Keynote talk CIPPM Symposium
3 December, 2007.

Regulating Copyright Collecting Societies

Ruth Towse
Professor of Economics of Creative Industries
Erasmus University Rotterdam, Netherlands and Bournemouth University

Introduction

This paper is based on a paper with Christian Handke that is work in progress.[1] The context of the paper is the recent efforts by the EC to introduce greater competition into the world of the copyright collection societies (or rights management organisations as they are also called).

As an economist working on cultural economics with a special interest in artists' labour markets, I began to realise some fifteen years ago that copyright could be a source of income for artists. In the 1990s, I worked on the impact on musicians' earnings of the EU Rental Directive and my interest in collective rights management stems from that. I then began to work on economics of copyright and creative industries with the emphasis always on artists' earnings and on empirical research.

Economics of copyright

I do not intend to spend any time in my talk on the economics of copyright, except to note that there is now a well established literature with the publication of the *Review of Economic Research in Copyright Issues* (RERCI) published by the Society for Economic Research in Copyright Issues (SERCI – www.serci.org). The website contains several surveys and references to a wide literature. All I want to do here is to present some of the main research results that are germane to this paper:

i) All economists have noted the monopoly element of copyright (though it is weak compared to patents and trade marks).

[1] Ruth Towse and Christian Handke 'Regulating Copyright Collecting Societies: current policy in Europe' presented at the Society for Economic Research in Copyright Issues (SERCI) conference at Humboldt University Berlin, July 2007. We have also published recent survey 'Economics of Collective Management Copyright' commissioned by SGAE (Spanish Authors' Collecting Society) and Fundacion Autor, which is available on http://www.serci.org/documents.html

ii) Copyright law must balance the benefits of the incentive to create with the costs to users (including later creators); and
iii) One of the main questions arising from this is: how strong is the monopoly that is called for? How much enforcement/protection etc. there should be is essentially an empirical question, the answer to which varies from industry to industry and by the size of enterprise and therefore economists study the topic in a range of contexts.

Economics of Copyright Collection Societies (CCS)
It seems that Peacock and Weir (1975) produced the first empirical study on the topic[2]; other writing dates from the mid 1980s – see the Towse and Handke survey cited above.

Economists are interested in the fact that these societies are spontaneous market developments that overcome government failure; statutory copyright law itself exists to overcome market failure but it could not be effectively administered without collective rights management by these societies as transactions costs would be too high, not only for the rights holders themselves but also for **users** (and this is a very important point). But the existence of copyright law in and of itself is insufficient to enable the majority of rights holders to exercise all their rights and the burden to comply for users would be very high without copyright management organisations.

As is well-known, the function of CCS is to: license rights for members, collect royalties and remuneration, distribute them and protect members' rights. These points are analysed in more detail later on.

The economics literature has focussed on the fact that CCS are natural monopolies for a certain bundle of rights, meaning that the greater the number of works and rights holders (typically separate data sets), the lower the cost per unit. This is because of high fixed (set-up) costs. However, marginal costs are very low. This natural monopoly is in addition to having grant of monopoly by the state in many countries: thus there is both natural and an 'artificial' monopoly.

The tendency to natural monopoly is reinforced by network economies. Network economies mean that benefit to consumers of goods and services rise with their numbers: the classic example is e mail – one's benefit (and therefore willingness to pay) is greater the more people you can reach. In CCS, the benefit to users and rights holders rises with number of members in the collecting society. Reciprocal agreements between national societies

[2] Peacock, Alan and Ronald Weir (1975) *The Composer in the Marketplace*, London, Faber.

handling same bundle of rights extend the network and enhance these benefits.

Another feature of CCS that has greatly interested economists is blanket licensing; again, this reduces transaction costs for users and right-holders but it has the disadvantage of blunting market signals: the licence fee is an average of value of all repertoire to users and therefore does not reflect the higher value of some repertoire; many works in the bundle licensed have no value to users, however, but the cost of sorting them out would be excessive. The distribution systems of the CCS are not exact but reduce the arbitrariness of the blanket licence by using playlists etc to get data on the use of individual works so that revenues are shared out according to use.

The blanket licence tariff is collectively bargained between representatives of users and the collecting society; again, this greatly reduces transaction costs because a local hairdresser or restaurant playing music can get a standard licence that authorises use of all the works in the CCS repertoire at rate already agreed by their respective trade organisations. This is a bilateral monopoly situation that seems never to get mentioned in the complaints about CCS monopoly power: the bilateral monopoly (first analysed by Peacock and Weir in relation to the PRS and the BBC, the latter being at the time a virtual monopolist of the public performance of music). The bilateral monopoly blunts the monopoly power of CCS.

