

OXFORD ECONOMICS

Consultation on Copyright Comments on Economic Impacts

A report for the Alliance Against IP Theft



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Executive Summary

This report aims to provide a critical analysis of some of the work undertaken by the government's recent *Consultation on Copyright*, ("the Consultation") launched on December 12, 2011.

The Consultation follows the earlier work of the Hargreaves Review (*Digital Opportunity: A Review of Intellectual Property and Growth*) released in May 2011.

Key issues identified include the following:

- An appropriate economic framework must take the interests of consumers (users) and producers into account.
- Although the Consultation appears to do this through its use of Impact Assessments (IAs) the neutrality of its approach is open to question.
- The assumption that preservation of copyright is economically inefficient appears to be the starting point of the Consultation. There is, in fact, little empirical evidence to support this, while some recent evidence suggests the opposite is true¹.
- The Consultation's IAs often fail to quantify a net cost or benefit from the proposed exceptions. In spite of this lack of a quantitative basis, the proposed initiatives are often preferred to the existing status quo. In short, change is suggested even though there is no costing to support it. Where a net costing is not provided, there is no good basis for suggesting a change to the status quo.
- There is an assumption that there will be large scale benefits to business from the proposed measures, whereas much of the benefit may accrue to recreational consumer surplus. If this is the case then there may be little impact on economic growth. Indeed, in some cases growth may suffer, as existing rights holders experience reduced profitability with no corresponding increase in other industries. Even if commercial benefits do occur to other industries it is unclear if this will amount to more than a simple transfer of wealth. In other words, the effects of the proposed changes on revenue and GDP may be much smaller than the Consultation suggests.
- Issues such as market saturation, externalities and the costs of enforcement are ignored or given very limited attention. This means benefits could be lower and/or costs higher than the Consultation suggests.

¹ Liebowitz, S., (2008) "Is the Copyright Monopoly a Best-Selling Fiction ?", Centre for the Analysis of Property Rights and Innovation, and Liebowitz S.(2009), "The Myth of Copyright Inefficiency", *Regulation* Spring 2009

- The calculation of benefits is based on inappropriate comparisons in several instances, such as the application of international entertainment data to a “travel resistant” industry such as parody.
- Questionable assumptions are made about price effects in the advent of legislative changes to private copying in particular, i.e. it is assumed prices will rise if copyright restrictions are eased.
- There appears to be little acknowledgement of the potential for the proposed measures to be abused, resulting in additional copyright infringement and lost sales.

1 Introduction

This report aims to provide a critical analysis of some of the work undertaken by the government's recent *Consultation on Copyright* ("the Consultation"), launched on December 12, 2011.

The Consultation follows the earlier work of the Hargreaves Review (*Digital opportunity: A review of Intellectual property and Growth*) released in May 2011.

Accordingly, this report is structured in two parts:

- Chapter 2 examines the economic framework underlying the Consultation's impact analysis and whether it can be supported.
- Chapter 3 provides comments on specific exceptions.

2 Framework of the Consultation's impact analysis

2.1 The economic framework and welfare maximisation

Before considering the specific issues raised by the Consultation it is important to recall the economic framework which is typically applied in such cases.

Standard microeconomic theory suggests that social welfare is maximised under conditions of perfect competition (i.e. many competing firms). It is important to note that social welfare is comprised of **both** consumer and producer surplus.

The producer surplus (roughly, profit before allowing for fixed costs) is the difference between the price received by suppliers (the price line in Figure 2.1 below) and the minimum price at which they would have been willing to sell commodities, i.e. the supply curve in Figure 2.1. This represents the benefit to be derived from the sale of the good (such as films or books), and is captured by the shaded area (CBD) between the price line and the supply curve in Figure 2.1 below.

The consumer surplus represents the difference between what consumers pay and the maximum price they would be willing to pay for a commodity (the demand curve). For example, someone may pay £5 for a DVD but enjoy it so much that they would have been willing to pay (WTP) £15 for it. The consumer surplus is £10. Perhaps a second customer also faces a price of £5 but is only willing to pay £12 for it – his/her consumer surplus is £7. The shaded area (ABC) between the price line and the demand curve represents the sum of all these individual consumer surpluses – i.e. the total consumer surplus.

Adding up the changes in producer and consumer surpluses from some new initiative gives the net total benefit to society as a whole from that initiative.

It should also be noted that a welfare-based approach measures changes in efficiency based on the primary market – that is the market in which the defined goods and services in question are directly exchanged. From a welfare perspective, there is no need to consider indirect or secondary market effects (unless externalities are involved or in some exceptional cases involving distorted secondary markets).²

So, for example, changes in copyright legislation on private copying may reduce the producer surplus of rights holders and increase the consumer surplus of consumers (both commercial and non-commercial ones). Unless there are

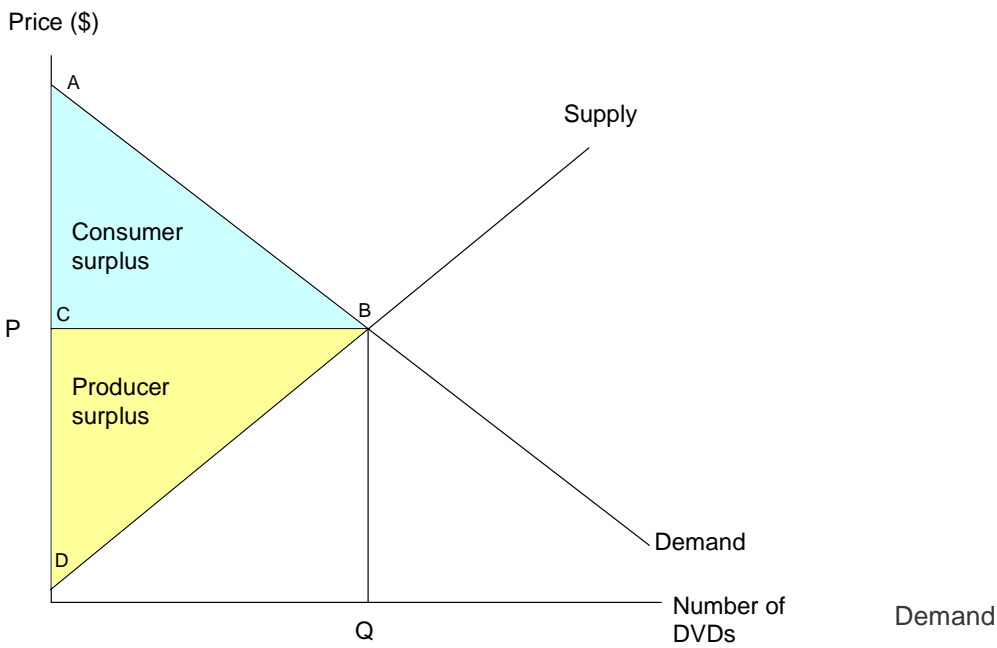
² Boardman A., Greenberg D., Vining A., Weirner, D, 2006) *Cost Benefit Analysis: Concepts and Practice*

