Chapter 15

Compensation Systems for Online Use

Christian Handke

15.1 Introduction

Digitization—the increasing application of digital information and communication technology (ICT) for a variety of purposes—has great potential to strengthen the productivity of cultural industries and to foster users’ access to a vast stock of cultural and creative works. However, digitization also puts into question traded modes of rewarding those who invest in creativity. For the cultural industries, one of the major lessons of the past two decades has been that it is hard to enforce exclusive rights online. Fundamental economic reasoning implies that without clearly defined quasi-property rights, private enterprises in markets will fail to provide a socially adequate amount of new, valuable copyright works. Thus, digitization appears to raise the stakes of the underproduction-underutilization trade-off (Novos and Waldman 1984) that is at the heart of copyright in the economic perspective. The challenge is to provide sufficient incentives to those capable of creating valuable works, while not restricting access to users, or at least to strike a reasonable compromise where these two objectives are irreconcilable.

The traditional lever used (or not) by policymakers to approximate a widely acceptable solution has been copyright enforcement. The results have been mixed at best (Handke 2016). Unauthorized digital copying remains rampant and measures to enforce copyright are contentious. This chapter discusses an alternative to copyright

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enforcement: copyright compensation systems (CCS), which (a) provide end users with legal certainty when using widely available online resources to access and use creative works, in return for (b) a surcharge on Internet subscription, the receipts of which are disseminated among rightsholders. In a recent study on the Netherlands, Handke et al. (2016) demonstrated the potential of CCS to make markets for music recordings much more efficient. This chapter argues that CCS hold great promise in particular for cultural industries in what in this volume is referred to as countries in the “digital peripheries”: Central and Eastern European (CEE) countries that were part of the Warsaw Pact and have now acceded to the European Union.

As usual, technological change and digitization have ambiguous effects. With fewer technical restrictions, it is often easier for people in small communities or remote locations to access and even actively participate in cultural life. On the other hand, so-called platform capitalism means that the dissemination of culture is run by a handful of multinational corporations, usually operating from large and highly developed economies, who do not necessarily have strong incentives to pay little attention to the specific needs of the populations of smaller countries. This chapter argues that well-designed CCS could make a major contribution to avert some of the risks associated with digitization and globalization for cultural industries in CEE countries.

15.2 The Basic Economics of Copyrights

To discuss CCS, a reiteration of the basic economic reasoning behind copyrights is merited here (for a more comprehensive treatment, see the chapter by Stepan in this volume). Copyright systems stipulate exclusive rights regarding creative works and thus enable conventional market transactions. In a nutshell, an effective copyright system endows rightsholders with exclusive control over who can use protected works. Since creative works tend to be imperfect substitutes for each other, rightsholders of valuable works enjoy some market power: They can sell copies or licenses for prices in excess of marginal costs, which may enable them to recover the initial costs of creation and even to incur profits, encouraging further investments in creativity. Higher prices are disadvantageous for potential users. What is more, markets for copyrighted works are complex—with many and highly differentiated works and great variety in consumers’ preferences—and there are substantial transaction costs in operating these markets. Nevertheless, proponents of effective copyright protection argue that even most users will be better off in the long run. The question is whether the discounted future value of additional works created due to copyright exceeds the immediate drawbacks of higher prices and transaction costs (Handke 2017).

An important extension of this analysis is that there is no clear boundary between creators and users. Most creators draw on prior creations so that strong copyright protection not only fosters rewards for creators but also increases the costs of creativity (Landes and Posner 1989). Current creators must acquire licenses or work

around the claims of the rightsholders of existing copyrighted works. This insight also applies to new ways of disseminating copyright works or other complementary goods and services, such as online subscription services: powerful rightsholders may appropriate much of the value of new related goods and services and exert centralized control, undermining pecuniary incentives to develop new means of making works accessible and usable (Handke 2015).

