ACSFA College Textbook Cost Study Plan Proposal
Dr. James V. Koch
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AN ECONOMIC ANALYIS OF TEXTBOOK PRICING AND TEXTBOOK MARKETS

Between 1986 and 2004, textbook prices rose 186 percent in the United States, or slightly more than six percent per year (GAO, 2005). Meanwhile, other prices rose only about three percent per year (GAO, 2005).

What difference has this made? When textbook price increases are combined with the seven percent average annual increase in tuition and fees over the same time period (GAO, 2005), this has caused the overall price of higher education to increase significantly and has posed serious financial problems for the students and parents who must meet these burgeoning costs. These financial stresses have evidenced themselves in two ways. First, over time, student access to higher education has declined and second, students have taken more time to complete their programs of study.

CALPIRG (2005) found that students at California public universities spent an average of $898 on textbooks in the 2004-2005 academic year. If textbook prices have continued to rise at six percent per year, then this expenditure will rise to $1,009 in the 2006-2007 academic year and constitute 6.1 percent of the estimated annual cost of education for a resident student at a four-year public university (College Board, 2005).

Students coming from lower income families have suffered the most. As noted, textbooks now will constitute a $1,000 item annually for many full-time students and this is especially burdensome to low-income students. Financial aid expert Thomas G. Mortensen reports that whereas about one-half of all students coming from families with incomes in excess of $90,000 annually earn a bachelor's degree by age 24, fewer than five percent of students coming from families earning less than $35,000 annually do so (Kahlenberg, 2005). Textbook costs, of course, are not the only cause of these differentials, but it is apparent from student behavior that they are a contributing factor.

Rising textbook prices also have placed increasing demands on the resources of stakeholders such as the federal government and colleges and universities that provide need-based financial aid to students. Since federal financial aid formulas typically include some measure of the cost of textbooks, textbook price increases have forced Congress either to appropriate more money to financial aid and/or to ration scarce available financial aid funds among an increasing large number of students. Both things have occurred, but the end result still has been that need-based financial aid per eligible student has fallen far behind both the rising cost of higher education.

Why have textbook prices been rising so rapidly? What are the economic reasons why textbook prices have escalated so briskly and what reasonable alternatives are available that might slow down these price increases? These questions are examined in the sections below.

TEXTBOOK MARKETS: AN OVERVIEW

With few exceptions, textbook markets in the United States are not regulated by any governmental agency. Thus, textbooks prices reflect the relatively free interplay of demand and supply influences and can be analyzed in this context. Nevertheless, there are unusual, even quirky aspects of textbook markets that differentiate them from most other markets. It is these unusual, uncommon characteristics of textbook markets that make it difficult for policy makers to influence prices there.

Demand Side of the Market

The primary purchasers of college textbooks are the estimated 17.66 million students who will attend institutions of higher education in Fall 2006 (*Chronicle*, 2005b). They will spend more than $4.9 billion on textbooks.[1] Approximately $1.9 billion, or 39 percent of this amount, will be spent on used textbooks (Mindlin, 2006 and NACS, 2006). Additionally, colleges, government agencies and businesses purchase some textbooks. For example, some two-dozen institutions of higher education operate textbook rental operations such that they purchase textbooks they then rent to students, who do not own the textbook, though they usually have the option to purchase it at the end of the course.

- The textbook market is remarkable because the primary individuals who choose college textbooks (faculty) are not the people that pay for those textbooks (students). Only a few other organized markets in the United States are similar in this regard. A comparable situation exists in medicine where doctors prescribe drugs for their patients, but do not pay for those drugs.

  Analogous to the market for prescription drugs where prices have risen rapidly, in the market for textbooks the separation of textbook choice and textbook payment profoundly influences pricing. Albeit for primarily good purpose, students end up being coerced to pay for someone else's choices. This tends to make their textbook purchases less responsive to price increases than their purchases of items such as cheeseburgers and jeans.

  Long-standing academic custom assigns faculty the right to choose the textbooks and other course materials that are required or recommended for their courses. Sometimes a collective group of faculty will make that decision. For example, the faculty of an institution's Department of History might jointly choose the textbook for an introductory American History course. More than 90 percent of the time, however, individual faculty make their textbook choices independently, and often with little

[1] This represents an extrapolation from the $4.416 billion datum supplied by NACS (2006) for the 2004-2005 year.

regard to the cost of the textbooks, because they are not the individuals who pay for them.

College faculty members in the United States are evaluated on the basis of their performances in three classic areas---teaching, research and public service. It is fair to say that a faculty member's choice of a textbook seldom is considered in any evaluation and even less often is the price of that textbook a factor. A Connecticut Board of Governors for Higher Education study (2006) revealed that only 58 percent of that state's faculty were aware of the cost of the textbooks they selected for their courses.

Further, faculty typically receive free examination copies of textbooks from publishers, whether or not they actually end up using the books and examination copies comprise about ten percent of any textbook production run. Hence, it is not surprising that the Connecticut study revealed that only 43 percent of faculty chose their textbooks on the basis of their prices and affordability.

Parenthetically, it should be noted that many faculty sell the examination copies of the textbooks they receive, but do not intend to use. If the copy of a textbook the faculty member has received for examination is in demand, then he/she will be paid 30 to 40 percent of the price of what the book would sell for new. The independent operators who purchase these examination copies then resell the book at its full price.

Of course, students may choose to purchase or rent different textbooks than faculty have chosen; they also may decide to purchase used copies of their textbooks; they also may purchase older editions of textbooks; and, up to 40 percent may not purchase a textbook for at least one of their classes (Kinzie, 2006). Most campus bookstores, however, report that only about 20 percent of the students in a typical class apparently do not purchase a textbook. Thus, it is atypical when massive numbers of students totally disregard faculty choices. Faculty behavior, then, is one of the keys to the actual textbook pricing we observe.

In any case, unusual separation exists between those who choose the textbooks (faculty) and those who eventually must pay for them (students). Very few other organized markets in the United States exhibit a similar situation.

