

The Use of Price Controls to Eradicate
Optical Disc Product Piracy in Malaysia:
A Preliminary RIA Analysis

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23 November 2003

Abstract

The piracy of optical disc products (ODPs) remains a serious problem in Malaysia. The levels of piracy in various industries such motion picture, music recordings and computer software exceed 70 per cent. Several copyright laws such as the *Copyright Act of 1987* and the *Optical Disc Act of 2000* have been enacted and enforced to reduce ODP piracy. In September 2003, the Malaysian Government announced proposals to regulate the price of selected optical disc product via the *Price Control Act of 1946*. The effectiveness of this policy may depend on greater enforcement of existing copyright laws. Sanctions under existing copyright laws are sufficient to deter piracy provided they are enforced more stringently. Quantifying the full effects of the price control regulation may be difficult especially for the longer-term.

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1. Introduction

The problem of optical disc product (ODP) piracy is quite serious in Malaysia particularly since the early 1990s. In the past, the Malaysian government has attempted to reduce ODP piracy in the country through the enactment and the enforcement of copyright laws. Despite such efforts, ODP piracy remains rampant. More recently, the government announced that it will implement price controls to combat ODP piracy. Such controls will take the form of price ceilings on selected ODPs such as CD music recordings and VCDs. On the whole, local producers, distributors and retailers have expressed doubts about the efficacy of the policy. Some have even attributed to recent declines in sales of music CDs to the government price control policy.¹ Such anecdotal evidence does not provide sufficient grounds to abandon the Government's price control policy.

A comprehensive analysis of the desirability and efficacy of the price controls will require the use of a coherent and systematic framework of analysis. The regulatory impact assessment (RIA) method may provide such a framework of analysis. In this paper we attempt to use the RIA method to sketch out the elements that should be taken into consideration in analyzing the usefulness of price controls in reducing ODP piracy.

¹ Consumers are said to have postponed the purchase of music CDs in anticipation of lower prices following the implementation of price controls in January 2004.

The outline of the paper is as follows. Section 2 briefly reviews the use of RIA in Malaysia. This is followed by a discussion on the problem of ODP piracy in Malaysia in Section 3. The various regulatory initiatives to reduce ODP piracy in the country is discussed in Section 4. Section 5 sketches out a RIA framework of analysis for assessing the efficacy of price controls to reduce ODP piracy. Section 6 concludes.

2. Regulatory Impact Assessment in Malaysia

Impact assessments are not entirely new in Malaysia. Environmental impact assessment reports are required by the *Environmental Quality Act, 1974 (Amendment 1985)* for certain prescribed activities that have significant environmental impact. The Ministry of National Unity and Social Affairs is currently drafting a handbook for social impact assessment that is aimed to provide guidelines for assessing the ‘social’ impacts of projects on communities.² These regulatory initiatives are aimed at assessing the impacts of *projects* rather than *regulation*.

In general there is no evidence that all regulations, prior to their implementation, are consistently and systematically subjected to formal impact assessments in Malaysia.³ Some regulations do undergo some form of assessments, either in-house (i.e. conducted by government officials) or as part of the recommendations contained in consulting reports commissioned by the government.⁴ The extent of public participation in such exercise is very limited. There are exceptions, namely the public consultation process for regulations in the communications

² ‘Social’ here includes people’s preferences, social activities (e.g. health and education), and interactions between groups of people. See p.1 in Malaysia SIA Project Team (2002).

³ This is consistent with the findings of Kirkpatrick and Parker (2002).

⁴ In terms of the classification of decision methods (see Jacobs (1997)), existing practices involve expert decision, political decision, benchmarking decision and empirical decision.

and multimedia sector that is required by law (Communications and Multimedia Act). This approach has not been replicated in other sectors.

3. The Optical Disc Product Piracy Problem in Malaysia

Optical disc product piracy is a serious problem in Malaysia particularly since the late 1990s.⁵ The extent of digital piracy can be discerned by the level of piracy and loss of revenues to the rightful/legal producers and distributors in the various industries. **Table 1** summarizes such information.