substantial externalities³ the welfare effects should be captured through the efficient operation of the primary market. For example, the purported benefit to innovation that copyright relaxation may bring should be captured by the primary market demand curve because this reflects a firm’s willingness to pay for copyright material (and implicitly the benefits they derive from such material).

Further, this perspective makes the trade-off involved under the welfare approach clear. There may indeed be innovation benefits from copyright relaxation but the producer surplus of rights holders is reduced. The question is whether one of these effects is greater than the other – an issue at the heart of most cost-benefit analysis⁴.

Figure 2.1 indicates the producer and consumer surpluses using DVDs as an example.

Figure 2.1: Producer and consumer surpluses



³ An externality may occur when the interests of third parties who are affected by a purchase or use decision are not taken into account. A classic example is pollution from vehicles causing health or global warming impacts.

⁴ Other analysts have argued that there is a need to go beyond this “static” framework and analyse dynamic effects. Handke (2010) for example argues that the defence of copyright partly relies on dynamic effects while the costs are discussed only in static terms (Handke (2010) *The Economics of Copyright and Digitalisation*). However, as Handke himself notes, there may be issues of definitional blurring here. Copyright may not only support long term increases in creativity and an *expansion* of supply (Handke’s dynamic effects). In an immediate (short run) sense it supports the existence of the *current* marketplace of existing works. Further, as Handke admits, fully dynamic models are very difficult to formulate. There is in fact a lively (two-sided) debate about the usefulness of dynamic modelling as opposed to static models in a variety of contexts.

This diagram assumes that both suppliers and consumers operate within a competitive market. The price P represents the efficient price for DVDs in such a market. At this price, consumers demand quantity Q , as represented by their purchase of DVDs. They are willing to pay P for a DVD and retailers are willing to offer it at this price.

In short, an acknowledgement of the interests of consumers **and producers** lies at the core of standard microeconomic theory. There is no attempt to favour one above the other. As Cseres (2005)⁵ notes:

Economists have traditionally focussed on social or total welfare. They do not make a value judgement between consumers or producers.

Consistent with this, efforts to support competitive markets should, therefore, take the interests of both consumers and producers into account. It is acknowledged that the Consultation's Impact Assessments (IAs) follow the BIS guidelines and seek to measure outcomes on a net approach, allowing for both consumer and producer interests. However, it is important to keep these issues in mind given that so much attention is often paid to consumer-focussed analysis and implicitly to consumer surplus. This fact should also be kept in mind in terms of the discussion of neutrality below.

For example, there often appears to be an implicit belief among many commentators that lower prices and/or increased availability of a product must constitute "a good thing." However there is nothing intrinsically "good" about lower prices – indeed, if there were, then it would be "good" if the price for all commodities sold in the UK was £0. What is relevant from a welfare perspective is whether outcomes are economically efficient.

2.2 Economic welfare and economic growth

A further point is that there is an important distinction between economic welfare (as outlined in the framework above) and economic growth. Increases in producer surplus flow directly into GDP (as profits form part of GDP) and can drive economic growth.

To take a classic example from another industry (and ignoring externalities for simplicity) the development of a toll-road which offers faster travel for users could increase the producer surplus of the company which owns and/or runs it. The consumer surplus related to the toll-road can be divided into commercial and recreational components. As other companies are consumers of transport services, they will also benefit from the new road, as faster travel times allow them to cut down on non-productive travel time. This productivity benefit to the economy is typically measured through the value of business travel time saved.

⁵ Cseres K. (2005) *Competition law and consumer protection*

However, the new road may also benefit non-business consumers who simply use it for recreational purposes. Their recreational usage of the new link (the recreational consumer surplus) will indeed add to economic welfare. However it will not necessarily add to GDP or drive economic growth.

The above example indicates a situation where producers and consumers both benefit from a genuine productive improvement in the country's infrastructure.

Conversely, it is also possible to conceive of situations where producer surplus falls and there is a transfer of benefit to consumers. In some cases (e.g. where markets are already reasonably efficient) there may be little or no net welfare gain, since the result may simply be a transfer from one (producer) industry to another (consumer) industry. Even if there is a positive welfare gain as a result, it is not necessarily the case that this will foster a rise in GDP, because the resulting consumer surplus gain may be largely or entirely recreational. In the latter case, GDP falls due to a decline in the producer surplus but there is no corresponding increase in GDP on the consumer side because the recreational consumer surplus does not enter into GDP.

This distinction is important. As indicated below, economists such as Tylor Cowan⁶ have recently cited the development of the internet and related technologies as an example of how consumer surplus might well increase due to an innovation, without the underlying technology contributing much in terms of fostering economic growth.

However, it is worth pointing out that the Hargreaves Review and the Consultation itself frequently refer to the promotion of *economic growth* as the impetus behind the review of current copyright arrangements. Accordingly, the Consultation's Foreword notes that:

The Hargreaves Review was launched by the Prime Minister to look at enhancing the impact the IP system has on growth and reported in May 2011. In August 2011 the Government set out the range of actions that it will take in response to the Review. Its aim is to remove unnecessary barriers to growth from the IP system while maintaining appropriate incentives for investment in the creation of IP (p.3).

And the Consultation itself:

seeks relevant evidence on the potential for the proposed measures to improve the contribution of the copyright system to UK economic growth, to inform decisions on legislative and other action in these areas (p.3).

