

# RENTS, RIGHTS N'RHYTHM: CONFLICT AND COOPERATION IN THE MUSIC INDUSTRY

Birgitte Andersen, Richard Kozul-Wright and Zeljka Kozul-Wright

## **ABSTRACT**

The economic importance of copyright industries in developed market economies has been well documented. Although less important in developing countries, this could change with the spread of information technologies. This paper first addresses how copyrights underpin the modern music industry, and in particular the role copyrights and cooperation among individuals and firms play in creating and expanding income and composite quasi rents from musical ideas. The conflicts throughout the music system in appropriating that rent, is then discussed. Overall, the paper argues that rent creation and rent distribution in the music industry is as much related to institutional capabilities, strategic interaction and bargaining power of individuals and firms, and the governance structures of copyrights, as to the presence of musical talent or market forces.

Key Words: Music industry, copyrights, rent, cooperation, conflicts.

**JEL:** L1; L8; O1 (to be revised)

Birgitte Andersen is a Senior Lecturer at Birkbeck, University of London. Richard Kozul-Wright and Zeljka Kozul-Wright are economists working at the United Nations Conference of Trade and Development (UNCTAD) in Geneva.

## 1. INTRODUCTION

*'Music is spiritual. The music business is not'*  
*Van Morrison*

The significance of copyright industries in developed market economies has been amply documented; according to recent estimates, the core copyright industries in the United States generate \$260 billion dollars annually and earn more than \$60 billion in foreign exchange (RIAA 1999, Jehoram 1989 and Silberston 1998). The core copyright industries include printing and publishing industries, the computer industry (also protected by patents), radio, recording, music, televisions, and advertising. Thus, the copyright industries consist mainly of audio-visual and cultural industrial sectors. However, developing countries lag far behind the developed economies in this respect. Therefore we have experience the stress by policy makers, particularly in multilateral development agencies, for a closer integration into the global market economy. They suggest that the copyright industries in the poorer countries now have the opportunities to experience some new growth for such sectors due to the increasing scope and importance of information technologies.

The music industry, which generates global revenues of close to \$45 billion and is one of the fastest growing export sectors of the global service economy (UNCTAD 1999), offers some obvious advantages for developing countries seeking to establish a copyright industry. Many developing countries have the basic music talent resource in ample supply, and the economic potential of music is already recognized in some developing countries, such as Brazil, India, South Africa and the Caribbean, with large domestic markets. However, in most developing countries policy makers are still reluctant to accord copyright industries, such as music, the status given to more traditional industries, and serious economic studies and data on their performance are missing or unreliable. (This despite the fact that the global music industry is as big as bananas, coffee and cocoa combined, with output figures for 1999 of \$27.5b, \$17.2 and \$3.7 respectively).

Correcting this situation is not helped by the treatment of copyrights in the economics literature. In conventional analysis, the copyright 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). Implicit in much of this literature is the assumption that the copyright institution is already in place, that the copyright system automatically provide an enabling value creating role for all parties in the industry, and that the real challenge resides in reconciling any possible conflict of interests between the innovator and the consumer. On the other hand, more critical law and economics see the copyright system as a crude expression of commercial power relations and in the specific case of music, a weapon used by multinationals against the creative independence of small countries and producers (Frith 1993, Macmillan 1998). In this paper, we will research those issues in depth. We will look at how the copyright system underpin the music industry for value and rent creation, as well as the processes of cooperation and conflicts throughout the economic system in appropriating that rent. In addition, the role of copyrights for business and society have largely been treated from a legal point of view. This needs to be

complemented with a more systematic economic analysis regarding how copyrights underpin industrial sectors. Therefore, researching the institutional role of copyrights and its roundabouts in underpinning the music industry is the central aim of this paper.

