ON THE RELATIONSHIP BETWEEN ANTITRUST AND COPYRIGHT LAW: ECONOMIC versus MORAL RIGHTS

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Abstract

The paper examines the interaction between copyright and antitrust laws with special emphasis on the distinction between economic and moral copyrights. The analysis finds that the validity of economic copyrights can depend on an effective antitrust law in cases where copyrights are only justifiable if antitrust law can guarantee that the monopoly power in copyright is not abused (at a level where welfare would be less than that which would arise in the absence of copyright enforcement). In contrast, the analysis highlights that moral rights rely on a very different economic model than that normally applied to antitrust and economic rights. In particular, authors who care about status and reputation can cause a ratchet effect to occur. If status is governed by authors comparing the price of their works or the value of their relative publishing deals then market price tends to ratchet upwards – even beyond the monopoly price. If, alternatively, status is driven by ranking in unit sales charts prices tend to ratchet downwards. The analysis indicates that if the appropriate economic model is employed then antitrust law becomes even more effective when moral rights values matter (alongside economic right values) than in the more standard case analysed in economics, namely a welfare model underpinning pure economic copyrights. An empirical issue remains as to whether creative artists behave more in line with the economics of economic or moral copyrights.
For economics readers it is important to point out that a common taxonomy in legal studies and more importantly practice is to divide copyrights into what are termed ‘economic’ and ‘moral’ rights (for example, Cornish 1996, and Vaver 1999). Economics rights are assumed to be based on values associated with utility based welfare maximisation while moral rights are believed to be derived from values associated with individual liberties. Thus, in practice a view prevails where economic analysis is perceived to be fundamental to the interpretation of an appropriate application of economic rights but of peripheral relevance in the case of moral rights. Thus, within copyright law itself there is potential for conflict between economics and non-economics objectives. We investigate this claim below. Section 2 focuses on the economic right and section 3 examines moral rights. The findings and implications of the analysis are summed up in a concluding section.

2. **Antitrust and the Economic Copyright.**

The economic right is motivated in order to overcome market failure problems associated with loss of creators' income due to unauthorised copying. This practice reduces the potential income that creators may derive from the generation of new intellectual property. It also places creators at a competitive disadvantage in relation to imitators who may sell copies of their work. A creator has to cover the fixed costs of producing a new work while an imitator is not burdened by these costs. Therefore, an imitator can offer copies at a price which is profitable for an imitator, but which is less than the break-even price for the creator. The more prevalent unauthorised imitation becomes, the greater the financial disincentive for a creator to produce new works in the first instance.

We can depict this as follows. Suppose a creator's profit function is represented by

\[ \pi_i = p_i (q_i, g, v) q_i - c q_i - F \]  

(1)

where \( p_i \) is price which is negatively related to output \( q_i \) and the supply of substitute products \( g \) but is positively related to market power generated through copyright law, \( v \).
From society's point of view too much resources may be devoted to the creation of new works. Salop (1979) has demonstrated this point in relation to product differentiation innovation by observing that the fixed costs of creating a new work may exceed the net benefit of that work to consumers. Thus, in this case the application of copyright law which in turn increases creative output would not be justifiable from an economics perspective.

To illustrate, let $W_i$ and $W_{-i}$ represent the welfare of society when creative work 'i' is and is not produced respectively.

$$W_i = u_i(\pi_i(p)) + U(\Pi(P)) + S(P) \quad \text{if } u_i(\pi_i(q_i(v))) \geq 0 \quad (3)$$

or

$$W_{-i} = U(\Pi(P_{-i})) + S(P_{-i}) \quad \text{if } u_i(\pi_i(q_i(v))) < 0 \quad (4)$$

where $U$, $\Pi$, $P$ and $S$ are vectors of other creators' utility ($U$), other creators' profitability ($\Pi$), the price and existence (represented by the elements of the vector) of work 'i' and related products ($P$), and consumer surplus ($S$). $P_{-i}$ denotes the price and existence of other products when work 'i' is not created. The difference between the welfare that results when work 'i' is created than when it is not, is represented by equation (5).

$$W_i - W_{-i} = u_i(\pi_i(p_i)) + [U(\Pi(p)) - U(\Pi(p_{-i}))] + [S(p) - S(p_{-i})] \quad (5)$$

