

Remarks to the SERCI Panel on Regulatory Copyright Tariff Setting - Turin, Italy, July 10, 2017

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This Panel concerns possible lessons for European copyright practitioners learned from the North American experience. I pose two key questions that arise from our existing copyright tariff setting processes: 1) do we need regulatory intervention to achieve appropriate prices?; and 2) how has the process worked so far and how can we make the process better?

1) Do we need regulatory intervention to achieve appropriate prices for IP use (such as music use)?

The economic rationale for regulatory intervention in setting copyright tariffs is well established¹. In general, economists view the need to provide incentives for the creation of intellectual property works where the market would otherwise fail as a sufficient reason for intervention.

“A distinguishing characteristic of intellectual property is its "public good" aspect. While the cost of creating a work subject to copyright protection—for example, a book, movie, song, ballet, lithograph, map, business directory, or computer software program—is often high, the cost of reproducing the work, whether by the creator or by those to whom he has made it available, is often low. And once copies are available to others, it is often inexpensive for these users to make additional copies. If the copies made by the creator of the work are priced at or close to marginal cost, others may be discouraged from making copies, but the creator's total revenues may not be sufficient to cover the cost of creating the work. Copyright protection—the right of the copyright's owner to prevent others from making copies—trades off the costs of limiting access to a work against the benefits of providing incentives to create the work in the first place. Striking the correct balance between access and incentives is the central problem in copyright law. For copyright law to promote economic

¹ See for example “The Economic Rationale of Copyright” Robert M. Hurt and Robert M. Schuchman *The American Economic Review* Vol. 56, No. 1/2 (Mar. 1, 1966), pp. 421-432 and William M. Landes and Richard A. Posner, “An Economic Analysis of Copyright Law” 18 *Journal of Legal Studies*, 325, 325-33, 344-53 (1989). More generally, see *The Economics of Copyright: Developments in Research and Analysis* edited by Wendy J. Gordon and Richard Watt. Cheltenham, UK; Northampton, MA: E. Elgar, 2003.

efficiency, its principal legal doctrines must, at least approximately, maximize the benefits from creating additional works minus both the losses from limiting access and the costs of administering copyright protection.”²

As a society, we have come to accept that strict reliance on market forces will not achieve the desired outcome and therefore, we have turned to regulation as the preferred option. We view the regulatory tariff-setting process as a balancing act – a means of setting prices that compensates creators but does not overly limit access to those works.

There are other economic factors that have been cited as reasons to choosing regulation as the best means to set prices: the potential for monopoly (or monopsony) behaviour on the part of creators (e.g. music licensing collective agencies); the transactions costs of having to deal with individual creators; and accounting for additional externalities that would otherwise be overlooked in a market solution.

In summary, the theoretical economic reasons for regulation seem compelling.

However, as a practical exercise, it is worth asking: “what would happen if copyright regulation suddenly ceased to exist?” Initially, existing regulatory-set prices would likely provide a sufficient short-term price point or benchmark for continued commercial relations between those that create content and those services that use the content. Collectives would for a time continue to represent creators and users (such as radio stations) would continue to serve their audiences with music. However, functioning markets could begin to break down due to the medium term uncertainty that would likely grow. How would price and related disputes be resolved? Would the potential financial liability (for either party) prove unacceptable? Would disputes be protracted?

Copyright regulation therefore reduces uncertainty and helps the market function so that creators are paid and users can access creative content and supply service to consumers who want that service. Would we be better off with no regulation, relying on parties (e.g. collectives and content users) to privately negotiate expeditiously and efficiently so that consumers are well served? I would argue that we are best to continue with regulation for the foreseeable future. There is nothing stopping the parties from negotiating outside of the regulatory process and agreeing to a set of rates.³ The presence of a regulatory authority ensures that rates are set in a relatively timely manner, allowing markets for creative content to function and consumers to obtain goods and services that they desire.

² Landes and Posner, *Ibid*.

³ Negotiated rates may still need to be sanctioned by the regulatory authority.

What is problematic about copyright regulation? I won't belabor the discussion of flaws in the regulatory process or in copyright laws.⁴ I instead focus on a possible "big picture" deficiency: that the copyright regulatory process may only address one of many incentive issues that characterize the market.

