Rents, Rights N’Rhythm: Cooperation, Conflict and Capabilities in the Music Industry

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ABSTRACT The need for better informed copyright policy and management is a huge problem because of the enormous and growing size and scope of the creative industries. In this paper we challenge the prevailing thinking dominating the theoretical literature on the economics of copyrights. By integrating the very real effect of cooperation (strategic interaction and creative interdependence) and conflict (asymmetric relationships in terms of interests, financial dominance, power and capabilities) throughout the economic system in generating value and appropriating rent from music copyrights, we argue how prevailing theory on copyright can be improved by integrating it into a framework of New Institutional Economics. Focus is on the interplay between (i) the “institutional environment” (or “rules of the game”) with respect to the regulation of copyrights underpinned by the economic rationales; and (ii) the “institutions of governance” (or the “play of the game”) with respect to the specific institutional mechanisms in organizing the creation and distribution of value and revenue from music copyrights, and with respect to royalty management.

KEY WORDS: Music industry, copyrights, revenue and rent, cooperation and conflict, New Institutional Economics

1. Introduction

“Creativity” has become a central term in the knowledge economy. It is now increasingly seen as an object for academic discourse and an object for policy. Developing policy for the creative industries has been a major item on the United Nations agenda since 1997.
when they were identified as being the fastest growing export sectors for many least developed economies (UNCTAD, 2003) and the UK’s agenda since 1997 (DTI and ESRC, 2005).

The need for better informed copyright policy and management is a huge problem because of the mere and growing size and scope of the creative industries in the current micro-electronic paradigm and knowledge-based global economy. The increasing economic impact of the core copyright industries in the era of globalization is now a stylized fact; including printing, publishing and advertising industries, audio-visual and cultural industrial sectors (radio, film, television, recording, music) and the computer industry (also protected by patents). In the UK the creative industries (grouped as mainly music, film and television) account for 8.2 per cent of Gross Value Added to the national economy (DTI and ESRC, 2005).

Thus, copyright industries are growing in importance in terms of value added to gross national product, they are faced with new technological challenges with the revolution in information and communication technology (ICT) and micro-electronics, and they are subject to globalization due to their intangible nature. This provides huge challenges for copyright regulation and management, and policy makers and industrialists seek help from the current understanding of the economics of copyright in order to respond to the new business opportunities and challenges.

Furthermore, the process of globalization has involved an international norm-setting in the area of intellectual property rights (IPRs) towards the strengthening of the global system through harmonization of national and international rules on IPRs in order to establish some universal or international minimum standards for IPR protection. This has also resulted in an increased enforcement of IPRs, such as the section of the WTO Agreement on Trade-Related Aspects of Intellectual Property, or TRIPS, and there are numerous other examples, see Andersen (2004). However, it has become evident that such global harmonization processes, and increased enforcement, of IPR rules have led to very asymmetrical results across the board (across countries, across regions, across sectors, across firms within sectors), in terms of meeting the originally intended objectives of such IPR regulation in terms of stimulating innovation-based competition; facilitating spill-over and expansion of knowledge-based ideas and creative expressions of ideas; rewarding inventiveness and creativity throughout the economic system; and in terms of facilitating sustainable development of firms and industries. Thus, while defenders of this trend of strengthening IPR regimes promise that IPR regimes bring in convergence and closing income and technology gaps, there is a growing concern among some policy makers and researchers (including the authors of this paper) that strong IPR regimes may cause the very opposite.

In the context of all of the above, this paper asks, and provides answers to, two key questions or puzzles for the copyright research community to consider in their copyright research and in their consultancy when advising on copyright policy: (i) How, and how well, do prevailing “state of the art” theories on copyright conceptualize and explain the “real-life” performance of copyright systems with respect to innovation and investment processes, the functioning of markets (e.g. in terms of dissemination of original products in trade), industrial development, competition, as well as any benefit from copyrights to inventors, innovators, consumers, firms and governments or nations? (ii) How prevailing copyright theory can be improved by integrating it into the framework of New Institutional Economics. (Further
elaboration on the research questions is carried out below in the sections on methodology and outline of paper.

However, even if copyright regulation is designed to fit all creative industries (assuming that "one size fits all"), we profoundly believe that the system operates and performs differently within the different industries. Therefore, sector studies are essential for copyright research and policy to move forward. We have chosen to focus on the music industry simply because of the growing economic importance of the industry. The music industry, which generates global revenues of close to $45 billion has been identified as being one of the fastest growing export sectors of the global service economy. The global economic size of the industry is as big as bananas, coffee and cocoa combined, with output figures for 1999 of $27.5 billion, $17.2 billion and $3.7 billion, respectively (UNCTAD, 2003). Also, the involvement of UNCTAD (under the direction of Zeljka Kozul-Wright), over almost a decade, in the enhancement of the global music industry has provided us with superior (or more detailed) insight into the role and issues of copyrights regarding the performance of the music industry in comparison to others. Thus, as a third (i.e. iii) objective, this paper also investigates the relationship between one of the most well-known creative industries, namely, the music industry, and copyright. In this context, the empirical evidence or information underpinning this paper was primarily gathered through explorative qualitative interviews with a broad range of actors in the music industry (including writers, performers, major music corporations/record producers, collecting societies, government officials, business and trade associations, music boards, music rights associations, policy makers/ministries, music experts and specialists, interest organizations, etc.) during the United Nations’ music industry fieldwork in many least developed and some developed countries. They included some Asian (India), South American (Brazil), African (Senegal, Burkina Faso), Caribbean (Cuba, Jamaica, Trinidad and Tobago) and European (UK and Ireland) countries. Interviews were also carried out with officials from WIPO, UNESCO, UNDP and the IFPI. Furthermore, a major international workshop in relation to the performance of the music industry in the least developed countries was hosted by Zeljka Kozul-Wright at the UN-LDC3 2001 congress in the European Parliament. Participants from industry, government, business and academia had a leading role in debating the issues of copyright for music industry development.

Thus, in this paper we challenge the prevailing thinking on the economics of copyrights by integrating several neglected elements or variables into the story of the economics of IPRs. These include:

- the very real effect of cooperation (strategic interaction, collaboration and creative inter-dependence) and conflict (asymmetric relationships in terms of interest, size, development and power) throughout the economic system in generating value and appropriating rent from music copyrights;
- the very real effect of institutional capabilities.

In other words, we relax the assumptions of the IPR literature that firms act autonomously, that there is no collaboration or conflict among agents, and that capabilities and institutions can be treated as given.

For this reason we demonstrate, using the music industry as an example, that the copyright system may not (as in prevailing theory of IPRs) automatically provide an enabling role with respect to all the rationales mentioned above, including for all parties involved
Thus, a final important message of this paper is that the copyright system is not, by design, a blessing. Appropriate IPR policy and management is required for it to achieve its enabling value creating roles and in order to minimize some of the adverse effects the system may have. However, we will still argue that the copyright system, for all its flaws, is the best option we have right now, as there is no alternative system in existence to take its place, so the need to gain a better understanding of the performance of the copyright system is essential for policy and management.

The design of our conceptual framework underpinning the analysis is inspired by New Institutional Economics (Williamson, 1998). In this framework the “institutional environment” is the “rules of the game” and the “institutions of governance” are the structures in which the “play of the game” is carried out. In our context, copyrights form a central part of the “institutional IPR environment” in setting the “rules of the game” for the commercial exploitation of creative expressions of musical ideas. The rules underpinning the copyright system, in terms of the law creating copyrights, depend on what we want from IPR regulation. In conventional “law and economics” analysis, the copyright rationale is discussed under the general rubric of technological change and analysed as a more or less efficient system for rewarding creativity (Besen and Raskind, 1991; Hurt, 1996), but this paper also considers other rationales. The rationales in relation to music copyrights are addressed in Section 2 and they include copyrights as market facilitators for commercial exploitation; copyrights as an incentive mechanism for investment in creativity and innovation; copyrights as industry facilitators for achieving sustainable development; and copyrights as a means to protect and reward inventors of creative expressions. This section also includes an overview of the basic economic characteristics of music-related products.

The players in the game of commercial exploitation of creative expressions of musical ideas, and where the “institutional IPR environment” sets rules, can be defined as both public and private sector organizations and firms as well as individuals (e.g. composers, artists/performers, record producers, collecting societies, etc.). The nature of the interaction between the players for revenue and rent creation and distribution from music copyrights is termed “the play of the game”. Each interaction is formed within a certain structure of contracts entitled the “institution of governance”. Such institutions of governance are addressed in Section 3. In particular, the economic incentives (goals) and nature of interactions are outlined and discussed. This includes the incentives for transferring ownership or control of music copyrights, or economic incentives for sharing revenue from musical works. Goals primarily include better music and profit, but there are also other goals. The section also addresses the important role of the royalty collecting societies as an unusual institution enforcing and orchestrating copyrights in the music industry.

