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**Department of Broadband,
Communications and the Digital Economy**

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Inquiry into IT Pricing

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1. Introduction

The use of broadband enabled IT hardware and software products and solutions by consumers and business is a key driver of productivity growth in our economy. It is important for Australia's global competitiveness that Australia pays no more for the technology that underpins its success than it must. The ubiquity and affordability of technology is a key requirement for Australia's competitiveness in the global economy and underpins everything from home finances to our export trade.

Further, the ICT sector, empowered by the digital economy, is an increasingly important part of Australia's innovation agenda, accounting for 28 per cent of all businesses expenditure on research and experimental development in 2009-10.¹ The industry itself also generated \$82.3 billion in revenue.²

The use of IT can have a transformative impact on business. Between 2009-10 and 2010-11, the results for all key indicators of IT use rose. For example, Australian businesses received online orders worth \$189 billion in 2010-11 compared to \$143 billion in 2009-10, a 32 per cent increase.³

The economic value of the digital economy to Australia was most recently estimated at about \$50 billion, or 3.6 per cent of GDP.⁴

This inquiry will also be looking into the costs of consumer goods such as films, video games and e-books. While not directly underpinning economic success in the same way as business software and hardware, these items are of great value to Australians and represent a key way in which Australians both interact with and learn from the wider world. It is entirely appropriate that Australians pursue the best prices possible for their consumer goods.

However, where Australians are spending overseas to avoid higher prices locally, this has a direct effect on the prosperity of the Australian marketplace. The Department is aware of industry concerns about pricing, particularly with regards to international competition.

The following submission addresses each of the terms of reference in turn.

¹ Australian Bureau of Statistics (ABS), *Research and Experimental Development, Businesses, Australia, 2009-10*, 8104.0, 11 September 2011. <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8104.0/>

² Australian Computer Society, *2011 ICT Statistical Compendium*. (only available to members) <http://www.acs.org.au/index.cfm?action=show&conID=compendium>

³ ABS, *Summary of IT Use and Innovation in Australian Business 2010-2011*, 8166.0, June 2012. <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8166.0>

⁴ Deloitte Access Economics, *The Connected Continent: How the Internet is transforming the Australian Economy*, August 2011. http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Services/Corporate%20Finance/Access%20Economics/Deloitte_The_Connected_Continent_Aug_2011.pdf

2. The Australian market for IT hardware and software products

In comparison with other regions, Australia is not a major market for software and hardware. With a relatively small population, it cannot support the level of competition found, for example, in the US, which has about 14 times the population and about 15 times Australia's GDP.⁵ However, Australians are heavy users of IT products; a recent Nielsen Online Ratings survey found that 15.3 million Australians went online in April 2012, about 70 per cent of the total population. Eighty-three per cent of Australian households contain a home computer, and 79 per cent of Australian households had access to the internet to the home, primarily through a broadband connection.⁶

Even on the move, Australians are among the biggest users of IT. A recent study from IPSOS OTX MediaCT found that 52 per cent of Australians own a smartphone and 58 per cent of those access the internet every day on their phone.⁷ They're also spending money on their phones; the average Australian smartphone user has bought seven apps for their phone, and will have 27 total installed.⁸

Australia is a small but significant part of the global packaged software market. According to the Business Software Alliance, the total value of the packaged software market for 2008 (the most recent data publicly available) was US\$297 billion.⁹ A report from industry analysts IDC estimated that the total business software market in Australia was worth \$6.95 billion in 2011, with spending expected to grow by 7.4 per cent year-on-year over the following five years to reach \$9.91 billion by 2016.¹⁰

⁵ CIA World Factbook, 2011 estimates, accessed 1 July 2012. <https://www.cia.gov/library/publications/the-world-factbook>

⁶ ABS, *Household Use of Information Technology 2010-11*, 8146.0. <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8146.0>

⁷ Ipsos OTX MediaCT, *Our Mobile Planet: Australia: Understanding the Mobile Consumer*, May 2012. Research funded by Google. http://services.google.com/fh/files/blogs/our_mobile_planet_australia_en.pdf

⁸ Ibid.

⁹ Business Software Alliance, *Software Industry Facts and Figures*. http://www.bsa.org/country/Public%20Policy/~media/Files/Policy/Security/General/sw_factsfigures.ashx

¹⁰ IDC, *IDC Australia Expects Growth in Business-Facing Applications* (press release), June 2012. <http://www.idc.com/getdoc.jsp?containerId=prAU23553212>

The global computer hardware market was valued at \$176.17 billion in February 2012, with the Americas accounting for about 50.8 per cent of that market value.¹¹ A similar report estimated Australia's hardware market to generate total revenue of \$2.9 billion in 2011.¹²

3. Pricing in Australia relative to selected other countries

As at 4 July 2012, 35 submissions have been lodged with the Committee. Many of these submissions highlight the differences in prices in Australia compared to other countries across a range of digital goods and hardware, such as e-books, video games and films.

