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Levies: Distortion Effects on Trade in the Single Market

Until only relatively few years ago technology products differed from country to country and from region to region, reflecting different local standards and regulatory systems. For example less than fifteen years ago an analogue mobile phone designed to work in the United Kingdom would not work on the different analogue system in Germany or in most other EU Member States for that matter, and vice versa. Analogue products developed for different countries usually had different bases for their pricing structures reflecting different product development and technology content costs. In short, pricing models were more complex and varied from market to market.

However, the ever-growing trend towards global markets – a key reason for the creation of a single European market – in parallel with the increasing trend towards global standards, particularly in the digital environment, means there are significantly less product variants across different territories. Returning to the mobile phone example, a current GSM digital mobile phone will work in all EU Member States and indeed in most other parts of the world. This means that exactly the same product can be sold into all Member States without the need for any variations to meet local requirements. One size really does tend to fit all in the contemporary digital environment.

The Internet has helped promote more uniform international standards in an ever-increasing range of products and services in the digital space and eEconomy.

This increasing product uniformity across different territories is making more evident the anomalous and unfair distortion effects on trade caused by the continued application of copyright levies on a country-by-country basis, yet in an entirely non-harmonised manner, within the EU.

And this problem is going from bad to worse as the application of levies is being extended in some countries to all sorts of digital products. To illustrate the broad and ever-widening range of products that are being targeted in the digital environment, claims for levy payments have now been made on 'new' product categories such as: mobile phones, PCs, printers, digital cameras, broadband networks, even internet access....

There follows a list of examples illustrating some of the distortion effects that levies are actually having on trade within the EU, from the point of view of the Internal Market and unfair practices and competition, and the impact this is having on the consumer in Europe. These examples are supported by a number of "Scenarios" in the Annex, providing specific case studies, evidence and elaboration of the negative impacts.

**Examples of
Distortion Effects on Trade
caused by Levies
on Digital Products in the EU**

- Levies represent an extremely high proportion of the final sales price to consumers in some countries – *see scenarios 1a-1c*
- Consumers are paying much higher prices in some Member States for exactly the same products due only to the burden of levies – *see scenario 1a-1c*
- The price differential between different Members States due to levies will induce cross-border trade – *see scenarios 1a-1c.*
- Manufacturers who pay levies are at a serious competitive disadvantage compared with counterparts that do not pay – *see scenarios 1a, 1c and 9.*
- Manufacturers sometimes have to absorb the cost of levies to remain competitive, giving rise to different business models on different products in different countries – *see scenario 9*
- Levies are collected on products even when there is no entitlement to levies – *see scenarios 2a and 2b.*
- Levies are collected on products even when the rights holder has been fairly compensated by other means, e.g. payment of a licence fee, amounting to double payment – *see case study 2b*
- Levy income is considerably more than the losses caused by legal private copying, and even more than would compensate for piracy – *see scenarios 1a and 3.*
- Some products and content services are unavailable to consumers in some Member States because the cost of levies is too high – *see scenario 4.*
- Some products or services available elsewhere in the world are delayed or simply not available to consumers in the EU because the cost, complexity, and uncertainty of negotiating with all the collecting societies on a country-by-country basis, and the resulting different price models across the EU – *see scenario 5*
- The complexity of levy payment arrangements creates a huge administrative burden - *see scenarios 2a and 6*
- Uncertainty and risk imposes a huge financial burden – *scenario 7*
- Huge cash reserves are being built up, diverting funds from investment in innovation – *scenario 7*
- The lack of a one-stop shop impacts staff resources and increases costs – *scenario 8*

Levies – Trade Distortion Effects Case Studies

Scenario 1.

Levies represent a high portion of the final sales price to consumers.

1a) Spain:

The levy imposed on so-called multifunctional devices (MFDs) - which combine various functions in one device e.g. copier + fax + printer - in Spain is disproportionately high. The net retail price of a low end MFD in Spain is around € 79 (including 16 % VAT) and the levy on a MFD with a capacity to make 1-9 copies per minute is € 45.08 + 16% VAT, increasing the final price paid by the consumer for these devices to around € 131. The levy amounts to 66% of the price of the device without the levy.