A necessary condition for the application of copyright to reproductions of work 'i' is that equation (5) must be positive. The three terms in equation (5) demonstrate the welfare effects of creating work 'i'. The first term is the utility derived by the creator. By definition, this must be positive otherwise work 'i' would not be produced in the first place - copyright law aims to ensure that this is the case by raising the price the creator can expect to get for reproductions. The second term denotes the sum of competition and complementary effects of a new work on other firms. If the new work 'steals' business away from other firms (cannibalisation) this causes a reduction in their welfare. On the other hand, the second term may be clearly positive if the creation enhances the profitability of other firms. This is the case when it complements their business.
hence utility from producing. Secondly, higher marginal costs, $c$, cause an increase in price and hence an increase in allocative inefficiency. If these costs are significant they can eliminate copyright as a solution to public good market failure. In the case of music performance rights, transactions cost can be reduced by collective licensing which enables economies of scale in policing, monitoring, contracting and enforcing copyright. Similarly, electronic copyright management systems (ECMS) may be necessary to justify the adoption of copyright by reducing transaction costs. However, if they sufficiently reduce information goods' public good characteristics, they can eliminate the need for copyright altogether (see Dam, 1999).

However, assuming that equation (5) is positive, so that the creation of a reproduction right for creative work ‘i’ is justified, then as long as equation (2) is positive there is still scope to enhance economic welfare still further. In this instance, the creator is being overcompensated and there is scope to enhance welfare by increasing dissemination of the creative work. The problem becomes one of maximising the lagrangian

$$L(p_i) = u_i(\pi_i(p_i)) + U(\Pi(P_i)) + S(p_i) + \lambda\left[ u_i(\pi_i(p_i), \gamma, A, \omega) \right]$$  \hspace{1cm} (6)

where welfare maximisation implies that as long as the creator is earning some supernormal/monopolistic rewards it is possible to reduce price and raise welfare. Economic welfare is maximised by a unique price, $p_i^*$, which for a downward sloping demand schedule is defined by

$$u_i(\pi_i(p_i^*), \gamma, A, \omega) = 0$$ \hspace{1cm} (7)

The creator’s profit $\pi_i(p_i^*)$ in equation (7) is in fact the economics interpretation of terms such as ‘fair’ and ‘reasonable’ compensation used in copyright laws. The ‘fairness’ is defined within an economic welfare context. Fair compensation ensures that creators receive sufficient income in order to be inspired to create but not a surplus above this
implies that one must address the issue of legal design in order to adjudicate on the desirability of establishing copyright law in a particular case.

Frequently, it is claimed that competition law is in conflict with copyright law. For the most part, this is a misunderstanding of the economics of these laws. Competition law will tolerate the existence of market power when it is in the public interest and devotes its wrath towards the abuse of such power. Thus, for example, Article 82 of the EC Treaty does not ban the existence of a dominant position, merely the abuse of a dominant position. Similarly, Article 81(3) is willing to tolerate the creation of market power when it is an inevitable feature of wider economic actions which in turn enhance economic welfare.

The economic right in copyright law parallels these approaches. It creates market power by assigning an exclusive right to creators because it views this as a necessary condition to enhance economic welfare (the benefits to society of new creative works). However, it then places a restriction on the abuse of this market power by introducing clauses relating to compulsory licences and fair prices.

Thus, both laws tolerate the existence of market power when it is a necessary side effect of achieving higher levels of economic welfare. Subsequently both laws place restrictions on this market power in order to ensure that unnecessary reductions in economic welfare do not occur. In sum, these laws are quite complimentary.

Thus, for example, if the economics underlying Articles 82 and 81(3) of the EC Treaty were applied to the above example they would yield the same regulatory price, $p_r^*$. The existence of market power is viewed as a necessary condition in order to have the capability of covering fixed costs (including R&D) and give the creator a fair return. However, competition law prevents the creator from abusing the monopoly in the copyright when it is against the public interest. In other words, in economically

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7 See Burke (2000) and Audretsch, Baumol and Burke (2001) for relevant analyses dealing with the overlap of antitrust law, innovation and intellectual property rights.
infringement is desirable in order to both disseminate the benefits of creative works to consumers, as well as securing a more competitive price for consumers who buy from the creator. One application of this approach would allow some forms of (unauthorised) reproductions which reduce creators' income but where the transaction costs of licensing and enforcing these rights would be excessive. In other words, these acts of reproduction would have no justifiable economic significance because enforcing copyright would cause a reduction in economic welfare. Note that in the case of a region or market which has no culture of respect for intellectual property rights that these transactions costs may appear excessive if calculated during the early period when creators entail significant enforcement costs in order to establish a conducive culture to IPRs.