The issue of whether the proposed measures are *welfare enhancing* or *growth enhancing* is therefore one that should be carefully considered in this context. As indicated below, it is not clear if the Consultation has always considered this distinction.

⁶ Cowen, T. (2011) *The Great Stagnation*

2.3 Onus of proof

The above framework provides a starting point for considering the issues raised by the Consultation.

In considering whether the initiatives proposed by the Consultation can be justified on economic grounds, an initial question is what economic issues are posed by the current copyright regime. Or in more colloquial terms “what is the problem that the proposed measures are meant to solve”?

It cannot be simply presumed that there is indeed “a problem” in terms of inefficient outcomes. Rather it must *be demonstrated* in the first instance that there is such a problem and the solutions must be justified in this context.

In fact, the reasoning behind the Consultation is largely spelt out in *Digital Opportunity: A Review of Intellectual Property* (“the Hargreaves Review”).

The typical case against copyright is based on the argument that it is analogous to a monopoly. Movement away from a perfectly competitive outcome (for example through monopolies, oligopolies and distortionary trade practices) can result in market distortions and a “deadweight loss” to society, where economic welfare is not maximised. Critics of copyright often argue that it constitutes something akin to a monopoly or a distortionary trade practice which will produce a “deadweight loss” - reducing economic welfare through higher prices and/or reduced production of the good in question (be it books, DVDs or other media). It is also argued that the administration and transaction costs associated with the maintenance of these monopoly rights add further to this deadweight loss.

Historically, copyright has been criticised for providing too much power to rights owners. For example, the length of time over which copyright was deemed to be in force over published works has been a source of controversy in the past.

Against this is the fact that copyright can allow for the protection of existing works within the current marketplace and the continued production of works. Copyright can, therefore, be justified as a response to a “market failure”. If it did not exist then a “free for all” would ensue and creators might get little or no return for their work, even in the short term.

In the case of the current Consultation, as indicated below, there appears to be a desire to alter the status quo. This would appear to be driven by technological change. However, the Consultation itself does not quite “join the dots” in this regard or explicitly address these issues within an economic framework. As a result it is not quite clear what the reasoning process is held to be with respect to copyright reform in general. While the Hargreaves Review pointed to several broad issues of concern with existing copyright legislation, it is not quite clear how these tie into the Consultation’s apparent stance on overturning the status quo (as discussed below).

Following on from the themes in the Hargreaves Review, presumably the Consultation’s broad stance is that:

- Previous copyright arrangements may have produced economic distortions;

- technological change has meant that the distortions are even more significant; and that
- such distortions are now likely to outweigh any benefits of copyright (see the discussion on neutrality below).

There are hints that some of these issues are taken into account in the Consultation, such as through the discussion at various times of the role of technological change and impacts of proposed Options. However, it would be helpful if this framework of reasoning had been spelt out within the Consultation itself.

The case for copyright itself actually distorting markets is, in fact, not as obvious as it appears. The Hargreaves Review itself refers to the fact that there is “next to no [economic] evidence on copyright policy” (p.17). One of the works it refers to in support of its claims on the inefficiency of copyright also cites the lack of empirical evidence and the conflicting results of the studies which do exist.⁷

Other authors raise questions about the standard assumptions relating to the monopoly power attributable to rights holders. For example, Liebowitz (2008, 2009)⁸ has conducted empirical work which questions the size of the deadweight loss created by copyright in the field of book publishing. Liebowitz (2008) notes that:

I endeavour to infer the extent of monopoly power by measuring the price increase, if any, caused by copyright. Amazingly, this has to my knowledge never been previously examined (p.3)

He also questions the assumptions of “monopoly power” by examining the book market more closely:

Economists, along with almost everyone else, tend to equate intellectual property protection with monopoly. But authoring and publishing are really two separate markets, and either could be monopolistic or competitive. It is easy, for example, to imagine an industry in which publishers wield no monopoly power. Authors would reap any excess profits from the sales of their books and, indeed, the entire industry rent would go to those authors with hard-to-replace talent. A more common and opposite view is that copyright industries consist of large, powerful corporations that usurp most of the industry rents, leaving the creative artists with little to show for their efforts. But if the publishing industry were a pure monopoly, there would be no need for copyright at all because there would be only a single seller

⁷ Handke (2010) *The Economics of Copyright and Digitalisation*

⁸ Liebowitz, S., (2008) “Is the Copyright Monopoly a Best-Selling Fiction ?”, Centre for the Analysis of Property Rights and Innovation, and Liebowitz S.(2009), “The Myth of Copyright Inefficiency”, *Regulation* Spring 2009

of any (and every) title, making copyright redundant (Liebowitz 2009, p.29)

One could make equal observations about other markets such as the audio-visual industry. In short, the market landscape for copyright products may be very different to the characteristics suggested by monopoly. This suggests closer examination of specific issues in affected industries (in both the Hargreaves Review and the Consultation) before assumptions are made.

Liebowitz (2009) uses two different measures to determine deadweight loss from copyright in the book market. In the first approach he finds that:

Copyright does not raise price and that there is no monopoly deadweight loss. The remarkable implication of this result is that increases in copyright unambiguously enhance economic efficiency.

In terms of the second approach:

copyright increases price by a modest amount, which is generally about the same percentage of revenues as typical royalty payments. This implies that any economic rents in publishing go to authors. An examination of the size of the deadweight loss resulting from this increased price indicates that it is quite small in absolute terms and much smaller than the deadweight losses that might be expected under proposed alternatives to copyright (Liebowitz 2009, p.28).

Results such as this suggest caution and a neutral approach to the treatment of copyright-related issues. It also implies that a staged approach could be used to the treatment of these issues.

First it must be *demonstrated* that there is indeed a market distortion due to the existence of copyright *per se* – that the outcomes are themselves *not* economically efficient and that the existence of copyright through legislative or other requirements does indeed impose a “deadweight loss”.