This significant percentage represents an additional problem in connection with parallel imports and similar practices by importers who commercialise their products without paying the applicable levy, while competing companies are paying these substantial levies on the same products.

The ICT industry has been in negotiation with the relevant collecting society to try to address this market distortion recognising the fact that it would be the only way to remain competitive in this market and survive in the face of importers not paying levies on such products. An agreement has eventually been reached with the collecting society which would mean a reduction of applicable levies on such low-end MFDs from € 45,08 to € 16,67. However, the levy still amounts to between 7% and 20% of the end-user price, and the industry has had to accept payment of levies on scanners (€ 10), products which had not been subject to payment of copyright levies in the past, in return for a lower levy on MFDs. The level of income collected from levies by the respective collection society is extremely high, especially when compared with actual harm caused by private copies that might be eventually made with such products and represents more than 10 times the income collected by the collection society from reprography licenses granted to reprography and copy centres and bureaus (which are the copies that could more legitimately be regarded as actually harming right-holders sales).

1b) Germany:

In the court case of the German collecting society VG-Wort vs. HP regarding levies on Multi-Function Device (MFD), the Arbitration Board at the Patent Office in Munich recently decided that MFDs fall under the photocopier levies tariff. For products up to 12 ppm this means a tariff of € 76,70, for 13-35 pages per minute (ppm) units - € 102,26, for 36-70 ppm units – € 153,40 and for 70+ ppm units - € 613,56. (Tariffs for black & white MFD are half of the previously mentioned tariffs). This would mean that a levy of € 76,70 on a MFD product such as an HP PSC 1210xi with a retail price in Germany of € 129 (offer on German Website of Retailer RedZac Dec 02,2003) represents approx. 68% of the purchase price.

The same collecting society claims between € 20 and € 300 for every colour printer (tariffs for black & white printers are half of these amounts). Apart from the fact that a printer is definitely not meant to be a copying machine and as such should not be levied at all, the claimed tariffs can represent more than half the purchase price that the consumer pays. For example, a standard colour inkjet printer in Germany would retail at € 39. VG-Wort claims a levy of € 23,20 representing a mark up of 59% on the retail price and taking the price for the consumer up to € 62,20.

1b)(i) Cost impact on a PC package in Germany:

If the collecting societies in Germany succeed in their demands for levies on printers and PCs, consumers will be forced to accept the following additional costs for a complete computer package:

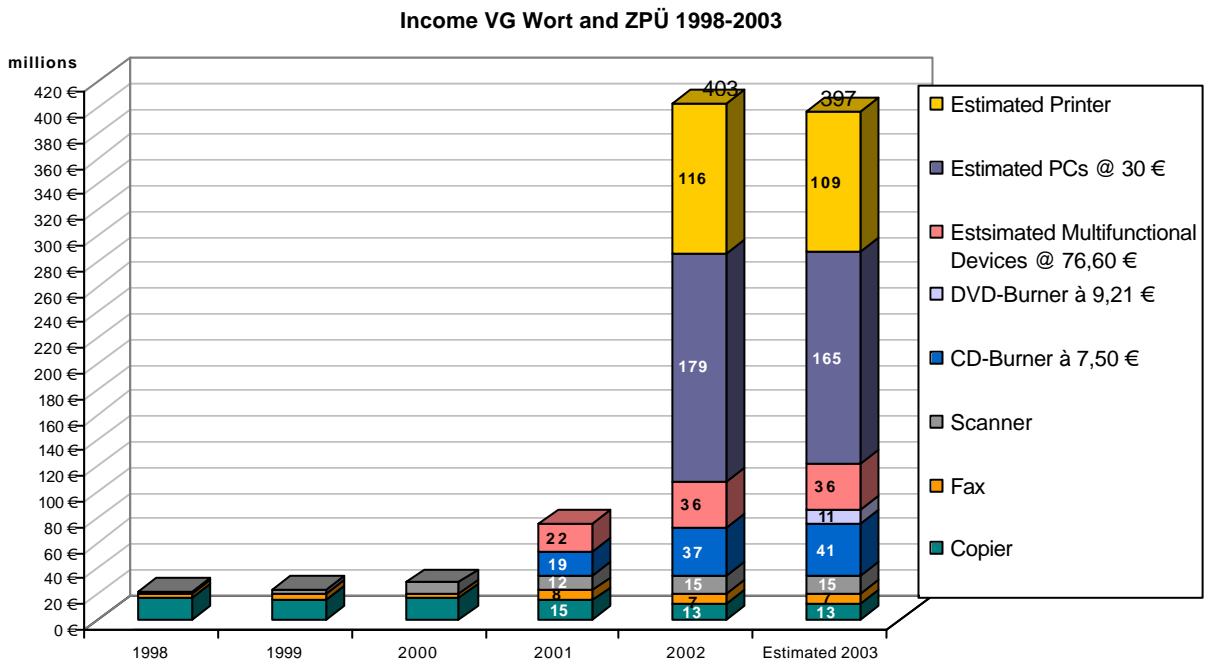
PC	+ 30,00 €
Printer	+ 20,00 €
Scanner	+ 10,00 €
CD Burner	+ 7,50 €