Table 1: Trade Losses and Levels of Digital Piracy in Malaysia, 1998-2002
(Losses in USD, million)

Industry	1998		1999		2000		2001		2002	
	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level
Motion Picture	40.0	80%	42.0	85%	41.0	80%	40.0	80%	42.0	75%
Records & Music	13.0	70%	5.0	40%	15.6	65%	148.9	70%	110.2	70%
Business Software	63.8	73%	67.8	71%	75.4	66%	75.0	70%	82.7	70%
Entertainment Software	135.2	99%	164.0	99%	NA	98%	56.4	93%	NA	NA
Books	8.0	NA	8.0	NA	8.0	NA	8.2	NA	8.3	NA
	260.0		286.8		140.0		328.5		243.2	

Note: NA - Not Available

Source: International Intellectual Property Alliance, 2003 Special 301 Report, Malaysia.

While the overall level of piracy in the various industries has declined over the past few years, the level of piracy and total loss of revenues remains relatively high. The average level of piracy in most industries exceeded 70 per cent in year 2002. In the same year, the total loss of revenues was at least USD243 million.

⁵ For a more comprehensive analysis of digital piracy in Malaysia – see Lee (2003).

The seriousness of the digital piracy problem in Malaysia is also reflected in the placement of the country on the Special 301 Watch List since 1999.⁶ In 1999, Malaysia was classified as a country that required close monitoring (through an out-of-cycle review or OCR). This deteriorated to 'Priority Watch List' status in years 2000-2001. Malaysia's status changed to that of 'Watch List' in year 2002 following improvements in the country's IPR record (chiefly through legislative changes). More recently, in February 2003, IIPA recommended that Malaysia be placed on the 'Watch List' but with an OCR.

4. Regulatory Initiatives to Eradicate Digital Piracy

The Malaysian Government has implemented several regulatory measures to eradicate digital piracy in the country. These include legislative enactments of laws to protect intellectual property rights (IPRs), enforcement of new and existing laws (via checks on raids on users, retailers/distributors and factories producing optical disc products) and more recently, price controls.

4.1 Legislative Enactments

The main legislation dealing with the infringement of intellectual property rights in Malaysia is the *Copyright Act* which was enacted in 1987.⁷ Section 41 of the Act covers the various offences related to IPR infringement and their penalties. Another important legislation is the *Optical Disc Act* of 2000.⁸ While the *Copyright Act* focuses on the manufacturing, sale and use of pirated goods in general, the *Optical Disc Act* deals with the licensing and regulation of optical

⁶ Under the "Special 301" provisions of the US Trade Act of 1974, the US Trade Representative is required to monitor and identify countries that deny adequate and effective protection of IPRs or fair or equitable market access for US persons that rely on IPR. Countries that have poor record in this area (e.g. 'Priority Watch List') can be subject to US trade sanctions.

⁷ It is interesting to note that the IIPA states that the enactment of the Copyright Act was a result of bilateral negotiations between the governments of Malaysia and the US. See http://www.iipa.com/rbc/1999/rbc_malaysia_301_99.html.

⁸ The need for a legislation to control the manufacture of optical media was highlighted by IIPA as far back as year 2000.

media production facilities in the country. Under the *Optical Disc Act*, licensed manufacturers of optical media are required to use unique source identification (SID) codes in the replication of masters as well as the production of masters. These manufacturers also have to keep inventories of optical grade polycarbonate, production runs, shipment of finished products and production orders received. Prior to recent amendments to the *Copyright Act*, the much older *Trade Descriptions Act* was used to prosecute retail pirates via labeling violations.⁹

4.2 Enforcement of IPR Laws

A variety of government agencies are involved in combating digital piracy. Enforcement of the above laws is carried out mostly by the Ministry of Domestic Trade and Consumer Affairs (MDTCA). MDTCA carries out raids and checks on both manufacturers of optical media and retailers/distributors of ODPs. The Royal Malaysian Police Force also undertakes raids and prosecutions. Local municipal councils have also conducted raids, confiscated pirated ODPs and levied fines on pirate retailers via trading licensing requirements. Even though the *Copyright Act* provides for the prosecution of individuals for using pirated ODPs there are very few instances of such cases. The enforcement's focus on users has mostly involved business firms.