- It's also important to note that many differences exist with the overall group of 17.66 million student customers. They don't all reside in the same location and their financial statuses differ dramatically; they vary in their knowledge of textbook markets, their mobility and their ability to utilize the Internet; and, of course, they don't all take the same college courses. Publishers and bookstores are profit-maximizers; they recognize these differences and take advantage of them. As a consequence, significant geographic price differentials often exist in the prices charged students for identical textbooks (Clay and Tay, 2001).

Students located in Great Britain, for example, may pay a much lower price for an economics textbook than students in the United States. This phenomenon, which is labeled price discrimination, reflects the differing price sensitivities of student textbook consumers in Great Britain versus those in the United States. Sometimes these price differentials are so large that they result in the re-importation of textbooks that have been produced in the United States. Students may find it profitable to purchase the economics textbook from a British bookseller and then pay to have it transported back to the United States.

For example, in mid-July 2006, Barnes and Noble's (U.S.) website offered to sell a new copy of Krugman and Wells' *Economics* textbook for $126.75, whereas Blackwell's in Great Britain advertised the same book on its web site at $76.31. Needless to say, it does not cost $50.44 to send the book from Oxford to the United States.

Faced with this incentive for students to re-import textbooks, publishers have responded by attempting to shut off this venue for student textbook purchasers by restrictive contractual relationships with non-U.S. bookstores that prohibit re-importation. Nevertheless, re-importation continues because arbitraging students who use the Internet to price and purchase textbooks (and even resell them for a profit in the United States) have a financial incentive to do so.

- The demand of students for textbooks is what economists label "price inelastic." Here this means that students are not very sensitive to price changes, especially to price increases. The price elasticity of demand for textbooks has been measured to be as low as -.2, which means that a ten percent increase in textbook prices will cause only a two percent decline in the number of textbooks purchased. Chevalier and Goolsbee's 2005 examination of the impact of new textbook editions on student behavior estimated a -.41 price elasticity of students for a book they were certain would be revised. Here a ten percent increase in textbook prices would cause a four percent decline in the number of textbooks purchased.

  Independently, these two economists (2003) analyzed the demand for all types of books at Amazon.com and BarnesandNoble.com and found consumers there to be more price sensitive, particularly at Barnes and Noble, where they estimated price elasticity of demand to be -3.5. This suggests that a ten percent increase in BarnesandNoble.com's price on a book would cause a 35 percent decline in the quantity of that book purchased.

There are two lessons here. First, all consumers are much more sensitive to book prices than students, who in many ways constitute a captive consumer audience. Second, price sensitivity often depends upon the precise nature of the product being sold and where, how and when it is being sold.

Consider the 2004-2005 academic year, when rising prices caused students to reduce their purchases of new textbooks by 600,000. However, students paid an additional $89.4 million for these new textbooks, meaning they paid substantially higher average prices for a smaller number of textbooks. Many students either did not purchase any textbook at all, or they purchased a used textbook.

- Used textbooks now constitute about 35 to 40 percent of the total dollar value of textbooks that students purchase (but only 18 percent of sales at college bookstores, according to NACS, the National Association of College Stores, 2006). The Internet plays a particularly large role in the purchase of used textbooks. The variance in posted prices for used textbooks on the Internet is astonishingly large; a sign that this market is still evolving and in economic terms still are relatively inefficient. College bookstores earn a somewhat higher gross margin (35.1 percent) on the sale of used books than on new books (22.3 percent), according to NACS (2006).

- As noted above, need-based financial aid formulas usually include textbook costs. When textbook prices increase, financial aid also increases. The result is that colleges and the federal government tend to facilitate textbook price increases by injecting additional need-based financial aid after textbook prices have increased. It's worth noting that a roughly analogous situation exists in some medical care markets where rapid medical care price increases have been validated by insurance coverage that expands to meet the price increases. The effect in both cases (textbooks and medicine) is to encourage even more rapid price increases.

- Finally, in a few cases, groups of institutions or bookstores purchase textbooks together in an attempt to pay lower prices. This can yield savings, but requires that diverse faculty across campuses agree to utilize the same textbook and to make changes at the same points in time. As noted above, such agreement can be difficult to obtain, especially in academic fields where the body of knowledge is changing rapidly, or when there are sharply contrasting points of view about the discipline.

Supply Side of the Market

The textbook market is vertically integrated in three major stages. In stage one, publishers produce books, which they typically distribute to wholesalers, who sell new and used books to college bookstores. Textbook publishing is oligopolistic---five firms dominate the college textbook publishing (Thomson, McGraw-Hill, Wiley, Houghton-Mifflin and Pearson) and account for about 80 percent of all college textbooks published. Stage two sees textbooks distributed via a relatively small number of wholesalers to bookstores (on-campus, off-campus, Internet) that sell them to students (stage three). In a small number of cases, textbooks are purchased directly from publishers.

- Instinctively, many fingers are pointed at textbook publishers when someone broaches the subject of textbook prices. After all, the publishing market is oligopolistic and such markets typically are characterized by elevated prices relative to costs.

  However, the key to a firm being able to maintain elevated prices is the presence of barriers to the entry of new competitors. Such barriers do exist in textbooks markets in the form of significant capital requirements, product differentiation and reputation, contractual relationships with wholesalers, bookstores and authors, and the like. Nevertheless, it is possible for publishers to enter the market at much smaller sizes and dozens of academic presses exist that potentially could publish textbooks (and some do). Further, digitization of data and textbook materials means it is possible to offshore textbook production with some efficiency. Therefore, the overall level of entry barriers to new firms in textbook publishing is not overwhelmingly high.

- Textbook publishers typically distribute their books via a textbook wholesaler/distributor. This market also is oligopolistic. Four wholesalers dominate this market: Follett, Barnes and Noble, Nebraska and College Bookstores of America. These firms also own or operate college bookstores under contract. Follett operates about 730 stores, Barnes and Noble about 550, Nebraska about 140 and College Bookstores of America about 130. Hence, they have a major influence on textbook pricing.