Total	67,73 €
+ VAT	10,84 €

Total add.cost	
Due to levies	76,57 €

1b)(ii) Increasing Cost impact on digital products in Germany:

The overall economic impact of the levies being paid or claimed in Germany is clearly shown in the graph below put together by the German ICT association Bitkom.



1c) France:

In France levies on blank DVD's now represent over 47% of the final end-user price. As prices of such relatively new products are decreasing rapidly, the share attributable to the levy (which is a fixed amount) grows disproportionately.

Moreover, French customs are only concerned about checking payment of taxes like VAT. They are not at all concerned - and even refuse to check - whether levies have been or will be paid for products imported into France. Not surprisingly, therefore, levies reportedly have not been paid on more than 50% of the blank DVD's offered in the streets in Paris.

This has an inevitable market distortion effect as illustrated by the following pie-chart, which shows officially reported sales of DVDs in a number of European countries. Although other factors may be relevant in France the the reported sales of DVDs in France is curiously extremely low, for example only one fifth the level of Germany. It is not unreasonable to deduce from this that there is a sizeable illegitimate DVD market in France, on which levies have not been paid.

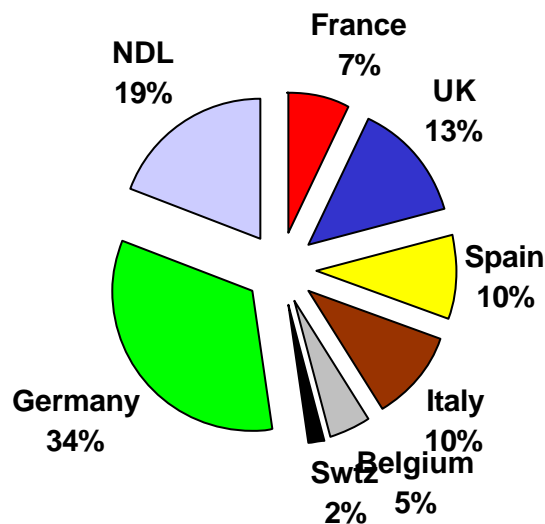
All these scenarios 1a-1c show how the disproportionate amount that levies represent on some products would clearly put both industry and consumers in those countries at a disadvantage compared to the situation in other EU Member States without a levies system or with no levies on those particular products.

Scenario 2.

Levies on products that are not legally liable to levies.

2a) Levies on exported products:

Although technically no levy is due on exported products under the different copyright laws of EU Member States, the process that the collecting societies have adopted is so complex in practice that in fact even exported products are often subject to levies. In Germany, for example, the process involved in reporting product shipments versus exports is so complicated that the easiest way is for companies to pay levies on all of the shipped products. In addition, collecting societies demand evidence when products are held in bonded warehouse which is logistically problematic so levies are generally paid and then claimed back.