Overall, this economic analysis entails a number of important yet not entirely obvious insights regarding copyright policy. First, for a normative assessment, the effects of copyright on rightsholder revenues are not decisive, but the effects on innovation and the supply of creative works are. Second, it is not a given that stronger copyright protection always fosters creativity. Third, the optimal level of copyright protection varies with changing market conditions. Fourth, pure theorizing does not yield a general justification of copyright. More technically speaking, copyright protection is not Pareto optimal in the sense that it would make some stakeholders better off without leaving any worse off.¹ Like most public regulation, copyright does not bring us close to an optimal state as envisaged in perfectly competitive markets according to the Paretian welfare economics. That any policy aimed at improving the cultural industries fails to do so is a moot point. Instead, copyright and its alternatives need to be evaluated in comparison to their best real-world alternatives. The question is not whether any of the options is perfect, but which appears to be the best under current circumstances and to the best of our knowledge. To make that call, up-to-date empirical evidence is required.

Finally, there are three alternative means to ensure adequate rewards to those investing in creativity in the presence of digital copying technology:

First, consider so-called business model solutions: Private enterprises could develop strategies that entice users to pay for access to content or to contribute to the costs of creation in spite of the possibility of accessing creative works from unauthorized sources (an excellent overview of options is found in Varian 2005). Most promising in this respect seem to be Internet platforms that either finance themselves through advertisements (e.g., YouTube or the free version of Spotify) or that charge subscription fees to users (e.g., Spotify Prime or Netflix). The main issue with these Internet platforms is that they are subject to vast economies of scale and scope, as well as network effects. They thus tend to give rise to narrow oligopolies or quasi-monopolies. The productive efficiency of large firms (low average costs) entails the problem of centralized control and market power.²

Second, there is copyright enforcement, which falls into four types according to two aspects (cf. Danaher et al. 2013): On the one hand, enforcement can be directed at either private end consumers or at commercial enterprises disseminating works online without proper licenses from rightsholders; on the other, enforcement can be conducted by private agents—in particular rightsholders or their representatives—or

¹Think, for instance, of individuals with a low life expectancy and thus a low discounted future value of any creative works to be generated in the future.

²Crowdfunding is another business solution, where potential creators seek to attract financial contributions from a broad public before finalizing production.

by public agencies. There is widespread dissatisfaction with any means to enforce copyrights (Handke 2016). This is not for lack of trying. Suppliers of creative works and public authorities have experimented with various methods to enforce copyrights in the digital realm. Technical protection measures (TPM) have aimed at preventing unauthorized copying or access to content. Other actions have included injunctions against firms whose goods and/or services are related to copyright infringements, cease and desist notices to firms or private households and notice and takedown requests directed at online platforms for hosting allegedly infringing content. However, according to the empirical literature, the methods tested so far have often been inefficient and commonly conflict with other objectives, such as privacy and freedom of speech (see Handke 2016 for a summary).

The third option is CCS, which do not rely on any enforcement of exclusive rights and case-by-case licensing, but on revenues from surcharges on more excludable goods and services (copying hardware and telecommunication services), to be distributed among rightsholders according to the metrics of use. This chapter focuses on this latter option.

15.3 Copyright Compensation Systems (CCS)

As stated above, CCS have two definitive characteristics: First, they raise revenues for rightsholders/creators from a surcharge on Internet subscriptions. Second, they provide end users with legal certainty when accessing and using creative works online. As such, CCS essentially extend the existing system of so-called copying levies to cover Internet access.

The first copying levy was introduced in Germany in 1966, and it applied to audio-tapes and compact cassettes. The idea was to avoid the costs of fighting unauthorized copying on the level of millions of private households and instead raise revenues for rightsholders associated with copying. By now, copying levies are in place in virtually all European countries, as well as other major economies such as the USA and Canada, and over time, they tend to apply to new copying technologies (WIPO 2017). In major economies throughout the EU and North America, surcharges were applied to many copying technologies that became widely available in the late twentieth century, subject to territories; for instance, to music cassettes and players, to photocopiers and scanners, to CD/DVDs and burners, and more recently even personal computers and smartphones. Notable exceptions are some types of (built-in) computer memory, Internet access and “cloud” external memory services, as these have many applications other than to reproduce copyrighted works and—so the argument goes—it would seem unfair to charge all users for potential unauthorized copying. See WIPO (2017) for an overview, including the Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia, among many others.