Other features of CCS that have been mentioned in the literature are: their role as providers of 'solidarity' - they act qua trade unions by collective bargaining; this is important in Europe for 'free groups' ie performers etc outside state-run arts organisations (in which they are civil servants – hard for the UK mindset to comprehend, but true!). Another feature that may turn out to be important is that the CCS distribute the 'copyright levy' or blank tape levy, that is now widespread in Europe. The CCS have the mechanism in place (data banks and play lists) for distributing it.

European Commission

Recent efforts by the EC the Internal Market Division to introduce greater competition into CCS have been initiated by the belief it is they that have held back online licensing of music (something few observers accept: the record industry itself is mostly regarded as having been the problem). The creative industries are seen as drivers of economic growth and therefore there has been concern about the licensing process and the role of CCS. Points that have been made are; that there must be a level playing field for rights holders and users throughout the EU but this is not the case; there is a lack of clarity and accountability in many national CCS and about their agreements with other national societies. Competition is seen as a way of

breaking monopoly control of rights management services and bringing market discipline into them.

There is, however, another aspect to this: the EC and many other policy-makers, for example, WIPO want to promote individual DRM (digital rights management) and to replace CRM (collective rights management). This appears to be an article of faith not based a realistic assessment of either the technologies needed or the ways these markets function in their institutional contexts.

Regulation of CCS

Having set the stage at some length, I now come to the main point of my talk. The first thing to note, and it is a very important impediment to the progress called for: in many cases, the CCS are already regulated by governments in terms of their constitution, articles, membership rules and so on and, more significantly, in most countries (including the USA), rates for the tariff of licence fees are set or closely monitored by a court or ministry. In other words, many CCS have little room for manoeuvre. Moreover, the CCS are typically co-operative membership clubs and it therefore seems more appropriate that either national governments or members should deal with management and governance issues in them, perhaps aided by EC regulation of standards.

However, that is not a matter for economists. The question we ask in our paper is how should or could the CCS be regulated by economic means and here I explore in more detail than in the paper two economic models for regulation that could apply: what we have called the natural monopoly model with its 'Common Carrier' feature and the 'Social Insurance' model with its case for regulated membership. I would like to point out that these models are applied as anaologies: it is not my intention to recommend a particular course of action for CCS but to show that regulating them could follow principles already well-trodden by the EC Competition Authority and by national governments.

Natural monopoly

Natural monopoly is when a firm becomes sole supplier due to ever-increasing returns to scale: unit costs (ATC) fall as output increases without limit and marginal costs (MC) are low in relation to them. This comes about where there is a very high initial investment in fixed capital. Marginal cost pricing is impossible as MC below ATC. This is typical of utilities – any enterprise with a network eg water, gas, electricity, railways,

For such enterprises, standard regulatory policy is:

i) to split up different parts of the enterprise – services and network, production of different products, etc;
ii) to retain benefits of increasing returns;
iii) to regulate price equal to MC and adopt some charge that contributes to fixed costs eg connection charge. Price per use then mimics the competitive market price:
iv) to enforce Common Carrier conditions - the regulator forces the enterprise to open its network to competitors eg other telephone service companies can use BT lines.

Applicability to Collecting Societies?

It has already been argued that CCS are natural monopolies; to apply these regulatory rules to them requires that we understand what are the fixed and variable costs, the network and service features of rights management and how the different operations of the CCS could be split up, if that was regarded as necessary to increase competition.

The databases of works and of rights holder information held by CCS are essentially fixed costs; though they are added to frequently, new additions are small in relation to the total. We could regard these databases as the common carrier element in the service of rights management that the CCS could be forced to make available to competitors who would collect and distribute revenues. Play lists are already public information or are obtained from users.

The issue of licences can be done very easily and for low cost online. This is clearly a variable cost once the standard licence has been drawn up and the fee negotiated (a fixed cost). It is hard to imagine a competitor could do this better than best practice CCS already do.

Monitoring use of members' works could be hived off. This service has both fixed and variable costs and it obviously depends upon having access to the database of works. The most difficult aspect of the problem is monitoring use in far off places; at present, this is achieved through reciprocal agreements between national CCS and it is the case at present that CCS in different countries operate on a somewhat different basis. Note that if DRM/TPM worked, this structure would be unnecessary!

The distribution of other remuneration eg from a copyright or blank tape levy could be done by a competitor via the common carrier access to databases. The actual service of distribution is a variable cost depending upon the number of works used and the number of rights holders. As with the licensing, it is probably done easily and efficiently by the CCS once the rate per use has been agreed by CCS members.