An alternative but similar indirect approach is to enforce copyright completely in a given set of markets for an information good but to allow free use in other markets. This is implicit in the approach adopted by Deardorff (1991) who examines this from the perspective enforcing patents across geographic markets. Deardorff demonstrates that if IPR owners can charge a monopoly price for their output then welfare can be enhanced by allowing free use in some markets. This result of course precludes parallel importing which would limit, if not eliminate, the scope for what is in effect geographic price discrimination.\(^9\)

Closely related to these models is the strategy of allowing free use in a proportion of markets within a particular geographic region. In legal terms, this is sometimes referred to as 'fair use'. For example, Britain's decision not to adopt a blanket tape levy or the Court's ruling in *Twentieth Century Music Corp. v. Aiken*\(^{11}\) in the USA which effectively eliminated music performance rights in the case of some radio performances in retail outlets. The welfare effects entail a form of price discrimination as one set of consumers

\(^9\) The impact is similar to Landes and Posner to the extent that a set of consumers benefit by having free access to creative works. However, it differs to the extent that the free provision of creative works in some markets does not cause the creator to price more competitively in markets where copyright law is enforced.

\(^{10}\) Fair use is also applied in circumstances where transactions costs are prohibitive. In this case, the costs of enforcing copyright are so high to cause economic welfare to be lower than that which would occur if consumers were allowed free use.

\(^{11}\) *Twentieth Century Music Corp. v. Aiken* [422 U.S. 151, 157 (1975)].
Thus, in sum the welfare economic analysis of the economic right does not find a conflict between antitrust and copyright laws both in general terms and given the various regulatory means through which welfare optimal prices are achieved. In contrast the justification for the existence a valid copyrights in a range of markets, where the net welfare benefits of copyright are marginal, may hinge on the coexistence of an effective competition law.

3. **Antitrust and Moral Rights.**
To varying degrees, copyright laws have attempted to protect the reputation of authors by creating some or all of the following moral rights for an author to

(1) be explicitly acknowledged as the author of her work;
(2) prevent false attribution;
(3) decide when and if her work should be published;
(4) determine the manner in which her work may be published;
(5) determine the form of adaptations of her work;
(6) prevent criticism of her work;
(7) withdraw her work from public access.

Of course, not all legal jurisdictions protect the author to the same degree; moral rights receiving less support in common law countries. In general, most legal jurisdictions including international agreements, such as the Berne Convention and the TRIPS Agreement protect rights (1) to (5) above.

Moral rights are motivated by values which are not usually emphasised in economics. Most economics analysis is either a close variant of Harberger’s (1971) sum of producer and consumer surplus. Adaptations often account for production and consumption externalities, transactions costs and Leibenstein’s (1966) x-inefficiency. Moral rights are not inconsistent with this framework but necessitate further augmentation. In order to
analysis is able to shed more light on this interpretation of Locke. In fact, it indicates that the extension of Locke’s notion of property rights to intellectual property implicitly allows for the limitation of these rights through price regulation. In other words, as long as an author charges a price in excess of the marginal cost of a copy then as long as demand is responsive to price it follows that allocative inefficiency will exist. In this case it is clear that the author is ‘taking more than she can use’. In other words, she is using her copyrights in order to ensure that a proportion of the consumer population do not gain access to copies of her creative work. Since these consumers are willing to pay a price which is in excess of the marginal cost of supplying them this refusal to supply is clearly wasting the potential fruits of the author’s labor. The economics depiction of allocative inefficiency clearly illustrates that this is waste in a Lockean sense. This point is underlined by the fact that allocative inefficiency is frequently referred to in the economics literature as a ‘deadweight loss’ as the supplier (in this case the author) is not able to appropriate this loss to consumers. It is in fact a complete loss to all in society.

Of course, the reason authors (and their publishers) are willing to cause allocative inefficiency is because it is a necessary side effect of the practice of monopolistic pricing. Thus, in a bid to maximise profits authors must effectively waste (in the Lockean sense) some of the fruits of their labors. The process is identical to the reasoning why farmers sometimes destroy crops in a bid to promote higher prices. The procedure is profitable because the extra profits derived from the resulting higher prices more than offsets the loss of revenue from choosing to waste output which consumers would be willing to buy. Thus, the ramifications of translating the Lockean argument for property rights to economics analysis is to demonstrate that authors rights, as justified by Locke’s Treatise, must be created in conjunction with a legal capacity to regulate the price of copies when pricing is deemed to cause a waste (in terms of a loss of consumer benefit) of the fruits of the author’s labor.

