keep looking for new solutions. One of the most important limitations is the price which members are willing to pay for different categories of books. Many attractive books, especially non-fiction, have not been selected by the clubs, simply because they have been deemed too expensive. The price levels are frequently tested, and should the interest increase for a certain type of books, at a higher price, the assortment can be enlarged.

It was therefore only natural that the offers from the book clubs quickly changed when the VAT was reduced, and the clubs gave more space to books which were a little more exclusive and more expensive than before. Examples can be found at most clubs.

### **Marketing**

Price competition is part of the regular marketing efforts by the book clubs, and they naturally did not want to miss the opportunity to inform their members about the lowered price level. All clubs kept reminding the members of the lower prices, and proclaimed it in their recruitment activities.

This proved effective and the book clubs experienced an increase in sales which is still felt. But the resistance to recruiting could not be broken. This is caused by deeper structural factors of a kind that reduced VAT cannot overcome.

## 5. Measuring the development of book prices

By Dan Ahlmark

### Introduction

In this chapter the measuring of book prices which have been carried out in 2002-2004 are examined, and some conclusions regarding their shortcomings are reached. These shortcomings are different in character, but they may – alone or together - influence the results.

One shortcoming concerns the inadequate assessment of the quality of books (in a wide sense: binding, size, illustrations etc). Because of this the tendencies to publish books of better quality, which seems to be one effect of the VAT reduction, are not taken into account. The prices of these books are registered, which makes the results incorrect. Another source of error is the fact that teaching aids were included in the measuring for 2003-2004 in the book stores. The purchasing conditions for teaching aids are very special. The customer is the public sector, which has had a weak economy for several years, resulting in decreasing orders and, therefore, higher prices. Furthermore the public sector is not affected by VAT in the same way as consumers. Including these products affects the monitoring, and leads to a categorization, especially regarding non-fiction, that nobody recognises. Since teaching aids are not consumer goods, this undermines the comparisons with the general consumer price index (CPI).

The monitoring does not cover the literature which most Swedes read, but rather titles of small or insignificant sales. These indices thus have another meaning than the CPI, which takes consumer preferences into account. The fact that different books are aimed at different market segments, and that this affects pricing, is not sufficiently considered. The Council for Official Statistics (Statistiska Centrabyrån, hereafter SCB) uses measuring techniques developed for general trade books to measure teaching aids as well, which leads to further uncertainty regarding the results.

One effect of the VAT reduction is the publishing of more specialised books, which incur a greater risk, and therefore command higher prices. These titles are overrepresented in the price measurements, and this may be one reason for the price increases noted. The dynamic, and one of the desired, effects of the tax reduction, is therefore totally misinterpreted. Something positive is construed as something negative! Together with other weaknesses in the monitoring, this can easily explain the difference between the observed price changes, and the price level that was established by the VAT reduction. But what is the real development of book prices?

Two results primarily show deviations from the VAT reduction level. Children's books in 2002, measured in the book clubs; and non-fiction in 2003, measured in the book stores. For children's books the unregistered rise in quality seems to be the reason for the deviation. This factor also affects non-fiction, compounded with the fact that teaching aids were added to the book store measurements for 2003, although they were not included in 2002. These books are not included in the book club measurements, which are based on another definition of non-fiction. The added categories, and other measuring weaknesses, explain why the prices of non-fiction seem to have risen in the book stores in 2003. At the same time the prices for non-fiction marketed by book clubs have fallen. Sales development disproves the claimed price

increase for non-fiction. Until the contradictions have been explained, little importance should be attached to the measuring results for non-fiction.

Considering the two sales channels combined, the total price level seems for 2002-2003 to stay at the VAT reduction level. Price measurements made by Temo (see the end of this chapter) regarding fiction and children's books, and which carefully took quality of books into account, found that prices fell below the VAT reduction level.

## Background

In order to gauge the effects of the VAT reduction, the government appointed the Book Price Commission (hereafter BPC), with representatives for state authorities, the book industry, and various interest groups. SCB were given the task to measure prices from 2002 until 2004. The BPC's reports are based on SCB's findings. The results of those measurements have surprised the book industry, and they contradict other studies. The prime questions are therefore, how reliable are SCB's indices, and what is the actual development of book prices, since the VAT was reduced.

## Measuring the development of book prices

Price changes for books may stem from several reasons: variation in quality, a changed mix of distribution channels, price fluctuations in input goods, changes in production and distribution costs, or increased output. There is also the possibility that publishers or the retail trade have increased their profit margins.

