

The Chair  
**CABINET POLICY COMMITTEE**

## **PARALLEL IMPORTING AND THE CREATIVE INDUSTRIES**

### **PURPOSE**

- 1 This paper reports back on the outcome of a review of the impacts of parallel importing on the creative industries in New Zealand.

### **EXECUTIVE SUMMARY**

- 2 The outcome of the review, and experience in Australia, suggests that New Zealand should maintain its current treatment of parallel importation and supports the findings of the previous review, reported to Cabinet in 2001. The review found that, to date, the probable gains to society as a whole of parallel importing exceed any observable detriments. The one possible exception is in relation to children's book publishing; however, the extent of the impact in this area is unclear.
- 3 The review also confirms previous findings that parallel importing has resulted in improved choice, and quality and timeliness of service to retailers and consumers through an actual or threatened increase in competition.
- 4 The review process has involved extensive consultations with creative industry stakeholders both by Network Economics Consultancy Group Ltd Pty ("NECG") in the preparation of the report, and subsequently in two rounds of consultations by the Ministry of Economic Development to seek comment on the report and its findings, and to elicit further information on whether outcomes predicted by stakeholders at the time of the last review have eventuated.
- 5 It is, therefore, recommended that the current treatment of parallel imports be maintained. Given the findings regarding children's book publishing, however, and other concerns expressed by the publishing industry about potential future developments, it is recommended that the impact of parallel importing on the creative industries generally be reviewed again, in conjunction with the review on the film ban, due to be completed in 2008.

### **BACKGROUND**

- 6 Following the 1999 election, the Ministry of Economic Development ("MED") carried out two rounds of consultation at the direction of Ministers to determine if and how a parallel importing ban would achieve the government's objectives of encouraging overseas investment in and promotion of New Zealand creative industries. The conclusion of those consultations, reported to Cabinet in 2001,

was that there was no substantive evidence that a parallel importing ban would lead to decreased investment in the creative industries, with the possible exception of the film distribution industry. Consequently, following decisions by Cabinet [POL Min (01) 30/3, CAB Min (01) 35/5, POL Min (01) 33/8 and CAB Min (01) 38/6 refer], some narrow amendments to the Copyright Act 1994 (“the Act”) were introduced by the Copyright (Parallel Importation of Films and Onus of Proof) Amendment Act 2003 (“the 2003 Amendment Act”), implementing a limited ban on the parallel importation of films (for 9 months from first release). The 2003 Amendment Act also made some targeted amendments to the importation provision to address concerns in relation to copyright piracy, which arose during the consultation process.

- 7 The level of investment and innovation in creative industries continues to be an issue of significant importance to this government, and forms one of the main platforms of the Growth and Innovation Framework (“GIF”). In addition to the economic implications, there are important wider interests in the creative industries through their contribution to fostering New Zealand’s national identity, promoting its image abroad and developing viable career paths in the cultural and creative sectors. As such, Cabinet also decided in 2001 that the wider issue of parallel importation should be kept under review and directed that a further report on the impact of parallel importing on the creative industries be provided by the end of 2004. To allow for more extensive consultation, an extension of time was granted by the Chair of the Cabinet Policy Committee to early August 2005.
- 8 To assist in this further review, MED commissioned a report from Network Economics Consulting Group Pty Ltd (“NECG”) to provide analysis on the costs and benefits of parallel importing and its economic impact on investment in, and promotion of, New Zealand’s creative industries. MED also requested that NECG provide analysis of the Australian experience of parallel importing.
- 9 NECG contacted a number of key stakeholder groups in the preparation of its NECG report: Copyright Council of NZ Inc; Mallinson Rendel; New Zealand Retailers Association; Harper Collins Publishers (New Zealand) Limited; Penguin Books (NZ) Ltd; Interactive Software Association; Whitcoulls Group Ltd; Royal New Zealand Foundation of the Blind; Microsoft New Zealand Ltd; Auckland City Libraries; Lexis Nexis; Australasian Performing Rights Association; Dymocks Wellington; Screen Directors Guild of New Zealand; Books and More Lambton Quay; Information Technology Association of NZ; Motion Picture Distributors’ Association.
- 10 The report was finalised in November 2004 and made available by MED to stakeholders for comment and to ensure that stakeholder views were accurately reflected. Responses were received from the Consumers’ Institute of New Zealand and the Royal New Zealand Foundation of the Blind, both supporting the findings of the report. Given this limited feedback, an extended process was developed to seek feedback from the Recording Industry Association of New Zealand, Independent Music New Zealand, Booksellers New Zealand and Book Publishers Association of New Zealand.