Second, if it is argued, as the Consultation seems to imply, that current copyright law and regulations are “outdated” due to technological change and have therefore become distortionary (or more distortionary than previously), this must be shown. It is not sufficient to simply assert these contentions and argue that the status quo must be changed. While the Hargreaves Review stresses the fact that much copyright legislation is “pre-digital” this in itself does not void the essential concepts behind copyright. Further, it is often the case that legislation based on international treaties has been drafted in a flexible way that may be interpreted and applied to new situations.

It is acknowledged that part of the purpose of Consultation itself is to gather such evidence. However, as indicated below, while an observer might expect this to be undertaken in a neutral way, it is not clear that this is the case.

2.4 A note on neutrality

In examining a complex issue such as copyright, there are important arguments to be considered on both sides of the debate. An expectation might therefore be that any body set up to examine such issues should effectively be a neutral arbiter to the fullest extent possible.

However, the tone and emphasis of the Consultation would appear to be strongly inclined to overturning the existing status quo. As discussed below, arguments in favour of change to existing legislation and procedures are often given lengthy consideration, whereas arguments for the preservation of the status quo are typically given only a short discussion. Likewise there appears in several instances to have been a greater attempt to quantify benefits rather than costs.

There is no intrinsic reason why this should be the case. Indeed it might be argued that the opposite should be the case. That is, existing copyright legislation could be seen as a good compromise between contending parties and an approach which is rooted in established economic relations. As suggested, if the argument is that copyright legislation (i.e. the status quo) is creating a deadweight loss or some other type of economic distortion then the first order obligation is to specify and quantify that loss, rather than to simply assume that existing arrangements are economically inefficient.

It is again acknowledged that part of the purpose of the Consultation is to gather such empirical evidence. However the corollary of this is that it imposes an obligation of impartiality until such evidence is indeed gathered. This fact is reinforced by the lack of *a priori* empirical evidence on copyright inefficiency, referred to by the Hargreaves Review and Liebowitz's findings above.

In particular, in five of the six IAs discussed below the Consultation suggests that its preferred Option is to overturn the existing status quo. (The status quo is specified as "Option 0".) However, it is unable to provide a quantifiable estimate of the alleged benefits in four of these five cases (i.e. BIS1057, BIS0311, BIS0312 and BIS0306). This is puzzling, since one would expect such a preference to be based, in the first instance, on a quantification that shows benefits exceeding costs. Otherwise what is the basis for the preference?

If no such quantification can be offered initially then the preferred option should be Option 0, i.e. the status quo. A neutral approach would recognise the fact that, without any strong quantitative evidence to the contrary, Option 0 should be preferred in the first instance.

3 Comments on specific exceptions

3.1 Introduction

The Consultation considers a number of the proposed changes to existing copyright legislation. This section seeks to provide some brief commentary on the IAs connected with the proposed changes to copyright law in the following areas:

BIS1057: Copyright exception for parody

BIS1055: Copyright exception for private copying

BIS0311: Extend exception for copying for research and private study

BIS0312: Exception for copying of works for use by text and data analytics

BIS0306: Copyright exception for archiving and preservation

BIS0317: Extending copyright exceptions for educational use

Page references below relate to specific pages in the relevant IA's, referred to under each chapter heading.

3.1 Copyright exception for parody

These comments relate to the proposed copyright exception for parody.

Most of the points below relate to the Consultation's preferred option (Option 1), although these points also apply in equal, if not greater force, to Option 2.

Note that in this case the "primary market" is assumed to be the current market for parody.

3.1.1 Lack of net costing and neutrality

As indicated in the description of the IA, there is insufficient evidence to indicate that either Option 1 or Option 2 would produce a cost or a benefit. Nonetheless, as indicated below, substantial space is given over to attempting to assess the benefits of the proposed changes while the costs are discussed only in passing. Apart from the issue of neutrality the essential fact remains that the Consultation, to date, has not provided evidence that the proposed change is indeed beneficial in economic terms. Indeed, the consultation itself (p.8) also refers to work by Rogers, Tomain and Corrigan (2009) pointing to both positive and negative effects of a parody exception without a decisive finding either way.

It is, therefore, not clear why Option 1 is the preferred option to Option 0. If there is uncertainty that the benefits of Option 1 do indeed outweigh the costs then the most appropriate preference would be to favour the status quo (Option 0).

3.1.2 Assumptions of market size

As indicated on p.5 of this IA, the Hargreaves Review assumed that comedy makes up 1% of the entertainment market and that a parody exception would capture 1% of that comedy market. Supporting Document EE of the Hargreaves Review itself states the following:

One conservative suggestion would be that this exception could to add between 0.01 per cent of that market from domestic improvements to 0.05 per cent if a more global success were to occur. This would translate into additional growth of between £130m per annum to £650m per annum. This may be a conservative estimate. Even if the comedy market is only worth one per cent of the global entertainment market (probably an under estimate) it is possible the UK would gain one per cent of this market with one or two successes under a comedy exception, and up to five per cent if it enabled a global hit.

It is unclear how these proportions were derived or what the reasoning process behind them was. The Consultation does not provide an independent assessment of the validity of these estimates. Instead it simply applies them.

There also appears to be a conflation of the terms “comedy” and parody here. It should be recalled that parody is simply a sub-set of comedy. Estimates based on “comedy” would, therefore, overstate the benefits to be gained from a parody exception.

3.1.3 Assumption of commercial benefits

There appears to be an implicit assumption in the Consultation that there will be significant benefits to business from the relaxation of copyright on parody.

However, it is far from clear that the development of a parody exception will provide such benefits. Three issues are relevant here:

- Market saturation and diminishing returns;
- The assumption that parody “travels well”; and
- The balance between commercial and non-commercial benefits

The Consultation would appear to assume that current regulation inhibits the growth of the market in parody. In effect, this implies that the quantity of (commercial) parody produced would be greater if only the exceptions were granted.

Likewise, this would also seem to imply that the UK has previously suffered from a deficiency in the quantity of parody produced due to copyright restrictions. However the rich tradition of British parody in all its forms – radio, TV, plays, literature and other forms - must raise doubts about this. Indeed the Consultation itself points to the UK’s “rich history of parody and satire” (p.8).

If the current output of parody is indeed already sufficient to meet consumer demand within the UK then the implementation of an exception will make little

difference to such output and will not generate the types of additional economic returns suggested by the Consultation.