Negotiating licence fees and the rates of distribution of the blanket licence fee between members are obviously the crucial issues in this debate. The EC believes that DRM could replace collective rights management and stop blanket licensing; the individual can manage her own rights and set an individual price. But would each rights holder be in a position to do this or want to (always assuming technological protection measures work, which no-one in the business seriously believes)? We doubt it; a new type of private enterprise could enter the market and offer rights holders a licensing and distribution services replacing the CCS but it seems to us that the tendency to natural monopoly in these services is so strong that the eventual outcome would be a private monopoly, possibly unrestricted by national boundaries and regulation, which would hardly be a better solution.

Social Insurance model – issue over membership of societies
This is the second model that could serve as a template for regulating the CCS. By the social insurance model is meant the type of situation in which there is a private insurer (say for health or pensions) that is required by the government to accept everyone - no cherry picking or cream skimming. Unregulated insurance would not insure older people, people with genetic defects etc.

In social insurance, the healthy pay for the sick and the young pay for the old. Insurance is a system of risk pooling and can convert individual uncertainty into a predictable risk.
It is well documented in cultural economics that creators face uncertainty about the reception of their work: a small creator could have a big hit but since it is uncertain, she would not pay a lot to enforce rights. However, the CCS acts as an insurer. The same applies to genres of works eg Classical and pop music. By including diverse works with same rights in same CCS, individual uncertainty becomes a pooled risk.

How does social insurance model apply to CCS?
One topic that has been analysed in the economics literature is the optimal size of membership of a CCS - is it a public service or a club? A private club would limit membership to the size at which the membership fee is equal to the individual's benefit. As a public service (to rights holders and users), it fits the model of social insurance but requires regulation to maximise benefits and reduce costs.

The CCS maximises revenues subject to transaction costs but the ratio of transaction costs to revenue for small creators is higher. Stars are probably cheaper to collect for and distribute to. They would attract a competitor able to cherry pick; but if top earners withdraw from collective management, the cost would rise for small low revenue members. Members seem willing to accept this as Rawlsian social justice – each one could be a

winner or loser and so they agree to rules that cross-subsidise costs of different rights holders and distributions (including allocating 'cultural subsidies' for needy members and giving young people help to develop their work).

Policy Issues
The issue for a Competition Authority is this: is the market contestable or does it have to be regulated to mimic market competition?

The irony with the CCS is that contestability is ruled out by existing national regulation: a CCS is typically already regulated as the sole organisation for CRM of a particular bundle of rights in certain markets. In many cases, their licence fees are also regulated not bargained for on the open market.

The CCS are non-profit, membership organisations. Non-profit organisations have a tendency to be less careful about costs than for-profit organisations, especially when they are monopolies. But for-profit organisations would cut costs and would not redistribute the increased net revenues to rights holders!

One question we can ask is: could there be horizontal integration of CRM – eg could societies merge to administer broader bundle of rights (in the UK there have been two such mergers: PRS/MCPS; PAMRA/PPL)? This leads to less not more competition, however. We need to do further work on the exact nature of this natural monopoly at the level of the different operations of the CCS.

The real policy question is this: do we want a copyright system that effectively allows all creators to collect money for their work? Without that copyright law protects only the well established, larger rights holder. If not, we need to adopt other ways of rewarding creativity.

Conclusion
Individual licensing is not feasible for many small rights-holders and the absence of stars would make things worse. A private agency may well not have the incentive to manage small creators' rights unless forced to do so by regulation.

Individual licensing would impose considerable transaction costs on **users** finding where to go for a licence and would introduce lack of certainty about authorisation.

Without a monopoly, the CCS could not issue a blanket licence. One thing research might contribute is to consider how blanket licensing could be made more pliable in connection with DRM. The analysis presented here

suggests that on balance the benefits of natural monopoly and low transaction costs of collective rights management could be retained with appropriate regulation.

The EC seems to generalise from the fact that some countries' CCS have very poor administration of CRM (perhaps their public administration is also poor in general). We recommend that EC work with international bodies like CISAC to discuss how to put pressure on the offenders to improve. It would be a much easier task for the EC regulate by laying down common rules based on best practice for EU collecting societies than to break up the CRM structure. The 'good' CCS offer a good service - why throw out the baby with the bath water?

However, when one thinks deeply about these problems, one conclusion that persistently comes to mind is that that copyright law itself is the root of the problem – there are just too many rights that last too long. This has been called the tragedy of the 'anti-commons' by economists – property rights are just too fractured and the values too small in relation to the whole.