With the diffusion of peer-to-peer file sharing around the turn of the millennium, several legal scholars called for CCS (Lunney 2001; Ku 2002; Netanel 2003; Fisher 2004; Eckersley 2004; see Handke et al. 2018 for an overview). Nevertheless, to

this day, there are virtually no applications of CCS. Internet access and “cloud” external memory services remain out of the scope of copying levies. No CCS has been introduced that would allow Internet users against a fee to download (or even upload) copyrighted works without specific authorization by the rightsholders.

15.3.1 The Reasoning Behind CCS

Copying levies circumvent a major problem with copyrights: it is costly to enforce copyrights on the level of a myriad of individual households or in informal parts of the economy. These costs accrue not only in resources but also in terms of privacy infringements, as copyright enforcement requires monitoring. Levies can do away with the need to monitor private behavior by shifting liability and payment to sales of excludable goods and services that are often used for unauthorized copying.

To comprehend the major advantages of CCS, an application of transaction cost economics is useful. The concept of “transaction costs” refers to all costs of conducting economic exchanges: search costs to identify potential trading partners, bargaining costs to establish mutually acceptable terms of trade, monitoring costs to establish whether trading partners stick to an agreement and enforcement costs to fight behavior that infringes on the terms of a trade. Where the full economic value—in terms of money but also the time and effort required—of transaction costs exceeds the value of a transaction, deals that would otherwise be mutually beneficial do not come about. All potential trading partners lose out. In the cultural industries, this can be a huge problem. Markets for cultural works are very complex. On the supply side, there are many different suppliers and many different works supplied. On the demand side, there are many users that appreciate diversity in the works they have access to—virtually everyone prefers access to several musical works, films or books during any month or year, for instance. With a vast number of different cultural products available, the willingness to pay (and incur transaction costs) for specific works is typically modest. What is more, the marginal costs of supplying additional users are very low, so that rightsholders could benefit from selling at low prices to at least some users. Thus, many potential transactions that would make both creators/rightsholders and users better off are averted by transaction costs in cultural industries. This has important implications for cultural diversity. Due to the inefficiency introduced by transaction costs, it is not worthwhile to even create many cultural products that would be supplied in a theoretically feasible, more efficient market without transaction costs. Works catering to smaller and less wealthy communities (say works in Czech or Latvian) are particularly susceptible to this problem.

The conventional means to lower transaction costs are standardization and bundling of transactions. There are many related practices in cultural industries. For instance, within their scope of activities, copyright management organizations (CMOs) such as GEMA and ASCAP operate as national monopolies and offer blanket licenses to near-comprehensive repertoires of works. Spotify and Netflix offer

subscriptions to a vast bundle of works based on a single payment and a single contract, and they do not vary pricing on the user side subject to the intensity or diversity of use per subscriber. However, for any works not available within such a bundle, the situation may deteriorate. Users are left with a choice between staying within a bundle to which they have already acquired access and incurring additional transaction costs and prices if they venture beyond. Whatever is in a bundle becomes more competitive relative to anything outside of it. One could speak of a new type of digital divide between that which is featured or promoted on the major platforms and that which is not. CCS that establish standards for the use of anything found online for those who make a single payment would avoid much of that problem and could thus come to benefit cultural diversity.

That said, the effects of CCS are ambiguous. Copying levies will almost inevitably mean that users of goods to which a levy applies, who have little interest in unauthorized copying, are worse off. Another way to put this is that any non-copyright infringing users of copying technology are made to finance goods and services (copyrighted works) in which they have no interest.