- The four textbook wholesalers are especially active in the used textbook market. They purchase unneeded used books from college bookstores and typically pay 15 to 25 percent of the new book price for these used books, which they then resell to other bookstores for about 50 percent of the new book price.

- The cost of developing a new textbook can be substantial ($1.0 million or more). Fifty percent or more of the sales of a textbook usually occur in the first year after its publication. After the first year a textbook is available, or even after the first semester, used textbooks can be purchased from a supply that develops when students sell back their textbooks to a bookstore, or sell them to other students.

- In the typical case, the author of a textbook (usually a faculty member) will receive a financial royalty from the book's publisher, based upon the sales revenues earned by the textbook. Some colleges and universities prohibit faculty from requiring students to use a textbook that they themselves have written and from which they will receive royalties. Or, alternatively, they may require the faculty member to remit those royalties to the institution. However, it is often true faculty are allowed to keep the royalties they receive from sales of their own authored books to students who have been told they must purchase these books. In many other markets, such as arrangement would be regarded as a conflict of interest, but higher education is far from unanimous on this score.

  In a minority of cases, faculty will develop their own textbook-like course materials, which usually consist of materials faculty have developed on their own. These often include copies of their lectures, copies of related scholarly and newspaper articles, data sets and the like. In all but a few cases, faculty who do so make individual arrangements with a local bookstore to handle and sell these materials and usually do not receive royalty payments. When students purchase these local course materials, in nearly all cases the price is lower than it would be if the same students had to purchase a textbook. The downside is that such course packages usually cannot be resold in a used market when the student has finished the course. Hence, it is not clear that in net terms students end up substantially better off when they purchase locally generated course materials rather than a textbook.

- Because the unit sales of a new textbook are highest in the first year or two after it has been published, there is a tendency for publishers to push the development of new editions of textbooks that have sold well in order to render obsolete the inventory of used books that seriously reduces their sale of new books. In this respect, textbook markets are similar to many durable goods markets (automobiles and electronics provide examples) in which sellers periodically offer for sale new versions of their products. In such situations, these sellers end up in competition with themselves as both new and used versions of their products are bought and sold.

  The difference here is that the textbook publishers and the bookstores together have a much greater ability to remove the older versions of textbooks from circulation. By contrast, the Ford Motor Company cannot wipe out used car markets. Textbook producers, however, in conjunction with the textbook wholesalers and bookstores, have a substantial ability to eliminate competition from previous editions of their textbooks.

Some economists (Chevalier and Goolsbee, 2005) argue that students are rational, knowledgeable consumers who anticipate publisher behavior in the form of new textbook editions and therefore are not greatly disadvantaged by the appearance of frequent new editions. They make a similar argument with respect to bookstores. However, even if one agrees with Chevalier and Goolsbee, and the typical student is capable of gaming the system, their economic welfare still would increase if new textbooks appeared less frequently.

- Yet another distinctive characteristic of textbook markets is that nearly every institution of higher education has a financial stake in higher textbook prices. With a few exceptions, noted below, institutions of higher education either own and operate their own bookstores, or they contract that responsibility to an external vendor such as Follett or Barnes and Noble, in which case they usually receive a lump-sum payment plus a percentage of dollar value of sales at contracted on-campus stores.

  Textbook prices, however, constitute a two-edged sword for colleges. On the one hand, higher textbook prices usually generate more money for institutions of higher education, whether they own and operate their own store, or contract the operation of a store to an outside firm. On the other hand, higher textbook prices generate greater student financial need and most institutions make some effort to recognize such increases. In the case of public institutions, it is state governments who typically pay most of this financial freight, even while the public institutions keep the profits that their bookstores are generating for them. Seldom are the institutions ever required to devote these profits to student financial aid, or similar purposes.

- Approximately 50 percent of all college bookstores are owned and operated by colleges and universities; approximately 35 percent are operated by wholesalers such as Follett, Barnes and Noble, Nebraska, and College Book Stores of America; the remaining 15 percent are private and independent bookstores, including some non-profit bookstores (NACS, 2006). Bookstores at the Universities of Montana, Oregon, Texas and Wisconsin, along with UCLA, are non-profit. Their announced purpose is to provide students with textbooks and other merchandise at low prices and there is some evidence they do under price other bookstores.

- One of the problems associated with measuring textbook price increases is the changing nature of the textbook product. Comparing textbook prices in 2006 with those twenty years previous is an apples and oranges comparison because the products have changed so significantly. For example, today's textbooks, especially in courses that enroll tens of thousands of students nationally, are bundled packages of items. The package often now includes the conventional textbook, a student workbook, supporting technology such as a CD or DVD, an instructor's manual, a test bank of questions and answers for faculty use, PowerPoint slides for faculty use and a well-developed web site that may include some or all of the above.

- The media take on the recent GAO (2005) study of the pricing of college textbooks was that these bundled enhancements to conventional textbooks are the primary reason why textbook prices have increased so rapidly. Publishers and some faculty argue that tremendous differences in student preparation, plus the increasing volume of students who are undertaking distance learning, make it essential that many different learning modes be accommodated in the bundled textbook packages.

  While textbook prices reflect many other influences than an increased tendency to bundle textbook packages, there is some validity to the view that increasingly diverse student bodies perhaps require increasingly diverse textbook and learning packages. Three prestigious higher education organizations reported recently that 40 percent of four-year college students and 63 percent of two-year college students must take at least one remedial course when they enter college (Schmidt, 2006). These are students who may not do well when confronted only with a conventional textbook and therefore require additional learning aides. Already in 2003, there were 1.9 million students taking distance-learning courses in American higher education (Carlson, 2004) and it seems likely that approximately 3.0 million are doing so in 2006. This is 17.9 percent of all headcount students. By definition, these students are doing higher education a different way and must rely upon a variety of means to learn. Technology, perhaps in the form of a CD, or via access to materials on web sites, looms large for these students.