**COMMENT**

- 11 Parallel importing relates to the acquisition through importation of legitimate goods made by or with the authority of the right holder, other than through authorised distribution channels. This will generally occur where goods can be sourced more quickly or cheaply in this manner. The potential risk that parallel importing poses to New Zealand's creative industries is that it may reduce the ability of right holders to extract greater returns from their intellectual property investments and, therefore, reduce the incentives to invest in and promote New Zealand creative talent.
- 12 The NECG report looks at the effect that the removal of the restriction on parallel importing has had on New Zealand creative industries through its impact on three key sectors: the book industry, the music industry, and the computer software industry. The film industry is subject to a separate review to be completed by 2008 [POL Min (01) 30/3, CAB Min (01) 35/5, POL Min (01) 33/8 and CAB Min (01) 38/6 refer].

**Investment in Creative Industries***Book Publishing*

- 13 The NECG report concludes that there is no evidence to date to suggest that the removal of the restriction on parallel importing has had an adverse effect on investment in the book industry in New Zealand. The report finds that the total investment in the publishing of local works by subsidiaries of multinational publishers does not appear to have fallen dramatically. One local subsidiary noted that their level of investment in the New Zealand book industry has remained relatively constant for the past decade (i.e. since before the restriction was lifted).
- 14 The NECG report also finds that the level of exports of books from New Zealand has risen substantially since 1998. Of the 3,600 domestic titles published in 2002, nearly 2,100 were exported. These were particularly in the area of educational books, which are the main feature of New Zealand's domestic publishing sector. The NECG report also notes that, since 1998, the level of real income earned by publishers in New Zealand has increased substantially, although real operating surplus remains unchanged. There is no evidence, however, to suggest that the decline in real operating surplus compared with real income represents anything other than the erosion of margins through increased competition.
- 15 The evidence presented suggests that the level of parallel importing in the book industry remains low. Retailers indicate that reasons for not engaging in more parallel importing include that they want to maintain good relationships with the local subsidiaries of major publishers. Many noted the improved service performance of these subsidiaries since the restriction was lifted. Publishers have indicated that the key change resulting from parallel importing is the increase in remaindered books available to consumers here. Remaindering is a provision in some contracts with publishing houses, which allows the wholesaler or retailer to significantly discount any books that remain unsold after a period,

and removes the obligation to pay royalties on those sales back to the copyright owners. NECG found that the level of remaindered books available in New Zealand had increased significantly since the ban on parallel importing had been removed, resulting in overall lower prices for consumers.

- 16 In regards to children's books, however, some publishers have indicated that the proliferation of remaindered children's books has made them very selective about taking on children's illustrated works because they cannot be produced at prices that match the overseas remainders. This raises concerns about New Zealand children having access to books that reflect New Zealand culture and experience. This issue does not, however, appear to be common to all publishers of New Zealand children's books. Other publishers have indicated no similar constraints in determining whether to publish children's books.
- 17 These findings are generally consistent with the findings of the previous reviews. In 1999 the local book publishing community argued that the investment in publishing local works by the agents of the international publishers would fall dramatically if the parallel importing restrictions were lifted; the contention being that New Zealand subsidiaries of international publishers cross-subsidise the publication of local authors from profits made on the distribution of foreign titles in New Zealand. To date, there has been no evidence presented to support this contention, and no evidence presented to support the suggestion that the absence of a restriction has resulted in the publication of fewer New Zealand books.
- 18 The Book Publishers Association of New Zealand ("BPANZ") expressed concern in its submissions, however, about potential future developments in its industry. It states that a major New Zealand retailer is on the verge of deciding to source its books from its Australian sister company rather than through New Zealand warehouses. BPANZ argues that this could encourage overseas companies to reduce their local infrastructure and, ultimately, undermine the viability of local publishing by those companies as the balance of cross subsidisation would be lost. Without local distribution and sales capability here, BPANZ claims that independent publishers would not have a platform to take their books to market as easily.
- 19 Such a situation, were it to eventuate in its totality, would be a serious concern in terms of the government's GIF and cultural objectives. It is not clear, however, that this scenario will occur. It cannot be assumed that if the retailer concerned were to source its books from Australia in the main, it would cease to purchase as many books by New Zealand authors as before, simply because there is money to be made from selling these titles in New Zealand. Further, if a major retailer were to reduce stock of New Zealand works, it could create a competitive advantage for other retailers who stock such works, where there is a demand for them from the local market. This situation also relates to the issue of closer co-ordination with Australia and the encouragement of a single market between the two countries.
- 20 On balance, I do not consider at this time that it would be prudent to alter New Zealand's parallel importing policy, which has other benefits, particularly for consumers, when the threat to the publishing of New Zealand books may not

