

SOME REMARKS ON BARGAINING POWER, INNOVATION, AND 21ST CENTURY COPYRIGHT LAW

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ABSTRACT. This short article, which is my Keynote talk from the 2023 SERCI annual congress, explores and discusses some of the main issues and questions that arise when one thinks about the role of copyright. We discuss why it is needed and the relevance of transaction cost. We then explore the question of what the optimal nature of copyright is and how to go about addressing that. We discuss the crucial role of bargaining for copyright policy and optimal copyright.

1. INTRODUCTION

In exploring the relationship between asymmetric bargaining power, the speed of innovation, and the need for “optimal” copyright law in the 21st century, we first address the obvious: Why Copyright?

The renowned economist Douglass North asserted that “institutions are the rules of the game – that is, the humanly devised constraints on behaviour.” (North, 1990). Applying this perspective to the realm of intellectual property, particularly copyright, raises pivotal questions about the incentives that drive innovation, creation, and production. Glynn Lunney’s insights, as discussed in his talk at this congress “Transforming Copyright”, further emphasize the transformative potential of copyright in shaping these incentives.

At the core of the discussion lies the necessity for creators and innovators to obtain the permission of copyright owners. This prerequisite, while seemingly straightforward, prompts a deeper examination of the underlying dynamics. The allure of incentives to

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innovate, create, or produce is certainly a powerful motivator, yet it raises a critical question: does the current copyright framework adequately address the distribution of rents from the value or utility generated by the creative work?

On the surface, the idea of needing permission from copyright owners appears reasonable and necessary. However, the broader impact on the distribution of rents derived from the value of the work warrants closer scrutiny. How does this distribution affect overall efficiency, encompassing the size of the value generated and the incentives for further innovation, creation, or production?

Efficiency, in this context, extends beyond the mere existence of copyright laws and delves into their optimization for the contemporary landscape. As one navigates the complexities of asymmetric bargaining power and the rapid pace of innovation, it becomes imperative to assess whether the current copyright framework strikes the right balance. Does it encourage innovation by adequately rewarding creators, or does it inadvertently stifle progress by disproportionately favouring certain stakeholders?

In this Keynote talk, I will briefly aim to discuss the interplay between copyright law, incentives, and efficiency. By critically examining the distribution of rents and its impact on the overall ecosystem, one seeks insight into the formulation of an optimal copyright framework for the 21st century – one that fosters innovation, accommodates diverse interests, and stands the test of time in an era marked by unprecedented advancements and challenges.

2. COASEAN EFFICIENCY AND COPYRIGHT: THE LANDSCAPE OF FRICTIONS AND RIGHTS

The Coase Theorem, conceptualized by Ronald Coase, often regarded as the Father of Law and Economics, serves as a pivotal lens through which we examine the dynamics of efficiency, property rights, and the role of copyright in the 21st century.

At the heart of Coase's contributions are two key papers, with the 1960 *Journal of Law and Economics* paper titled "On the Problem of Social Cost" standing out as a seminal work, giving rise to the Coase Theorem (Coase, 1960). The Theorem posits that,

provided property rights are well-defined, clear, and enforceable, and there are minimal frictions in the system, efficiency can be achieved regardless of the initial distribution of rights. This efficiency is facilitated through costless bargaining, a state where asymmetry of information, commitment problems, externalities, and other impediments are absent. All relevant parties are presumed to be at the bargaining table, with full knowledge of the possible states of the future world, creating a scenario where the entire “state space” is known.

In the Coasian world, the theoretical framework implies that, under these ideal conditions, there is no real role for copyright. The efficiency achieved through costless bargaining seemingly eliminates the need for legal constructs like copyright to regulate the use and distribution of creative works. The question that naturally arises is: Why would copyright, a fundamental tenet of intellectual property law, be seemingly obsolete in a Coasian environment characterized by perfect information and frictionless interactions?

However, this seemingly straightforward conclusion comes with a significant caveat. The Coase Theorem operates within the realm of idealized conditions – clear property rights, enforceability, and absence of frictions – which may not perfectly align with the complex realities of the creative and innovative landscape.

Exploring the intersection between the Coase Theorem and copyright requires a critical examination of the frictions and imperfections inherent in the real world. As we look a little closer into the implications of these imperfections, one sees the complexities that necessitate the existence and adaptation of copyright laws to address the inherent challenges of asymmetric bargaining power, speed of innovation, and the evolving nature of creative industries in the 21st century.

3. INCOMPLETE CONTRACTS, OPTIMAL PROPERTY RIGHTS, AND THE QUEST FOR THE PINNACLE OF COPYRIGHT LAW

A crucial paradigm shift from the Coase Theorem to the realm of incomplete contracts beckons our attention as one examines the multifaceted world of optimal property rights, particularly in the context of copyright law for the 21st century.

The journey begins with Ronald Coase’s 1937 *Economica* paper, “The Nature of the Firm”. Coase’s inquiry leads us to some fundamental questions: Why do firms exist? Why do countries exist? Why do any organizations exist at all? The answer, Coase asserts, lies in the presence of “transactions” costs. (Coase, 1937).