  Publishers also argue that faculty have become much more diverse in recent years and therefore many now require teaching aides and materials that were not necessary when the staple was a full-time faculty member. A 2003 U.S. Department of Education study reported that 43 percent of American college faculty were part-time, up from 33 percent in 1987. The argument, then, is that adjunct faculty members require more support than full-time faculty and bundled textbook packages respond to this need.

  With respect to the increased use of part-time faculty, it should not escape those concerned with textbook prices that part-time and adjunct faculty represent a cost-minimizing action by colleges. Unfortunately, it may also be true that the employment of large numbers of part-time faculty imposes costs on students and one of those costs may be expensive bundled textbook packages. Rather than increase tuition and fees, then, institutions pass the cost of supporting part-time faculty to students by means of higher textbook prices.

Hence, publishers are not simply blowing smoke when they assert that increasingly diverse student bodies and faculty rosters encourage progressively more diverse textbook packages. The problem is that these packages are expensive to develop and this has driven textbook prices upward. A textbook bundle may cost more than $200. Further, many students do not use the bundled items and would prefer not to have to purchase all of them in a package. They want to be able to purchase textbook and learning items a la carte. One is struck here by how similar these arguments are to those one hears when the subject is the “unbundling” of cable television packages.

Many observers believe that the total amount students spend on textbooks would decline if textbook packages were unbundled and students could purchase what they wanted on an a la carte basis. This seems plausible, but whether it actually would occur depends on each student’s choices. Consider the cost of developing and producing a bundled item such as a CD. That cost is substantial and publishers attempt to recoup that cost in the price of bundled textbooks they sell. If textbook packages are unbundled and many students choose not to purchase the CDs, then the price of the CDs to those who do purchase them will be higher, perhaps substantially so.

Thus, those students who do not wish to purchase the CD will end up better off, but those who do purchase the CD (and perhaps other items as well) plausibly will end up worse off. Is the sum of the gains to students (the money some do not have to spend on the CDs) greater than the sum of the losses to students (the higher prices some must pay for the CDs)? That is unknown. In a comparable situation (that involving the possible unbundling of individual stations that comprise cable television packages), the cable television firms have argued that unbundling will lead to higher, not lower prices. However, it is not clear either that this supposition is true empirically, or that it holds importance for the unbundling of textbook packages, where some bookstores and some faculty argue that unbundling would unleash a torrent of independent, privately developed learning packages that would initiate highly desirable price competition and lower prices.

What is also unknown at this stage is whether students who purchase only some of the recommended items in a textbook package achieve more or less in classes than students who opt for the entire package. I.e., do students learn more or less when they have access to bundled textbook and learning packages? If any conclusion is merited, and it is tentative, it is that such packages do not have a statistically significant impact on student learning and performance.

Still, the unbundling of textbook packages appears to represent a partial solution to rising textbook prices and one that deserves more exploration. One firm that has pushed this unbundling (Aplia) claims some success. The National Association of College Stores reported that when students had the opportunity to choose not to purchase items in a bundled textbook package, nearly 60 percent choose not to purchase all of the items (Kinzie, 2006). If nothing else, this reflects where students believe their own welfare resides.

- An interesting innovation in textbook markets is Thomson Learning's decision to market "no frills" versions of some its textbooks. These textbooks are black and white, reduced versions of larger, more elaborate textbooks and sell for 25 to 50 percent less than the regular version. It's not yet clear either if students like this option, or if Thomson is earning an acceptable rate of return doing so.

- Textbook publishers seldom make the actual sale of a textbook to a student. More often, a bookstore does so. Internet-based bookstores have become increasingly important in recent years and an estimated 12.7 percent of all new books (not just textbooks) are sold via the Internet (Rappaport, 2004). However, 67 percent of all used books are sold via the Internet (Wyatt, 2005). The GAO (2005) estimated that between 25 and 30 percent of all textbooks available in college textbook markets are used (which is not necessarily equivalent to unit sales, though it appears that about the same percentage of textbook sales are done online). The National Association of College Stores (2004) reported that 28.5 percent of the revenues earned by its members from textbooks and course materials were from used items in 2003.

- College bookstore operators believe Internet textbook sales are putting a serious dent in their own sales. College bookstore operators assert that the Internet has made student demand for textbooks much more price elastic (that is, much more sensitive to price changes). They cite stagnant book sales data as support for this notion (unit sales increases lag enrollment increases) and argue in particular that students purchase used textbooks on-line. Even so, a recent study of the possibility that used book sales cannibalize (reduce) new book sales (Ghose, Smith and Telang, 2005) found that only sixteen percent of used book sales at Amazon.com ended up cannibalizing new book sales. They also found that the overall benefits generated by used book sales via the Internet outweighed any harm that was inflicted on bookstores and publishers.

It is apparent that the Internet has provided beneficial new competition both to publishers and college bookstores. Developments that increase student ability to shop prices by utilizing the Internet are likely to restrain textbook prices and reduce overall student costs.

- Some observers see electronic books as providing a neat technological solution to rising textbook prices (Glazer, 2004) and Colorado has mandated that its higher education governing boards consider online electronic libraries of textbooks. Currently, relatively few textbooks are available in entirety in an electronic form, for example, on a CD or DVD, or via the Internet. In 2005, ten institutions, including Princeton, Utah and Oregon, began to use textbook wholesaler MBS to offer electronic versions of some textbooks at about two-thirds of the price of print copies (Buss, 2005). Elsewhere, Pearson launched SafariX Textbooks Online, consisting of 300 online texts available on the Internet at approximately one-half the price of new print version.

  Student reception to these innovations has been mixed, for they cannot resell an electronic textbook as they can a print textbook. Further, their right to utilize the contents of electronic books typically expires after five months.