By constructing measurements in a suitable way, the first two factors can be eliminated. When trying to measure price changes using an index, several problems arise. A great number of titles are required, and selection, description and analysis are cumbersome tasks. Selection causes uncertainty. Apart from the random errors caused by selection uncertainty, there are also systematic errors in the weightings given to sub-categories. For CPI the systematic errors usually refer to the difficulty in measuring quality changes in existing goods, the emergence of new goods, and to some extent new retailers.

The greatest difficulty, when constructing a book price index, is that books are heterogeneous. Each title is (more or less) a unique product. Books are perishables, and you rarely measure the same trade books twice, since they have a short life-cycle. The task is thus to measure a book at one point in time, and then to measure a *similar* book again at another point in time. In statistical terms we have a source of variation due to actual price changes, and one due to changes in product. The differences in the quotient price:quality decides the price development. Comparing similar products in different years becomes the main issue, but other problems also arise. The following factors must be given special attention in the process:

- Large variations in the price quotients because books are extremely heterogeneous.
- The number of sub-categories is large, as distribution channel must be regarded as a basis for classification.
- Uncertainty about the weightings.
- Uncertainty of selection.
- Systematic errors may occur.

## Development from 2002 to the spring of 2004

On January 1, 2002, book prices in Sweden fell due to the change in VAT rate. This instantaneous price reduction was successful according to SCB, and it was at least as big as the change in the VAT rate (-15.2 %). The measuring method used for the first year – 2002 – shows that the decrease stayed at this level the whole year. The exception was children's books sold through book clubs.

After that the industry has for a year and a half developed as usual, with the extra stimulation brought about by the price reduction (see Table 1.) But for 2003 SCB maintains that publishers and retailers have raised prices too much, that is more than CPI for non-fiction in the book stores. Table 3 shows the results of the price changes SCB has found for the period 2002 to April, 2004. The column on the right shows the development of CPI.

**Table 1.** *Publishers' sales\* 2001 – 2003 (SEK million)*

	2001	2002	2003
Fiction	822	872	858
Children's book's	290	265	380
Non-fiction	628	692	819

\* Members of the Swedish Publishers Association

Looking at the development of publishers sales in Table 1, we find a sales increase for all categories of books since 2001. A minor weakening for fiction can be seen in 2003, while that year shows a real boom in children's books. Non-fiction has grown every year, as have total sales. The total number of copies sold has risen continuously, for both back list and front list. While the number of copies sold *per title* has increased every year for fiction and non-fiction, it has decreased for children's books.

**Table 2.** *Different methods of measurement used by SCB*

	2002	2003	2004
Book clubs	Method 1	Method 1	Method 1
Book stores	Method 2	Method 3B (Previously Method 3A)	Method 3B

Tables 2 and 3 show that different methods have been used, both for different categories of books, and in different time periods. This makes it harder to understand how accurate and relevant the results are. The methods are analysed below.

### The purpose of price measurements

SCB have been governed by a consumer perspective. They say that they have considered the variables which are valued by consumers. They do not consider variables which are not connected to consumer interest, but which could have improved comparability. This reasoning has certain drawbacks. For example no consideration is given to the print run,

despite the fact that this influences the price level of a book. This information is not gathered, since it is not directly valued by consumers. But you can say that edition is valued, as it is a measure of consumer demand. It is naturally a merit if titles are objectively comparable. Therefore the consumer perspective ought to be complemented by objective criteria.

**Table 3.** *Price increases for different categories of literature*

	Fiction	Children's	Non-fiction	Total	CPI- change
<i>Book stores</i>					
01-02 Method 2	-15.5 +/-1.5	-14.4+/-2.2	-11.3+/-1.6	-13.3+/-1.0	-13.4
02-03 Method 3A	+3.1+/-3.2	+4.6+/-4.5	+8.6+/-3.7	+5.9+/-2.2	+1.9
Method 3B	(+5.6+/-2.6)*	(+5.5+/-4.1)*	(+10.4+/-2.9)*	(+7.8+/-1.8)*	(+1.9)*
01-03 Method 2+3A	-12.9+/-3.5	-10.4+/-5.0	-3.6+/-4.0	-8.2+/-2.4	11.7
01-03 Method 2+3B	Not reported				
Apr.03- Apr.04 Method 3B	(-0.4+/-4.0)*	(-2.3+/-5.2)	(+1.9+/-4.1)	(+0.4+/-2.5)	+0.1
<i>Book clubs</i>					
01-02 Method 1	-12.4+/-1.6	-6.6+/-3.1	-9.7+/-2.9	-10.6+/-1.1	-13.4
02-03 "	+2.2+/-1.9	+0.3+/-2.0	+0.2+/-2.7	+1.0+/-1.4	+1.9
01-03 "	-10.5+/-2.5	-6.3+/-3.7	-9.6+/-4.0	-9.7+/-1.8	-11.7
Apr.03-Apr.04	+0.4+/-2.6	+0.5+/-3.2	+3.7+/-5.2	+1.8+/-2.4	+0.1
<i>Total, both channels</i>					
01-02 Method 1+2	-14.6+/-1.1	-12.2+/-1.8	-10.8+/-1.4	-12.6+/-0.8	-13.4
02-03 Method 1+3A	Not reported				
02-03 Method 1+3B	(+4.1+/-1.5)	(+3.8+/-2.5)	(+7.2+/-2.0)	(+5.3+/-1.1)	(+1.9)
01-03 Method 1+2+3A	-12.2+/-2.6	-9.3+/-3.8	-5.5+/-3.1	-8.9+/-1.8	-11.7
01-03 Method 1+2+3B	Not reported				