In addition to these submissions, which outline personal and professional experiences with price disparities, the Department has conducted a comparison of prices for consumer electronics, software and online content across four categories: Australian retailers, US retailers, Australian online retailers and International online retailers.

The comparison suggests that:

- Store-based retail prices in Australia are generally slightly higher than store-based retail prices in the US across most product categories. (refer *Appendix A*)
- Purchasing online is generally cheaper than purchasing from a store-based retail outlet.
- Prices for purchasing IT hardware and software are commonly lower from international online retailers compared with online retailers located in Australia.
- Comparison with UK retail prices shows that in some product categories the UK is more expensive, and in some it is cheaper than Australia.
- However, retail prices in the UK and Australia for some non-customised goods are higher than the US. Research suggests this may be due to regional pricing strategies.

Appendix A outlines these price differentials across a range of goods.

¹¹ Marketline, *Computer Hardware: Global Industry Almanac* (summary), February 2012.
<http://www.reportlinker.com/p0846847-summary/Computer-Hardware-Global-Industry-Almanac-MarketLine.html>

¹² Marketline, *Computer Hardware in Australia*, February 2012.
http://www.researchandmarkets.com/reports/2094413/computer_hardware_in_australia

4. Potential drivers of different pricing

There are a number of potential explanations for disparities in pricing between Australia and other markets. The extent to which these drivers are a genuine factor in the final price will differ depending on the product; in some cases some potential drivers will be irrelevant, particularly in the case of software which is identical to that sold in other markets, distributed online, and the seller has no local presence.

The Productivity Commission investigated price differences as part of its Inquiry into the Economic Structure and Performance of the Australian Retail Industry in 2011.¹³ A summary of its findings is at *Appendix B*.

4.1. 'Sticky' pricing

There has traditionally been a delay between price reductions in foreign markets or movements foreign exchange rates and their reflection in the Australian market. Recent years have marked a significant shift in the value of the Australian dollar relative to other currencies, particularly the United States dollar and the United Kingdom pound. While the rise in the value of the Australian dollar places downward pressure on domestic prices of imported goods the observed evidence is that in many cases prices have remained stable. These delays can reflect inefficiencies in the supply process or where some importers buy stock well ahead of time in order to protect against currency fluctuations.

To some extent, these delays are fixed, for example where the discrepancy is caused by an overstock of goods purchased at an earlier, higher price, or where the price is fixed through a long-term contract. The stability may also reflect lower competition in the Australian market and/or strategies where vendors seek to add value to products rather than reduce prices.

Recently there has been some evidence of price 'harmonisation' over time. For example, the cost of Apple hardware has reportedly become more consistent globally over the past decade, including new products such as its MacBook product line.¹⁴ However, submissions note that price differentials still exist on some hardware.¹⁵

In some areas, such as videogames, prices have remained high in general but there are some examples of moves towards pricing consistency. In submission 19, Duncan Wallace noted that the price of Mass Effect 3 was listed at \$59.99 on the Origin online store in both the US and in Australia. In some cases this will mean the game will be cheaper in Australia, as many US citizens would also

¹³ Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011. Available at <http://www.pc.gov.au/projects/inquiry/retail-industry>.

¹⁴ LeMay, Renai, 'Apple Harmonises Aussie MacBook pricing', *Delimiter*, June 2012. <http://delimiter.com.au/2012/06/13/apple-harmonises-aussie-macbook-pricing/>

¹⁵ See for example submission 33.

need to pay sales tax. However, as illustrated more extensively both in Mr Wallace’s submission and elsewhere, it remains unusual to see prices lower in Australia than in the US.

4.2. Sales taxation and customs charges

There are no customs duties or tariffs on software or computer hardware in Australia. Australian business importers are required to pay GST, however, on the customs value of their goods, which is then passed onto the consumer at the point of sale. Sales taxation differs both between countries and, in the US, between states. In Australia and the UK, retailers are required to publish ‘a final price’ which incorporates sales tax. In the US, this is not a requirement, which means direct comparison of advertised prices may not indicate the ‘true’ price of a good or service.

Table 1 Sales taxation for Australia, the United Kingdom and the United States

This table sets out the sales taxation rates for Australia, United Kingdom and the United States and whether prices in each country are advertised inclusive of taxation or exclusive.