eventuate or require government intervention. Given concerns about the remainder of children's books and potential future developments in the book industry, it is recommended that the situation continue to be monitored and that the impact of parallel importing on the creative industries generally be reviewed again, in conjunction with the review on the film ban, due to be completed in 2008 (see conclusion).

### *Music*

- 21 As with the book industry, no evidence has been presented to suggest that investment in and promotion of the New Zealand music industry and the development of local artists has declined since the ban on parallel importing was removed in 1998.
- 22 The evidence presented points to improved performance of the local music industry in this period. The number of sound recording studios has increased and available data suggests that their financial performance has improved also. There is also no evidence of a discernable trend to suggest royalty incomes have been detrimentally impacted upon since the restriction was removed.
- 23 These findings are consistent with industry reports that 2004 was again a successful year for the New Zealand music industry. New Zealand artists produced seven of New Zealand's top 20 singles and eight of New Zealand's top 20 albums during 2004, as well as the biggest selling album and single of the year. New Zealand music was also heavily supported by radio, with five New Zealand singles in the top 20 radio plays. This is in part due to the Radio Broadcasters' Association's Voluntary Code of Practice for New Zealand music, which is supported by broadcasters.
- 24 Since 1998, the government has implemented a significant number of important initiatives aimed at boosting the New Zealand music industry, including direct funding, which may have counteracted any negative effects caused by the lifting of the ban. These initiatives include promotional efforts, the Cultural Recovery Package (2000), which doubled NZ On Air's budget for New Zealand music, and the recent announcement of an additional \$5.4 million to support export growth. While it is not clear what the impact of the removal of the ban would have been in the absence of such initiatives, these results are consistent with previous advice that direct funding initiatives appear to be more likely to achieve the government's policy objectives than a blanket ban on the parallel importation of creative goods.
- 25 The recording industry has suggested that parallel importing in Australia is affecting traditional wholesalers with a probable flow-on effect for record companies' investment in Australian artists. In terms of substantive evidence for New Zealand, however, the NECG assessment and 2004 statistics both support the findings of the earlier review that the absence of a ban on the parallel importation of music has not led to a decline in investment in the domestic music industry or in the quantity of New Zealand music produced by international record companies or promoted internationally.

### *Computer software*

- 26 A similar result can be found in relation to computer software. The New Zealand industry is, by nature, generally specialist rather than creators of commodity (“off-the-shelf”) software and is largely produced with private finance rather than relying upon investment by overseas companies. Consequently, there is little evidence to suggest that the lifting of the ban on parallel importing has had any impact on the investment in the New Zealand computer software industry.
- 27 As with the previous review, software producers cited piracy as the key concern resulting from the liberalisation of parallel importing. The computer software industry argues that:
- it can be more difficult to detect infringers with the multiple distribution channels possible in a liberalised parallel importing environment; and
  - copyright owners have to prove some degree of knowledge that the goods were pirated before any remedy is available and the multiple distribution channels possible in a liberalised parallel importing environment make it easier for dealers in pirated goods to claim lack of knowledge.
- 28 Piracy is a global problem for computer software manufacturers and is best addressed directly. As the New Zealand computer software industry noted in consultations with NECG, the changes introduced by the 2003 Amendment Act go some way to addressing this concern and Microsoft commented that the reintroduction of a ban on parallel importing is not a necessary means of addressing piracy. These amendments to the Act shifted the evidentiary onus of proof to the defendant in civil proceedings concerning whether the imported goods in question are infringing copies. These changes to the onus of proof only apply to sound recordings, films and computer programs. Changes were also made to create a more objective test for the knowledge requirement of whether imported goods infringe copyright.