SOURCES EMA October 2003

In practical terms, the process in Germany works as follows: The levies paid by the manufacturer/importer are passed on to wholesalers in the price of the products. The wholesalers then claim back the levies paid on the products they export, directly from the collecting societies. In order to do this, wholesalers require a letter from the manufacturer/importer, validating the numbers of exported products reported is correct and entitled to reimbursement by the collecting society. However, this system only

applies in the case of one of the collecting societies, namely VG-Wort/VG Kunst. The collecting society ZPÜ will not reimburse 3rd parties. ZPÜ is only prepared to deal with the companies that do the original reports, which then means that manufacturers/importers have to do the reports on the exports. This means that, prior to doing the reports, manufacturers/importers have to chase every single one of their partners to find out from them how many products were exported so that the manufacturer/importer can deduct those numbers from the report before they send it in. Once a report has been sent, manufacturers/importers cannot change the figures. This means that if a partner informs the manufacturer/importer about exported products after the report has been finalized and sent, the manufacturer/importer has to wait until the next report period before the numbers can be deducted. This results in a huge amount of administrative work and more likely than not, the collecting societies are benefiting because numbers will have inadvertently not been deducted.

2b) Levies on products sold to businesses:

Levies by definition are to compensate for copies made for personal, private use. This would in principle exclude businesses from the payment of levies. However, in practice levies are paid not only on products sold to end-users who are private individuals (who are legally authorized to make private copies), but also to business end-users - who are not authorized under the private copy provisions – and who buy such products for use in their business.

Furthermore, copy centres and reprography bureaus are being requested to pay not only the levy on the products they buy (although the products cannot be used for private copying by the copy centre) but also a reproduction license fee in order to have authorization to make copies (with limitations: 10% of the book, etc) for third parties.

Scenario 3.

Levy income is considerably more than the losses due to private copying and even exceed the amount that would compensate for piracy.

On September 15, 2003 the Spanish Internet Users Association published the following levies figures to show that the levies applied on CDs and DVDs in Spain represent a level of compensation that far exceeds harm caused by legal private copying and looks more like it is actually compensating for piracy losses (data taken from an article - in Spanish only - available at <http://www.internautas.org/article.php?sid=1205>):

Breakdown of the forecast of digital media sales for 2004 and income from the corresponding copyright levy:

Medium	Forecast		Levy Total	
	Sales 2004	Levy	Euros	Pesetas
CD-R data	200,000,000	0.17	34,000,000	5,657,124,000
CD-RW data	6,200,000	0.17	1,054,000	175,370,844
CD-R/RW audio	4,350,000	0.40	1,740,000	289,511,640
DVD data	13,162,500	0.60	7,897,500	1,314,033,435
DVD video	7,087,500	1.40	9,922,500	1,650,965,085
TOTAL			54,614,000	9,087,005,004

* Source: Report BSA - Understanding & Solutions

* 80 minutes CD's (700 MB) and 4,7 GB DVD have been taken into account for the forecast.

Levies will represent a turnover for the collecting societies of more than €54 million (9 billion pesetas) in 2004. This income is divided up as €33 million for audio rights and €21 million for video.

Allocation for CDs			
Audio	87.50 %		
Video	12.50 %		
		Allocation of levies income	
		Audio	33,024,070€
		Video	21,589,930€
		Total	54,514,000€
Allocation for DVDs			
Audio	3.43 %		
Video	96.57%		

According to Article 36 of Royal Decree 1434/1992, the allocation of the levies income is as follows:

Allocation for Audio		
Authors (SGAE ¹)	50 %	16,512,035
Artists	25 %	8,256,018
Producers	25 %	8,256,018
Total	100 %	33,024,070

Allocation for Video		
Authors (SGAE+DAMA²)	33%	7,124,677
Artists	33%	7,124,677
Producers	33%	7,124,677
Total	100%	21,589,930

SGAE expects €16.5 million as income from levies on audio (discs) alone. This can be compared with the 2002 turnover figures to see the impact the levies have on the authors' accounts.