Country	GST/VAT/Sales tax	Advertised prices include tax?
Australia	10 per cent	Yes
United Kingdom	20 per cent	Yes
USA	Varies by state and county; the 2011 average is 9.64 per cent.	No

Sources: UK Government,¹⁶ Forbes.¹⁷

4.3. Marketing

Some software products may have marketing services in Australia. Local distributors will generally charge slightly more to compensate for the costs of conducting this marketing activity particularly for advertisements and promotions which directly target local audiences and consumers. As these costs are recouped against the small Australian market the result may be higher retail prices.

4.4. Unique features for the Australian market

Products which provide customised features based on unique national characteristics, such as local accountancy practices, a person’s accent or even the voltage and plug requirements for electricity, will generally require additional research and/or development work to be sold in Australia. In many

¹⁶ Directgov, *VAT Basics for Consumers*. Accessed 1 July 2012.

http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/BeginnersGuideToTax/VAT/DG_190918

¹⁷ Barrett, William P, ‘Average US Sales Tax Rate Hits Record High’, *Forbes*, February 2011.

<http://www.forbes.com/2011/02/17/average-sales-tax-rate-record-high-shopping-arizona-25-highest-sales-taxes.html>

cases the additional cost of developing these features for the smaller Australian market will be reflected in a price discrepancy.

4.5. Testing and certification

Some products – particularly hardware – will require testing and certification in Australia. The cost of this certification to Australian standards can contribute to the Australian sale price. In its submission to the Productivity Commission's Inquiry, the Australian Music Association noted the costs of attaining certification for each product imported.¹⁸

4.6. Insurance costs

Public liability or professional liability insurance is a requirement for some products to be legally sold in Australia. This will generally be reflected in the final price. Submission 34 from Cyberworld Publishing notes the requirement for liability insurance for dog training e-books as one example of an Australia-specific cost.

4.7. Local customer support

Some products, particularly hardware, may require Australia-specific customer support. This may be in the form of:

- > Staffing for call centres or retail shops
- > Trainers
- > Technicians and repair workers
- > Infrastructure, such as Australian offices

In many cases – particularly with software – the growing trend towards centralised support, often in a third country location such as the Philippines or India, allows for the amortisation of these costs on a global rather than regional or national basis. But for those products which retain Australia-based sales structures, additional costs may come from servicing the Australian market as a discrete unit.

4.8. Freight costs

Freight in Australia can be more expensive than in other countries. The 2012 Online Business Index by eBay found that 55 per cent of its top 2000 retailers considered postage costs a negative factor impacting growth. 68 per cent of respondents wanted more competitive shipping rates.¹⁹

The impact of freight costs will largely depend on the size and weight of the product being purchased. In most cases, the cost of shipping packaged software in bulk to a retailer will have a

¹⁸ Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, p 151.

¹⁹ eBay, *Online Business Index 2012*, March 2012. <http://media.ebay.com.au/NewsArticle.aspx?pid=1377>

marginal effect on the end price of a good compared to the cost of shipping it individually to a consumer from a foreign website.

4.9. Consumer guarantees

Warranties in Australia can be more rigorous and provide greater protections than those in other countries. The Australian Consumer Law, a schedule of the *Competition and Consumer Act 2010*, can provide different and in some cases stronger protections than that found in US or UK law. Where goods are faulty, this may result in higher costs for importers than they might face if they operated in other markets.²⁰ The Treasury is the government department with responsibility for the *Competition and Consumer Act 2010*.

4.10. 'Green' schemes

Commonwealth, State and Territory and local government schemes to cover the costs of recycling IT goods can contribute to the costs of hardware products bought in Australia. For example, the National Television and Computer Recycling Scheme can contribute to the costs of providing goods to the Australian market, as it places responsibility on manufacturers and importers to partake in product stewardship arrangements at their own expense.²¹ The Department of Sustainability, Environment, Water, Population and Communities is the government department with responsibility for the National Television and Computer Recycling Scheme.

4.11. Local distributor networks

Australia is a small market, but many software products are sold by local distributors who market, supply and in some cases support these products. The need for these distributors to extract profit on their transactions will inevitably increase prices. This has the potential to make it difficult for Australian retailers to compete for the custom of Australian consumers, who by shopping online in a product's home market can avoid the costs associated with the additional layer of distribution.