\* Figures within parentheses denote hedonic (Method 3B)

The purpose of the price measurements is not to construct a general price index for books, in order to describe price development according to this index. This is what SCB regularly do, and probably what they want to do. But the purpose was to make sure that the tax reduction was passed on to consumers, and one goal is thus to find out whether the industry handled the dramatic change in demand in ways which support the political purpose. This means that prices should not have risen – for similar products – above the level of 2001. This requires knowledge about how the industry priced its products, in different circumstances, and that pricing is studied under comparable conditions.

The question is not only what consumers observe and value. Comparison should be made between books with a similar *cost structure*, which affect pricing in the same ways. Otherwise products, the prices of which have very little to do with each other, will be compared. The challenge when measuring prices, according to the task given the BPC, is precisely to find such comparability over time.

Have prices actually increased? If so: What could be the reasons for higher prices?

The first peculiar price deviation concerns children's books sold through book clubs in 2002 (see Table 3). The prices are said to have fallen by only half of the VAT reduction. At the same time prices in the book stores are fully reduced. Why would the book clubs suddenly raise prices for children's books in 2002, but not for other categories? And why do this when the clubs must have known that prices would be closely monitored? The answer is that the calculated price increase is not due to changes in pricing. The main reason seems instead to be that parents after the tax reduction have been able to afford better and more costly books.

There is empirical data that indicates that during the first year after a VAT reduction regarding children's books, consumers will buy books that are so much more expensive, that half the tax reduction is "consumed" (see Table 5). The problem is that only a minor part of the shift in quality (more pages, more illustrations, more colour etc) is registered. SCB cannot differentiate between changes in quality and regular price hikes. The importance of this argument is not weakened by the fact that SCB measures what has been *published*, and not what the consumers have bought.

Children's books may be extra sensitive to the demand for more expensive books, and similar effects can probably only be found for certain sub-categories of non-fiction. The problem is that already smaller increases in quality, if not correctly assessed, will make the price measurements inaccurate. Without a sufficiently precise instrument for measuring changes in quality, any tax reduction will give the impression that prices rise. Assessing quality is therefore a key issue for all price studies.

**Table 5.** *Development of average prices for children's books, after a "VAT reduction". Prices (in SEK) were reduced by the VAT rate (25 %) in 1996.*

	1995	1996	1997	1998
Book store 1, Täby	83.99	76.55	84.24	89.14
Book store 2, Nacka	77.60	68.48	78.08	79.74

The book clubs could very quickly adjust their offerings to a VAT reduction that was known already in the early autumn of 2001. The publishers did not have to change lists towards higher quality, for the book clubs to change what they had to offer. The club selections could quickly be adjusted to the expected sales increase. This shift in quality was not included in SCB's index, which therefore has to be reinterpreted.

The second peculiar price increase regards non-fiction in the book stores in 2003. SCB claims that these prices have risen, while the book clubs show no such increase. The price level for fiction in book stores has decreased by more than the tax reduction from 2001 to 2003. Why would book sellers suddenly raise prices for non-fiction in 2003, but not for other categories?

The answer is not higher prices. Regarding non-fiction SCB for their measurements in 2003 used a new method for selection and computing, and at the same time they introduced a new definition of non-fiction. In 2003 they include new kinds of books, namely text books and school books. The new definition is applicable only to book stores. Book clubs do not sell school books or text books, and the measurements for clubs are based on the generally accepted definition of non-fiction. It could therefore be argued that development in book

clubs gives the best indication of how prices for non-fiction, by an accepted definition, actually changed during 2003. In book clubs prices for non-fiction (general trade) rose by 0.2 per cent in 2003, which means a price decrease compared to CPI. SCB tries to persuade us that prices for non-fiction in book stores rose by 8.6-10.4 per cent. Sales development does not confirm the statement about price increases. Still, SCB use those figures to maintain that publishers and retailers have raised prices considerably.