  Since the typical college store buys back a print textbook in reasonable condition for about one-half of the price of the new textbook, students could end up worse off financially if they purchase the electronic version of the textbook. For example, when students purchase a $100 print textbook, they will lose $50 after they trade it in at the end of their class. If the comparable electronic version costs $67, then they lose that entire amount.

  Placing electronic versions of textbooks online in library style at an institution is technologically possible, but would require institutions to purchase the right to do so, much in the fashion of computer software licenses. This would not be inexpensive and is one of the reasons this notion never has proceeded very far.

  Electronic textbooks, then, are more attractive in theory than in practice. Interestingly, electronic scholarly journals appear to hold greater promise than electronic books for institutions to achieve cost economies and enhance access.

- Student rental of textbooks always has constituted a major alternative to outright purchase. The rental of textbooks was more popular fifty years ago than it is today, though recent increases in textbook prices and the CALPIRG study (2005) have spurred renewed interest in the practice. In brief, in a textbook rental system, institutions purchase textbooks they subsequently rent to students, who must return the book in good condition at the end of their course, or pay for it. Rental systems work best when they service classes with large, predictable enrollments and when institutions utilize the same edition of a textbook for two to four years (a practice objectionable to some faculty for a variety of reasons). It is not until the second year of the use of a textbook that a typical rental system breaks even financially on that textbook.

  Rental systems typically cut the total cost of textbooks to students by one-half or more. More than two-dozen institutions currently operate textbook rental systems, including Eastern Illinois University, Southeastern Louisiana University and seven campuses within the University of Wisconsin system (though not Madison or Milwaukee). Textbook rental rates at the University of Wisconsin campuses averaged $124 annually in 2002-2003, a fraction of the cost of what students would have paid under a typical textbook purchase system in that year (CALPIRG, 2005). Eastern Illinois students paid $7.95 per semester hour for their textbook rentals. Hence, an Eastern student who registered for a conventional 32 hours during an academic year expended $254.40 for textbooks.

  Other than the disdain of some faculty for textbook rental systems, there are two other major barriers to their implementation. The first is the sizeable initial investment that institutions must make to initiate such a system. Institutions that develop full-blown textbook rental systems covering nearly all undergraduate courses can expect to invest millions of dollars on inventory, facilities, training and orientation before they rent a single book. An Illinois Board of Higher Education study (2004) estimated start-up costs for ten of its public university campuses to range from $2.68 million to $15.93 million.

  Capital expenditures of that magnitude obviously are a deterrent to establishing a rental system. However, the mathematics are attractive. If 10,000 undergraduates save $500 per year on textbooks, this generates a $5.0 million annual saving for students. It does not take a textbook rental system very long to pay for itself and to benefit students, even if they pay for the rental system.

  The second significant barriers to founding a rental system are the colleges themselves. Nearly all institutions garner profits from owning and operating their own bookstores, or contracting the operation of their stores to outside firms such as Follett or Barnes and Noble. Institutions are reluctant to forfeit this revenue stream, which for very large institutions can amount to a million dollars per year. In essence, rather than raising student tuition, institutions tax students via a less visible route---profits on textbooks.

It is important to note, however, that the National Association of College Stores reports that its members earn minimal overall profits on textbooks and instead earn most of their profits from the sale of other items such as logo t-shirts, supplies and food. If so, and college administrations understand this, then this should reduce their reluctance to move to textbook rental systems.

POLICY OPTIONS AND PATHS FOR ACTION

Assuming that restraining or even lowering textbook prices is the goal, what options are available to the primary stakeholders in textbook markets that might improve the existing situation? In the space below, I examine a set of actions and policy options. The analysis is subdivided into seven parts, recognizing the differing interests and positions of the major stakeholders in situation.

Textbook Publishers

- **Publish New Editions Less Frequently**

  New editions of a popular textbook render obsolescent the inventory of used books for that textbook. Since one-half or more of the sales of a new edition occur during the first year, there is a natural tendency for publishers to generate new editions, especially in disciplines where content is changing rapidly.

  In the absence of Soviet-style market interference, the incentives for publishers to produce frequent new editions are not going to disappear. One could exercise moral suasion on publishers and attempt to push them to issue fewer new editions of textbooks. In the long run, however, this strategy is unlikely to work.

  If fewer new editions are to be published, then it will be because those who purchase or influence the purchase of textbooks (students, faculty, bookstores, universities) insist that this occur. For example, if institutions that have textbook rental systems asserted that they are going to use the same textbook for four years, then this would reduce the financial reward publishers derive from new editions. Or, if faculty adopted policies that accomplished the same end, then this also would reduce the incentive for publishers to issue new editions.

Thus, realism requires us to recognize that the solution to the publication of fewer new editions of textbooks lies on the demand side of market and depends primarily on institutions and faculty action. Whatever one's feelings about the publication policies of publishers, a sober assessment of the textbook market generates the conclusion that unless there is a change in the demand-side incentives publishers face, they are quite unlikely to change their behavior.

- **<u>Unbundle Textbook and Learning Packages</u>**

  Much the same analysis applies to the unbundling of textbook and learning packages by publishers, who package items such as textbooks, workbooks and CDs together because it is profitable. They are unlikely to change their behavior unless those who purchase textbooks send them clear market signals that they must do so.

  What does this mean? It means, for example, that authors could insist that their work be sold unbundled (and some have done so); faculty could refuse to adopt a textbook unless it is sold unbundled; bookstores and institutional textbook rental operations could do the same.

  Of all the actors in this situation, it is colleges and universities that have the greatest ability to influence publisher behavior. For example, if the University of Michigan, or all Big Ten institutions collectively, or all public universities in California, declared they no longer would allow their campus bookstores to sell bundled learning packages, then textbook publishers would react quickly to such market signals. The solution to unbundling, then, resides on the demand side of the market. However, as noted above in the analysis of textbook markets, those who require unbundling should understand this actually might produce higher textbook prices for some students. Unbundling will produce winners and losers.