In general, the boundary between the “institutional IPR environment” and the “institutions of IPR governance” is blurred in prevailing mainstream IPR literature. However, definitions of the “institutional IPR environment (i.e. the rules of the game)” and “IPR governing institutions (i.e. the play of the game)” are useful, as they enable us to separate various elements of the IPR system for analytical purposes. Thus, we believe that Williamson’s (1998) distinction between, and description of, the “institutional environment” and “institutions of governance” is very useful when examining the institutions underpinning...
copyright systems, despite the fact that the theory was developed for a very different purpose.

The paper concludes in Section 4.

Finally, we have adopted a dual (sometimes even muddy) focus in this paper on (i) creating better theory on the economics of copyright, and (ii) understanding how copyrights underpin the music industry. This is because we believe that the exercise of creating better theory on the economics of copyright cannot be done without empirical examples introducing us to the real-life situations, and because industry cannot advance without appropriate theory which appreciates the specificities of the industry in question.

2. The Institutional Environment

The copyright system has been one of the most essential institutions applied in the developed world to facilitate the creation and dissemination of cultural works through business enterprises. Copyright law is the most important factor of the institutional environment setting the rules of the game because it presents the legal mechanism for protecting and appropriating from creative expressions and symbolic material.

In this section we critically review the more theoretical mainstream economic rationales for copyrights in the music industry with respect to how they enable the creation of music markets and the development of a sustainable industry, and hence the foundation for a music industry. The story put forward in Sections 2.1–2.3 is very much about how the incentives to copyright music for rent seeking at the micro level, in principle, should operate as the mechanism to obtain music markets and hence welfare goals throughout the industry and at the macro level.

2.1. Facilitator for Commercial Exploitation in Music Markets and Cultural Expansion

Most fundamentally, copyright has provided a framework to manage the problems arising from the joint consumption and imperfect excludability of musical works. To recognize this rationale for copyright we have to address the complicated nature of creative expressions themselves. The fact that a creative expression can be consumed jointly (e.g. via a music concert or a radio programme), its value does not diminish by use (e.g. a song is not worth less in size or quality because many have heard/consumed it, as opposed to a cake which is diminished by consumption), involves significant fixed costs in development and that it can be reproduced very cheaply (e.g. by copying) means that it has some of the qualities of a “public good”. This characteristic is usually referred to as the “non-rival” aspect of a public good. But, unlike a public good, it is possible for the creator of a creative expression to exclude others from using it by use of copyrights, opening the possibility for wider commercial exploitation. Establishing property rights for creative expressions means a market price higher than its marginal cost, which tends to zero, giving rise to rents (Rivera-Batiz and Romer, 1991). This in turn implies an incessant drive to expand the market for creative expressions so as to generate greater rents. Similarly, as musical creative expressions, by definition, face increasing returns to scale, which gives rise to rents as markets expand, copyright provides direct economic incentives for sharing musical creative expressions through trade. Thus, the economic status of a musical creative expression changes once it can be separated from a performance and embodied in a tangible product
(for example, compact disc, digital music file), whose reproduction becomes the focus of business strategies and technological innovations. The consumption of a creative expression is no longer limited by time and place and nurturing profit becomes much more closely tied to the organization and management of copyrights in growing music markets (see Section 3). Furthermore, assessing the economic nature of creative expressions themselves, it can be claimed that musical creative expressions and other associated intangible assets are taking on a greater market scope in today's globalizing world.

However, as the creative expression acquires the properties of a non-rival product, this does open up the possibility for widespread copying and imitation when music is reproduced (on magnetic tapes, LPs, CDs, music files) via use of modern technology. The low cost of (re)producing a creative expression means that its market can be uncertain and fragile, quickly undermined by copying. This makes any investment in activities that rely heavily on creative expressions and other intangible assets inherently risky (Landes and Posner, 1989). The threat is particularly apparent with cultural products, such as a sound recording or a film, where the investments made in establishing and promoting an artist are very specific and where short product cycles mean profitability relies on explosive but ephemeral market growth.

Thus, despite the effort in adjusting copyright legislation and royalty management to protect music fixed on new technological carriers (paper, magnetic tapes, LPs, CDs, music files), there has long been a substantial leak in the copyright system, with illegal copying on cassette tapes, CDs and music files (as CD writers become more common) and this has become big business and, in some regions of the world, part of organized crime. The piracy problem arises from the combination of high fixed costs of development compared with the very low marginal costs of making copies. It has also been argued that international copyright conventions have not been effective in reducing audio counterfeiting to comparatively low levels (Burke, 1996). By the end of the last century industry even claimed that one in three recordings sold in the world is based on piracy (BPI, 1998). In this context economic development has been found to be the main determinant of low counterfeit levels (Burke, 1996).

The size of the problem is of course debatable. Landes and Posner (1989) discuss in some detail how there are various practical obstacles to copying, even in the absence of copyright, as well as various non-legal norms against it. Also, in an interview carried out by two of the authors in Dublin, December 1999, the Director of Services of the Irish Music Rights Organisation (IMRO), Eamon Shackleton, questioned whether the common great claims of global music piracy are necessarily market distorting. That is, he argued, sometimes piracy might create music markets in poorer regions where most cannot afford to enter the "legal" music market in the first place; and, secondly, in such a situation, piracy may function as a diffusion mechanism of the social or political culture with which the music is associated. Both actions may have broader, indirect implications for increased income generation within the music industry.

Nevertheless, in the world's more developed regions piracy is now mainly due to access to advanced ICT of the common population. CD writers, and so on, are easy to access at almost any school, university, workplace or home, and they are also relatively cheap to buy and form part of any standard PC or laptop today. P2P file sharing networks and ownership of MP3 players have also matured in most developed countries. In such
situations a discussion has been raised concerning the introduction of levies on copying
equipment and material as a corrective measure for dealing with the impossibility of
charging for home taping and similar activities (Besen et al., 1992). Furthermore, court
cases against music and movie down-loaders from, and up-loaders to, the web are growing
dramatically and followed by the press.

This new type of digital piracy is often argued to be more directly associated with
market substitution (Liebowitz, 2007), as it is done by those who potentially could pay for the
music. Even so, the extent to which P2P file sharing also increases music interest and
awareness of music which in turn also facilitates the growth of new music markets is quite
plausible (Andersen and Frenz, 2007; Oberholzer-Gee and Strumpf, 2007), but it is not the
aim of this paper to move into this discussion. Furthermore, illegally downloaded copied
music tunes do not necessarily mean that the consumer necessarily would have bought it if
it only could be acquired legally.

Thus, although creative industries have become global, regions differ when under-
standing the causes, effects and impact of piracy. Therefore, global regions need to be
governed differently with respect to coming to terms with piracy issues.

It can, in theory, also be argued that the economic copyright rationale for market
creation and expansion (described above) also improves cultural expansion when there are
externalities or cultural spill-over from the trade of musical creative expressions. However,
the rationale that copyright leads to general cultural expansion of musical creative
expressions is controversial, as there are many other economic and institutional factors that
need to be in place (see Section 2.2 for discussion).

Deconstructing music copyrights. As reviewed above copyright helps to define a
marketable music product by contributing to an institutional framework that aims to create
a reliable revenue flow through protecting the musical resource, and hence the rent derived
from it. With respect to defining a marketable music product from a copyright perspective,
we have to be aware that this contains several copyrights. A musical composition contains
two principal copyrights, with which separate authors are associated. Then there is the
sound recording with which a single author is associated. Those rights will now be
described.

A musical composition consists of music (that is, the melody) and any accompanying
words (that is, the lyrics). The authors of those copyrights are also the initial owners. The
author of the melody is generally the composer and the author of the accompanying words
is generally the lyricist. When registration occurs, copyrights in the musical composition are
normally registered as performing art. For registration purposes, the musical composition
must be in the form of a notated copy (for example, sheet music) or in the form of a phono-
record (for example, cassette tape, long-playing vinyl record or LP, CD or digital file).