To some extent the price increase reflects the quality enhancement, caused by the tax reduction, which SCB describe as a pure price change. The difference between the channels is unrealistic, and it shows that the mistake SCB's makes by including new categories, which are normally not embraced by the definition of non-fiction, clearly leads to a misinterpretation of the actual development.

Another factor might be that for the book store selection in 2003-2004 books from small publishers were included. Many of those are driven by non-commercial interests, and it is reasonable to assume that they took the opportunity to fill their books with extra content, as low price elasticity allowed for increased prices. Such books are rarely included in the book sellers' catalogues, which were the basis for selection in 2001 and 2002.

### **Why teaching aids?**

School books form a specific market. Most school books are purchased by the local authorities, and they are not affected by the VAT reduction, since they are compensated for VAT. This market segment is furthermore weak, and falling demand, due to poor economy in the counties, has led to considerable price increases.

Text books are bought by students, and demand is affected by the VAT. SCB are conducting a separate study regarding the price development for school books and text books, for the Department of Education. There is therefore no reason to include these categories in non-fiction, especially since this is in conflict with established definitions in the book trade.

The definition of non-fiction was changed between 2002 and 2003. The definition of non-fiction is also different in book stores and in book clubs for 2003 and 2004. This undermines the reliability of the results. The price measurements for trade books in general are destroyed. The purpose was to find how the book industry handled the VAT reduction for trade books. This purpose is not achieved.

### **Index for small groups of readers?**

In their measurements SCB do not consider sales volumes. A majority of politicians, consumers and culture journalists most likely believe that the conclusions which can be drawn from SCB's reports reflect how consumers are affected by price changes. But this is not the case at all. SCB do not consider how important different books are to the consumers. They do not consider sales. As a minority of titles have a great importance for total sales, the way SCB measure price changes may be relevant only to a small group of book-buying Swedes.

SCB lowers the relevance of their measurements, by departing from the usual way in which CPI is constructed, and thus taking too little into consideration what people actually buy. Right after the VAT reduction, price measuring using unweighted titles might have been appropriate. After that another method should have been used, and it seems that SCB chose a less suitable way. Their approach does not seem to satisfy the instructions to the Book price Commission.

## SCB's quality classification

The great differences in design and quality are the main reasons why they are hard to compare. As seen above SCB have used several methods. Those methods, and the problems they create, primarily in measuring quality, are discussed below.

### **Method 1: book clubs in the years 2002-2004**

The measurements relating to book clubs have been carried out in much the same way during the whole period. As basis for classification the following variables have been used: category of literature (fiction, non-fiction, children's books), binding, number of pages, and rate of illustrations. This sounds promising, but in reality not even these variables have been used properly.

For fiction three classes have been used for number of pages, and three classes for illustrations: no illustrations, black and white, and colour.

The classification is unique for every book club, but for fiction the classes for number of pages are usually: 1-300, 301-500, 501 pages or more. If there is a general increase in quality, let us say by 10 pages per title, in the class of 301-500 pages, this will be noted in only 5 per cent of the cases. And if the publishers, due to the lower tax, increase the rate of illustrations in illustrated titles, this will not be registered at all, unless the number of pages rises.

Regarding children's books there is no classification by volume of illustrations, just a few classes for the number of pages. It is hard to believe that over time similar titles are measured.

Page classification for non-fiction comprises of three classes: 1-200, 201-400, and 401 pages or more. But for illustrated titles of non-fiction only two classes is said to have been used, 100 pages marking the distinction. Since SCB disregard such variables as size, obviously very different books will be compared to each other. Regarding other quality variables, for example printing and paper, there is no control.

The classification is generally very rough, and books that are very different in character may end up in the same class. If there is a trend towards higher quality it will mostly pass unnoticed.

### **Method 2: Book stores in 2002**

For the basic measurement of books in the book stores in 2002, book stores' catalogues were used, and there was no quality classification at all. For the subjects that were measured, all titles were registered, and the average price per subject was compared to the same subject in the catalogue of the year before.

During the first year after the VAT reduction the absence of quality classification was probably no problem. Prices were cut according to all guidelines. The dynamic effects started to appear already in 2002, and this may have lead SCB to overstate the price increases after the initial decrease. There is no reason to believe that the tax cut leads to lower quality, while there are many reasons to believe that it leads to higher quality. If changes in quality are not measured carefully, the quality increases will pass unnoticed, while the higher prices caused by the quality shift will always be registered.

Since SCB have no way of assessing quality changes, the foundation for SCBs comparisons, the development for the year 2002, wavers. As the results of the first year are important for the entire period, this will affect the reliability of the total measurement.