- **<u>Cease Negotiating Contracts That Forbid Reselling and Re-importation of Textbooks</u>**

  Tremendous international disparities exist in the prices of textbooks and most publishers strenuously attempt to write contracts that will diminish or eliminate the possibility that textbooks sold for a low price in another country can be re-imported into the United States and sold here at a price less than the usual U.S. price for new books. Some argue this practice is illegal (see NACS, 2006, for a discussion). Regardless, it causes American students to subsidize foreign students. However, in the absence of judicial action or changes in the law, this pricing behavior is unlikely to cease. Further, action in the textbook arena would call into question thousands of international pricing arrangements in a multitude of industries and therefore would truly open the proverbial can of worms.

Colleges and Universities

- **Publish Textbook Lists on the Internet**

  The simplest and most direct action colleges and universities can take to help students select the textbooks they wish at the lowest possible price is to require that all faculty textbook requirements and recommendations be published on an easily accessible Internet web site, preferably with ISBN ("International Standard Book Number") information accompanying each item. This low-cost action reduces search costs both for students and for prospective suppliers and has the potential to reduce textbook costs significantly.

- **Establish Direct Internet Links to Other Book Sellers**

  At least one university bookstore, the University of Montana Bookstore, goes one step further. On its web site, next to its listing of textbooks and their prices (new and used), is an icon that connects student customers directly to Amazon.com. With a single click, students can check out Amazon's prices for any textbook. In Summer 2006, for example, Gregory Mankiw's *Principles of Microeconomics* was listed for sale at $99.40 new and $78.30 used at the Montana Bookstore. A single click revealed that Amazon was selling the identical book for $106.95 new and that it had an inventory of 970 used copies of the book for sale at $3.00 per copy and up. The Montana bookstore receives about six percent of the sales price of any books Amazon sells via this route.

  Many sites exist that enable students to compare book prices. One, www.isbn.nu, enables students to compare prices at fourteen online bookstores if they can insert the title, or author, or the textbook's ISBN. An institution of higher education truly committed to reducing student textbook costs as a matter of course will link students from its own on-campus web site to other Internet price comparison sites such as www.isbn.nu.

  Bookstores such as the University of Montana that have established links to other book sellers are not popular with most publishers, authors, and other bookstores. Most would prefer to sell more new books at higher prices. Regardless, it is an excellent way for institutions to reduce the search costs of students and enable them to shop for textbooks easily. Institutions that are serious about reducing student textbook expenditures should hasten to adopt this innovation. Improved student knowledge and increased competition make a difference.

- **<u>Negotiate Directly with Publishers</u>**

  Some institutions have begun to negotiate directly with publishers in order to reduce textbook prices. Those that do so typically must guarantee the sale of certain number of textbooks at a given price, or guarantee that every student in the course will purchase the textbook, perhaps paying a pre-negotiated "intellectual property" fee. Discussions with bookstores suggest that this technique can reduce textbook prices by 25 to 40 percent. It should be explored by more institutions. For-profit bookstores may be less enthusiastic about this approach, which potentially could bypass them and/or reduce their profits.

- **<u>Negotiate Different Contracts with Campus Bookstores</u>**

  Institutions of higher education that contract with textbook wholesalers to operate their campus bookstores have the ability to specify conditions in their contracts. They can, for example, require that textbook lists be posted on the Internet, that links to other booksellers be established (the Montana model), or even that textbooks in certain courses be rented (see below). The point is that institutions have considerable leverage if and when they decide to contract out the operation of their campus bookstores and they should use that leverage to benefit students.

- **<u>Establish Nonprofit Campus Bookstores</u>**

  Among the universities that operate non-profit bookstores are Montana, Oregon, Texas, UCLA and Wisconsin. The goal of these bookstores is to provide students with textbooks and learning materials at the lowest possible cost. This does not prevent these bookstores from paying the institutions for resources they use (for example, rent for space occupied). Preliminary evidence suggests these bookstores tend to offer lower prices on the typical textbook than for-profit bookstores. Note, however, that when an institution moves in this direction, it may forfeit a significant profit stream and therefore many have shied away from this approach.

- **<u>Establish Textbook Rental Systems</u>**

  Textbook rental systems were quite common in the 1950s, subsequently lost popularity in the 1960s and 1970s, but now are regaining popularity. Demonstrably, they usually reduce student textbook costs by one-half or more. However, as noted in the textbook market analysis above, some faculty do not like rental systems because such systems tie them into the same textbook for several years. In disciplines where the body of knowledge is changing rapidly, or where significant divergences exist about what should be taught, faculty often object to textbook rental systems.

Institutions often balk at rental systems for three reasons. First, they usually require multi-million dollar initial investments for space, inventory and training. Second, rental systems do not work well for courses that have small enrollments and are offered infrequently. Therefore, they do not fit graduate courses as well as they do undergraduate. Third, they once again diminish or eliminate the profit stream that most institutions have been extracting from their bookstores.

Nevertheless, textbook rental systems have the potential to reduce the textbook costs of a typical full-time undergraduate student by $500 annually, or more.[2] Here again, the focus must be on institutions; those that really are serious about reducing student textbook costs should give strong consideration to textbook rental systems, even if they contract that rental system to a textbook wholesaler.

- **Supply Textbooks as a Part of Tuition**

  This is a variant of a rental system and would introduce a K-12 type of textbook system into higher education. The idea recognizes that neither faculty nor universities now have significant incentive to reduce or restrain textbook prices, because they do not pay for textbooks. Ayres (2005) suggests that institutions, like K-12 schools, provide textbooks as a part of their tuition charges. He agrees that tuition initially will rise to meet this expense, but over a period of time, he believes tuition will rise less than otherwise because the institutions now would have a direct interest in avoiding expensive textbooks and learning packages. It might also be possible to remit back to faculty some of the savings achieved if they adopt less expensive books and/or utilize the same edition of an existing textbook. Also, all students would now have a textbook, something that clearly now is not the case. This is an idea worth discussion.