This argument is in strong contrast to the view frequently taken that Locke’s belief that the author is entitled to the fruits of her labor implies that price regulation of copyright whether stimulated by the economic right (or the incursion of antitrust law) is by
the motivation for moral rights has ignored the dual concern with public interest but in fact also shows that it is actually inspired by similar concerns to that which motivated subsequent antitrust laws. Thus, again, serious doubt is cast over whether author’s rights were ever intended to be absolute rights. If this is the case then a degree of enforcement can be envisaged which trades-off the objectives of the author’s right with the public interest and in consequence we enter familiar territory for economic welfare analysis. Namely, the issue becomes one of embodying moral rights values in welfare optimization rather than treating it as separate and incompatible optimization challenge\(^{16}\).

We now turn to moral rights justified by the work Immanuel Kant who argued that a creative work is an extension and representation of an author’s unique personality. The creative work could be viewed as the physical embodiment of the author’s personality. Therefore, respect for the creative work is synonymous with respect for the author\(^{17}\). Correspondingly, injury or insult to the creative work is respectively injury or insult to the author. Thus, as Rose (1993) argues, the moral right of the author is about propriety rather than property. Furthermore, he argues that in France the moral right preceded the economic right and clearly emphasises an interest in the status and reputation of authors\(^{18}\).

\(^{16}\) Of course, from a price regulation perspective, competition laws have not attempted to interfere with the duration of copyright. Their main impact has been in terms of affecting the ‘fruits of a creative artist’s labour’ by attempting to increase the competitiveness of the price charged by artists. The price and hence revenue generated by an artist for her work is very much governed by the fiscal regime alongside a range of factors in a demand function. Many of these are influenced by policy actions right from macroeconomic monetary and fiscal policy through to industrial and enterprise policy and onto antitrust and copyright law (direct and indirect) regulation of price. A claim that competition policy is in breach of moral rights because it affects the income of artists would simultaneously need to claim that moral rights imply an immunity from state interference with artist income that has neither resulted at any time from the legal practice of moral rights and simultaneously would so restrict government action as to effectively paralyse it from most libertarian based activities envisaged by Locke. The same interpretation would restrict the freedom of agents in the same and related (upstream, downstream and substitute) markets to seek to secure the fruits of their labour through normal and welfare enhancing commercial activities – thus again in conflict with Locke’s libertarian depiction of society. Clearly, and even apart from the reasons already outlined outside of this footnote, moral rights cannot be viewed as being absolute within the libertarian doctrine outlined by Locke.

\(^{17}\) Hence the view in France which holds that moral rights are indeed intangible and hence cannot be transferred or waived (as in US and Britain).

\(^{18}\) “My argument suggests that the author was recognized as an individual with an interest in the status of his name and reputation before he was recognized as a fully empowered figure in the marketplace.” P.18, footnote 3, Rose (1993), Authors and Owners: The Invention of Copyright, Harvard University Press, MA.
nation with the longest duration. It seems, therefore, that whether due to successful rent seeking behaviour on the behalf of publishers and authors or a strong commitment to authors’ personal rights, that the public interest objectives of the economic right played a subsidiary role in the framing of new copyright law.

However, the fact that the duration of copyright is attached to the author’s life at all implies a prerogative to protect personality of the author. The fact that these rights extend beyond the life of the author and that these rights are assigned to heirs appears to raise arguments of associated reputation and status for the author’s family just as Hansmann and Santilli (1997) argued that such attributes of the author could be assimilated by society’s culture.

It is very clear that the main motivation for moral rights is an individual right. However, authors such as Hansmann and Santilli (1997) and Vaver (1999) show that public interest arguments can be made in favor of moral rights. These are akin to the public benefits which emanate from trademark law. Vaver (1999) argues that ‘truth in marketing’ is promoted in moral rights given that they ensure that a work attributed to a particular author is indeed the work of that author. Thus, the consumer is better informed of the quality of a work and indeed the author has an interest in producing works of a high standard in order to build up a reputation for high quality. Therefore, similar to the reasoning in Akerlof’s (1970) market for lemons, effective moral rights can reduce uncertainty over quality in a market for creative works and thereby increase the incentive for authors of high quality works to supply the market – thereby promoting the public interest. Hansmann and Santilli (1997) argue that upholding the reputation of the author has a further benefit in that it maintains the value of other copies of the author’s work. Thus, a reduction in an author’s reputation (for example, due to confusion between authentic and fake copies or through defamation caused by alteration of copies of an author’s work) would not only negatively affect the author but also the value of copies of the author’s work owned by other consumers. Furthermore, they argue that if the perceived value of a society’s culture is closely intertwined with the status of an author then damage to the author’s status is also denigration of the reputation of the associated
the rise in relative popularity has decreasing positive effects on her utility. Thus the author's optimal price for work $i$ is defined

$$U_i'(p_i) = U_i'(\pi_i'(p_i)) + U_i'(q_i'(p_i)/Q) = 0$$

(2)