### **Methods 3A and B: Book stores in 2003-2004**

Using the traditional method for price measurement – the quality class method – a set of variables is specified (regarding important characteristics for a title), and classes are defined for each variable. Certain combinations of variables and classes are selected, to form a number of categories. For calculation purposes the number of categories is limited. After that, titles which fall into the same category are compared over time. Index values are decided for every category, and the category values are weighted to form a total index.

Method 3A designates the quality class method in SCB's measurements. Using regression analysis they have selected these dimensions, apart from category (fiction, non-fiction, and children's books): binding, dust jacket, weight, and – for non-fiction – trade or professional (to differentiate between books used for work/studying, or for pleasure). These dimensions were used to form categories, the annual development of which was measured. SCB thereby believe that they have tried to measure all books published in Sweden and which are of commercial interest.

In the very first phase after the VAT reduction SCB had lower demands on the quality classification. In the next phase, the problems controlling book quality in a sufficiently precise way, *may have been* so great, that they could not be carried out, at a reasonable cost, *for all books*. Maybe SCB should have limited their study to a small number of formats, and to books with certain characteristics, which account for the big volume on the book market, and have measured these very carefully. The choice of general approach is a relevant issue, that should have been discussed, and the arguments could have been presented.

### **Introducing hedonic regression**

In its fifth report (August, 2004) SCB present price measurements using a method called hedonic regression. For this method, here called 3B, individual factor prices (=beta coefficients) are calculated for the different characteristics of a book. These prices are meant to indicate how each characteristic of an individual title, affects the total cost, when comparing how the magnitude of these characteristics differ from those, which were found in an average of titles during the preceding period. If the price of a specific title is reduced by the factor prices (multiplied by relevant volumes), which apply to the individual title's characteristics (exceeding the average in the previous period), the price that is to be compared with the price of the preceding period for the category, is reached.

Hedonic regression is used in Sweden for CPI for clothes. The method has never previously been used for books. In the USA the method has been used for CPI, regarding one, limited, category of books: college text books, which is one of three text book categories. Why the method has not been used for general trade books is not known. The method has not been used anywhere for a general book price index, or in a study similar to the one carried out by the BPC/SCB. There is no report of its ever being used for general trade books. By choosing this method, SCB have made the study an internationally distinctive project, somewhat pioneering. Should an untried method really be introduced, when carrying out such an important, national study?

One must naturally question how well hedonic regression corresponds to traditional methods, when products with an artistic content in varying circumstances, are measured. This ought to have been discussed, as methods were changed, between reports 4 and 5. It is difficult to gauge the quality of products with an artistic content, since only easily measurable dimensions are included in the regression equations. Since much is left out of the calculations, large parts of the price variations are not explained.

This may be one of the reasons for the uncertainty intervals which are found in Table 3. For the period April 03 to April 04 the price variation for fiction is -0.4 per cent +/- 4.0 per cent, and for children's books -2.3 per cent +/- 5.2 per cent. What is the use of a method which produces an uncertainty interval of over 10 per cent?

The method used for fiction in 2002 (Method 2) is not affected by the introduction of hedonic regression, neither are the methods used for book clubs 2001-2004 (Method 1).

In material presented to the BPC, SCB have shown how results vary in 2003 between hedonic regression and the quality class method. This is presented in Table 6, and shows significant differences between the two methods. It should be pointed out that SCB's way of using the quality class method has obvious shortcomings. The number of variables used is low, and the classes are wide. Therefore, books which are very different end up in the same quality class. This together with other methodological errors, leads to SCB's overestimating price increases for all categories of literature.

**Table 6.** Price increases using Method 3B and Method 3A

Fiction	Children's Books	Non-fiction	Total
<i>Method 3B Hedonic regression</i>			
+5.6 +/-2.6	+5.5 +/-4.1	+10.4 +/-2.9	+7.8 +/-1.8
<i>Method 3A Quality class</i>			
+3.1 +/- 3.2	+4.6 +/-4.5	+ 8.6 +/-3.7	+5.9 +/-2.2
<i>Difference</i>			
+2.5	+0.9	+1.8	+1.9

The indices for hedonic regression show that the errors are accentuated. In no case does hedonic regression produce a lower price increase, compared to the quality class method. This may be due to a systematic tendency for hedonic regression to indicate higher price increases.

The size of the differences is alarming. Regarding fiction the difference is as high as 2.5 per cent in one year. If there is a systematic tendency for hedonic regression to produce higher price changes than the quality class method, we find a difference in price increases of 7.5 per cent during a three year period, if the conditions are similar to those in 2003.

The uncertainties presented regarding the measures, are uncertainties *within* the model, due, for example to the fact that titles have been randomly selected. This uncertainty has little to do with the uncertainty for the whole model, and what confidence we may have in its data producing a correct description of reality.