- **Provide Financing Options to Students**

  Offer bookstore credit to students who have not yet received their financial aid disbursement and/or offer a payment plan to students who are not able to pay for their books upfront.

[2] Undergraduates constituted 86 percent of headcount student bodies in higher education in 2002, according to NACS (2006).

Faculty

- **Become Knowledgeable About Textbook Costs and Issues**

  The Connecticut study demonstrates that the typical faculty member is unknowledgeable about textbook prices. Faculty should ask for price information for every textbook or learning material they examine. Once again, institutions probably are in the best position to ensure that faculty receive price data by including such a provision in the contracts they negotiate with their campus bookstores, or simply supplying that information to faculty as a matter of routine.

- **Make Textbook Choices Early and Recommend Multiple Textbooks**

  Last-minute textbook orders tend to be more expensive. Timely textbook orders by faculty (once again, probably stimulated by their own institutions) reduce students' costs. Further, many faculty should imitate the European model whereby faculty recommend multiple textbooks so that students may choose among them. Choice, especially when used books are involved, reduces student costs. Once again, individual institutions occupy the optimal position in terms of ensuring that such a policy is followed as often as feasible.

- **Use the Same Edition for Multiple Years and Allow the Use of Earlier Editions**

  Students save one-quarter or more of the price of a new textbook when they purchase a used version. The more semesters a textbook is used, the more student savings are generated. While some faculty object to requirements that they utilize the same textbook (perhaps department wide) for several years, the benefits to students and rental operations are substantial. Similarly, the use of earlier editions of a textbook may force faculty to construct multiple syllabi and recognize content differences, but students will save money when earlier editions are utilized. Bookstores and publishers will be less enthusiastic because this practice reduces their profits. Here again, it is institutions of higher education that are best placed to lengthen the use of a specific edition of a textbook. Whether institutions have the stomach to tackle their faculty on these issues is not so clear.

- **Encourage Student Use of Used Textbooks**

  Some students, especially those who are new, are unknowledgeable about textbook markets and either don't know that used textbook markets exist, or they don't know how to utilize them. Institutions can and should advertise the existence of used textbooks markets just as they advertise financial aid, student activities, and the like. The University of Montana model, whereby its bookstore supplied students with a direct link to a used bookseller such as Amazon, is commendable and should be emulated by most other institutions. Provide students with choice in a competitive textbook market and they will make better decisions and save money. Such a policy may reduce bookstore profits and the profits earned by institutions, but it is equivalent to a decrease in tuition and almost unambiguously makes students better off.

- **Advocate and Accept Textbook Rental Systems**

  Textbook rental systems save students significant money; a typical in-state public undergraduate student usually saves $500 or more per year when a textbook rental system exists. This is roughly equivalent to a three percent decrease in educational costs. Textbook rental systems require investment by institutions and cooperation by faculty, but the rewards to students are considerable. Most institutions should consider some variety of a textbook rental system for their undergraduate courses.

- **Patronize the Creative Commons**

  The Creative Commons is a nonprofit organization dedicated to promoting a different variety of copyright---not “all rights reserved,” but “some rights reserved.” Faculty can publish course materials and entire textbooks using the Creative Commons. If they do so, then in essence they forgo most or all royalty payments. However, this will make their materials available at almost zero marginal cost to students everywhere. This is an admirable approach for faculty who wish to provide low-cost textbook and learning materials to students, but maintain the ability to revise these materials and have some control over their use. This understood, the Creative Commons is in competition with publishers who pay royalties to faculty authors and therefore is unlikely to interest many faculty.

Students and Parents

- **Actively Shop Textbook Markets**

  Shop! Compare! Use the Internet! These should be part of the battle plan for students and parents who wish to reduce the cost of textbooks and thereby the cost of higher education.

- **<u>Purchase Used Textbooks</u>**

  Used books are less expensive and most students will not suffer any degradation in their learning if they purchase used textbooks. One of the keys to obtaining the lowest prices for used textbooks is to utilize the Internet.

- **<u>Advocate Unbundling and Textbook Rental Systems</u>**

  As noted several times, textbook rental systems save students substantial money, perhaps $2,000 over the course of a typical undergraduate degree program. Students, both individually and via their student government organizations, would be well-advised to advocate that their institutions give full consideration to the operation of textbook rental systems.

<u>Textbook Wholesalers and Bookstores</u>

- **<u>Provide Links to the Internet</u>**

  Textbook wholesalers and bookstores can make students better off if they provide Internet links to used booksellers. They can themselves be a used bookseller, or instead they can opt to receive a portion of the price of a used book when they successfully refer a student to another used bookseller. Either practice is likely to reduce their own profitability and therefore is unlikely to occur unless institutions of higher education specifically negotiate such provisions in their contracts.

- **<u>Support Unbundling and Textbook Rental Systems</u>**

  Unbundling the items within textbook and learning packages may reduce the textbook costs of most students, though unbundling might increase costs to a minority. Textbook rental systems clearly save students money. If textbook wholesalers and bookstores cooperate with both developments, then student textbook costs will decline. Once again, both of these practices are likely to reduce profitability and are unlikely to occur unless mandated by institutions of higher education.

- **<u>Offer Extended and Guaranteed Buy Back Programs</u>**

  The purpose of this is to encourage students to sell their books back to the campus bookstore, to give them more time to sell back to the campus bookstore, and to provide the service of guaranteeing a certain buy-back price for many books.

States

Public institutions enroll approximately 77 percent of all students in American higher education (Chronicle, 2005a). Hence, states are in the catbird seat with respect to action on textbook pricing. Several states, including Connecticut and Virginia, have passed laws directed at ameliorating the rate of increase in textbook prices. Colorado mandates higher education governing boards to consider online textbook libraries; Connecticut requires publishers to inform professors of the prices of the textbooks they are considering and to advise them when new editions are imminent. Florida offers a sales tax exemption for textbooks purchased in designated stores. Virginia's law requires that textbook lists be published online; encourages faculty to use the same edition of a textbook as many times as possible; encourages unbundling textbook packages; encourages placing textbook copies in the institution's library; and, encourages faculty to make textbook decisions early so that students can shop. A half-dozen higher education authorities and commissions throughout the states have studied textbook prices and have urged similar behavior (for example, State Council of Higher Education for Virginia, 2006).