Transactions costs, the barriers inherent in the exchange of goods, services, or information, are integral to understanding the formation of firms, countries, and organizations. Coase contends that contracts, despite their significance, are inherently “incomplete” due to the presence of transaction costs in the form of unforeseen contingencies or unexpected events – the black swans, as it were. This concept is exemplified by employment contracts, a notion further explored by Herbert Simon (1951).

The seminal work of Oliver Williamson, Oliver Hart, Sandy Grossman, John Moore, and others laid the foundations for the incomplete contract literature, underscoring the pivotal role of property rights.¹ In this landscape, the relevance of copyright law comes to the forefront. The recognition that property rights matter is a critical juncture in our discussion, as it implies a role for legal constructs such as copyright to navigate the intricacies of incomplete contracts and transactions costs.

Yet, as we navigate this terrain, a fundamental question emerges: What constitutes the “optimal” copyright law and property rights in a landscape characterized by incomplete contracts and inherent uncertainties? This question is central, prompting us to evaluate the evolving nature of creative industries, the dynamic interplay of stakeholders, and the need for a legal framework that strikes a balance between incentivizing innovation and addressing the challenges posed by incomplete contracts.

In the pursuit of the optimal copyright law, one has to weave together insights from economic theory, legal scholarship, and the practical realities of the creative and innovative landscape.

¹For a review and summary, see Hart (1995)

4. THE HOLD-UP PROBLEM: CRAFTING SECOND-BEST OPTIMAL COPYRIGHT LAWS

The hold-up problem emerges as a critical focal point in an exploration of the dynamics between asymmetric bargaining power, innovation, and the optimal design of copyright law. To illustrate, let us consider a hypothetical scenario involving the iconic musician Elton John.

In the realm of ex-ante agreements, Elton John collaborates with a record label or producer. He invests time and resources to create a masterpiece – in this case, the timeless “Candle in the Wind”. The success of the song surpasses all expectations, leading to a scenario that is all too familiar in the creative industry – the ex-post “hold-up”.

The hold-up, characterized by renegotiation after the success of the investment, is a recurrent challenge in the creative landscape. The basic result of this phenomenon is the inefficiency of the initial investment. Elton John, despite his creative genius and the success of his work, doesn’t fully reap the rewards of his investment. The label secures a fraction of the marginal benefit in the ex-post renegotiation, leading to a suboptimal distribution of benefits.

This inefficiency underscores the importance of crafting policies that address the hold-up problem. The concept of Second-Best Optimality comes into play, suggesting that the ex-ante design of copyright law and protections can play a crucial role in enhancing Elton John’s bargaining power. By doing so, we create a ripple effect, enhancing his marginal benefit from the investment and mitigating the risks of hold-ups in the aftermath of success.

In essence, the Second-Best Optimality approach recognizes the imperfections inherent in the creative industry’s bargaining dynamics. Rather than relying solely on the ideal conditions of costless bargaining as proposed by the Coase Theorem, it acknowledges the need for proactive measures in the form of copyright law and protections. These measures aim not only to incentivize creativity but also to fortify the bargaining position of creators like Elton John, ensuring a more equitable distribution of benefits in the face of unforeseen success.

As one aims to deal with the hold-up Problem, one has confront the need to design good copyright laws that serve as a proactive tools for enhancing bargaining power, fostering creativity, and optimizing the distribution of benefits in the complex and dynamic landscape of the 21st century.

5. BARGAINING POWER, DIVERSE PLAYERS, AND THE INTERSECTION OF OBJECTIVES

Bargaining power in the creative landscape is a multifaceted phenomenon, characterized by the involvement of multiple players such as creators, producers, intermediaries, and consumers. Each participant contributes distinct inputs to the production process, creating a complex web of interactions and negotiations.²

In this intricate ecosystem, creators bring their artistic vision, producers contribute resources, and intermediaries facilitate the connection between creators and consumers. Understanding the dynamics of bargaining power becomes essential as these diverse players navigate the complexities of the creative and innovative landscape.

Consumers, integral to the ecosystem, introduce the element of maximum willingness to pay, a concept underscored by the downward-sloping demand curve. The economic dynamics at play, influenced by consumer behaviour, further shape the bargaining power relationships within the ecosystem.

At the intersection of these diverse interests lies the concept of social welfare, where the well-being of both consumers and producers is considered. The notion of “net surplus” emerges, representing the shared benefits derived from the creative output. Navigating this delicate balance is essential for optimizing outcomes in terms of both efficiency and fairness.

The challenge is further compounded by the multiple objectives inherent in the creative and innovative landscape. The pursuit of appropriateness, efficiency, and fairness concurrently creates a complex negotiation space. Striking a balance that accommodates these multiple objectives is essential for the sustainable growth and development of the creative industries.

²See Muthoo (2000) for a non-technical introduction to sources of bargaining.