A sound recording results from the fixation of a series of musical, spoken or other
sounds and, in the UK, is always registered as a sound recording. The author of a musical
sound recording is generally the record producer (or publisher) who processes the sounds
and fixes them in the final recording, or the recording artist(s), or performer(s), whose
performance is fixed, or both. Thus, it should be noted that a musical composition in the
form of a phono-record, or similar, does not necessarily mean that there is a claim to
copyright in the sound recording. Nor is a copyright in a sound recording the same as, or a
substitute for, copyright in the underlying musical composition.
The authors of the copyrights in a musical composition and sound recording will be granted a bundle of rights, associated with the copyrights. For example, in the UK, in accordance with the Copyright, Designs and Patents Act 1988, the copyright in a musical composition and sound recording contains the exclusive right: (1) to copy the work; (2) to issue copies of the work to the public (including the right to rent or lend the work to the public); (3) to perform, show or play the work in public; (4) to broadcast the work or include it in a cable programme service; and (5) to make an adaptation of the work or do any of the above in relation to an adaptation. These rights can either together or separately be sold or licensed to a third party (see Section 3).

The initial focus of music copyright was sheet music and live performance. However, due to the development of techniques in music creation, recording and delivery, some neighbouring copyrights have been issued. That is, with the evolution of (i) new sound recording and music playing technologies (for example, magnetic tapes, LPs, CDs, high fidelity and stereos, video, digital audio technology), as well as (ii) new broadcasting and public performance techniques (for example, radio, television, cable, satellite, Internet), the musical copyright, which was originally designed to protect printed copies of musical compositions (that is, music sheets), as well as live performances, has likewise expanded to include sound recordings and some neighbouring rights to receive also payment for public and broadcast performances (whether live or recorded).

Neighbouring rights include performance rights, which are the right of the performer to receive royalty payment for almost any (live or recorded) broadcast and public performance of a composition. Then there are the mechanical rights, which are the right of the copyright holders to receive royalty payment for almost any (live or recorded) broadcast and public performance of a composition. Finally, there is the synchronization right, which is related to the contractual right, see point (5) above, concerned with the right to make an adaptation of the work. In this respect, the synchronization right is a right for the copyright holders to receive a royalty payment for music that is timed to the display of visual images in films or videotape soundtracks. These neighbouring copyrights also provide the basis for collecting various types of licence fees (Baskerville, 1995) (see also Section 3.2 on royalty management by the collecting societies).

2.2. Facilitator for Sustainable Development of Industry and Better Music

Copyrights on music are also believed to protect entrepreneurial spirit in industry development. Basically, efficient copyright protection allows profit-oriented firms to enter (or develop) an industry or market. This rationale for copyrights can also be compared to that of tariff protection. Just as with tariffs, a copyright protects against market entry and thereby allows a firm or an industry to cover the fixed costs of product development, production and marketing. The idea is that this production and trade privilege will allow a firm or industry to develop and mature, which, in turn, causes (or opens space for) industrial development and progress. It could be argued that copyright allows breathing room for the inventor to invest in development without fear that another individual or firm will steal the creative expression.

In accordance with Posner (1992), an efficiency argument for IPRs reads that in a world without IPRs, where anyone is free to use others’ ideas or creative expressions of such, inventive activity would be biased towards activities that involve minimum preparatory
investment. A well-known implication is that, in the absence of IPR protection, inventors would not be encouraged to conduct their inventive activities, as without an IPR they would not be able to recover the costs of development (that is, pricing at marginal production costs in order to compete with imitators means that the inventor or entrepreneur will not recover development costs) or expect any profit. Thus, a sustainable music industry would not be able to ripen. The main dynamic point in the music industry context is also that legal protection of musical creative expressions creates incentives to use musical resources more efficiently through investment in planning the industry and developing musical resources. The validity of an incentive argument in relation to music products is critically discussed in Section 2.3 below.

However, we believe that some arguments can be raised against copyrights as an incentive to use and allocate musical resources more efficiently for industry development, as there is no evidence that it really creates “better” creative musical expressions. David (2001) argues that the creation of scarcity by use of copyrights within information and knowledge spaces is inefficient for creativity expansion. Basically, information or knowledge spaces are likely to be enriched, the more creators are allowed to climb through the same knowledge spheres. Although David’s work was in relation to the rationales for database protection in research communities, it can similarly be argued how musical creative expressions are likely to be enriched the more inventors, artists and creators are allowed to participate in the same musical spheres. It is well known that it is through creative efforts to replicate musical creative expressions within new contexts that music communities build bodies of musical cultures. A question that can be raised here is whether there is a trade-off between the incentives to copyright protect music for the development of a music industry, on the one hand, and musical expansion through very little protection, on the other hand. Perhaps little protection is needed to ensure free exploration in order for a rich musical culture to thrive. This would argue for a shorter time span for music copyright. Furthermore, it has similarly been argued (DTI and ESRC, 2005) that any expansion in the copyright term in terms of length/years would make it more likely for companies to focus on further exploitation of their back catalogues, while limiting or shortening the copyright term would compel companies to spend more resources uncovering and developing new talent.

This brings us to the discussion of the assumed general spill-over (cultural expansion) from trade, as outlined in Section 2.1. In this context, we believe that the industry dominance of only five Western record companies (Sony, Universal, EMI, Warner, BMG), which control 75 per cent of the global market, is not only a financial problem (as discussed below in Section 4 on the global music industry), but it is also a cultural problem. Basically, those record companies do not only control markets for music but, as music possesses a considerable power to influence behaviour and beliefs, they also control the flow of human ideas, language or speech, emotion and expression. This is a huge responsibility for the five giants and, with their extreme promotion of Western pop music, it could be argued that they do not seem to accept this responsibility. The copyright system seems to enforce a trade-off between music for profit and music for cultural expansion.

Finally, there is the problem regarding how some cultures can safeguard or expand their cultural heritage of non-commercial music or minority music in many regions of the world. Here it does not seem like the copyright system is able to provide the answer, as it stimulates a bias towards advancing and expanding commercial mainstream music.
2.3. The Problem of Scarcity Rent Revisited, Innovation-Enhanced Competition and Incentive Systems

Some classical economists argued that a scarcity rent arising from a specific attribute of land could also characterize other resources:

To excel in any profession, in which but few arrive at mediocrity, is the most decisive mark of what is called genius or superior talents. The public admiration which attends upon such distinguished abilities makes always a part of their rewards; a greater or smaller proportion as it is higher or lower in degree. (Smith, 1776/1937 reprint: 122–123)

Thus, where the supply of such talent is fixed and the service highly specialized, earnings could take the form of a scarcity rent, contingent on the extent of the market reached. Subsequently, the term quasi-rent was coined to suggest that, while the supply of most resources was invariant to price in the near term, they were usually augmentable over some longer period (Marshall, 1890/1952 reprint). Consequently, while most resources can earn rents, these are likely to be temporary, lost through competition as new supplies enter the market. However, Marshall, like Smith, maintains that the properties of indestructibility and non-augmentability might be more enduring with respect to the supply of talent:

When an artisan or a professional man has exceptional natural abilities, which are not made by human effort, and are not the result of sacrifices undergone for a future gain, they enable him to obtain a surplus income over what ordinary persons could expect from similar exertions following on similar investments of capital and labour in their education and start in life; a surplus which is of the nature of a rent. (Marshall, 1890/1952 reprint: 517)

While Marshall had in mind the exceptional abilities of skilled labour and management in traditional manufacturing activities, one could easily imagine how this is also very much the case for cultural industries (such as the music industry) where creative effort and talent actually define the nature of the product itself.

However, it is debatable if we really can treat “talent” in the music industry as a scarce resource, as land, and from here explain the generation of rent. Musical talent is an intangible asset and therefore not fixed as land in terms of size and quality. Musical talent is very subjective, and music is the soul of many cultures. In this context, it can be argued that copyrights in music are not the consequence of protecting scarce musical resources, but they are the deliberate legal creation that produces scarcity (that is, it is about making an intangible product or service with public good character into a rival good, see Section 2.1). In a Schumpeterian vein (Schumpeter, 1912/1934 reprint) it could be argued that this rival aspect of copyright-protected creative expressions, embodied in the production and trade of goods and services, stimulates innovation-enhanced competition by providing incentives to invest in innovating new musical creative expressions in the hope of profiting from first mover advantage.