Recall that one of the key reasons for adopting regulation is to ensure that sufficient compensation to creators exists as an incentive to create. I would question, in part, the need for copyright in this role.⁵ Using music as an example, consider three "extreme" types of music creators. We will term the first group "Artists". We suggest that this group does not need the monetary incentive provided by copyright tariffs to create. They do not create for financial reasons.⁶ The second group we will term the "Madonna" category. This group is also not particularly incited by financial gain. They are primarily driven to create by the need for attention, or fame. Finally, the third creative group we term "Entrepreneurs". This group is acutely aware of the (or has high hopes for) demand for their works and is very much focused on deriving the maximum financial return from their creative efforts.

For ease of analysis, we posit these three creative groups as distinct categories, although any given creator may well have a combination of these characteristics (and other relevant characteristics that we have not identified).

For an "Artist" creator, the copyright regulatory process has little value. More specifically, copyright regulation is unnecessary for increasing the level of creative output. I would also note that competitive forces do not play a significant role in increasing the level (or perhaps even the quality) of output for this group. It is the creators' own internal drive and vision that factors most prominently in their efforts.

For a "Madonna", the existence of prices set by a regulator (or prices set by any market for that matter) is similarly inconsequential. Popularity (or adulation by the many) drives these creators. However, unlike "Artists", competition for the "Madonna" group is very much a part of their creative process. That is, in order to earn the attention that they crave, they must compete with all other creators for that attention. Competition for attention can be brutally difficult. That competition can be a significant driving force in the level and quality of their creative output.

⁴ See for example <http://www.thefader.com/2015/06/19/music-copyright-laws-robin-thicke-marvin-gaye>; <http://www.joebaugher.com/copyright.htm>; <http://www.becker-posner-blog.com/2012/09/do-patent-and-copyright-law-restrict-competition-and-creativity-excessively-posner.html>; <https://www.eff.org/document/doc-whitepaper-copyright>; and https://www.newmediarights.org/business_models/artist/what_are_major_criticisms_copyright_la_ws_us

⁵ This may relate as much to the role of copyright in the short run as to the longer term.

⁶ In brief economic parlance, the creator receives sufficient incentive from the creative process itself to continue creating.

Finally, an “Entrepreneur” needs the incentive of payment for his or her works. They would not create without this financial incentive. And, similar to the “Madonna” creator, they function in a highly competitive environment.

Incentive Relevancy and Characteristics Matrix

	The “Right” Price	Rivalrous Behaviour	Need for subsidy to incent
“Artist”	Low	Low	Low
“Madonna”	Low	High	Low
“Entrepreneur”	High	High	Low - High

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We have not considered issues of relative size (e.g. the percentage of creators who fall into each category) or of “fairness”.⁷ But our point is that from an economics perspective, copyright price setting by a regulatory agency is not necessary for some types of creator.⁸ Therefore, the regulated process of price determination may be inordinately focused on a subset of the market, raising the question of whether a non-regulated solution or an alternative incentive mechanism would provide a better overall outcome. Specifically, are copyright tariffs the best means to generate the highest level of creative output and the highest quality levels?

I raise these questions but readily admit my inability to provide answers.

2) How has the process worked so far and how do we improve it?

Setting aside the issue of how the copyright regulatory approach may be incomplete (as described above), we adopt a narrower framework to address this question. The setting of tariffs in North America has involved input – often extensive in more recent proceedings - from economists. I see that as a fundamentally important attribute of the current process. I understand and support the involvement of legal and related analysis and examination in the process, but the tariff setting process is a **price setting** exercise. Economists

⁷ We don’t mean to downplay the importance of the “fairness” issue – it may be as, or more, important to societal welfare than the strict economic issues. However, that question goes beyond what we are willing to address in this paper.

⁸ Economists have typically dealt with this and related issues with the assumption of “non-satiation” – i.e. individuals prefer more to less, and therefore in our current example, all creators would prefer to have greater payment than less. We hypothesize that some would not.

focus their study and their tool set on price setting: no other discipline does that or is as well equipped to tackle that specific problem.

In a 2004 article⁹, Pamela Samuelson predicted that economic analysis within the copyright ambit would continue to grow in importance. She even recommended the hiring of a Chief Economist at the U.S. Copyright Office. In many ways, her predictions and recommendations have come to fruition, at least in part.