Firstly, the next Section 2 addresses the economic rationales and incentives for establishing music copyrights. This section includes the ‘basic’ economic characteristics of music-related products, especially in relation to how rent is generated from intangible cultural ideas. The specific way in which the music industry is organized around copyrights is then addressed in the two following sections. Section 3 addresses the sectoral system of individuals and firms creating and appropriating value and rent from music copyrights. In this context, the economic incentives for transferring ownership or control of music copyrights, or economic incentives for sharing revenue from musical works, are discussed. Section 4 addresses the important role of the royalty collecting societies as an unusual institution enforcing and orchestrating copyrights in the music industry. The possibility for exploitation of the participants in the sectoral system of rent creation from music copyrights is then addressed in Section 5. The appropriation conflicts with respect to how copyrights underpin the music industry (as addressed in previous Sections 2, 3 and 4) will be the subject matters of discussion.

In the paper, it is illustrated that because the music copyright is closely tied to the creation and distribution of income and rents, specific institutional mechanisms play a central role in organizing the industry. The paper concludes in Section 6 that creating a successful music industry is as much related to institutional capabilities for copyright enforcement at all levels (i.e. the individual, the firm, the sector and the nation), as well as specific governance structures of copyrights, as opposed to the presence of superior musical talent or market forces. Thus, where the required institutions and governance structures associated with the copyright are weak or missing, as in most developing economies, the chances of becoming competitive in this sector are greatly diminished.

## **2. ECONOMIC RATIONALES FOR ESTABLISHING MUSIC COPYRIGHTS**

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. Copyrights are important because they present the legal mechanism for protecting and appropriating from creative expressions and symbolic material. In this section we will review the 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 is very much about how the incentives to copyright music for rent seeking at the micro level, operates as the mechanism to obtain music markets and hence welfare goals throughout the sector and at the macro level.

### **2.1. Market facilitator for commercial exploitation**

Most fundamentally, the 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 ideas themselves. The fact that an idea can be consumed jointly, involves significant fixed costs in development, and can be reproduced very cheaply means that it has some of the qualities of a public good (This characteristic is usually referred to as the “expansible” or “non-rival” aspect of a public good). But, unlike a public good, it is possible for the creator of an idea to exclude others from using it by use of IPRs, opening the possibility for wider commercial exploitation. Establishing property rights for ideas 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 ideas so as to generate greater rents. Similarly, as musical ideas, by definition, face increasing returns to scale, which gives rise to rents as markets expand, copyrights provide direct economic incentives for sharing musical ideas through trade. Thus, the economic status of a cultural musical idea changes once it can be separated from a performance and embodied in a tangible product (e.g. Compact Disk, CD, digital music file), whose reproduction becomes the focus of business strategy and technological innovations. The consumption of a cultural idea 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 Sections 3 and 4). Furthermore, assessing the complicated by the economic nature of ideas themselves, it can be claimed that musical ideas and other associated intangible assets are taking on a greater market scope in today’s globalizing world.

It can in theory also be argued that the economic copyright rationale for market creation also improves cultural expansion when there are externalities or cultural spillover from trade of musical ideas. However, a rationale that copyrights lead to *general* cultural expansion of musical ideas is highly controversial, as there are so many other economic and institutional factors that need to be in place (see Section 5.1).

As such, copyrights helps to define a marketable music product by helping to provide an institutional framework that aims to create a reliable income flows 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 to which separate authors are associated. Then there is the sound recording to which a single author is associated. Those rights will now be described.

A musical composition consists of music (i.e. the melody) and any accompanying words (i.e. 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. The copyrights in the musical composition are normally registered in the copyright Class PA [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 phonorecord (for example, cassette tape, LP, CD, or digital file).

A Sound Recording results from the fixation of a series of musical, spoken, or other sounds and is always registered in Class SR [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 phonorecord, or like, 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.

Hence, once a musical composition is fixed or codified into a notated sheet or a phono-record a music product becomes 'copyrightable', provided it meets certain conditions of eligibility, such as 'originality' and sufficient 'creative effort'.

The deconstruction of musical ideas for copyright registration and the associated division of labour among its authors or creators are presented in below Table 1.