The conclusion is that there is an unexplained difference between the two methods. If this is a systematic error and not only applies to 2003, it is of course not acceptable. Since they have changed methods of measuring during the three year period, SCB must be required to present their results produced by both methods in future reports.

The conditions regarding how applicable hedonic regression is, when studying products which are heavy in artistic content, are not presented by SCB. In such a product area most products are a collection of characteristics, producing a unique experience, which cannot normally be reproduced. Is it possible for such products to carry out price reductions regarding measurable qualities, as you would with for example shirts or computers? Even if it is, the question should have been asked and analysed, and the arguments should have been presented.

If the most important characteristics cannot be measured and are therefore excluded, the equations' ability to explain price variations is very limited. For products with an artistic content, the relative share of characteristics which are not measurable is high compared to most other products.

One variable that SCB do not measure is the cost for manuscripts and editorial work. For school books, text books, and certain titles of non-fiction this cost can be considerable. It is normally a fixed cost, which means that the cost per copy decreases as volume grows. Thus this variable is especially important for titles published in small editions.

The print run has a great effect on pricing. When determining the price, the sales volume at different price levels is estimated. This will affect pricing. Edition and price are connected, by consumers' demand. Edition can be seen as a variable that is determined by the size of demand. It is of very little interest that consumers do not value edition as such, since the size of the variable is a measure of consumers' demand.

The quantity of illustrations is determined by rules set up by the Royal Library (Kungliga Biblioteket). The assessment is based on whether illustrations are black and white or four colours, and few or many. By many they mean covering more than 20 per cent of the pages. The four groups which are the result of this assessment, is hardly enough to capture how the quantity of illustrations determine costs, and thereby price.

The same quantity of illustrations will in reality affect pricing differently. For books printed in small editions the effect is great. For books printed in large editions illustrations affect costs much less. Factor prices, which are included in the regression calculations, ought therefore to be changed. Close to a fifth of the variables in the regression equations for fiction are related to quantity of illustrations. It is regrettable if these variables have not been given the correct influence.

One question concerns the importance of the fact that the cost structure for books of small editions has a great influence on factor prices for various dimensions. Titles sold in large editions have a different cost structure, especially regarding fixed costs. When hedonic regression is used, consumer preferences regarding different measurable characteristics are reflected in the price. But if sales volume is neglected, the preferences of some consumers will be weighted much higher than others.

According to SCB binding, dust jacket, weight, and for non-fiction whether a book is meant for pleasure or work/study, are the most important variables for price determination. If we disregard non-fiction, binding, dust jacket and weight, are the most important variables when determining price. The problem with these variables is that they are closely connected. These variables explain very little within each type of binding, regarding a certain category of literature. Maybe SCB have chosen a level of analysis that is too trivial.

The weight of a book is determined primarily by: width-height-number of pages- paper quality-cover. But two books of the same weight may have very different costs. For example the costs for manuscript and editorial work might differ. At a certain total cost, varying sales volumes will have very diverging influence on pricing, for titles with the exact same weight.

The explanation value attached to weight is a consequence of the fact that bindings correspond to price levels. However, within a homogenous group, weight probably explains very little. It is the conditions for a certain type of binding (regarding a specific category) that should be used to get titles which are comparable over time. In this regard SCB have not come very far. By disregarding important variables, such as edition, it is hard to find comparable titles.

The most important characteristic of a book – literary quality – is not a dimension in the regression equations. This dimension is very hard to measure. Hence a variable which can be expected to have a great influence on the sales of a book of fiction is missing. In regression equations much is said concerning the physical aspects of a book: number of pages, format etc determines as much as 90 per cent of price variations, according to SCB. If that which creates the very essence of a book, its literary merits, is disregarded, nine tenth of price divergence can be explained. It that reasonable? This calls for consideration regarding the measurements and the interpretation of their meaning.

### **Considering demand**

SCB do not pay enough attention to the special market conditions of different titles. Books published for different markets (for example golf, sailing, food and photography) may be very different in terms of price sensitivity, although their costs for production and manuscripts are the same. This is reflected in pricing, but SCB do not sufficiently consider this. Since the market conditions, including demand and competition, are not adequately considered, titles for which the pricing conditions are very different are compared to each other.

In report 5 SCB describe the four categories chosen for non-fiction: natural science, hobby, psychology and social science. According to oral information, some categories have later been added. But these are subject groups, not markets, with their specific price sensitivity and conditions for product design. The category “hobby” is very wide and diverse, and includes anything from books which are exotic and expensive, to those which are trivial and cheap. It is those different interests which create markets to consider. The price sensitivity is different for books on ocean racing and knitting. A category like “hobby” includes far too many areas of interest, with their specific characteristics. It is possible that there are as large variations within each category, as there are between the categories. For what is, in that case, the categorisation meant to be used?