In keeping with Samuelson's position, economists must not only provide input, but in my view they must provide the bulk of the analysis leading to the setting of rates. Which is why I believe that economic analysis should not only be provided as part of the evidence, but substantive economic analysis must necessarily take place internally within the tribunal that is adjudicating the process. In the United States, The Copyright Royalty Board (CRB) has three judges that, by statute, must have a law degree and legal experience. As a key further requirement, one of the judges must have significant knowledge of copyright law and one must have "significant knowledge of economics".¹⁰

This statutory requirement ensures that the consideration of economics is fundamental, if not paramount, in the CRB's deliberations. The current "economist" judge at the CRB has emphasized the "judicial need for continued and comprehensive research in this field so that testifying economists can provide a foundation" for the CRB's determinations.¹¹

Samuelson also recommended that there be greater reliance on economic expertise in the national legislative and policymaking process. I strongly agree. The legislative and regulatory framework needs to endorse the use of economic analysis while at the same time clarifying the objectives and mandates of copyright tribunals.

The copyright regulatory experience in Canada has also had some positive developments. The Copyright Board of Canada (CCB) now employs an economist as Director of Research and Analysis along with an Economic Analyst. Much of the evidence filed before the Board over the last few years has been prepared by economists. However, economics expertise at the CCB "board member" level remains limited.

⁹ P. Samuelson, "Should Economics Play a Role in Copyright Law and Policy?" *University of Ottawa Law and Technology Journal*, 2004 Volume 1.

¹⁰ <https://www.loc.gov/item/prn-12-176/interim-copyright-royalty-judge/2012-09-17/> and <https://www.copyright.gov/title17/92chap8.html>. There is no requirement that any of the three staff appointees have an economics background, but at least one of the current staff attorneys has a significant economics background. See 2012 Library of Congress bulletin cited above.

¹¹ D. R. Strickler, "Royalty Rate Setting for Sound Recordings by the United States Copyright Royalty Board: The Judicial Need for Independent Scholarly Economic Analysis", RERCI, 2015, Vol. 12.

I would also point out that the mandate and objectives of the Canadian Copyright Board lack definition, particularly as they relate to economic principles and outcomes. In Canada, the Board is statutorily guided by a vague instruction to establish or certify “fair and equitable” royalty rates. The Board has described its rate-setting principles as follows:

“The *Act* requires that the Board take into account the following principles. First, the royalties must satisfy the performers’ and makers’ right to equitable remuneration as set out in subsection 19(1) of the *Act*. Second, the tariff must address only the use of the properly represented eligible repertoire. Third, the tariff must not place some users at a greater financial disadvantage than others because of different linguistic and content requirements of the *Broadcasting Act*. Finally, the tariff must provide that the payment of royalties by users is made in a single payment.

The Board also intends to rely on other principles already expressed in previous decisions. Thus, the tariff should reflect Canadian circumstances. It should be simple to administer, transparent and comprehensible. It should be based on a set of statistics for a test period.”¹²

Not only is this set of principles lacking a readily understood methodology for setting tariff levels, it is bereft of the basic economic concepts that should guide the determination of welfare-enhancing prices.

The Board has over the years received written evidence and oral testimony from numerous economists. The Board has even stated that they “believe economic modeling should remain central to the Board’s tariff determination”.¹³ However, there is very little insight from the Board’s written decisions on how economic analysis played a fundamental role in past rate determinations, or even that it played a meaningful role. There is some evidence that the Canadian Copyright Board is moving in a better direction, as more recently the Board has attempted to elaborate what they might do by way of economic analysis in certain circumstances and has even provided an “Economic Analysis” section in a recent decision.¹⁴

¹² <http://www.cb-cda.gc.ca/decisions/1999/19990813-m-b.pdf>. August 13, 1999.

¹³ <http://www.cb-cda.gc.ca/decisions/2010/20100709.pdf>. July 9, 2010. We also note that while the Board was testifying to the importance of economics in copyright rate setting, they ultimately rejected all proposed economic models (primarily on the basis of non-economic criteria) and did not offer any of their own economic analysis in support of their decision.