Therefore, as long as $U_i'(q_i'(p_i)/Q) < 0$ when $U_i'(\pi_i'(p_i))$ is equal to zero, then the impact of status can cause the author to set a price lower than the profit maximum. Now given that the vector $Q$ is determined by a vector prices of copies of these works, it follows that there is dual effect in terms of price competition where a reduction in the price of other works not only tends to cause author $i$ to reduce the price of her works in order to optimise $\pi_i$ (i.e. the normal price competition effect) but in addition there is a stimulus to reduce price in a bid to maintain status.

In this framework status and reputation performance measures such as position in sales charts have an important bearing on the utility of artists and their behaviour. Thus, an artist may be willing to drop the price of her product in order to secure a higher placing on the weekly charts – this effect is independent of motivations to do similar actions in order to generate publicity and hence future sales. This type of dynamic is positive for consumers as they benefit from lower prices but it can put authors and publishers in conflict with one another where one seeks to maximize profits while the other is willing to trade off lower profits for greater status and reputation.

Case 2: status dependent on sales price.

The utility function is the same as in case 1 except for the fact that the second component now has relative prices instead of sales.

$$U_i = U_i(\pi_i(p_i), p_i/P)$$

(3)

In this case the utility optimal price of work $i$ is defined as

$$U_i'(p_i) = U_i'(\pi_i'(p_i)) + U_i'(1/P) = 0$$

(4)

It follows that as long as $U_i'(1/P) > 0$ when $U_i'(\pi_i'(p_i))$ is equal to zero the author can feel stimulated to charge a price higher than the monopoly price for work $i$. It, therefore,
relative to those received by other artists can generate the same ratchet effect for an advance on royalties.

In fact, there is a ratchet effect implicit in all three cases examined above. In the first case, it is to the consumers' advantage in that it can cause artists to offer increasingly competitive prices in a bid to secure a higher placing on weekly/monthly/annual sales charts (of course, monopolistic publishers can prevent this effect occurring). In the second and third cases, a desire for status causes downstream consumer prices to gradually be forced upwards. This happens directly in case 2 where authors seek to enhance their status by charging higher prices for their works than competitors. In case 3 they do so indirectly by securing more advantageous royalty rates (which causes downstream suppliers to reduce supply) and/or advances on royalties (which must be recouped from consumer revenues).

In this setting antitrust intervention in the market can have a greater impact on economic welfare than that possible when only economic rights values are considered. As normal, a reduction in price (or royalty rate) below a monopolistic level has the direct effect of enhancing welfare in the market. However, a second welfare gain is unleashed in that the reduction price (royalty rate) implies that status of the non-regulated artists increases – as a result of now having higher relative prices – and hence at the margin if price is above the monopoly level (for the reasons explained above) they will be incentivised to trade-off lower prices for greater financial returns. If price is already below the monopoly level then the competition between artists should cause prices to decline (or in the case of royalties enable publishers to gradually negotiate lower royalty rates). Obviously, this latter effect will be enhance the degree of competition in the artist market which not only depends on rivalry at any one time but also the degree of turbulence in terms of the popularity of individual artists.

However, in addition to this enhanced impact of antitrust on welfare it is important to highlight that effective indirect (e.g. through reduction in barriers to entry or prevention of firm strategies designed to reduce firm rivalry) or direct antitrust price regulation can
can be generated by an infinite number of scalar values). Thus, cumulatively we find that antitrust price regulation of moral copyrights is consistent with the values promoting the creation of moral copyrights in the first instance. Furthermore, if these moral rights values are indeed important at an empirical level the paper highlights that antitrust price regulation is likely to be even more welfare enhancing than that possible in a world where only the values underlying economic copyrights apply. Most notably, *ceteris paribus* it can prevent an underlying tendency inherent in artists’ desire for status and reputation, to gradually cause a ratcheting upwards of artists royalty rates and advances as well as the price of their creative works. It is clear that empirical research is required in order to ascertain how important status and reputation really are for artists, how it affects their behaviour and which of these effects dominate. However, the paper highlights that there is more consistency between the values and objectives of economic and moral copyrights and antitrust law than is frequently suggested by some legal practitioners.