4.12. Higher costs of doing business

Some submitters have argued that the costs of doing business in Australia may be responsible in part for the price differential, particularly for hardware. Morgan Stanley conducted research into retail

²⁰ For more information about the *Competition and Consumer Act 2010* and the Australian Consumer Law, visit <http://www.consumerlaw.gov.au>

²¹ For more information on the scheme, visit <http://www.environment.gov.au/settlements/waste/ewaste/faqs/tv.html>

prices in Australia and found that when compared with similar sites in the US and the UK, Australian retailers tended to pay more for shop space.²²

The Productivity Commission noted that labour and rental expenses can be as much as 70 per cent of the Australian retail industry's operating costs; quite high by international standards.²³

5. Potential impacts of pricing inconsistencies

The digital economy creates many opportunities for the Australian consumer. With regards to IT pricing, it undermines the ability of exclusive licensing arrangements and makes accessing global marketplaces significantly simpler and more affordable. As the Productivity Commission noted in their inquiry report:

People can use their computers... to compare the prices and features of dozens of goods from hundreds of retailers across the world and then arrange home delivery. Nor do consumers just rely on traditional advertising or product tests to inform themselves about a product. There is a proliferation of websites providing online reviews and customer discussion.²⁴

Despite these advantages, many Australians pay more for their goods than those in other countries.

5.1. Impact on disadvantaged Australians

In the short to medium term the higher pricing of IT software and hardware may have the potential to reduce the take-up of new technology by low-income consumers, disadvantaged consumers or not for profit organisations. More research would be needed to determine the effects in this area.

These low-income consumers are also less likely to engage in e-commerce and shop online to seek out the cheapest deal. Anecdotally, this is also true of consumers with a disability who most often turn to local or trusted retail suppliers of goods and services.

5.2. Impact on Australian retailers and distributors

The evidence suggests that a significant proportion of the increased cost of buying hardware and software in Australia is beyond the influence of the average Australian retailer, particularly for small to medium businesses. Factors such as local distributor networks, global pricing policies which include regional price discrimination, and the cost of 'value-added' services such as localisation,

²² Schlesinger, Larry, 'Australia's retail rents the highest in the world', *Smartcompany*, July 2011.
<http://www.smartcompany.com.au/retail/20110701-australia-s-retail-rents-the-highest-in-the-world-report.html>

²³ Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, p148.

²⁴ *Ibid*, pXXI.

warranty provisions and 'green' schemes can reduce the perceived competitiveness of Australian retailers.

In some cases, retailers will be able to sell the benefits behind their higher costs, such as superior warranties, environmental protection, or localised content and repair services. Australian retailers which compete on price alone will likely lose business to international competitors who are able to provide identical products at an even lower price, and may need to consider their business models in light of these challenges.

5.3. Impact on international distributors

In some cases it appears likely that decisions by international distributors are the primary causes of price differences between Australian and other markets.

To protect these differences and the margins they represent, some distributors use or require retailers to use technologies such as geo-blocking.²⁵

These efforts are unlikely to prove successful in the long run. Other submissions and correspondence received by the department suggests these activities create considerable ill will towards the companies involved. It is apparent that many consumers consider these price differences to be unfair or unjust, and will go to some lengths to avoid paying extra compared to consumers in other markets.

Consumers have already found that they can pay lower prices for many software or hardware products by ordering direct from US or UK suppliers. Further, where businesses have used geo-blocking technologies to prevent use of Australian credit cards, mailing addresses or IP address ranges from accessing US or UK pricing, it is likely consumers will continue to seek innovative approaches to bypassing these controls. Most recently, for physical goods available more cheaply in the US, this has involved techniques such as 'renting' mailing addresses in the US or arranging for US third parties to purchase goods and ship them. Some consumers may also engage in black or grey market piracy, particularly for software products and other digital content.

International distributors will need to consider whether the reputational and financial costs of preventing Australians from accessing the global market are profitable in the long-term, particularly in business software, where open source software is increasingly a viable alternative to for-pay equivalents. In the entertainment market, distributors will need to consider whether premium prices in Australia reflect a uniformly premium market, or whether a global market approach will prove more beneficial.

²⁵ Geo-blocking is the name for a variety of techniques used to verify a user's location and provide related content on that basis. It is most commonly used for content delivery, such as films and television programs, and to verify a purchaser's location at point of sale. A person's location can generally be derived from their computer's IP address, but at the sale stage can be verified using the person's credit card details or mailing address.

6. Opportunities for reform

There remains an ongoing role for the market in restoring the balance of costs across international borders. The digital economy offers consumers an unprecedented opportunity to act as independent rational agents on a global scale, with enormous potential to benefit from lower prices and a much larger market of goods than is available in Australia alone.