Will the VAT reduction hold prices down?

The study carried out by Temo indicates that the VAT reduction has had dynamic effects, with a pressure on prices that actually exceeds the cut in VAT rate.

Larger volumes allow for more aggressive pricing. Volume has probably not led to similar increases in fixed costs. Therefore, profits rise without a change in pricing. But there is another, stronger, force that affects profitability. The increase in the number of copies sold per title, allows for further price reductions *and* higher profits. Consumers can benefit from improved profitability in several ways: broader and more risky publishing; more aggressive, and thereby more risky, pricing of titles for which price elasticity is not known.

One weakness in the SCB study is that price increases are always registered, but quality increases usually pass unnoticed. Still, for both fiction and children's books, the price development corresponds to the tax cut. This means that publishers have lowered their prices even further, since the price level is retained despite the unregistered quality improvements. If the sales volumes are considered, showing how consumption is affected by price changes, the indication of further price pressure is confirmed.

### Book prices and Consumer Price Index

The Book Price Commission thinks that CPI is a suitable comparison to a book price index. SCB keep referring to this general price index, which is obviously interesting, when comparing price development in the book industry with that in other industries. But the book industry is reproached because price increases are higher than that of CPI. Is CPI a reasonable standard of comparison when monitoring book price development?

CPI represents the goods which Swedes consume. It includes a large number of goods, some of which will during a specific period show higher price increases than the CPI, and some of which will show lower price changes than the CPI, which is an average. Because of globalisation, international economies of scale, international competition etc, some goods will show a more beneficial cost development than others. Books form a very fragmented group of goods, characterised by artistic and intellectual content. The products are very national, and international economies of scale can only occasionally be taken advantage of, despite the existence of international co-productions and printing abroad.

It is not self-evident that it should be assumed, that the production and distribution of books can be rationalised as can for example beer, toys or bicycles. Books form a group of goods, which probably have a cost structure, and therefore price development, which is different from average consumer goods.

### Temo: a study of book prices in book stores and book clubs 2001-2003

By Arne Modig

The Swedish Publishers Association and The Swedish Booksellers Association has commissioned Temo (a survey institute) to take recurrent measurements of the book prices in Sweden, in order to create a basis for assessment of the price development among its members. The purpose of the measurements is to show how book prices have changed after the VAT reduction.

#### **The method**

Measurements were taken in 2001, 2002 and 2003. The annual price changes are presented in the table below. A reference group, including members of the book industry, has discussed the procedure for the study, which was decided together with Temo.

Temo has collected publishers' net prices, and consumer prices in both book stores and book clubs. The measurements were taken on October 16 each year. October was considered a suitable month, since that meant that most of the books published in the autumn were included, and at the same time Christmas price promotions had not started.

The aim was to create lists of book titles which were comparable at each measurement occasion, so that similar titles were studied. At every measurement titles were selected, which were similar in quality for each category of books. The quality variables were binding, number of pages, size, indigenous versus translated literature, illustrations, paper quality etc.

The titles included in the study were selected by a reference group, consisting of representatives for publishers, booksellers and book clubs, all with long professional experience. The titles were selected from book store catalogues, bestseller lists, and book club member magazines, thus representing a considerable part of total book sales. The group is confident, that the selected titles for all measurements are fully comparable in terms of quality.

The measurements taken for book stores include 51 titles of fiction, 41 children's books, and 9 non-fiction titles. Prices were collected by a survey among selected book sellers. The 48 participating book stores were selected to reflect geographic distribution, chain affiliation, market share and size. They were all contacted prior to the survey, to guarantee a high response frequency. In the survey booksellers have reported the price of the 101 titles on the agreed day. If a title was out of stock, booksellers have reported the price they would have charged if the book was ordered. All prices are consumer prices inclusive of VAT. Order fees, if charged, were not included.

For book clubs the prices charged in October 2001, October 2002, and October 2003 were collected. The book club study includes 68 titles, about 10 per participating club, with an emphasis on fiction and children's books. The titles were chosen so that it would be easy to find as similar titles as possible in coming years. The six book clubs surveyed are well established and are good representatives for this channel. The data, consumer price inclusive of VAT, was collected from the book club's magazines for each month of measurement.

### **The results**

During the period from October 2001 to October 2002 prices in the book stores fell by 15.9 per cent. From October 2002 to October 2003 prices fell by another 1.1 per cent.

During the period October 2001 to October 2002 the prices which book sellers charged their books were reduced by 13.4 per cent. To get a fair assessment of price development in the book stores during this period, general inflation must be considered. This was done using the Consumer Price Index produced by SCB.