The main objection to CCS raised by economists is that CCS would introduce standardized prices and terms of use, thus reducing the scope for private bargaining and contracting, hindering market mechanisms (Liebowitz 2003, 2005; Merges 2004; Liebowitz and Watt 2006). Handke et al. (2016, 2018) and therefore suggest voluntary participation on the user side. Then, the participation of users would provide information on-demand conditions and would guide pricing decisions and the setting of other terms associated with CCS.

Another concern with CCS is that some organization would have to be in charge of setting terms, collecting revenues and distributing them among members. These are the typical functions of copyright management organizations (CMOs, also known as copyright collectives). For an introduction to the economics of CMOs, see Handke and Towse (2008) and Handke (2014). CMOs have mixed reputations and as large, quasi-monopolies under more or less intense public regulation, they may be subject to inertia and protracted decision-making. Reasonably efficient CCS would require reasonably low operating costs of CMOs and that levies would be distributed among rightsholders according to some rather precise metric of actual use and valuation by consumers. Randomized monitoring of user behavior online could accomplish this.

It follows from this that copying levies are hardly Pareto optimal; levies do not make some stakeholders better off without putting others at a disadvantage. However, neither is copyright enforcement, as argued above. In comparison with real-world alternatives (more or less copyright enforcement), the question is whether copying levies pass the Hicks-Kaldor compensation test: Are those who gain from a levy so much better off that they would be willing to fully compensate those who lose?³

Furthermore, CCS relate to the emergence of Internet platforms for the dissemination of copyrighted works and their potential market power, beyond the argument

³According to standard welfare economics, it is not required that the winners actually compensate the losers. The value of their benefits just has to exceed the value of the losses for others.

developed above regarding the problems of marketing works outside of large, attractive bundles. In recent years, Internet platforms such as Spotify, Amazon, Steam and Netflix have accounted for a steadily growing share of the total markets for recorded music, books, video games and linear audiovisual entertainment (e.g., movies and television programs). Exploiting economies of scale and network effects, these firms have acquired large market shares and many worry about the market power of these multinational, profit-oriented enterprises. In contrast to CMOs, regulation of these new central agents in the cultural industries remains limited. There is considerable worry that market failure will result. Dominant Internet platforms could acquire market power and set standard prices and terms in their favor. They could collude with major rightsholders. They could also neglect smaller national markets, as it may be more cost-efficient for them to focus on major productions in large economies and sell productions suitable for international/global markets rather than dealing with a multitude of producers and productions in smaller markets. CCS could counter some of these threats by setting transparent, universally applicable standards for any enterprise disseminating copyrighted works online. With no fixed costs of licensing for such enterprises, as long as they comply with the CCS regulations on reporting the use of works on their sites, online platforms would ideally compete over who can provide the most efficient access to an attractive repertoire. There would thus be greater scope for smaller platforms specialized in domestic productions in CEE countries, too. In essence, CCS are a means to make markets for e-commerce more contestable, and to steer platforms to compete based on user services rather than on licensing strategies on the rightsholder side.

Finally, let us consider the current debate on Articles 11 and 13 in the prospective new EU Directive on Copyright in the Single Digital European Market⁴: If online platforms were to report usage data to a trusted CMO, and revenues from a copying levy would flow back to rightsholders according to that data, neither more extensive licensing of copyrights for derivative use online nor upload filters might be required. The contested Articles 11 and 13 could be revised accordingly, or perhaps even abandoned altogether.

15.3.2 *The Empirical Evidence*

The limited empirical evidence so far regards the USA and Western European countries and suggests that CCS could make rightsholders and users at large much better off than current markets. In a user survey conducted in the USA and Germany, Karaganis and Renkema (2012) established that about half of all inhabitants were willing to pay more than 15 Euros or dollars per month (Karaganis and Renkema 2012:

⁴These two articles of the Directive have different numbers in the final version of the document. We stick to the outdated numbering here, as the original numbers have been widely used in a very extensive public debate.