Hence, perhaps the dynamics of quasi-rent creation is better understood from a perspective of first mover advantages, in the context of competition among many talented inventors and artists, in developing a musical product that holds a desired new attribute. Basically, on the demand side quasi-rent can be explained from the Schumpeterian theory.
of the innovator’s head-start profit (Schumpeter, 1912/1934 reprint). The argument is that if an inventor is really ahead of other inventions, then the time interval before catching up and imitation have happened should secure inventors’ profits and rent for their contribution. The essential issue is the rate by which new ideas or expressions of such spread (that is, the rate of imitation): the faster the speed, the more protection is needed to ensure reward, and the slower the speed, the less IPR protection is needed to ensure reward. Thus, as imitation (or copying) is very cheap and easy in music (it is all about the “upfront” investment), copyright is essential to ensure reward to the creator or just to ensure the full financial covering of the investment in the creativity. Thus, an important copyright rationale here is that it is believed to stimulate a competitive dynamic environment as well as to strengthen continuous inventors and innovators.

The basic proposition of many utilitarian classical economists (reviewed in Andersen, 2004), including Jeremy Bentham, Adam Smith, Jean-Baptiste Say, John Stuart Mill and John Bates Clark, may be used to support the argument that, as IPRs provide “the prospect of reward”, this in turn encourages creative and technological advance by providing increased incentives to invent, invest in and develop further new creative expressions, and that without such incentives the invention inducement would be weakened. North (1981) also points out that sustained inventions and innovations first began after the establishment of IPRs to raise the private rate of return. However, the “IPR-induced incentives to invent” rationale for the IPR system rests on two assertions: first, not enough inventions will be made without effective incentives: neither invention nor exploitation of inventions will take place unless inventors and capitalists believe they will yield profits which make it worth their while to make their efforts and risk their money. Second, IPRs are the cheapest and most effective way for society to hold out these incentives. The first assertion will now be discussed.

However, we cannot resist questioning whether something so personal as musical expression really is the outcome of an incentive system as we see how all societies have musical expressions, even if they have very weak copyright enforcement. That is, we believe that non-commercial musical cultures flourish well without the copyright system. Furthermore, in developed economies less than 10 per cent of composers or writers make a living from royalty income. However, in those economies it is often argued that:

Authors want to communicate and copyright ensures that their work is recognised as their own and that it might include the freedom to use and appropriate material in innovative and personal ways. For publishers (in this case, the record company) copyright is an economic matter, an incentive to invest. (DTI and ESRC, 2005)

We do recognize that the problem of commercial music for industry development is entirely different. Here commercial music value-added is maximized by putting together joint effort to create a joint product between the music authors and a range of complementary musical resources that are not freely available, but need incentives. In Section 3 we discuss how these resources for musical effort would not be put together, and that the venture capital would not be raised, without suitable economic incentives.

Furthermore, it has also been argued on the basis of the work of the above-mentioned classical economists that even if the IPR system is not the most essential ingredient to make people invent and innovate, it helps when it comes to motivating the direction of such
invention and innovation. That is, only the inventions with most commercial opportunities will be explored for profit purposes, so in that sense it promotes “useful inventions” (that is, those that people want). Basically, according to the classical economists, as IPR privileges offer prizes to creative minds they arouse the mental powers and give them a direction. This commercial aspect of music may be able to explain why the music industry invests more money in mainstream pop music than the music valued by the minorities. Obviously, this type of economic incentive system has implications for the nature and narrowness of cultural expansion as reviewed above in Section 2.2. (See Section 3 for further discussion on whether the incentive system may be more designed for the venture capitalists than the musical authors.)

3. The Institutions of Governance

The players in the game of commercial exploitation of creative expressions of musical ideas, and where the “institutional copyright environment” sets rules, can be defined as both public and private sector organizations and firms as well as individuals (such as authors, composers, musicians, artists/performers, publishers, broadcasters, collecting societies, etc.). Building upon Williamson (1998), the nature of the interaction between the players for revenue and rent creation and distribution from music copyrights can be termed “the play of the game”. Each interaction is formed within a certain structure of contracts, also called an “institution of governance”. In this game there are some economic incentives for transferring ownership or control of music copyrights, as well as incentives for transferring revenue from musical works, to other parties. That is, although the authors of music copyrights have the exclusive ownership and control over a bundle of rights (such as the right (1) to copy the work; (2) to issue copies of the work to the public (including to rent or lend the work to the public); (3) to perform, show or play the work in public; (4) to broadcast the work or include it in a cable programme service; (5) to make an adaptation of the work or do any of the above in relation to an adaptation, as listed in Section 2.1), the ownership or control of these rights (either separately or together) may be transferred to another party, mainly in order to get the music product to the market. For example, it is common for the author of an original musical composition or a sound recording to transfer part of the copyright ownership to a publisher or record company, a performer and/or other entities. Ownership can be transferred by selling and buying each right (separately or together) within the bundle of rights.

Should the owner of the rights not wish to transfer the ownership, the control of each right can be transferred (either separately or together) via licensing agreements. Licensing agreements can be exclusive or non-exclusive. Consequently, as the ownership or control of the bundle of rights becomes spread between the author, the publisher and/or other entities involved in the commercialization of the music product, one can argue that the music copyright associated with a musical expression almost always represents a complex case of joint ownership and joint control.

A situation can also emerge in which neither ownership nor control is transferred, but instead, a share of revenue or profit from musical works is negotiated through contractual arrangements.

There are several reasons for this transfer of ownership or control or revenue. One is the economics of complementary assets where income and rent is maximized through all
best means of adding value to the musical composition in order to maximize rent or income. Another is risk management in volatile markets. A third is the rise of venture capital. They are all addressed in Section 3.1.

Finally, the performance of any copyright system (for example, whether and how much revenue and rent is generated from copyright) does not merely or essentially depend on the law and economics side of the copyright system. Rather, it depends on the form, function and efficiency of the copyright management and the related royalty collecting administration machinery. This is addressed in Section 3.2.

3.1. Maximizing Composite Rent Seeking and Reducing Risk Taking

The main economic incentive explaining the transfer of ownership or control of music copyright, or transfer of revenue from musical works, is the generation of composite rent from a joint effort in making the most of the musical resources and minimizing of risk in volatile markets, as well as the raising of venture capital. They will now be addressed in turn.

When seeking to maximize rent from the musical composition, a range of complementary assets is applied in order to add value to the musical composition. The incentive for such joint effort is to maximize music value-added for rent seeking. This section will elaborate on the economics of this process.

Given the work of the classical economists (especially the work of Marshall and others), it is now well recognized that in certain industries demand and supply conditions can lead to composite quasi-rents. A supply condition for the music industry is when the production process relies heavily on combining separately owned, specialized assets so that any rent is created jointly. This has been termed composite rent, and such rent can be well in excess of what each asset owner could receive if employed elsewhere (Marshall, 1890/1952: 520).

Complementary separately owned specialized assets include a producer knowing how to make the “right” musical mix or sound of the musical composition, the right musical band to play the music, as well as a talented musical performer or singer. In particular, as creative effort is divided between the original creators of the musical expression (that is, the musical writers), the producers and its performers, rent creation is about organizing multi-dimensional resources with a significant “social” component. In this context, the performer or singer (that is, the one that delivers the music to its audience) represents a complex bundle of value-added services to the musical composition, including, for example, voice type, stage presence, physical appearance, musicianship and ability to work with others.

Consequently, revenue and rent creation linked to a cultural service, such as music, is a collective process where the “right combination” means putting together various complementary skills to bring the “best” out of a musical expression. In the absence of these complementary skills, the total value-added to music and, hence, rent, can be significantly diminished. This type of innovation process (of combining various complementary skills in the innovation process) resembles the notion of “distributed innovation systems”, in which innovations are created through the fusion of diverse and separate knowledge sources. This might also be one of the reasons why firms and individuals within the audio-visual music industry are building their own networks of both intra- and inter-organizational linkages and relationships to ensure the highest possible rent. Basically, specialized assets within such organized institutional arrangements produce something so
unique, that it could not have been produced by combining assets via the market. As also noticed by Williamson (1985), asset specificity is among the most important factors when deciding how to arrange production.

In the patenting literature Teece (1986) points out that if a firm can get a strong patent, it may be in a good position to bargain a joint venture or licence deal with another firm that has the production and marketing capabilities. This can also be argued to be the case with music copyright where the copyright (or the revenue from the right) to perform, reproduce and distribute the copyright work (either separately or together) may be transferred or licensed to another party, mainly in order to raise venture capital to get the music product to the market. Basically, it is less risky to finance the implementation of a creative expression into a marketable product if the creative expression is covered by an intellectual property right; so with the copyright secured, fixed costs of production are covered (potentially) and minimum entrepreneurial potential risk is guaranteed. Thus, an important incentive and function of music copyright is basically to encourage venture capitalists to invest in commercializing copyright-protected musical expressions.