The effectiveness of the enforcement of the above laws to eradicate OPD piracy has been mixed. **Table 3** gives a summary statistics of the current state of copyright enforcement in Malaysia. There have been a significant number of raids on optical media manufacturers and pirate retailer in the past few years. However, there have been no convictions resulting in jail sentence thus far. Most

⁹ The reason for this is that, prior to the amendment, officials from MDTCA could not prosecute pirate retailers directly.

of the cases involved confiscation of goods (VCDs, DVDs) and production equipment, and fines.¹⁰

Table 3: The State of Copyright Enforcement in Malaysia, 2002

ACTIONS	MOTION PICTURES	SOUND RECORDINGS
Number of raids conducted	976	227
Number of VCDs seized	1,612,506	
Number of DVDs seized	246,773	
Number of CD-Rs seized	618,570	
Number of investigations	150	
Number of VCD factory raids	11	
Number of cases commenced by MDTCA	962	487*
Number of cases commenced by the Police, Customs & Censorship Board	14	224*
Number of defendants convicted	2	4*
No of acquittals and dismissals	2	2
Number of cases pending	800	21
Number of cases resulting in jail time	0	0
Number of cases resulting in criminal fines	28	
Total amount of fines levied (in USD)	48,538	

Note: * Figures covering 1997 – November 2002

Source: International Intellectual Property Alliance, 2003 Special 301 Report, Malaysia.

4.3 Price Control Regulation on Optical Disc Products

A more recent regulatory measure to eradicate OPD piracy is the use of price controls on selected ODPs. Following approval by the Cabinet, the Minister of Domestic Trade and Consumer Affairs announced on 25 June 2003 that all optical discs including video compact discs (VCDs), Digital Video Discs (DVDs), computer software and other optical discs are to be designated 'controlled items' under the *Price Control Act of 1946*. This action essentially enables MDTCA to set price ceilings for ODPs. The price ceilings for VCDs and CDs were announced by the Minister of Domestic Trade and Consumer Affairs on 17 September

¹⁰ Amongst the factors cited for inefficacy of enforcement include lack of manpower (on the part of MDTCA), lack of skill and manpower (MDTCA and court), slow legal process (as long as three years to conclude), and lack of follow-up on raids.

2003.¹¹ The Ministry has also deferred its proposal to fix the prices of the computer software CD-ROMs until a detailed study is carried out.

These price ceilings, which will take effect on 1 January 2004, are summarized in **Table 4** below. Interestingly, it was further announced that the price controls would be initially applied for a year (2004) after which a review will be conducted to assess the desirability of continuing the policy.

Table 4: Price Controls on Music CD Recordings and VCDs

(1 USD = RM3.80)

	New Ceiling (RM)
CD - local artistes	21.00
CD - international artistes	29.00
VCD	14.00

In addition to the price ceilings, the use of the *Price Control Act* to combat ODP piracy had additional implications - CD and VCD distributors and retailers have to apply for licenses at a nominal fee of RM1. The proposal to use price controls to reduce ODP piracy is a radical policy departure on the part of the government.

Will the price controls work? What are the considerations that ought to be taken into account in assessing the desirability and efficacy of price controls to combat ODP piracy? Some of these questions require a proper framework of analysis that perhaps a RIA may provide. We attempt to outline such a framework in the rest of the paper.

¹¹ Plans to set price ceilings for computer software CR-ROMs were delayed indefinitely pending further study. See STAR, "Ministry to set pricing on new music, movie CDs", 20 July 2003.

5. A RIA Framework for Price Control Regulation

There is no evidence that the implementation of the price control regulation on CDs and VCDs was preceded by any formal impact assessment. The Ministry of Domestic Trade and Consumer Affairs did commission a study to determine the appropriate level of price ceilings. However, to the author's knowledge, no study was commissioned to assess the feasibility of the price control regulation *per se*.

In this section, we attempt to draw up a framework for an impact assessment of the price control regulation. The purpose of doing this is not to determine the efficacy of the price control regulation but to show what would need to be taken into account IF such an assessment were undertaken *ex-ante* to its implementation. If doing so, we will also (hopefully) understand the complexity of the problem of ODP piracy. The value of such an exercise is not merely academic, it may be useful to policy makers at the MDTCA when they evaluate the need to continue or discontinue the price controls in 2005.

We rely on two sources for our RIA format, namely:

- (1) OECD's (1995) checklist¹²; and
- (2) Cabinet Office's (2000) *Better Policy Making: A Guide to Regulatory Impact Assessment*.

¹² These are: (1) Is the problem correctly defined? (2) Is government action justified? (3) Is regulation the best form of government action? (4) Is there a legal basis for regulation? (5) What is the appropriate level (or levels) of government for this action? (6) Do the benefits of regulation justify the costs? (7) Is the distribution of effects across society transparent? (8) Is the regulation clear, consistent, comprehensible, and accessible to users? (9) Have all interested parties had the opportunity to present their views? (10) How will compliance be achieved?