56–58). They referenced a number of other studies on the topic with similar results, many which are no longer available, however.

The most ambitious empirical study so far was by Handke et al. (2016). The data were produced using a specific survey technique—a discrete choice experiment using conjoint analysis—which is considered to be the most effective way to establish the value of goods or services when no data from actual markets is available (Arrow et al. 1993; Bateman et al. 2002). The authors concluded that, at least for recorded music, well-designed CCS could simultaneously make rightsholders and users much better off. This applies in particular to CCS that users could opt-out of, so that some market coordination would remain. The authors emphasized the uncertainty of survey-based data, but argued that as far as this type of data goes, the indicators regarding CCS could hardly be more positive. They thus recommended experimental adoption.

15.4 Copyright Compensation Systems in the Context of CEE Countries

Much research on copyright, digital copying and various ways of financing creativity has focused on highly developed North American and West European countries—for instance the USA, Germany, France and Italy. In comparison, many CEE countries such as the Czech Republic, Hungary, Poland, Slovakia and Slovenia share a number of characteristics that affect their domestic cultural industries.

First and foremost, these countries are comprised of small populations with relatively low average incomes by EU standards. Small domestic markets with distinct languages mean that domestic cultural industries catering to their home markets cannot exploit economies of scale and network effects to the same extent as firms in larger countries. Cultural industries in CEE nations are thus even more vulnerable to competition from abroad than cultural industries in EU Member States with larger economies. The integration of markets within the EU and globally thus threatens to inhibit the domestic production of creative content. A single digital market in the EU might even aggravate the situation, and so could the commercial decisions of large, multinational retailers of cultural products, if they were to focus on the most promising content and avoid the additional costs of actively fostering the presence of niche content in their operations. Where a broad range of creative works is available with virtually no cross-border barriers—due to technology or regulation—works with high production values could sideline domestic productions from smaller markets even more. Adequate CCS could safeguard the accessibility of culture, as well as the production of works catering to smaller communities.

Another issue concerns pricing. With relatively low average household disposable incomes and relatively high inequality in some CEE countries compared to major EU economies, many households cannot afford to spend great amounts on cultural and entertainment goods and services. Without regulatory restrictions, commercial Internet platforms will set profit-maximizing prices. They will set relatively

high prices, focusing on high-value customers, thus de facto excluding many East-Central Europeans, or leaving them with illegitimate methods as the only affordable way of accessing many creative works. In such circumstances, commercial supply does not respond to the interest of large parts of the population, and the rule of law is undermined. CCS could mitigate these problems by reducing transaction costs. The prices of copying levies and CCS tend to be set domestically, often under extensive regulation from national governmental authorities and reflecting the conditions of domestic inhabitants. Governments would thus have a means at their disposal to ensure broader access to culture than unregulated markets would bring about. Therefore, CCS are particularly promising in CEE countries.

The main counterargument that applies to many CEE countries regards the quality of regulation and administration. To fully exploit the potential of CCS to reduce transaction costs and for domestic prices to reflect the majority of the population's ability to pay, one reasonably efficient organization is required to collect and distribute CCS revenues to rightsholders. Existing CMOs in countries such as the Netherlands, Germany and throughout Scandinavia are quite efficient, with operating costs lower than 10% even in the relatively costly business of monitoring use and collecting revenues from traditional, offline markets. In other parts of Europe, this is not always the case. Existing CMOs differ widely in terms of their efficiency (Rochelandet 2003). A central question for CCS is thus whether reasonably efficient CMOs can be established. However, the argument regarding the general quality of governmental services and oversight of markets cuts both ways: with low-quality regulation more generally—say, relatively ineffective anti-trust regulation or inhibition of corruption—commercial solutions generated by private businesses in markets prone to market power will not tend to reflect the public interest, either.