¹⁴ <http://www.cb-cda.gc.ca/decisions/2016/DEC-2016-04-21.pdf>. While the Board has made these references, this decision still lacks a clear statement of the economic analysis underlying the Board’s rate level setting. In another recent decision the Board stated (in its Analysis section) “the analytical framework and the approach we use to derive the tariff make it unnecessary to review all the evidence in detail here . . . in particular, there will be no need to comment on issues such as the input cost pricing method; the difference in costs between conventional radio and webcasting; or the impact of recent technology advances on the value of the communication of sound recordings”. <http://www.cb-cda.gc.ca/decisions/2014/ReSound8-60-motif.pdf>

We would also note that the CCB has repeatedly rejected the economics arguments of most, if not all parties, due to a perceived lack of “sufficient evidence”, including relevant data. While we don’t necessarily agree with the Board that the economic evidence has always been insufficient, we do agree that the principal burden of providing sufficient evidence rests with appearing parties.

Turning now to the US Copyright Royalty Board (CRB), the US tribunal receives some statutory guidance in favor of using certain economic principles. In particular, rates for new digital uses should be rates that “would be negotiated in the marketplace between a willing buyer and a willing seller”. While on the surface this would appear to be fairly definitive, rates set between a willing buyer and a willing seller can span the spectrum from a monopoly price to a monopsony price. It would have been better to add a qualifier such as “where the market power of any party is not likely to unduly influence price”. In place of clearer guidance, the Judges in Web IV asked (and decided in the affirmative) whether the Act by law required the hypothetical willing buyer/willing seller market to be an “effectively competitive” market.¹⁵

In any event, the CRB has been exemplary in its detailed examination of, reference to and reliance on rigorous economic evidence. For example, the recent Web IV hearing involved lengthy examination of sophisticated economics arguments: “The Web IV proceeding ran from April 2015 through closing arguments in July 2015, and the Judges considered 660 exhibits, consisting of 12,000 pages, and heard oral testimony from 47 witnesses including 14 economists”. The manner in which the Web IV proceeding was conducted – with a strong reliance on economic analysis - is extremely encouraging.

Perhaps even more encouraging, and as a model for other countries, the CCB’s written decision outlined the key issues they expected parties to address: (1) the pros and cons of revenue-based rates; (2) the existence or propriety of price differentiation in a market in which the product (digital sound recordings) can be reproduced at a near-zero marginal cost; and (3) economic variations among buyers and sellers in the relevant market.¹⁶ The CRB included a section on commercial webcasting rates, spanning 134 pages, largely addressing the economic matters noted above as well as related economic concerns.

We have noted the mandate differences in how Canada and the US set copyright tariffs. Further, we have seen that the methodological approaches of the regulatory bodies also differ (irrespective of mandate). A cursory examination of European tariff setting confirms that regulatory rate-setting differences occur across many countries. So if different countries adopt different objective criteria and methodologies for rate determination, what impact might that have on national creative markets? Are relative (i.e. across country) royalty rates

¹⁵ Strickler, *op. cit.*

¹⁶ Determination of Rates and Terms, 2016-2020 (Web IV). <https://www.crb.gov/web-iv/web-iv-determination.pdf>.

important in terms of impacting creative behaviour? If relative international copyright rates are distorted (in an economic sense) then would resources leave one country for another? What are the social welfare costs of distorted inter-country royalty rates? To my knowledge, there has been no empirical study of this possible effect.¹⁷

Final Thoughts

The field of copyright tariff setting theory and application is very much in its early stages. We can expect that as economies continue to evolve from a “product to a service” orientation, copyright and related intellectual property pricing will increase in importance. The issue of whether regulated markets are better than non-regulated markets at price setting will continue to be debated. Perhaps most importantly, the role of economics and the transparency of decision-making should be a primary focus of copyright regulatory bodies and parties that participate in those proceedings. More rigorous economic analysis and clearly enunciated reasoning underlying tariff-setting decisions should be our immediate collective North American goal and a goal to be pursued by European copyright practitioners.

¹⁷ There is some literature on why and how creative people cluster in communities (e.g. to be with like-minded creative people) and how that may lead to community-specific competitive advantage. See <https://www.citylab.com/equity/2012/07/psychology-behind-why-creative-people-cluster/2243/> and <http://martinprosperity.org/media/Creativity-Clusters-and-the-Competitive-Advantage-of-Cities.pdf>.