Corresponding calculations for the book clubs show that from October 2001 to October 2002 total consumer prices fell by 20.4 per cent. From October 2002 to October 2003 CPI rose by 2.5 per cent. The total consumer price decrease in the book clubs from October 2001 to October 2003 was 17.9 per cent.

The conclusion of these measurements is that the VAT reduction for books was initially fully passed on to consumers, and that this effect can still be found during the second half of 2003

**Table 4.** Price changes from October 2001 to October 2003, according to Temo.

	Publishers' Net price	CPI	Consumer price change	Total change
<hr/>				
<i>Pricechanges October 2001-October 2002</i>				
Book stores	+2.7%	+2.5%	-13.4%	-15.9%
Book clubs	-0.9%	+2.5%	-17.9%	-20.4%
<i>Pricechanges October 2002-October 2003</i>				
Book stores	+0.2	+1.4%	+0.3%	-1.1%
Book clubs	+2.8%	+1.4%	+3.9%	+2.5%
<i>Pricechanges October 2001-October 2003</i>				
Book stores	+2.9%	+3.9%	-13.1%	-17.0%
Book clubs	+1.9%	+3.9%	-14.0%	-17.9%
<hr/>				

## 6. Books, reading and availability

By Kristina Ahlinder and Thomas Wyatt

The deregulation of the book trade in 1970 is strongly conducive to the professional and well functioning industry which we have today. Free prices have led to more fierce competition, increased creativity, and more efficiency. Today there are a couple of hundred professionally operated publishing houses and some 350 book stores. As much as 90 per cent of the Swedish population lives in counties which have at least one book store. And that is not all; there are several thousand other retailers who sell books: hypermarkets, grocery stores, gas stations etc. Together with book clubs and the internet stores, they make books easily available to the Swedish consumers.

The reduction of the VAT helped an industry which already showed a solid sales development. The reduced VAT meant lower prices and a dramatic sales boost. After three years the effect on price can still be felt. Price is not an impediment to availability.

These reforms – the deregulation and the VAT reduction – are two important factors for availability of books and reading in Sweden.

Books should be read by all

The Book Price Commission is instructed not only to monitor the price development for books, and to make sure that the VAT reduction is fully and lastingly reflected in consumer prices, its goal is also to increase book reading among all groups in the population.

The Commission has in its reports so far emphasized that three years is far too short a period to accomplish any changes in reading habits. Scholars have pointed out that maybe by the end of this decade will they be able to observe any changes in reading behaviour.

Hence, it is too early to tell if the VAT reduction has broadened reading to all groups. Most observers seem to agree that increased sales means increased reading. But turning non-readers into book readers is a complex process which requires long time and patient efforts. The lower VAT is a single factor, which can facilitate this work, but which cannot alone bring about the change.

What the trade associations do to promote books and reading

Two of the main tasks for the Swedish Booksellers Association and for the Swedish Publishers Association are to strengthen the position for books in society and to promote reading. Others also play important roles, schools and libraries for example. But they cannot be left alone.

Trade associations obviously work to create better working conditions for their members. In several ways the associations of the book industry also strive to broaden and increase reading. The annual sale in February is a joint effort, as are the activities to promote the World Book Day and to make it a tradition which is observed in Sweden.

The Publishers Association annually awards the August-prize to the best new book in three categories: fiction, non-fiction and children's books. The nominees and the winners receive a lot of attention, and the prize ceremony is televised. The PA also awards the Little August-prize, to writers between 16 and 20 years of age.

Paperbacks get special attention when the Gold Paperback Prize is awarded in March every year. It is a prize for sales and not for literary merits.

Through the foundation Boken i Sverige (The Book in Sweden) the Booksellers Association has taken a great initiative to stimulate efforts to promote reading locally. The work is done by booksellers, libraries and schools all over the country, and it is called En bok åt alla (A book for everyone). It is left very much to the libraries, schools, booksellers and children to agree about local activities. In each community the project, which is meant to run for four years, gets its own profile. A visit to the local bookstore is usually included, and every child gets a book for free.

Teachers and pupils in over 150 schools involving more than 15.000 children have carried out reading programs. Over 90 public libraries have participated. The Foundation has so far spent almost SEK 3 million to support these activities.

The trade associations will continue their efforts to promote books and reading. The most important part of their work will still be to keep improving the conditions for publishers and booksellers. This includes the legal and economic conditions, as well as the political changes as they relate to books and reading.

Improved conditions for producing, marketing and selling books are essential to making the reading part of the population even larger in Sweden.

## About this report

This is a translated and abbreviated edition of **Kulturmons på böcker. En utvärdering av de tre första åren** (ISBN 91-970326-7-0). The original was published by The Swedish Booksellers Association and The Swedish Publishers' Association in November, 2004.

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