Australian consumer law protections serve a valuable purpose and should continue to be available to consumers when they purchase locally. There remains a role for Government in ensuring consumers are adequately protected against predatory and unethical commercial practices. However, the Government must also act within limits; some measures, such as requiring foreign retailers to apply Australian laws and taxation arrangements, are unlikely to prove benefits in balance with the required expenditure of resources.

A. Price comparison for a range of computer hardware and software

The following table provides a snapshot comparison of prices for different goods across a range of retail distribution platforms. The structure is taken from that used by the Productivity Commission with the inclusion of prices for US store based retailers (such as Wal-Mart and Best Buy) and UK store-based retailers such as Tesco.

This sample is not statistically valid — the products below were selected for their ease of price comparison with different markets. There are blank spaces in the below chart where identical products were not available from the selected retailers.

All prices have been converted back to AUD using the following exchange rates:

- > AUD\$1 = US\$1.0035
- > AUD\$1 = GBP£0.644

Table 2 Comparison of prices for a variety of consumer goods as at 16 June 2012

This table sets out the prices across selected retailers in consumer electronics/games/DVDs; online content (music and videos); software; and disability equipment.

Product	Australian retailers		US retailers		UK retailers		Australia online retailers		International online retailers
Consumer electronics/games/DVDs									
Canon IXUS digital camera	\$169	\$176					\$194		\$188
ACER Aspire 18" 8950G Notebook	\$2498	\$2796					\$2399	\$2723	\$2198
Apple iPad 3 – Wi-Fi 32GB	\$646	\$648	\$599	\$599	\$747	\$747	\$630	\$649	\$630
HP Envy 4-1001 TU NB							\$899		\$799
Call of Duty Black Ops	\$74	\$89	\$59.96				\$56.99	\$76.99	\$39.40

Product	Australian retailers		US retailers		UK retailers		Australia online retailers		International online retailers	
Born This Way: Lady Gaga Album	\$17.99	\$19.99	\$17.88				\$21.45	\$21.90	\$13.95	\$20.18
Friends – season 1 – 10 Complete Collection DVD (Anniversary Edition)	\$190.99						\$139.95	\$165.00	\$84.77	
Online content (music and video)										
Toy Story Movie – iTunes						\$15.60	\$24.99		\$10.10	
iTunes – Beatles Anthology Highlights Album						\$17	\$20.99		\$13.09	
iTunes - Arctic Monkeys' 'Suck it up and see' Album						\$9.30	\$17.99		\$13.09	
Software										
Windows 7 Home Premium	\$228	\$279	\$199.99		\$119.99	\$171.55			\$152.01	
Adobe Acrobat X – home and student	\$179		\$119.00		\$185.70		\$163.62		\$129.00	
Norton antivirus 2012	\$39.77	\$59.95	\$39.99	\$44.00	\$35.90	\$46.80	\$45.63		\$25.99	
Disability Equipment										
Focus 40 Blue Braille Display	\$3850		\$2850							
JAWS Screen Reader (standard version)	\$895		\$1190		\$1077		\$550			

Source/Notes: Prices in the table reflect available stock at selected retailers. Where these retailers did not supply the good, no price has been listed.

B. Productivity Commission Inquiry into the Economic Structure and Performance of the Australian Retail Industry

In 2011 the Productivity Commission published a report on its inquiry into the performance of the Australian retail industry, which included analysis of the implications of online retail. The inquiry's findings included that Australian consumers are subject to substantial price differentials. For instance:

- > Australian consumers often pay more for goods and services purchased from 'bricks and mortar' stores than when purchased from an online sale-point, with a price differential of up to 50 per cent in some product categories
- > Some retailers set higher prices for the same products and services when sold in Australian online stores than when sold in international online stores, and these higher prices are passed on to Australian consumers

The inquiry and submissions to it identified a range of key factors contributing to higher store-based retail prices in Australia compared to the prices of online retail sites, including higher wages, product customisation, transportation costs, distribution and licensing agreements, tenancy costs, taxation effects and the relative size of the Australian market.

Whilst these factors may account for some pricing differences in hardware products, it is harder to justify the price differential for software products and online content, where there is little to no additional (marginal) cost to supply these. The Commission suggested that arguments made by international suppliers to defend regional price discrimination are "not persuasive, especially in the case, for example, of downloaded music, software, and videos where the costs of delivery to the customer are practically zero and uniform around the world."²⁶

The Commission concluded that "it is clear that international price discrimination is being practised against some Australian retailers, to the detriment of Australian consumers" but also that "the practice of [geographical] price discrimination is a common and generally legal business strategy to maximise profits and performance. It is sustained through sufficient demand from consumers, lack of competitive rivals, and the ability for market of consumer segments to be kept separate".

²⁶ Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, pXXIII.