As one examines the layers of bargaining power and the interactions among creators, producers, intermediaries, and consumers, we are confronted with the imperative of crafting a legal and economic framework that promotes collaboration, innovation, and fairness. The dynamic nature of this ecosystem necessitates an ongoing dialogue to address the evolving needs and aspirations of the diverse stakeholders involved. In the pursuit of optimal outcomes, we must navigate the complexities of this intricate web, striving for a harmonious balance that enhances creativity, fosters innovation, and indeed ensures the well-being of all participants in the creative process.

6. THE FUTURE OF COPYRIGHT: SHAPING BARGAINING POWER, EFFICIENCY, AND INNOVATION

As we stand at the intersection of the creative landscape and legal frameworks, the role of copyright emerges as a linchpin in determining the future trajectory of innovation, efficiency, and the distribution of bargaining power among the diverse players.

Why is copyright important in the evolving landscape of the 21st century? The significance lies in its profound impact on the distribution of bargaining power among creators, producers, intermediaries, and consumers. Understanding the nuanced ways in which copyright influences these power dynamics is crucial for fostering a balanced and equitable creative environment.

Beyond its role in bargaining power, copyright holds sway over the efficiency and innovation of the creative industries. By providing a framework for protecting intellectual property, copyright serves as a catalyst for fostering more Elton Johns – creators whose genius and innovation transcend boundaries, contributing to the richness of our cultural tapestry.

Yet, as we navigate the present landscape and peer into the future, a big open question looms large: What does the optimal, or second-best, copyright law look like? Crafting a legal framework that strikes the right balance between incentivizing creativity, promoting fairness, and adapting to the dynamic nature of the creative industries is an ongoing challenge that requires careful consideration and collaboration.

The future of copyright is not just a legal matter but a pivotal force in shaping the vibrancy and sustainability of our creative landscape. As we grapple with the complexities of optimal copyright law, we need to embark on a journey that requires continuous dialogue, collaboration, and adaptation to ensure that the legal frameworks we shape align with the aspirations of creators, the interests of diverse stakeholders, and the ever-evolving nature of creativity in the 21st century. The quest for the future of copyright is a shared endeavour - one that calls for a harmonious balance between legal constructs and the dynamic, ever-expanding world of human ingenuity.

7. BARGAINING THEORY, COPYRIGHT POLICY AND OPTIMAL COPYRIGHT

In my talk thus far, as stated above, we have covered some of main areas and discussed some of the critical issues. We have also raised several questions of interest.]

Let me conclude this talk by emphasizing the centrality of bargaining for copyright policy and for determining the nature of what “optimal” copyright ought to look like.

Future research will need to study and address these and related questions, but it might be worth laying down here, and briefly, the relevance of bargaining, the bargaining-theoretic research methodology and framework, and some of its key concepts.

We have noted that the Coase Theorem tells us that, given we have property rights in place to firmly establish who owns what, bargaining alone would lead to an efficient solution. So having property rights is necessary but not sufficient for an efficient outcome. To work well, we also need to deal with the issue of transaction costs.

The implication is that copyright is a way to work around transaction costs, by constraining the bargains that can be reached (constraining them in accordance with copyright law - e.g. copyright is of limited duration, the well-known exceptions, and even the US Copyright Royalty Board setting rates for songwriters directly) in such a way that enhances social welfare.

But we can always set up a model in which there are no transaction costs, and free unfettered bargaining happens. The solution to that model gives a split of surplus that depends on relative bargaining powers of the players. And of course, according to the

Coase Theorem, that split of surplus is socially efficient. Since the objective of the real-world regulator is to set down a copyright standard that achieves exactly such a socially efficient split of surplus, an optimal copyright law would simply be that which delivers the outcome that is calculated in the bargaining model. In short, there exists a “transformation function” of some type that sets an optimal copyright law structure as a function of bargaining power.

In fact, one would also make the size of shareable surplus dependent on the bargaining outcome (i.e. how much surplus the creators can expect has an effect on the size of the pie itself). It would not be a monotone function - if creators have very little bargaining power, surplus will be low since they won't have an incentive to create, and if creators have huge bargaining power, again surplus will be low since publishers (and other users) will not participate due to lack of potential earnings. Intermediate values of bargaining power lead to higher surplus than at the extremes.

But then, by backward induction, surplus itself (i.e. social welfare) is a function of bargaining power, and so we can maximise surplus with respect to bargaining power. That would give us a theory of what is the socially optimal level of bargaining power that creators should have in order that social welfare is maximised.

Finally, since there is a transformation function that tells us the optimal copyright standards given bargaining power, we can calculate the socially optimal copyright standard.

Given the above, the role of bargaining theory is critical, as detailed for example in Muthoo (1999). But there are other considerations since the bargaining problem is also one with more than two players and with the presence of externalities. One has to thus think about the possibility of tacit cooperation amongst some subset of the players in order for them to enhance their respective bargaining power. So, the notion of coalitional bargaining becomes relevant in the bargaining problem. Furthermore, given the presence of externalities, the traditional von-Neumann-Morgenstern “Characteristic Function” form approach may not be appropriate but instead the “Partition Function” form would be (see Ray, 2008).

We need to use such tools to carefully explore the critical role of bargaining for copyright policy, and to explore the nature of the “optimal” copyright. This we leave for future research.

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