This economics of music copyright here rests on the assumption that musical expressions serve no economic purpose unless and until they are developed into commercial use, and that a venture capitalist (for example, a recording company) would be unlikely to engage in the development of a music invention unless it owns or controls the property rights (that is, unless musical authors are in a position in which they can sell or license their invention), or are at least able to grab a share of the revenue from the musical words. The function of the copyright as a stimulus to the inventor’s financier plays a major role in the commercial music industry.

However, composite quasi-rents are also vulnerable. Vulnerability on the supply side reflects the high degree of risk that accompanies any production process combining specific assets (Williamson, 1985); that is, the danger of the whole music industry becoming hostage to each others’ specialized suppliers of specialized assets, as well as the damage arising from conflicts between the different suppliers within the strategic network.

Vulnerability arises not only from supply-side problems surrounding asset specificity but also from the unpredictable role of (often short lived) fashion in shaping music market tastes. Basically, quasi-rent from the demand side can especially occur from first mover advantage, where a Schumpeterian head-start profit from music with new fashionable attributes can be obtained before new music in similar lines arrives. However, as fashion is a pure intangible expression and, as much competition in music production is about challenging the established fashion by the creation of a new one, the fashion life cycle is often short lived and can change overnight, which in turn leaves music markets highly volatile, as rents and incomes related to musical creative expressions can and do change abruptly over time. Another reason for volatile markets is illicit copying and imitation (see above in Section 2.1 for a discussion), which can reduce the potential size of the market.

Basically, firms in the music industry survive by creating large markets for short music-product life cycles, and on sizeable investments in specific capital goods and complementary knowledge-based specific assets. As a consequence, such high levels of vulnerability are likely to give rise to a variety of non-market, risk-adverse or risk-sharing, institutional arrangements to guarantee their economic viability and success. Thus, composite quasi-rents from organized institutional arrangements in the music industry can also be guaranteed through collaborate strategic networks all the way down the music
supply chain. Such arrangements normally lead to transfer of ownership, or control of music copyright, or transfer of revenue from musical works. Such arrangements can also help to reduce conflicts between different asset owners as they now share some of the risks arising from a volatile market. However, whereas all the participants agree on maximizing the overall rent from the music product, we know very little empirically about the competitive processes of appropriating or distributing the rent from copyrights, and the efficiency of the governance structures surrounding copyright and its interaction with the strategies at firm level.

However, we need to be aware of that, whilst all those arrangements of transferring ownership of control of music copyrights or revenue for maximizing rent and minimizing risk, this also opens the possibility of problems that can arise from the fact that these rents or revenue are not necessarily shared evenly or “fairly”. It is interesting to see how the transaction and, hence, location of copyrights and royalties (which are the main revenue for the music industry), are determined by the bargaining power and collaboration of individuals and firms, including lobbying and statutory intervention, as opposed to market forces. Kretschmer et al. (1999) have illustrated how different incentives and interests, as well as asymmetry in information and risk, evolve into skewed power structures between composers, musicians, artists, publishers and record companies when they negotiate modes of royalty-sharing or payment.

Thus, whereas collaboration (networks and relationships) within the music industry help to maximize rent and reduce the uncertainty surrounding revenue and rent generation in the music industry, it certainly does not reduce the variation in income determined by accumulated rent from sales and performances. The Monopolies and Mergers Commission (MMC, 1996), which conducted one of the most detailed studies of income distribution within the music industry, using data from the Performing Right Society (PRS), showed how 80 per cent of those who own performance rights earned less than £1,000 from performance royalties for 1993 while 10 per cent of owners received 90 per cent of the total distribution. No systematic studies of such have been conducted since, but on the other hand, there is no evidence that the situation has changed. However, perhaps the new digital paradigm will change this as the power relations change away from music publishers/record producers, and as new artists can more easily access music markets.

Already, by the mid-20th century, Machlup and Penrose (1950) noted that in many situations, inventors find themselves in a bargaining situation where they have no option but to sell their patents at a price below their value. These bargaining situations often go against the moral rights to reward the rationale of the IPR system and are too well known in the music industry (and especially so in less developed countries). Therefore, in the words of Machlup and Penrose (1950: 25):

If the inventors could not hope to reap the fruits of their work … another theory could be substituted for the weakened theory of the patent [or copyright in our case] as an incentive to invent: a theory of the patent [or copyright in our case] as an incentive to venture capital for the financing of the development and pioneer exploitation of inventions.

In this context, it is not uncommonly argued that copyright law has been transformed from a legal regime protecting individuals to one that primarily protects the economic interests of powerful organizations and conglomerates. Furthermore, work in the creative
industries has increasingly relied on a freelance workforce and there has been direct encouragement of small enterprises in these sectors. However, while small companies have been given additional rights, those of individual creative workers have generally been reduced (DTI and ESRC, 2005).

This suggests that copyrights may not be used as a means to provide fair revenue and rent to the music creators and their local cultural communities. One can, of course, question here if this is really a problem. Musicians have always been poor, so how can we now blame the copyright system? We would argue that, given that the copyright system provides opportunities for maximizing revenue and rent from musical expressions, then it is a problem if this revenue is not spread in such a way that all participants in the commercialization of a musical creative expression are rewarded in accordance with their value-added contribution. This may not only be an ethical problem but also a problem for the long-term success of the industry and even cultural development and expansion. We argue that the reward system should feed back into the poor sub-cultures of artists and musicians, and the poor regions of rich musical talent, in order for those deprived communities to invest in and develop a better position within the industry. If this does not happen, then the commercial musical scene will lose soul and spirit, and many communities of the world will have lost one of their key opportunities in taking advantage of their traditional knowledge.

So who are the majors and minors in the global music industry? The combination of large specific investment along with market uncertainty has meant that vertically integrated firms with a strong international presence have been a long-standing feature of the industry. Dominant firms have often been the product of merger and acquisition activity and firms have established joint ventures and strategic alliances in the search for market expansion and greater financial predictability. In this respect, music claims a long pedigree as a truly global industry (Negus, 1992). Particularly since the late 1980s, the industry has become even more concentrated (Alexander, 1994). It has been estimated that approximately 75 per cent of the global market is controlled by five media giants: Sony, Universal, EMI, Warner, BMG. All but one (EMI) of these multinational corporations are highly diversified media conglomerates, in which music revenues account for between 10 per cent (Sony) and 33 per cent (BMG) of their global revenues (RIAA, 1999).

Through various oligopolistic practices these firms are able to earn the large rents needed to maintain their leadership role in the industry, and to generate the considerable financial resources, which allow them to carry the risks and costs involved in identifying and developing artistic talent and marketing a risky final product with very large sunk costs. The recent trend to increased concentration has been accompanied by a shift of strategy in the dominant companies from discovering, promoting and recording artists towards the marketing and distribution of recorded music in multiple listening sites and lobbying for the licensing of more and more public spaces where music is played (Negus, 1992). In this respect, corporate strategy has become increasingly tied to accessing risk capital. The large conglomerates also seek the opportunity to tie their music products to their other entertainment products, such as TV, films and videos, generating further revenue streams. Over 60 per cent of music performance revenues are derived from these sources (Vogel, 1998: 44). Only EMI, the smallest of the “majors”, remains primarily focused on music.

The various oligopolistic practices of the major record companies include strategies to: (i) maximize rent from collaborating with the musicians and artists adding value to the music, as well as (ii) maximize rent from the music users that pay for the recorded music.
With respect to the former, whereas court cases in the early days were based upon establishing the basic framework protecting “authors” with respect to publishing and performing rights, the more recent court cases have dealt with whether exploitation of the rights of music composers by multinational firms (especially the record companies) undermine the moral and long-term economic intention of the copyright system to protect creativity. The best-known court case in this respect is probably the artist George Michael versus Sony, which was lost by the artist in 1994 in the UK High Court. In the same year, the Monopolies and Mergers Commission undertook an enquiry into the business and pricing practices in the UK regarding the supply of pre-recorded CDs, LPs and tapes containing music, and they concluded (very controversially) in favour of the record companies’ business and pricing practices (MMC, 1994).

Despite the financial dominance of the majors, the industry continues to support a galaxy of smaller independent firms characterized by heterogeneity and offering a diverse range of services and products. Independent record companies have been able to survive often by specializing in market niches (classical, rhythm and blues, country and western, jazz) although increasingly these companies have only been able to continue by establishing alliances with the majors. There also exists a highly complex system of subcontracting on the production side among firms of different sizes. Most recording studios are independent and many producers subcontract their services to the majors. The presence of independent companies, particularly at the interface with artists, is probably a reflection of the limits of large firms with respect to creativity and experimentation, which remain an essential ingredient of a flourishing music sector.