As indicated above, some of these returns are themselves based on an estimate of parody's slice of the *global* entertainment market. However, parody is often culturally specific. For example, parodies of local celebrities or local public figures are common in the UK (and in many other countries) but would have little meaning to foreigners. In short parody often doesn't "travel well". Therefore, deriving an estimate of economic gain based on a global entertainment figure would not appear to be well-founded.

In the case of parody, the (preferred) Option 1 exception refers to "fair dealing". So, works which do not commercially compete with, or detract from, commercial sales of the original work would be permitted.

However, the balance between the amount of commercial parody and recreational parody which would be created is not clear in the Consultation's discussions. Under the fair dealing provisions described in Option 1, "the exception is therefore likely to permit use of a work where the parody does not compete or detract from commercial sales of the work".

Any non-commercial recreational user would then be free to produce their own parody. This could conceivably lead to more parody material being made and distributed across the internet on a non-commercial basis⁹. In combination with this, as indicated below, the development of technologies such as the internet would appear to offer the opportunity for consumers to enjoy an increased consumer surplus – in effect non-commercial parody would be providing "free" entertainment.

This increase in consumer surplus may produce (gross) positive welfare effects. However, this will not necessarily generate an increase in revenue or foster economic growth, particularly if the consumer surplus simply relates to recreational use. Indeed, if losses to rights holders' producer surplus are simply transferred into users recreational consumer surplus then this would be harmful rather than helpful to growth.

The Consultation's assumption that commercial gains must flow from the exception ignores this issue. However, as discussed further below, the fact that the internet and related technologies may, to date, have mainly impacted on consumer surplus is an issue which has been taken seriously by economists.

⁹ As indicated, the UK already has a rich history of parody and there is a standing question of market saturation on the commercial side of the market. The expectations, quality and nature of amateur parody might differ from this and arguably this leaves room for non-commercial expansion. However this in turn raises the issue of externalities – as discussed in the next section.

3.1.4 Externalities

As indicated above, an externality may occur when the interests of third parties who are affected by a purchase or use decision are not taken into account. One difficulty with the proposed exception is that the spread of parody (either commercial or non-commercial) runs the risk of generating significant (negative) externalities. In this case there is the risk of reputational externalities due to the risk of lost sales and/or reputational damage of the parties held up to ridicule.

For example, the endless parodying of Premier League referees (on either a commercial or non-commercial basis) could risk bringing the game of football into disrepute.

Externalities do not appear to be adequately handled in the IA. The discussion in relation to Option 1 (p.5) does refer to the question of “negative reputational effects”. However, it is simply argued that fair dealing limitations mean that such uses would fall outside the exception, which would “reduce” such costs. Likewise, it is argued that lost sales “are likely to be limited” as creators’ moral rights would still be protected.

However, these statements obviously imply that such costs would indeed occur. Moreover, no attempt is made to assess the size of these costs. Indeed, no attempt is made to determine how the fair use dealing would be enforced or by whom or what the costs of doing so would be, or who would bear such costs. The spread of non-commercial parody in particular could make such detection and enforcement very difficult.

Likewise, no attempt is made to assess the costs of the loss of licence fees, which are also referred to on p.5.

While cost estimates for these items are welcomed as a part of the Consultation, the failure to size such costs stands in contrast to the effort made to assess benefits. Further, an argument is made on pp.6-7 that parody could actually benefit rights holders by heightening interest in the original work. This is a questionable contention – it is not clear how being a continual subject of mockery would *enhance* the reputation of many public figures, for example. Nonetheless more space appears to be given over to arguing about this “positive externality” than the likely costs arising from the negative externalities cited above. These facts again raise questions about the neutrality of the Consultation.

Admittedly, the risk of such externalities may reduce if there is little increase in the amount of parody after the proposed changes – i.e. if the “diminishing returns” effects cited above come to pass. Conversely, if the Consultation’s implicit assumptions hold – and there is a major boom in parody – then the risk of such negative externalities increases commensurately.

The Consultation must, therefore, allow for the fact that either the creation of parody will be substantially less than is assumed under the Consultation or the fact that negative externalities will be produced. If the latter is the case, then serious consideration must be given to the size of such externalities.

3.2 Copyright exception for private copying

This Impact Assessment focuses on the relaxation of restrictions for private copying.

3.2.1 Stifling innovation and meeting consumer needs

A contention on p.6 of the IA is that the current legal position “stifles UK technological innovation and is considered unreasonable by customers”.

However, the discussion of consumer and producer surplus above should be recalled. Any price for any commodity in any market might be seen as “too high” by consumers (whether they be businesses or consumers) and/or be subjectively deemed to “stifle innovation”. Likewise, the supply restrictions could be seen as “unreasonable” by customers but this, in itself, tells us little from an economic viewpoint.

However, if markets are perfectly competitive (or if there is a justification for the prices in the primary market for copyrighted material) then there is no *a priori* rationale for change.

In essence, what is relevant is whether prices are efficient and producer and consumer surpluses are maximised. To give an example from the manufacturing industry, if aluminium were supplied free of charge to UK businesses this might also increase “innovation” elsewhere in the economy (via reduced input costs) but it would not be an efficient outcome from the point of view of the primary market for aluminium supply. Nor would it be an efficient outcome from the point of view of the economy as a whole: in effect the aluminium industry would be subsidising others - and subsidies are economically inefficient.

The key issue is that unless there is a change in the economic efficiency of the primary market (in this case the market for copyright material) then benefits elsewhere within the economy are not relevant in most cases. In colloquial terms all that is happening is a “shuffling of the deckchairs”; “innovation” benefits in other markets are simply being purchased at the expense of primary market (for copyright material).

So, transferring producer surplus into consumer surplus may not result in any economic welfare gains. Likewise, economic growth would not be fostered by simply transferring profits from one industry to another. Indeed, if the transfer is simply from producer surplus to recreational consumer surplus then growth could be harmed.

A further point is that the wording in this section also raises questions about the neutrality of the arguments being offered, as noted above.

3.2.2 iPod and Brennan cases

In considering Option 1, the IA includes a detailed discussion of the iPod experience in the United States with an application to Brennan in the UK. However its applicability in a UK context is open to serious question.