Each of the actions described above probably would restrain textbook prices somewhat, but pale before other actions states and higher education authorities could take, namely, linking students automatically to Internet bookstores and textbook price comparison sites (especially those that sell used textbooks), moving to nonprofit bookstores, negotiating different contracts with their bookstores, negotiating some textbook prices directly with publishers and introducing textbook rental systems. These actions are where the major immediate savings reside.

The Congress

- **Provide Incentives to Institutions to Participate in Certain Practices**

  The most far-reaching action the Congress could take is to tie the eligibility for federal financial aid to institutions and students to certain campus textbook practices. For example, the federal government could or reduce support to institutions by some marginal amount, if the institutions do not make their textbook lists available on the Internet, or provide Internet links to used book sellers, or provide students with the opportunity to purchase unbundled items in textbook packages, or provide undergraduate students with the opportunity to rent textbooks. Each of these constitutes a separate option.

  Needless to say, imposing any one of these requirements would be unpopular with a variety of parties (though probably not with students and parents) and each would represent an unprecedented degree of federal intrusion into the internal business of higher education.

- **Recognize the Impact of the Current Financial Aid System on Textbook Prices**

  By building textbook cost increases into its approved financial aid formulas, Congress has placed itself in the position of ratifying and even encouraging further textbook price increases. Student aid increases when textbook prices increase, so why not, is the economic position of many textbook wholesalers and bookstores. In this regard, the higher education market resembles certain markets for medical care where insurance coverage may tend to encourage price inflation. It does not seem likely that Congress could or should alter this situation; indeed, there are many other developments Congress should prefer. Still, in economic terms, Congressional policy has been shifting out the demand curve for textbooks for many years.

PROPOSED STUDY PLAN FOR THE ADVISORY COMMITTEE

It is a precarious enterprise for anyone to presume to offer advice to an Advisory Committee of Congress, perhaps especially an economist who has been a college president. However, that is one of my functions here. Therefore, if I were the Committee, I would move in the following directions.

Regarding conduct of the study:

- Using this paper as a starting point and frame of reference, the Committee should seek to corroborate its findings; placing particular emphasis upon the actions the paper suggests each of the major stakeholders might take to reduce textbook costs to students. The aim should be to assess how feasible and promising the proposed actions are.

- Place particular emphasis upon the role of colleges and universities, nearly all of which are not-for-profit and presumably therefore should have a strong interest in controlling or reducing student costs. In fact, institutions of higher education have an almost immediate ability to make a difference by actions such as requiring the textbook prices to be posted on the Internet on their campuses, linking students via the Internet to used book sellers, and moving to textbook rental systems.

- Sponsor a series of regional hearings which include college and university personnel ranging from presidents to bookstores managers, along with other stakeholders, designed both to enlighten and to gather information. These hearings could have four broad purposes.

    1. First, they could provide the opportunity to communicate valuable information to presidents and bookstore managers about textbook markets and the apparent economic impact of various activities in these markets on textbook prices.
    2. Second, these sessions could inform institutions of the options available to them, especially those being pursued by some institutions, for example, beginning a textbook rental system, a subject most college presidents know little about.
    3. Third, the hearings could recruit institutions that might cooperate enthusiastically with the critical pilot projects suggested below.
    4. Fourth, these sessions could provide institutions with a valuable opportunity to talk about their specific problems and thereby enable them to influence future discussion and the pilot projects themselves.

That is, rather than calling forth more public hand-wringing and finger-pointing about textbook prices, the hearings should anticipate and publicize to the extent possible the sorts of actions that states, institutions, and other stakeholders might take, and publicize their likely effects.

Regarding promising legislative and/or regulatory solutions:

- I do not believe there is any advantage whatsoever to be gained by pursuing the option of price controls on textbooks through federal legislation or regulation.

- If there is a federal role, it seems to me that a reasonable approach might be for Congress to promote three to four large-scale pilot projects—perhaps designed by the Department of Education—in which a sample set of institutions of higher education are rewarded for participating in real world tests in which the institutions undertake one or more of the textbook market actions noted above, but with the explicit involvement of one or more economists and several textbook market representatives. The point is to observe what happens to textbook prices when, for example, an institution adds an Internet link to used booksellers on its web site. This will require careful specification and data collection, as well as the use of control variables and control institutions, in order to ascertain what actually does happen. Ideally, a diverse set of institutions would participate in each of the three to four pilot projects. If the pilot projects are conducted appropriately, then the data they generate will make a huge difference in the behavior of institutions of higher education. Currently, most institutions simply don't know many of the economic facts about textbook markets and what difference their own actions could make.

- Ask the Bureau of Competition of the Federal Trade Commission and the Antitrust Division of the Department of Justice to probe the legality of various publisher market activities, for example, their attempts to prohibit the re-importation of textbooks from foreign countries and their maintenance of huge international disparities in the prices of identical textbooks.

- Have Committee staff explore strategies for the federal government to provide incentives to institutions to adopt one or more of the textbook market innovations noted in this paper, for example, placing all textbook lists on the Internet.

Finally, I think there is much to be gained by continued public consideration of these matters during the study—especially highly public discussions that highlight the significant impact of textbook prices on students and focus attention on existing efforts by states and institutions to alleviate the problem. If just a few states or institutions, with cooperation from the publishing industry, are seen to be moving in a successful way to significantly lower the financial impact on students, then the pressure on others to do the same will be enormous.

Ideally, the Congress, by giving the Advisory Committee this study, and the Committee, by in conducting it in an open and highly visible manner, will serve as the catalyst for the necessary changes and hence little in the way of legislation or regulation ultimately will prove necessary.

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