The contribution of a large number of highly specialized firms also explains the geographical clustering of the music business in a small number of key centres, for example, Lagos, London, Los Angeles, Miami, Nashville, Paris and Rio de Janeiro. The reasons for this reflect the professional advantages that songwriters and musicians themselves can derive from being part of a closely knit community of talent. But, at the industry level, it also reflects the need for a readily available supply of specific assets and the advantages from having close communication where relations of trust have to be established, for example, between artist and producer. Even for the largest companies, the presence of music centres such as London, Los Angeles and New York allow for close links to and familiarity with financial markets enabling a degree of intimacy to develop between creditor and borrower, which is necessary when large but inherently risky investment projects are involved.

Although the majors and minors in the global music industry currently tend to be companies rooted in developed countries, we suggest that developing countries are possibly better positioned to compete in audio-visual industries than in many traditional industries. This is because the basic raw material, such as talent to create musical sounds, is readily available and entry costs, at least in the case of music, are not as prohibitive as in many other industries. Some countries, such as Brazil, have already established a competitive advantage in the creation of music and a generation of new musical sounds based on the fusion of their traditional music with Western musical traditions.

A great deal of so-called “world music”, based on folk music heritage, originates with musicians from the developing world. This type of music has wide “cross-over potential” and appeal and, although its overall market share is very small, it is growing (IFPI, 1998). In an article in the New York Times (1999) David Byrne, formerly the lead singer with Talking
Heads and now a record producer whose label carries a number of artists from developing countries, has offered a caustic critique of the term “world music”. It is a problem that the term does not recognize the various music heritages from the various regions of the word, and it is also a problem that the section containing “world music” is always very small and usually located in the back of music retailer shops.

Developing countries, despite being large in population, only account for 10–15 per cent of world music sales [UN Comtrade Database, 1997]. In addition, and despite the global image of the music industry, there remains a very strong regional dimension to musical tastes. In 1999, two-thirds of global music sales originated from a “local” source, ranging from 40 per cent in Europe to over 90 per cent in the USA. Latin America and Asia fell somewhere between these figures although, for Africa, the figure is below one-third. This regionalization of tastes points to potential markets for fledgling industries in developing countries.

A clearer sense of the potential of the industry in developing countries is made difficult by its informal and unquantified nature. The availability of sales data reflects the interests of the international recording music business, which continues to see these countries as potential consumers, rather than potential producers. However, it is the case that, with some notable exceptions, the production of music in developing countries remains small scale, informal and essentially craft-based. There is little capacity to use mass production or marketing techniques and, as a consequence, the recording business tends to stop at a premature stage (only supplying artists and repertoires or initial recordings) of the supply chain with limited value-added. The initial recording is subsequently sold, licensed to a foreign company that makes the master copies and distributes the product in the high-income markets. Very quickly, successful artists from developing countries follow their recordings abroad, becoming cut off from the business organization of their own countries.

The difficulties facing developing countries are apparent even with the largest producers. Brazil, which is among the 10 largest markets for recorded music (and employs an estimated 8,000 people directly and a further 55,000 indirectly, through retail trade, publishing, radio broadcasting and so on), has built a strong local repertoire, which accounted for three-quarters of sales in 1998, compared with a little more than one-quarter a decade earlier. Still, the five majors (Sony, Universal, EMI, Warner, BMG), control over a quarter of the Brazilian market and are the leaders in both local and international repertoire. The two largest Brazilian independent companies control only 6 per cent of the market with the remainder split between a large number of small companies (ABPD, 2000). The growth of the largest domestic company (Abril) stems from a successful alliance with the largest Brazilian supermarket chain that provides a distributional network. Joint ventures between smaller Brazilian companies and the majors have by and large proved unsuccessful.

India, with a music market of $460 million, has been more successful in establishing domestic control of its music industry. In part this is because of the close link between music and the large Indian film industry: film music accounts for over 70 per cent of the total music market. But government policy has also played an important role. Following legislation in 1977 to limit all foreign holdings in India, the two dominant companies in India (EMI and Polydor) were sold to Indian companies. A more complex structure has evolved with the leading Indian-owned companies accounting for one-third of the market and the combined
share of the majors below 20 per cent. However, some of the smaller Indian companies also have licence agreements with the majors. The Indian industry also has a large domestic production capacity with CD and cassette duplication plants. (By contrast, the distribution system remains anarchic and piracy is a major concern.) Despite this success, there are growing balance of payments concerns linked to musical imports. Although a large export market created by Indians living abroad has begun to emerge, Indian producers are unlikely to find big outlets in the large Western markets. India’s worries have wider resonance as asymmetries remain. Not only does the music trade continue to be dominated by Western producers but the absolute size of the deficit in trade between the developing and developed world also grew during the 1990s [UN Comtrade Database, 1997]. Thus, while developing countries are becoming more important both as producers of, and markets for, music products there is clearly an urgent need to strengthen the export potential of this sector.

This pattern of trade is not altogether surprising. Developing countries do not have the large firms and financial structures necessary to invest significant capital into a sophisticated marketing and distribution machinery with a global reach. Moreover, the local music industry in most developing countries has suffered from weak institutional and political support, low levels of entrepreneurial capability, low value-added, and over-dependence on foreign manufacturing and distribution. Hence the earnings are far below the potential. This is unlikely to change very quickly. However, looking to play by the rules of the copyright regime, or demanding a change in the rules of the copyright regime, provides some possible focus for policy makers in developing countries concerned to build a more effective music industry and improve the trading opportunities for its music resources.

In a global context, it is not uncommon to argue that the international copyright system is designed for developed economies and that it undermines the less developed economies’ problems and interests. For example, it is not uncommon to argue that the TRIPS Agreement is formed by the interaction of the roles and interests of the current IPR stakeholders and that the Agreement undermines the interests of the less developed economies. In this context, it has been argued that we need to pay more attention to how social contracts (through which governments protect the individual rights of their citizens) emerge and evolve (Sened, 1997). Governments also represent the interests of social groups, including the stakeholders of the IPR system. This reflects the alternative view that our copyright regime and the international enforcement system cannot merely be viewed with a functional problem-solving approach, in the sense that there may not be anything rational about it. Critical theorists such as Sell and May (2001) present a number of key moments in the history of IPRs that eventually led to particular IPR agreements (the WTO Agreement on Trade-Related Aspects of Intellectual Property, or TRIPs, being one of them). They maintain that the key moments in the history of IPRs are not the final improvement to legislation governing IPRs or the culmination of a history of legal rationalization. Rather, the design of an IPR system at any one time is based upon a particular constellation of political power and, when the power relations change, the IPR arguments become contested and open to amendments through political engagement.

Moreover, as relative newcomers, developing countries may have the most to gain from new technologies such as the Internet. The way in which various ICT and software-based technologies operate (designing the “paradigm” of how music is developed,
delivered in the form of music carriers and used) is also central to understanding the economic and social effects of copyright. We see how the record companies experienced their heyday under the CD technological paradigm, while their market positioning comes under threat as the digital revolution sets in. Basically, technological shocks have not stopped shaping the industry. Owing to the impact of new digital technologies, especially Internet technologies that enable direct downloading of music, distribution costs are expected to drop substantially, thus allowing new entrants. In that fashion, global Internet music sales will threaten to change the balance of power within the music market, thereby allowing music producers to bypass the record companies as well as allowing consumers worldwide direct access to their favourite artists at discounted prices. Consumers will be able to bypass entirely traditional retailers, with significant implications for the cost structure and configuration of the present industry. The five major music companies are concerned about the latest developments in entertainment technologies and are already preparing themselves for the Internet’s full impact. Collecting societies also have to rethink how to identify the online music users and the online music right holders, and how to collect and distribute their royalties (which also will involve an upgrading of their ICT systems), as digitalization is challenging the tracing of music flow. Digitalization has worried royalty managers because, when information is no longer tied to a tangible good (carriers like tapes, CD, cassettes) that is physically transferred from one person to another, it becomes difficult to control and monitor its flow. With the existing system the music is protected via the carrier—metaphorically, the bottle is protected, not the wine. On the other hand, given the opportunity to create better sampling practices by the collecting societies today (see Section 3.2), it might be possible to trace a larger percentage of the music flow online if proper technology is put in place, so the digitalization might be a blessing for the royalty management of the industry in the long run. Only time will tell.