### **The Australian experience**

- 29 The Australian experience supports the case for maintenance of New Zealand’s treatment of parallel imports.
- 30 Australia has partially lifted the ban on parallel importation of books, allowing parallel importation if a book has not been released in Australia within 30 days of its overseas release. This has led to increased efficiencies of supply and improved availability. Prices, however, have remained substantially higher than in overseas markets.
- 31 In relation to sound recordings, the treatment of parallel imports has been more liberal. Since 1998 there have been no restrictions on the parallel importing of sound recordings. As with New Zealand, there is no evidence that this has led to a decline in the level of investment in Australian artists. Australia has also achieved local success since 1998.

Between June and December 2004, seven local acts held the number one chart position in Australia, the highest number in a six-month period since the Australia Recording Industry Association (ARIA) chart was established. Consumers in Australia have also benefited from lower average prices for CDs.

- 32 Restrictions on the parallel importation of computer software were removed in Australia in 2003. There have been no follow-up studies of the resulting effects on prices and other variables. Previous studies undertaken by the Australian Competition and Consumer Commission found that Australians paid more over the previous decade for consumer software than overseas consumers, and that the bans on parallel imports contributed to those relatively high prices by permitting copyright holders to price discriminate to the detriment of Australians.

## Films

- 33 The NECG report does not consider the impact of the introduction of a partial ban on the parallel importation of films. At the time that the report was commissioned, the reintroduction of the ban had only recently taken effect and it was considered too premature for its impact to be effectively assessed. The amended legislation also included a sunset clause. This means that if left the limited ban on the parallel importation of film would expire after 5 years from when the amendment entered into force. The ban will be reviewed by the end of 2007 to allow adequate time for any consequent legislative changes prior to the five year expiration date of 2008.

## Conclusion

- 34 The review provided no evidence to show that the level of investment in and promotion of, New Zealand creative industries has declined since the removal of the parallel importing ban in 1998, with the possible exception of children's books. This is consistent with the previous review undertaken by MED in 2000. While there are many factors that influence the market for creative works, the evidence does indicate that parallel importing has contributed to improvements in choice and quality of service to retailers and consumers through increased competition. These findings are consistent with the Australian experience.
- 35 There does not appear to be substantial evidence, therefore, that a ban on parallel importing would achieve the government's objective of increasing investment in, or promotion of, New Zealand creative industries. The review supports the contention that the government's policy objective of increased investment in local creative talent is better achieved through direct funding initiatives.
- 36 It is, therefore, recommended that the current treatment of parallel imports be maintained. Given the findings regarding children's book publishing, however, and other concerns expressed by the publishing industry about potential future developments, it is recommended that the impact of parallel importing on the creative industries generally be reviewed again, in conjunction with the review on the film ban. A review would also allow continuing concerns on the part of the music industry to be addressed further and allow both industries more time to gather evidence on any harm caused by parallel importing.

- 37 While our approach is consistent with international trading obligations, United States producers and distributors of music and software have voiced concerns in the past that allowing parallel imports makes it more difficult to detect and combat piracy and erodes the value of their products in New Zealand and third country markets. Following the amendments made in 2003 to New Zealand's Copyright Act (which included a ban on the parallel importation of films), the US has not included New Zealand's parallel importing provisions in the United States Trade Representative (USTR) "Special 301" Watch List. The US government did, however, note its industry's concern about New Zealand's parallel importing provisions in its 2005 National Trade Estimates report, which lists foreign trade barriers affecting US exports.

## CONSULTATION

- 38 As noted above, the following stakeholders were contacted in the preparation of the NECG report:

Copyright Council of NZ Inc; Mallinson Rendel; New Zealand Retailers Association; Harper Collins Publishers (New Zealand) Limited; Penguin Books (NZ) Ltd; Interactive Software Association; Whitcoulls Group Ltd; Royal New Zealand Foundation of the Blind; Microsoft New Zealand Ltd; Auckland City Libraries; Lexis Nexis; Australasian Performing Rights Association (APRA); Dymocks Wellington; Screen Directors Guild of New Zealand; Books and More Lambton Quay; Information Technology Association of NZ; Motion Picture Distributors' Association.