Amount of phonograms sold in 2002 (source: SGAE-IFPI - Arts Directory 2002)	65,300,000
Total turnover in 2002 (in €) - (source: SGAE-IFPI - Arts Directory 2002)	576,200,000
% Average income of authors for each phonogram - (source: Actualidad Económica)	9.40%
Total income for authors in 2002 for disc and cassette sales (€)	54,162,800
(data can be checked against the contents of the SGAE Report)	(52,561,449)
Average income as copyright for each phonogram (€)	0.83

¹ Sociedad General de Autores y Editores – collecting society representing composers, songwriters and music publishers.

² Derechos de Autor de los Medios Audiovisuales – represents rights holders from the audiovisual sector.

Given that for each phonogram the author gets €0.83, in order to reach an income from their own sales equivalent to what SGAE is claiming as levies on audio (€ 16,512,035), authors would need an increase in sales of 19,907,314 additional discs, representing an increase in sales of 30.5%.

In May 2003 the losses caused by piracy reached 21.3% which means that, according to their data, an estimate of the units sold in the pirate market gives a figure of 13,908,900 units (i.e. 21.3% of the 65.3 millions phonograms sold in 2002). This represents € 11,536,676 (€ 13,908,900 x 0,83) in non-collected copyrights, an amount substantially lower than the amount claimed from levies on CDs.

This means that the levy revenue would not only compensate losses due to piracy but would even yield a surplus of € 4,975,359 (more than 827 million pesetas).

It has to be emphasised that levies are not intended to compensate for piracy, but only for authorised private copying.

Notwithstanding such disproportionalities, SGAE continues to seek levies on as many products as possible and recently announced initiating legal actions in order to extend the payment of levies to a wide range of products with internal or external hard-disc devices such as PCs, hand-held devices, mobile phones, digital TV sets, etc.

Scenario 4

What one particular Company, Creative Labs, is doing about Levies on compressed Audio products.

Creative is a worldwide leader in digital entertainment products for the personal computer and the Internet.

Creative disagrees with levies because their products are “multi-functional devices” that can be used to store data and media (sound & graphic) files.

Creative also supports DRM technologies and accordingly believes that technical protection measures should be taken into account when calculating levies under the principles enshrined in the EU Copyright Directive 2001/29/EC.

Creative constantly reviews the levies demanded in each country and where they feel they are too high, they reserve the right to stop shipping into those countries. Currently, Creative does not ship hard disk based Jukeboxes into Austria due to the high levies demanded. This position is constantly reviewed in the light of changing circumstances in Austria and other countries.

Scenario 5

Deployment of DRM services are hindered in the EU as companies are compelled to work on a country by country basis.

On-line Digital Rights Management services are being deployed at a rapid pace in both the US and Japan and are very much welcomed by both consumers and right holders. These online services offer a secure, legal and attractive solution against illegal internet downloads which are detrimental to both the film and music industry.

However, services such as the successful iTunes Music Store in the US cannot be offered in Europe on a single EU wide basis which makes it extremely difficult and cumbersome for a company such as Apple to offer similar services to all EU customers.

Hence, partly due to a lack of EU wide licensing agreements, online DRM services such as music downloads need to be negotiated country by country with 15 different licensing agreements, different pricing levels and different music catalogues. Moreover, most of these negotiations have to go through national collecting societies who have a monopoly in their region and by definition have no interest in negotiating agreements which would avoid a market distortion in the EU.

Scenario 6

Payment arrangements create a huge administrative burden.

Administering levy payment arrangements within the paying company is an extremely burdensome and complex overhead for accounts departments. Accounts departments have to keep track of different product movements within different Member States, and monitor which products are exported from one Member State or exported outside the EU. Then there is the added complexity that levy amounts vary from country to country. The problem is exacerbated because the product categories and the way in which the levy is calculated vary markedly from country to country. Accounts departments have to have systems in place to deal with all of this complexity and uncertainty, which has an impact on resources and costs.