However, even if the new ICT systems and digitalization provide some new opportunities for both producers and consumers in the less developed countries, they are faced with huge technological capability problems in mastering and affording the new technology. The technology divide (more popularly termed the “digital divide”) in the world is commonly recognized.

3.2. Orchestrating Copyrights in the Music Industry: Royalty Management by the Collecting Societies

While the copyright regime may underpin the law, economics and organization of the music industry, the enforcement of the system of royalty flows between music users and copyright holders is by no means automatic but needs to be monitored and administered through a complex machinery. As it would be far beyond the majority of “copyright holders” to negotiate and collect their own royalties, royalty collecting societies have evolved as a particular institution of copyright governance to perform this service. However, as illustrated below the collecting societies also perform other important roles.

The first collecting societies emerged in Europe in the middle of the 19th century and proliferated in the early decades of the 20th century. They are essentially non-profit-making monopolies or oligopolies controlled by their members, and whose function is: (1) to license musical works of their members for specific uses (the licensing is based upon a pay-for-use principle which requires that for each and every use of each and every copyright, owners’
work is identified and paid for); (2) to monitor use of copyright material and collect revenue; and (3) to distribute the revenue as royalties to members of the society.

Collecting societies have evolved, in large part, to reduce the transaction costs arising from the continuous and complicated task of monitoring and policing copyrights, including abroad. Royalty management is a complicated and costly process, and two of the major goals of royalty collecting societies are efficiency, in terms of cost saving in royalty management, and licensing as much as possible. For example, around the millennium, the Mechanical Copyright Protection Society (MCPS) roughly used about 5 per cent of revenue in processing and 95 per cent used for distribution to copyright owners, whereas the Performing Right Society (PRS) used about 10 per cent of revenue in processing and 90 per cent for distribution to copyright owners. The new ICT (especially tracking systems) can enhance the collecting societies’ capabilities in doing both tasks. Thus, royalty management means building institutional capabilities with respect to knowledge about copyright legislation, as well as the system of all music copyright holders, music delivery and music users. It also means building technological capacities to track the flows of copyright materials and monitoring royalty payments. Finally, it means establishing credible legal threats in the event of copyright infringement. Collecting agencies can also often play a “spill-over” role in the industry, lobbying policy makers on music-related issues, providing information on the business to their members, promoting musical talent via scholarships and so on.

The structure of collecting societies differs significantly across countries, in terms of their size (that is, numbers of members and affiliates, total revenue, number of employees); their internal organization, including whether they are public or private bodies; eligibility criteria for membership; the structure of the board and members' influence; their methods of monitoring copyright use and their basis for revenue distribution; and in their external organization, including methods of licensing, structure of tariff agreements and international collaboration. The possibility for conflict in some of those royalty management procedures include the collection and distribution rules set by the boards within the collecting societies.

Although the royalty collecting societies are essentially non-profit-making business services for their members and controlled by their members, they are not neutral organizations, as they have to deal with the different interests of their members and the fact that it is impossible to make everyone “happy”. The members naturally differ in interests as they belong to different musical communities, experience different levels of fame and income, and they may even have different opinions as to what role the music should have in the industry and in society more generally.

Three of the most central issues debated within the collecting societies are: (i) the collection rules and (ii) distribution rules, set by the boards within the collecting societies; (iii) the impact of an internal support system for minority groups in music culture and music for education. These rules and policies are indeed open to pressures from different groups. As collecting societies are monopolies or oligopolies, the problems are not helped by the fact that their members have no (or very few) alternative collecting bodies to take care of their interests. Yet, the Monopolies and Mergers Commission of the UK has found that such monopolies exist in favour of their members and are not against the public interest (MMC, 1996). To provide an example of such debates within collecting societies, we will now elaborate upon the above-mentioned issues, that is, (i), (ii) and (iii), with respect to the PRS.
Regarding (i): as it is impossible to monitor all music played in the country in which the collecting society operates, collecting societies sample a smaller percentage of the music played and use this as a representative guide when distributing royalties. This process tends to favour mainstream music, as the collecting societies tend to focus on the more mainstream music outlets. It is not uncommon that the more low-income groups complain that the sampling practices are biased against their interests.

Regarding (ii): as payment for the operation of the PRS is income-based (so the high-income owners in the form of royalties pay more than the low-income owners), the PRS also tends to have a distribution policy that favours the high-income owners. The idea is that the PRS makes it possible for new low-income owners to become members. In that sense the organization seems more democratic. However, it is not uncommon that the low-income groups complain that the distribution rules are biased against their interests. The trade-off is basically concerned with how much support should be given for new musical entrepreneurs in terms of free collecting and distribution services (that is, what is the eligibility criteria), versus who pays for the collecting society system and how much, versus who gets the revenue collected and how much. These are important issues set by the boards of the collecting societies. Those issues are related to how much influence the different income groups should have on the decisions taken by the boards. All those issues open the possibility for conflicts.

Regarding (iii): as the PRS would like to be socially responsible for their music profession, they have implemented a policy of cross-subsidies, which operate between copyright holders. This is motivated by attempts to support specific categories (such as, for instance, classical and other minority music with “cultural importance”). Basically, valuation of the various music rights is made all the more difficult by the realization that much of the music industry talent (in music supply) and taste (in music demand) is socially determined (for example, based upon social, political attitude or fashion) or determined by record companies supporting certain groups. It is also motivated by the fact that support for non-commercial music for education or health therapy is in the public interest. Finally, it is motivated by attempts to redress perceived imbalances in income as the collecting rules—see (i) above—favour mainstream music. Here, also, the situation is opened up for conflict.

Royalties are managed on the basis of their exclusive rights in copyright works (as identified in Section 2.1). For example, in the UK we find one of the most formalized and disaggregated monopolistic management structures of royalties with four collecting societies managing different music rights exclusively for different right holders. First, there is the Performing Right Society, which collects licence fees for the public performance and broadcast of musical works. The PRS represents the authors (composers, lyric authors, songwriters or other); publishers, who own or control the rights in the UK of public performance (live or recorded); and broadcasting, including cable diffusion of musical works. In 2002 the membership of PRS topped 37,500. Secondly, there is the Mechanical Copyright Protection Society Limited (MCPS) of the UK, which collects and distributes “mechanical” royalties generated from the recording of music in many different formats. These formats include audio CDs, VHS videos, mobile phone ring tones, audio-visual and broadcast material. Basically, MCPS’s principal function is to act as a collecting licensing body, representing as an agent those who own, control or administer the rights in the UK to reproduce copyright musical works (that is, master copies). Such rights are commonly
known as mechanical rights. This is basically about licensing record companies when manufacturing musical works. The MCPS redistributes revenue flows of royalties received on to its relevant members. MCPS in 2004 had around 17,000 members, made up of approximately 12,500 writer members and 4,500 publisher members. PRS allied with MCPS mainly to broaden their scope of using ICT and share and extend interactive databases (PRS, 1998). Thirdly, there is the Phonographic Performance Limited (PPL) of the UK which is a music industry collecting society representing over 3,000 record companies (in 2004), from the large multinationals to the small independents. PPL collects licence fees from broadcast and public performance users on behalf of the record companies. This licence fee revenue, after deduction of running costs, is then distributed to their record company members and to performers. PPL grants licences for the use of sound recordings in the UK to all broadcasters, which includes the television broadcasters and production companies, commercial radio, and cable and satellite channels. In the public performance sector, PPL licenses the whole range of users, which includes clubs, pubs, hotels, restaurants and shops, as well as individuals such as exercise instructors and dance teachers. Fourthly, there is Video Performance Limited (VPL) of the UK, which is the collecting society set up by the record industry to grant licences to users of music videos, for example, broadcasters, programme makers, video jukebox system suppliers. Whoever owns the rights in a music video can become a member, and the licence fee income collected by VPL from users is paid out to their members (after deduction of administrative costs). VPL in 2004 had approximately 900 members, from the major record companies to the smallest independents, and 50,000 music videos registered. However, the UK disaggregated model is not the only model. In other countries, there may be only “one” society exclusively managing all these rights, or there may be several societies managing the same rights non-exclusively.

Thus, the size of royalties paid to copyright owners or controllers is not only based upon bargaining and collaboration among various individuals and firms in the music supply chain (see Section 3.1), but the size of the royalties paid by music users to copyright owners or controllers is based upon similar bargaining pressures within a complex system of tariffs and licensing agreements. For example, the UK Performing Right Society, now allied with the Mechanical Copyright Protection Society, negotiates licences on an individual basis with some broadcasters, but for other users a tariff structure is applied, some of which are set by the PRS, some are agreed through trade associations, and finally, some are subject to agreements set by order of the Copyright Tribunal of the UK. Finally, there are “special arrangements” between the PRS and some music users (MMC, 1996: 71–74). Furthermore, there is no common standard within or across countries and, as always, bargaining agreements are subject to bargaining power. The monopoly or oligopoly status of the collecting societies does open up the possibility of controversial prices in bargaining situations.