First, p.5 of the IA notes that “millions of iPods were sold before legal music downloads became available”. The IA then uses the value of iPod sales as a part of determining its “high” estimate for the benefits of reform. However, this seems incongruous. If many of the sales were made *before* legal downloads became available then a change in legislation would not produce the incremental value added suggested by the case study – precisely because these sales were made *in spite* of the legal status of downloads. So the “high estimate” of gains may well be too high - which implies the average estimate of gain is also too high.

Use of the Brennan case for the low estimate is also open to question. It is unclear if anything like the iPod experience could be repeated by a UK-based firm. Arguably, many of the potential gains from this and related technologies have already been exploited, suggesting that diminishing marginal returns may have set in. The Consultation’s halving of the high and low averages (p.10) to deal with the more limited global reach of UK firms does not appear to be based on any evidence in this regard (or appears to be nothing more than arbitrary).

3.2.3 Pricing of content

There must be serious doubts about the reasoning in the discussion of content pricing on p.10. A claim is made that because copyright infringement is widespread its costs are incorporated within the purchase price of copyrighted media.

However, advice provided to Oxford Economics from publishers groups indicates that in the case of e-books, in particular, there is no basis to this argument and that no additional allowance is built into prices to allow for piracy.

Nonetheless, it is worth considered the implications if the Consultation’s reasoning on prices is accepted. Presumably, if copyright infringement were *not* widespread then prices faced by consumers would be *lower* than is currently the case. Yet this seems to contradict the claims in many reports during recent years that prices for media such as CDs and DVDs are falling and that these falls may in part be due to widespread copyright violations.

As indicated in a recent report in The Economist magazine the average price of a CD album in Britain fell from £10.77 to £7.32 between 2001 and 2010. Not only does this represent a nominal price fall, it is almost a halving in real terms (i.e. after adjusting for inflation)¹⁰.

Likewise data supplied to Oxford Economics, sourced from the British Video Association (BVA), also suggests a similar fall in prices for DVDs and Blu-ray Discs in the UK since 2007.

¹⁰ <http://www.economist.com/node/21542438>

Table 2.1: UK DVD and Blu-ray average retail prices: 2007-2011

Year	Average DVD retail price	Average Blu-ray retail price
2007	£8.98	£19.08
2008	£8.56	£17.44
2009	£7.84	£16.20
2010	£7.80	£15.38
2011	£7.96	£14.51

Source: BVA/Official Chart Company

These declines would be even larger if measured in real terms.

While one might expect that Blu-ray Disc prices fall over time given the relatively new nature of this technology, it is not clear if this explains all of the fall and this is unlikely to explain the fall in DVD prices (or that of CDs), both of which are now relatively established technologies.

Of course, infringement may not be the only reason for these price falls. However, the clear trend is for such falls (rather than for price rises) in a context of persistent infringement¹¹.

Consequently, the claim immediately after this, that there would be no economic cost to copyright owners because purchase prices would adjust (i.e. rise) if Option 1 was implemented, is questionable. However, if prices did indeed rise then this would imply that at least some of the consumer surplus gains from the relaxation of restrictions would be wiped out. In other words, even if there is indeed no economic cost to producers – and they preserve their producer surplus in full - then this can only come at the expense of consumers.

However, in practice, the situation may be somewhat more complex than this – a point which does not seem to be allowed for in the Consultancy's description of pricing. As indicated above, the ability to impose such price rises in current markets is questionable. One issue concerns the distinction between wholesalers and retailers. In the UK major retailers are arguably the price setters

¹¹ Following the Consultation's reasoning it might still be contended that the price falls are driven entirely by *non-infringement* factors and that prices would have fallen even further but for infringement (which has acted as a countervailing force pushing prices back up somewhat). However this would be a bold claim to make and no evidence is offered by the Consultation in support of it. A simpler and more logical argument would be that competition from infringement has eroded producer margins and pushed prices down – and this is precisely the contention this paper makes.

and make decisions on what direction prices will go. They may well resist pressure for a price rise.

Further, given the competitive nature and reduced margins of the CD, downloads and DVD markets, it may well be the case that media companies holding copyright engage in cross-subsidisation and respond by putting up prices in other markets – such as those for live events where demand is likely to be more inelastic. (This might be seen as an externality). Nonetheless this would have the same effect: in essence consumer surplus would be lost due to higher prices. This does not appear to be allowed for in the discussion of net benefits for Option 1.

Pp.14-15 also make similar arguments, suggesting that producers and consumers will both benefit from private copying, with consumers being able to do more with content and producers being able to charge more. This claim is somewhat puzzling. As suggested above, rising prices should eat into the consumer surplus and if illegal copying is already widespread then (by the Consultation's reasoning) this should have forced prices for downloads, CDs and DVDs up not down in recent years. In reality, the fact that consumers "can do more with content" (i.e. make more personal copies because of a new exception) is likely to mean that there is *downward* pressure on prices through reduced sales.

The final paragraph on p.15 is likewise puzzling. If it is argued that iTunes and Amazon impose differential copying rights on users then by the logic used in the Consultation one might expect price differentiation, not uniformity.

3.2.4 Assumption of GDP gains

The emphasis on new business opportunities from private copying exceptions discussed in relation to the Brennan case should also be treated with considerable caution in a generic sense. Economists such as Tylor Cowen¹² have cautioned against excessive optimism connected with the growth of the internet and associated new technologies, pointing to the limited economic impact of such technology in measured GDP. Cowen has pointed out that much of the apparent gain arising from such new technologies has not manifested itself through an uplift to GDP. Rather, one of the major benefits has been an uplift to (recreational) consumer surplus, with the internet and associated digital technologies producing many hours of "free" entertainment for consumers. From a welfare perspective, of course, consumer surplus is important. But, as indicated, recreational consumer surplus does not in and of itself raise GDP.

This should be noted in the context of the Consultation. The Consultation has used several assumptions to develop a net benefits estimate for the proposed exception and likewise assumes that the proposed exception will spur new commercial development. Some of these assumptions have been questioned

¹² Cowen, T. (2011) *The Great Stagnation*

above. However, a broader question relates to the underlying assumption that the benefits of the exception will indeed accrue to commercial entities. It is entirely possible that the great majority of the benefit from relaxed legislation will simply accrue to recreational uses rather than spurring “innovation”. So the underlying assumption of the Consultation that it will simply be reflected in higher business revenues (and ultimately in GDP) is questionable. Given that the focus of the consultation is on fostering economic growth this is an issue that requires serious reflection.