Title of Proposal

Price control to eradicate optical disc product (ODP) piracy

Purpose and intended effect of measure

(i) The objective:

The purpose of the price control regulation is the eradication of ODP piracy.

(ii) The background:

See discussions in Section 3.

(iii) Risk assessment

The risk of incurring trade sanctions from the US due to failure to protect IPRs in Malaysia. It is difficult to quantifying this risk as the affected parties (i.e. sectors) cannot be identified.

The legal basis for price control is the Price Control Act of 1946.¹³

Comments:

There are significant variations between the different types of ODPs:

Table 5: Types of ODPs and their Characteristics

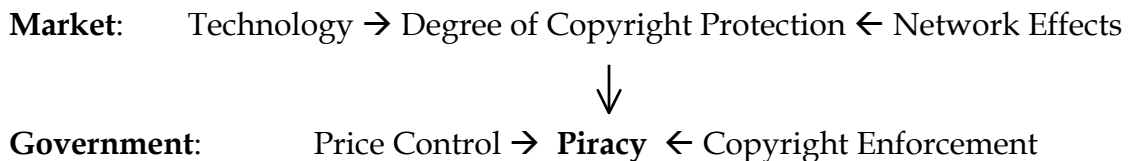
Product	Experience / Search Good	Network Effects Present?	Formats
Music Recordings	Experience Good	No	CD
Movie Recordings	Experience Good	No	VCD, DVD
Computer Business Software	Search Good?	Yes	CD
Game Console Software	Experience Good?	Yes	CD, Cartridge

¹³ The Price Control Act 1946 together with the Supply Control Act 1961 and their subsidiary legislations empower the Ministry of Domestic Trade and Consumer Affairs (MDTCA) to ration the supply of selected goods as well as to control and stabilize prices in the country. The subsidiary legislations include the Price Control Order 1980, 1993, 2000 and the Price Control Regulations 1984 and 2000. To date, these Acts have been mainly used to stabilize the prices of essential food items such as food items (poultry and vegetables).

The price control only focuses on music recordings in the CD format and movie recordings in VCD format. Thus, the price control may only have a partial impact on eradicating ODP piracy.

ODP piracy is also an outcome of complex interactions between different factors (see Figure 1). The ease of violating copyright protection depends on the degree of copyright protection that firms built in their product as well as technological factors that prevent or support piracy (e.g. internet, CD writers, DVD burners). Competing software may reduce the degree of copyright protection to encourage adoption to gain from the resulting network effects. The government's role is to reduce the piracy of ODP piracy.

Figure 1: Key Drivers of ODP Piracy



Policy Options (related to price controls)

The three options related to price controls are:

Option 1: Do nothing

Option 2: Persuade industry associations to lower prices of ODP

Option 3: Coerce industry to lower prices via price control

Risk assessment:

Option 1 is only feasible if enforcement is stepped up. Other it runs the risk of worsening the ODP piracy problem. Option 2 is not likely to happen given

past and current industry reactions. Distributors and retailers of ODPS have been slow in lowering prices on their own in the past. This could be due to the product differentiation strategy by ODP producers (e.g. via product differentiation).

Comments:

Price is just one dimension of competition. Other dimensions include:

- (a) variety (e.g. number of titles in a music recording);
- (b) quality; and
- (c) valued-added (bonus materials, packaging).

Price controls may prompt firms to change product characteristics in any of the above three non-price dimensions.

Benefits and Costs of Different Policy Options

The first step in identifying the benefits and costs involves identifying the various parties affected, namely:

- Owners/Producers
- Distributors/Retailers
- Consumers (both current and potential)
- Government

There are two types of consumers:

- 'existing consumers' who will purchase pirated versions if they are available but will purchase originals if pirated versions are not available.
- 'potential consumers' who will only buy pirated versions.

The second step is to compare the controlled price levels with existing prices for originals and pirated for various types of ODPs. A survey of these prices indicates that the controlled prices will still be higher than prices of pirated versions (see Figure 6).

Table 6: Comparison Between Price Ceiling and Existing Prices

(1 USD = RM3.80)

Product	Price Ceiling of Original Product (RM)	Existing Price of Original Product (RM)	Existing Price of Pirated Product (RM)
CD – local artistes	21	30 - 40	8
CD – international artistes	29	35 - 50	8
VCD	14	20 - 30	6 - 7
DVD	-	35 - 130	10 -15
PlayStation2 Software	-	100 - 200	5

Given the above price structure, the impact of the price controls will depend heavily on whether pirated products will be available in the market. This, in turn, will depend on the level of copyright law enforcement. If the supply of pirated versions is restricted, more originals may be sold.