Collecting societies usually have reciprocal arrangements with other analogous organizations all over the world in order to capture foreign payments from sources outside the countries of origin of music. In particular, international collaboration in the external organization of royalty collection societies is increasing, not only through royalty collecting agreements between societies but also in direct formal collaboration in collective monitoring or merging databases. For example, ASCAP of the USA, Buma/Stemra of the Netherlands and the PRS–MCPS music alliance of the UK have created an International Music Joint
Venture (IMJV) service centre to provide advantages in the digital age (PRS, 1999). This is only one example of several international initiatives, which, in addition to improving the services of the societies, also aim to have an impact on standardization issues in relation to their services.

However, international collaboration is not only enforced at the collecting society level. It is also built into a range of international treaties. Because intangible ideas and expressions can cross borders more easily than physical goods, copyright was embodied in international, multilateral treaties from a fairly early date. The first such treaty was the Berne Convention for the Protection of Literary and Artistic Works of 1886, which recognized the scope for enforcement of publishing rights across countries, and enforced a so-called principle of national treatment, subject to a minimum of protection years post mortem autoris. Rather than harmonizing national legislation, it was required that each member country gave the same protection to works of creators of member countries published within the country as they did to creators of their own country. This principle of national treatment today applies to the Rome Convention (1961) countries with respect to performing, mechanical and synchronization rights in relation to sound recordings (in the absence of other reciprocal agreements). However, the USA (the world’s biggest exporter of cultural products, including films, TV and recorded music) has not signed the Rome Convention. The WIPO Copyright Treaty and the WIPO Performance Phonograms Treaty (both entering into force 2002) are among the two latest treaties which relate to the Berne Convention and the Rome Convention (mainly as a response to new technology). Then there is the most recent Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) of the World Trade Organization (WTO) that came into force in 1994 as a part of the Uruguay Round to enforce IPR worldwide. By the time all signatories are in full compliance each is expected to have a system of IPR and effective enforcement consistent with internationally agreed norms and standards. TRIPS Agreement implementation is required from 1996 to 2006 (recently extended to 2016 in some cases), depending on the country’s level of development.

4. Conclusion

Prevailing “state of the art” mainstream theory on IPRs conceptualizes the objectives or rationales of the copyright system around some important key performance criteria. These central criteria are a good starting point to the economics of IPRs and also very useful for policy purposes. However, implicit in this IPR literature is the assumption that the copyright system automatically provides an enabling role with respect to all the rationales mentioned above, including for all parties involved in the industry. Thus, whereas mainstream copyright literature only considers the challenge in reconciling any possible conflict of interests between the music innovator and the consumer, in this paper we show that the story is a lot more complex. In this paper we found that:

- Even if IPRs in principle should facilitate markets for creative expressions of ideas, by adjusting for the inherent problems of market failure normally attached to knowledge and intangible expressions of ideas, markets may not always arise, for example, due to lack of institutional capabilities, or problems related to entering global music markets as a
result of the heavy corporate dominance in global music markets, or due to unauthorized copying is almost unavoidable, or other.

- Furthermore, trade in creative expressions may not always facilitate cultural/musical spill-over as expected. Rather, cultural imperialism may arise due to the heavy investment in mainstream music for profit purposes on a global scale. Considering the creation and distribution of music, as well as the price for a music CD, we also briefly addressed how the copyrights in this respect may not always generate “a wide variety” of “best quality music embodying best quality creative expressions” and at a “low price”.

- Even if IPRs signal prospect for reward, this may not always stimulate incentives to invest in invention and innovation, or stimulate innovation-based competition. Creative artists are often creative anyway (e.g. even countries with poor copyright regimes have a vibrant music culture), but we did find that the copyright was essential for the venture capitalists to undertake the investment in such expressions. However, we also found that innovation-based competition in the industry was somewhat distorted by the corporate dominance of five major companies controlling 75 per cent of the global music markets.

- Even if IPRs temporarily protect (or offer market privileges to) entrepreneurial talent from imitation, or for market entry of original creative expressions, we found this may not always facilitate sustainable development of a music industry. The central issue here is the lack of capabilities in managing IPRs at all levels (individual, firm, collecting societies, other support systems enforcing the copyright), where we found that the sustainability of the industry and income was closely tied to the organization, management and enforcement of music copyrights.

- This also brings us to the natural rights and moral rationale that can be attached to IPRs. Here we found that even if IPRs should in principle guard the natural right to claim an intellectual property, and the moral right to compensation and reward if someone else exploits another’s expression of an idea, individuals and firms inventing ideas and creative expressions may not always find their rights protected (again, due to lack institutional capabilities, but import here is also asymmetric relationships in terms of interests, financial dominance in bargaining situations, and level of development and power).

Thus, the prevailing theory on IPR is not able to explain why the IPR system generates different performance results and varying potential for growth across firms, sectors and nations participating in the IPR system, and this is one of the most essential questions for policy makers and problems faced by governments, the United Nations and other international organizations and developing countries.

In order to not assume economic enabling processes underpinning the rationales of copyright systems we have in this paper demonstrated how the copyright literature can benefit from merging the mainstream rationales into the framework of New Institutional Economics. Whereas the mainstream literature is useful in terms of setting out the objectives of the IPR system, we believe that its view on the mechanism regarding how these objectives are reached is too simplified as well as misses some of the real-life elements. All inventors are assumed autonomous and the very real effects of creative inter-dependence, strategic interaction, etc., in competitive copyright markets are largely ignored. However, by applying a New Institutional Economics perspective and using the music industry as an example, we have shown that *it is the very collaboration and
conflict in the “play of the game” which is the key in value generation and distribution from music copyrights, and therefore asymmetric relationships as well as power relationships (e.g. financial dominance) can have a huge influence on behaviour and outcomes.

New Institutional Economics is also useful for the copyright literature as its application does not assume that the copyright institution is already in place or that the institutional capabilities surrounding copyright management and enforcement are given. Rather, in this paper we show (using the music industry as an example) that because the copyright is closely tied to the creation and distribution of revenue and rent, the specific institutional capabilities at the national, sectoral, corporate and individual level are essential when organizing and profiting from creative expressions. We also demonstrated how the capabilities in the institutional support from, for example, the collecting societies in managing copyrights also play an important role. Indeed, building institutional capabilities regarding copyrights has been on the agenda of the United Nation’s for years in many less developed countries—but, do not confuse this activity with the argument for strengthening copyright institutions in initiatives such as stronger IPR protection or in agreements such as TRIPS (or at all).

In the “rules of the game” perspective we also learned it is not merely about the existence—or not—of an IPR (e.g. copyright), but it is about the specific rights, and the exclusiveness and exercise of such, which can make a huge difference to the performance of the system and that they should not be taken for granted but may vary. Change in the “rules of the game” can, for example, be implemented in the design of copyright law. Such design issues include: type of creative expression which can be protected, length and scope of protection, originality required, licensing law, costs and procedures and advantages of registering a copyright, type and costs of the remedies available for infringement, etc. Such elements are also often discussed in relation to regulation when minimizing some of the adverse performance effects of IPR regimes. However, in line with the arguments put forward by Macmillan (2006), we suggest that such focus should not be the only place to look for solutions, but that we also need to consider whether there are other legal approaches, not only within the structure of copyright law but also external to it, which might be capable of remedying some of the adverse consequences of copyrights and the commodification of creativity. In this context, we could, for example, turn to competition and trade policy, and policy related to human rights, etc. In our context, this is about regulating the “play of the game” rather than the “rules of the game” which always seem to be in focus in policy debates.

Thus, New Institutional Economics’ conceptual separation of the “institutional IPR environment” and the “institutions of IPR governance” is also helpful when designing IPR policy, IPR business strategy and IPR organization at the sector level. In particular, it helps us to understand which institutions to target when designing policy aimed at fostering the IPR-based economy and the actors best situated to improve performance of these institutions. For example, complex collective action by means of government intervention may be required to change the “rules of the game”, whereas less complex individual action between the sectoral players (i.e. public and private sector organizations and firms as well as individuals) may be necessary for changing the “play of the game”. However, the nature of the “play of the game” can of course also be regulated by rules placed by government.
References