3.2.5 Foreign vs. national benefits

A further issue is whether any business-related gains will ultimately stay within the UK (or indeed would be based in the UK in the first place). No allowance appears to have been made for the fact that innovative UK companies may simply be bought up by American or other entities.

How much of the human and physical capital would then stay in the UK is a moot point. A purchase of innovative companies may be economically efficient in a global sense, reflecting the best use of global resources (including the best application of economies of scale) and the respective comparative advantages of the UK and other nations. (The Consultation itself may obliquely suggest this by halving the average of the high and low value added estimates (p.9) to reflect the prospects of a *British* firm creating a successful device on the global stage.)

However, it is not quite clear if this is the outcome the Consultation (or the UK government) has in mind. While the UK, like most other developed nations, is a strong supporter of free trade, recent years have also seen concerns about the need to build up the country’s knowledge-based industries as well as the outflow of technical and innovative talent. This raises a number of complex issues about the balance between pure free trade and preservation of intellectual capital. It also raises questions about the nature of the growth that the Consultation is intending to foster. For example, is the Consultation (or the government in general) comfortable with the idea that innovations developed within the UK (and/or innovative UK companies along with their human capital) might ultimately be “sold off” to overseas entities, albeit for some agreed consideration? Regardless the merits of these arguments the Consultation does not appear to recognise the existence of these issues in the first instance.

3.2.6 One in one out estimate

This suffers from the flaws identified above, including the use of Apple accounts when some of these revenues would have accrued through copyright violations, the somewhat arbitrary halving of the estimates and the implicit assumption that benefits will be reflected in business outcomes. The assessment of gross business benefits from “innovation” in what appears to be a secondary market ignores the impacts on both consumer and producer surplus in the primary market for copyright materials – which should be the focus of the analysis.

3.3 Extend exception for copying for research and private study

This IA focuses in relaxation of exceptions for research and private study.

3.3.1 Lack of net costing and neutrality

No net costing is provided for this exception. In particular, the Consultation has been unable to fully quantify costs. As indicated above, where a net costing is not provided, there is no good basis for suggesting a change to the status quo. Yet in spite of this Option 1 is preferred to Option 0.

3.3.2 “Missed opportunities” and rationale for change

The discussion above has pointed to the fact that economically efficient outcomes do not generally arise when commodities are suddenly “free of charge”. The Consultation suggests that a do-nothing approach would result in “missed opportunities” for researchers and from the development of new products.

Judging from the discussion in the text, the reason for this is apparently technological change. However, technological change, in and of itself, does not suddenly mean that rights holders should not be protected. It does not mean that commodities should suddenly be “free” or that current arrangements are economically inefficient. Moreover, by the same token, one could argue that current pricing and administrative arrangements in other industries also result in “missed opportunities” for their existing or potential customers.

Presumably the implicit argument is that a deadweight loss associated with current copyright arrangements has developed or increased in size due to technological change. Likewise, this change presumably means that the costs of the status quo now outweigh the benefits of preventing “market failure” (which would see rights holders’ works freely copied).

However, these contentions are nowhere explicitly stated. The fundamental rationales for copyright remain unchanged and simply citing the argument that other industries “miss out” due to existing arrangements does not provide an adequate reason for change. As previously indicated, solid economic rationales must be given for such a change to the status quo.

3.3.3 Treatment of costs

Connected with the above, the Consultation is unable to make any assessment of the costs to rights holders. It seeks evidence of such costs as a part of the consultation. As indicated, in an environment where costs and benefits cannot both be assessed and weighed against each other it is odd that the preferred option should be the overturning of the status quo.

Likewise, p.6 makes the point that the incremental impact of technological workarounds on costs might be minimal in the event of an exception because such unlawful workarounds might already be in place. This could be true in a purely technical sense. However, it is interesting that the emphasis is on

ignoring the costs of current copyright violations by arguing that this activity be legalised. An argument could equally well be constructed focussing on the costs of the current violations to rights holders and asking whether greater efforts are justified in trying to halt it.

This last point relates back to the question of efficient markets and the onus of proof in the Consultation – if the current arrangements are indeed efficient such a question would be entirely justified. A justification for the *inefficiency* of current arrangements must therefore be given.

Further, as the Consultation then acknowledges, there may well be increased costs with increased infringement if the technological protection is removed. More broadly the Consultation admits (but does not cost) the potential revenue losses to rights holders

3.3.4 Openness to abuse

Taking up the point immediately above, the Consultation recognises that the exception holds the potential to be abused. Judging by the rate of copyright theft within the general community (including students) this potential could be very large indeed. However, this issue appears to be dealt with in passing. Further, no attention is given to the cost of preventing such abuse. The implication is that the increased abuse will simply be tolerated (at rights holders' expense) with no attempt to stop it (or alternatively that the costs of policing are simply omitted).

3.3.5 Consumer surplus, producer surplus and growth

The proposed exception holds the potential to increase consumer surplus; consumers will have freer access to copyright material, lowering the effective cost of accessing such material. This could be channelled into commercial pursuits (ultimately increasing the productivity of the economy as the Consultation suggests) or simply be channelled into non-commercial, recreational ones.

In simplistic terms, if the consumer surplus increases, some of this will come at the expense of producer surplus. In a direct sense there will be the loss of licence fees while there could be indirect effects such as the losses generated by increased infringement. The Consultation acknowledges these costs to producers (albeit in passing). These will offset the welfare gains to consumers (at least to some extent). However, it should be noted that not all of the gain in consumer surplus will necessarily result in increased productivity. As indicated, some of it might simply be channelled into recreational uses. This gain in recreational consumer surplus will come at the expense of a reduction in the producer surplus of rights holders.