Scenario 7

The uncertainty and risk imposes a huge financial burden.

There is a high degree of uncertainty associated with levies, because the law is not always crystal clear in this area, and it is difficult even for legal experts knowledgeable on the subject to advise the business with any certainty about the true obligations and payments that legally have to be made.

Even after taking legal advice Companies are often unsure about whether levies are strictly payable or not. Some companies will pay anyway to reduce or remove the risk. Others may decide for very good reasons that it is unfair an/or uncompetitive to pay levies. In that case the uncertainty means that the company remains open to a risk which could potentially be very substantial. Cautious companies are likely to build a contingency fund and effectively pay a notional levy into a reserve account. This creates very significant, possibly unnecessary, financial burdens for companies and has an impact, for example, on cash flow and financial reporting.

Although the information is generally highly confidential, various companies have confirmed that they keep considerable amounts of money in reserve for pending levy claims. In the Rightscom Study³ on the economic impact of levies, it is reported the total amount of levies collected in five European countries in 2004 will be over half a billion Euros. However, the total amount of levies actually claimed in the same year is over € 1 billion. This means there are half a billion Euros claimed but disputed. According to the same Study this amount of claimed but disputed levies will rise to over € 600 million by 2006. Assuming conservatively that companies are keeping half of the disputed amount

³ “Economic Impact Study: Private Copying Levies on Digital Equipment and Media in Europe”
Rightscom/BSA 2003

in contingency funds, this would suggest that collectively reserves in the region of € 250 million are being kept in 2004 rising to € 300 million in 2006. It should also be emphasised that in relation to disputed claims this money is being kept year on year, so that the reserves are actually accumulating with the passage of time. This huge amount of money is largely drawn from the innovation budget as it is so closely related to new technology developments like hard disk, solid state memory, compression technologies etc. etc. In summary, although because of confidentiality it is difficult to give concrete facts, the evidence points to the inevitable conclusion that enormous amounts of money are probably being tied up in reserve to meet potential levy payments which would otherwise go into research and development of new technologies and products in Europe.

More cautious companies may even decide not to make a product available in a particular Member State because the uncertainty and risk is too great and they do not want to be exposed to the risk and financial burden, to the detriment of the European consumer – also see scenario 4.

Scenario 8

Lack of a one-stop shop impacts staff resources, and increases costs, etc.

The current system of levies means it is necessary to have to negotiate with collecting societies separately in each Member State where levies might apply, using legal experts familiar with the local copyright law and levies regime. This requires companies to engage either internal experts or external consultants specially as negotiators and advisers, to undertake a complex network of negotiations across the EU, which requires special staff resources, and hence increases costs, attributable solely to the territorial nature of levies and collecting societies.

Scenario 9

Different manufacturers have to apply different business models for dealing with levies on different products in different countries.

Although this does not reflect the situation for all companies in all markets, an internal survey covering Philips' sales organisations across Europe revealed that on average 80 % of the levies paid by Philips cannot be charged to the end-user. This is because parallel imported products from other Member States effectively establish the price level in the market. Moreover, products ordered by consumers directly via the Internet are generally not levied. Internet selling is also a key contributor in setting price levels. Selling exactly the same goods at a higher price than either parallel-imported goods or goods purchased on-line would obviously make them uncompetitive. Looked at another way, this means the end-user does not actually pay the levy or even a contribution towards it. The non-harmonised application of levies in different member States, and the different mechanisms for establishing the de facto price level in a given Member State, thus conspire to create the result that the burden of cost of the levy is sometimes met by the manufacturer, and is not paid by the beneficiary, i.e. the end-user, at all. But, as already said this is not always the case, which highlights a further market distortion, namely that different manufacturers in different markets in different countries have to adopt different business models for dealing with levies depending on all of the relevant circumstances. There is no "one-size fits-all" business model.