- 39 The NECG report was made publicly available in December 2004, and the following stakeholders were directly contacted and invited to provide comments in response to the report and its findings:

Harper Collins Publishers (New Zealand) Limited; Penguin Books (NZ) Ltd; Retail Merchants Association of New Zealand; Whitcoulls Group Ltd National Office; Microsoft New Zealand Ltd; Auckland City Libraries; Lexis Nexis; Mallinson Rendel Publishers Limited; Interactive Software Association of New Zealand; Royal NZ Foundation for the Blind; Australasian Performing Rights Association; Consumers' Institute of New Zealand; Copyright Council of New Zealand Inc; Deaf Association of New Zealand (Inc); Distance Education Association of New Zealand; Faculty of Law, Victoria University of Wellington; IBM New Zealand Limited; Information Technology Association of NZ; Internet Society of New Zealand Inc; Motion Picture Distributors Association of NZ; New Zealand Book Council; NZ Computer Society Inc; NZ Film Commission; NZ Motion Picture Exhibitor's Association Inc; NZ Society of Authors; NZ Television Broadcasters Council; Radio Broadcasters Association; Recording Industry Association of New Zealand; Screen Directors Guild of New Zealand; Screen Producers & Directors Association; Sounds (Just Music) Limited; The Open Polytechnic of New Zealand; The Warehouse.

40 Responses were received from the Consumers' Institute of New Zealand and the Royal New Zealand Foundation of the Blind. Both supported the findings of the NECG report. Further feedback was sought from Recording Industry Association of New Zealand, Independent Music New Zealand, Booksellers New Zealand and Book Publishers Association of New Zealand.

41 The following have been consulted on this paper: Treasury, Te Puni Kokiri, Ministry of Justice, Ministry of Foreign Affairs and Trade, Ministry of Consumer Affairs and Ministry for Culture and Heritage. Department of Prime Minister and Cabinet has been informed. The Minister of Commerce has also been consulted.

#### **FISCAL IMPLICATIONS**

42 No fiscal implications arise.

#### **HUMAN RIGHTS**

43 No human rights implications arise.

#### **LEGISLATIVE IMPLICATIONS**

44 No legislative implications arise.

#### **REGULATORY IMPACT AND COMPLIANCE COST STATEMENT**

45 Not required.

#### **PUBLICITY**

46 NECG's report titled *The Impact of Parallel Imports on New Zealand's Creative Industries* is available on MED's website: [www.med.govt.nz](http://www.med.govt.nz). This paper will be released on the MED website as if it had been requested under the Official Information Act.

#### **RECOMMENDATIONS**

47 It is recommended that the Committee

- 1 **note** that, with the possible exception of children's books, there is no substantive evidence to suggest that parallel importing has resulted in a decline in investment in New Zealand creative industries;
- 2 **note** that this finding is consistent with previous review undertaken by the Ministry of Economic Development in 2000;
- 3 **note** that the Book Publishing Association of New Zealand has expressed concerns about future problems for their industry if New Zealand retailers source their stock from Australia;

- 4 **note** that the increased competition or threat of increased competition caused by parallel importing has, along with other factors, had a positive effect on consumer choice, quality of service and price;
- 5 **note** that direct funding initiatives appear to have been successful in achieving the government's policy objectives for growth of and investment in creative industries;
- 6 **note** that a review of the ban on the parallel importation of films is to be undertaken prior to the 5 year expiration date of 2008 [POL Min (01) 30/3, CAB Min (01) 35/5, POL Min (01) 33/8 and CAB Min (01) 38/6 refer] ; and
- 7 **agree** that the impact of parallel importing on the creative industries continue to be monitored and a further general review of the effects of parallel importing on New Zealand's creative industries be incorporated into the 5 year review of the ban on the parallel importation of films;
- 8 **agree** that the reviews of both the ban on the parallel importation of films and the impact of parallel importing on the creative industries should be completed by the end of 2007 to allow adequate time for any consequent legislative changes; and
- 9 **agree** to the release of this paper on the Ministry's website as if it had been requested under the Official Information Act.

Hon Judith Tizard  
**Associate Minister of Commerce**