The practical effect of this is that even if there is a *welfare* gain from the proposed measures this is not necessarily to say that there will be a productivity or GDP gain from such measures. As previously indicated, if the transfer is simply from producers to recreational consumers then growth could actually be harmed – as recreational consumer surplus does not enter into GDP. Even if

only some of the gains are attributable to recreational consumers the impacts on growth may be ambiguous at best.

Much, therefore, depends on how significant the recreational/non-recreational consumer surplus balance is - an issue that the Consultation does not appear to address. This would appear to be an oversight given the Consultation's growth-focussed emphasis.

3.4 Exception for copying of works for use by text and data analytics

This Impact Assessment focuses on the relaxation of restrictions for text and data analytics.

3.4.1 Lack of net costing and neutrality

No net costing is provided for this exception. In particular, the Consultation has been unable to fully quantify costs. As indicated above, where a net costing is not provided, there is no good basis for suggesting a change to the status quo. Yet in spite of this Option 1 is preferred to Option 0.

3.4.2 Consumer surplus, producer surplus and growth

The points made in the above discussions with respect to the trade-off between consumer and producer surplus apply with equal force here, as does the point about the extent to which a large proportion of that consumer surplus may simply be recreational. The IA refers to the initial benefits of Option 1 to non-commercial researchers but then holds out the possibility that commercial benefits may occur "to innovative companies and the economy" (p.5).

As the Consultation itself admits, the scope for such benefits is unclear. Against this commercial uncertainty is what appears to be a near certainty that "electronic publishers would forgo some opportunities to license access to their copyright materials of text/data mining purposes".

This again raises the question of whether the proposed measures could, in fact, harm economic growth, as producer surplus is simply transferred into recreational consumer surplus.

Moreover, data provided by The Publishers Association to Oxford Economics refers to survey evidence showing that 90% of publishers routinely permit content mining, with 60% doing so in all cases. Only 12% of requests are turned down on the basis of questionable applicant bona fides.

Should the exception be implemented, however, the ability of publishers to verify the bona fides of text miners could be comprised. This raises infringement issues. Another issue relates to the fact that the UK would be the only country in the EU to institute such an exception – which may reduce the desire of publishers to publish research based on contracts under UK law, given the increased level of risk.

Both of these matters again raise the potential for negative impacts on rights holders' producer surplus. When matched against the uncertain commercial benefits of the exception, this reinforces concerns about whether economic growth could, in fact, be harmed by the proposed exception.

3.5 Copyright exception for archiving and preservation

This IA focuses on providing a copyright exception of archiving and preservation.

3.5.1 Lack of net costing and neutrality

No net costing is provided for this exception. In particular, the Consultation has been unable to fully quantify costs. As indicated above, where a net costing is not provided, there is no good basis for suggesting a change to the status quo. Yet in spite of this Option 2 is preferred to Option 0.

3.5.2 Estimation of benefits

Pp.6-8 of the Consultation provide estimates of the unit cost benefits arising from this exception.

However, the precise reasoning process used here is somewhat unclear. It is argued (p.7) that a large number of film, broadcast, sound recordings and other works will need to be preserved at some point and that this will involve copying. British Library data are then used to infer that 73% of works could potentially remain in copyright. This proportion is then applied to the BBC Archive (2 million works) to provide an example of the benefits of avoiding the need to clear such work.

However, the ratio of 73% is itself based on adding the 57% of works known to be in copyright to the 16% of works of unknown status. In other words, it is assumed that all of the works of unknown status are indeed in copyright. No reasoning is provided here - it could just as well be argued that none of the works which are under copyright would be so, in which case the correct ratio is 57%.

Further, it is not established if any of the 73% of British Library works assumed to be under copyright had, in fact, already been copied with the permission of the rights holders under existing legislation. If so, then this also points to the fact that ratio of 73% may be too large.

The application of this assumed ratio of 73% to the BBC Archives is also questionable. The two archives comprise of very different materials. A similar issue arises when the ratio of 73% is applied to museums and galleries (p.10).

3.6 Extending copyright exceptions for Educational Use

This IA focuses on extending the copyright exception for educational use.

3.6.1 Rationale for change

P.13 indicates that a 1% copying limit may have “little value in practice” and provides various examples such as poems and newspaper headlines where copying 1% may have little practical value. However it is not clear why this is any more or less true in 2012 than it was in the past, as poems and newspaper headlines are not new developments. This would seem to imply that past decisions on the 1% copying limit (the “reprographic copying limit”) were fundamentally flawed. If this is the contention it should be clearly stated.

3.6.2 Lost sales and enforcement

Several of the proposed Options refer to the fact that there would be no lost sales under the proposed measures. Option 1 states that uses would continue to be non-commercial, while Option 2 (p.14) refers to the “fair dealing” provision, whereby copies would be “incapable” of competing with commercially available copies. Option 3 refers to releases over secure networks with the with no costs to rights holders “assuming file sharing does not happen”.

As suggested above, society’s experiences with respect to various forms of copyright theft or infringement are not encouraging in this regard. There is no acknowledgement of the potential for this, nor is there any indication that the potential costs of enforcing such measures have been allowed for.

3.6.3 Potential reduced incentives to create

The Consultation acknowledges that the reduction in income from educational licensing schemes may reduce the incentive to create and publish new works. However, it is stated that the US and some EU states already permit copying without licences “and there appears to be no evidence that this has reduced incentives to create new works in those countries” (p.19). It is not clear what the basis of this statement is. A formal econometric study and/or other industry statistical data might one basis for this statement. However no such evidence is offered.

4 Conclusion

The above analysis has provided some commentary on specific aspects of the Consultation and the need to base such studies on a robust economic framework.

These comments contain a number of interrelated points. As indicated above, it is important to take account of the interests of both consumers and producers when undertaking a Consultation of this nature and the approach taken should be one based on neutrality between these parties. Where costs or benefits cannot be fully assessed the status quo should be preferred until a convincing case for change can be made.

Moreover, it is important to distinguish between economic welfare and economic growth. Some of the changes proposed by the Consultation may impact on economic welfare. However it is not clear that they will promote economic growth, as losses to existing rights holders may simply translate into recreational consumer surplus gains. Given that the focus of the Consultation is on economic growth this is an issue which requires closer scrutiny if appropriate conclusions about the proposed changes to copyright legislation are to be made.

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