Furthermore, CCS could contribute to cultural policy in CEE countries. Many CMOs operate cultural deductions, where a share of CMO revenues from copying levies and other income is not distributed according to metrics of use but according to prerogatives of cultural policy. Such “social and cultural deductions” are already in place, for instance, in the Baltic states, Hungary and Poland (WIPO 2017: 14–15). A broader application of copying levies with cultural deductions could help sustain a critical level of high-quality domestic production.

In addition, many CEE countries have highly educated populations. Skillful and educated people have the potential to fully exploit opportunities for active participation in culture, for instance by creating user-generated content. The use of CCS could allow for that with minimal legal risks and may even generate pecuniary rewards for those who generate valuable content without the desire or means to operate in conventional markets, which involves the burden of obtaining conventional licensing (i.e., transaction costs).

Last but not least, CCS have implications for suppliers of related goods and services. Surcharges on Internet access, Internet services or computer hardware raise the prices of these products. Since the implementation of CCS would reduce transaction costs and thus make creative content available at lower costs, they would not necessarily conflict with digitization, however. Ideally, CCS could even foster demand for related goods and services, as they mean that attractive creative content

is available for users of these related goods and services under transparent terms and with minimal legal risks. To achieve that outcome, the amount of surcharges would have to be set at a reasonably efficient level. What is more, with lower fixed costs of licensing, greater competition between Internet platforms could come to benefit users.

Overall, the specific situations of CEE countries mean that CCS are particularly promising in these countries. To be sure, CCS entail difficult compromises, like any means of organizing cultural industries, in order to strike a reasonable balance between rewarding those who invest in creativity, and placing minimal restrictions on access and participation in culture by users. Nevertheless, well-designed CCS are an option to safeguard and promote domestic culture especially in the “digital peripheries,” where market failure is likely to be particularly grievous.

15.5 Conclusions

This chapter has discussed the pros and cons of CCS under some admittedly generic assumptions regarding the situation in CEE countries. Overall, it argues that CCS could foster cultural industries and access to culture, where markets seem to fail.

In essence, CCS are simply levy systems, extending the practice of copying levies in many major economies. Similar to existing levies for copying hardware, CCS entail a surcharge for Internet subscription, with the receipts being distributed among rightsholders according to some measure of the use of specific copyrighted works. The basic idea is not to enforce exclusive (copy) rights among private households but rather to compensate rightsholders for unauthorized use online. Arguably, CCS could be used in CEE countries to better achieve several objectives:

- To avoid market conditions in which many low-income households do not benefit from legal access to creative works online due to high prices. Achieving this could also reduce illegitimate dissemination of works and ensure that the preferences of low-income households influence decisions in cultural industries and in firms disseminating creative works online.
- To foster cultural diversity and the potential for niche productions by setting universal standards for online use of creative works and the compensation of creators, even for types of works neglected by multinational corporations;
- To finance cultural policy in a reasonably efficient manner based on cultural deductions of CCS revenues;
- To exploit the opportunities of digitization for skillful individuals to actively participate in culture, to generate value for themselves and others with minimal organizational costs and legal risks and even the potential for pecuniary rewards for the most successful suppliers of user-generated content.

However, CCS do require some effective CMOs and may require a great deal of political capital to resist multinationals operating in the cultural industries. It may also be hard to convince suppliers of goods and services, to which a CCS

surcharge would apply, that their commercial interests would not be unduly harmed. Furthermore, there are restrictions on interventionist national policies within the EU and the framework of international free trade agreements. That said, copying levies are already common practice throughout major economies so that CCS would not require revolutionary change. Furthermore, diverse cultural industries operating throughout the EU are essential to sustain cultural diversity and national identities in Europe. CCS could help ensure that digitization is harnessed to foster diversity and to keep those at the “digital peripheries” at the table, better than copyright enforcement or unregulated markets will. It is high time that policymakers explore this option by extending the system of copying levies, and CEE countries are especially likely to benefit.

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