The short-term (static?) benefits and costs under the three options are summarized in Table 7. Under the do nothing option, consumers benefit at the expense of producers and distributors. Under the voluntary price control option, producers and distributors may or may not sell more originals depending on the availability of pirated versions. The same results apply to the regulated price control option. Potential consumers may or may not cease purchase of pirated under both the voluntary and regulated price control options depending on the extent of copyright law enforcement.

Table 7: Short-Term Benefits and Costs Under Three Policy Options

	Do Nothing		Voluntary Price Control		Regulated Price Control	
	Benefits	Costs	Benefits	Costs	Benefits	Costs
Producers / Owners	-	Unsold Originals	Sell > Originals?	Lower Prices	Sell > Originals?	Lower Prices
Distributors/Retailers	-	Unsold Originals	Sell > Originals?	Lower Prices	Sell > Originals?	Lower Prices
Current Consumers (Buy originals or pirated)	Positive Gain	Pay Very Low Price for pirated?	Positive Gain	Pay higher price for originals?	Positive Gain	Pay higher price for originals?
Potential Consumers (Buy only pirated)	Positive Gain	Pay Very Low Price for pirated	Zero Gain?	Zero Purchase	Zero Gain?	Zero Purchase
Government	-	-	Higher Tax Revenues?	-	Higher Tax Revenues?	Admin. Costs

Note: CS refers to consumer surplus

The long-term effects are more difficult to assess or predict. Under the do nothing option, if the ODP piracy problem deteriorates over time, trade sanctions by developed economies may harm other economic sectors. Under the voluntary and regulated price controls, producers and distributors may also react by reducing the quality of their products, the amount of value-added (e.g. packaging) or in the case of entertainment products (e.g. movies) from abroad, delay the release of products in Malaysia. The introduction of new hybrid products such a combined CD-VCD may require new price control categories under the voluntary and regulated price controls options.

The quantification of benefits and costs can also present significant challenge to policy makers. While sales figures can be collected, estimates of consumer's benefits are more difficult to come by. AT least two type of additional information is required. First, a survey is required to determine the consumer's

willingness to pay for originals. Second, some estimates of the quantity of pirated versions purchased are required.

Is Greater Copyright Law Enforcement the Answer?

Pirated products will always be sold at lower prices compared to originals due the former not incurring the full cost of developing and marketing such products. This implies that greater enforcement of copyright law may be required to deal with the ODP piracy problem. Existing laws such as the sanctions under the *Copyright Act* and the *Optical Disc Act* are sufficiently punitive for this purpose (Appendix Table 1). In fact the sanctions under these laws are more punitive than that under the *Price Control Act*.

6. Conclusion

The piracy of optical disc products (ODPs) remains a serious problem in Malaysia. In the past, the government has relied on the enforcement of two copyright protection laws to eradicate ODP piracy, namely the *Copyright Act* and the *Optical Disc Act*. More recently, the government proposed to implement price ceilings on selected ODPs in an effort to lower prices of such products. The coverage of this regulation is limited to a few ODPs such as music CDs and movie VCDs and thus may have limited effects. Furthermore, an assessment of the benefits and costs of the policy require further information such as consumers' willingness to pay. The effectiveness of price controls also depend how stringent copyright laws are enforced to limit the supply of pirated ODPs. The sanctions under existing copyright laws are sufficient to achieve this.

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Appendix Table 1:

Sanctions Under Copyright Protection Legislations and Price Control Act in Malaysia

Legislation	Offence	Sanction
Copyright Act 1987	Sale or hire any infringing copy	RM2,000-RM20,000 for each infringing copy, or to imprisonment or/and to imprisonment for a term not exceeding 5 - 10 years or to both
Optical Disc Act 2000	Unlicensed production of optical disc products (ODP) or Submission of false or misleading information by licensed producers of ODP	For corporate body: (1) First offence: Fine < RM500,000 for first offence (2) Subsequent Offence: Fine < RM1 million For person who is not a corporate body: (1) First Offence Fine < RM250,000 for first offence or/and to imprisonment for a term not exceeding 3 years or to both (2) Subsequent Offence and < RM500,000 million for subsequent offence or/and to imprisonment for a term not exceeding 6 years or to both
Price Control Act 1946	Sale of items at prices higher than regulated prices	Individual: RM25,000 fine and 2 years jail