Table 1. Deconstructing musical copyrights for copyright registration

Music idea	Classification of right:	Division of 'music creators' (or authors for copyright purpose)*	Physical objects in which the music work can be fixed**
Musical composition	Performing art (PA)	The composer The lyricist	Notated copy (music sheet) Phonorecord (tape, cassette tape, disk – LP or CD, digital file, etc.)
Sound recording	Sound recording (SR)	The performer (or recording artist) The record producer (or publisher)	Phonorecord (tape, cassette tape, disk – LP or CD, digital file, etc.)

\*Composer, lyricist, performer (or recording artist) and record producer (or publisher) are not necessarily different people.

\*\* The physical objects are not musical compositions or sound recordings, but just various ways in which music works has to be fixed for copyright registration purposes

The authors of the copyrights in a musical composition and sound recording will be granted a bundle of rights, associated with the copyrights. E.g. in the United Kingdom (in accordance with the copyright, designs and patents acts 1988), the copyright in a musical composition and sound recording contain the exclusive right:

- a) to copy the work
- b) to issue copies of the work to the public (including to rent or lend the work to the public)
- c) to perform, show or play the work in public
- d) to broadcast the work or include it in a cable programme service
- e) 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, as (i) new sound recording and music playing technologies (e.g. magnetic tapes, Long Play (LPs) vinyl records, Compact Disks (CDs), high fidelity and stereos, video, digital audio technology), as well as (ii) new broadcasting and public performance techniques (e.g. radio, television, cable, satellite, Internet) have evolved, the musical copyright which were originally designed to protect printed copies of musical compositions (i.e. music sheets) as well as live performances has likewise expanded to include sound recordings and some neighbouring rights to also receive payment for public and broadcast performances (whether live or recorded).

Neighbouring rights include performance rights, which is the right for the performer to receive royalty payment for almost any (live or recorded) broadcast and public performance of a composition. Then there is the mechanical rights, which is the right for the copyright holders to receive royalty payment for almost any (live or recorded) broadcast and public performance of a composition). Finally there is the synchronisation right, which is related to the contractual right (e) (see above) concerned with the right to make an adaptation of the work. In this respect, the synchronisation right is a right for the copyright holders to receive royalty payment for music that is timed to the display of visual images in films or videotape soundtracks. Thus, these neighbouring copyrights also provide the basis for collecting various types of license fees (Baskerville 1995: 111-34; see also Section 4.1 below on *Royalty Management by the Collecting Societies*)

## 2.2 Industry facilitator for sustainable development

Copyrights on music are also believed to protect entrepreneurial spirit for 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 facilitate 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 its turn, causes (or opens space for) industrial development and progress. It could be argued that copyrights allow breathing room for the inventor to invest in development without fear that another firm will steal the idea.

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, 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 are not encouraged to conduct their inventive activities, as without an IPR they will not be able to recover the costs of development (i.e. pricing at marginal production costs of production in order to compete with imitators means that the inventor or entrepreneur will not recover development costs) or expect any profit or special rent. 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 ideas 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 below section 2.3.

### 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 characterise 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 (Adam Smith 1776/1937 version: 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 (Alfred Marshall, 1890/1952 version). Consequently, while most resources can earn rents, these are likely to be temporary, competed away as new supplies enter the market. However, Marshall, like Smith, maintain 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: 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 defines 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 creation of statute that creates scarcity (i.e. it is about making an intangible product or service with public good character to a rival good, see Section 2.1). In a Schumpeterian vein (Schumpeter 1912) it could be argued that this rival aspect of copyright protected ideas embodied in the production and trade of goods and services stimulate innovation-enhanced competition by providing incentives to invest in innovating new musical ideas in the hope to profit 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). 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 spread (i.e. 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 up front investment), the copyright is essential to ensure the reward to the creator or just to ensure the full financial covering of the investment in the creativity. Thus, an important copyrights 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, also argued 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 further develop new ideas, and that without such incentives the invention inducement would be weakened. Douglass 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:

- 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, and
- IPRs are the cheapest and most effective way for society to hold out these incentives.

However, we cannot resist to question *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. However, 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 needs incentive. 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.

Nonetheless, it has also been argued by 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' (i.e. 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 the mainstream pop music than the music valued by the minorities. Section 5.1 discusses further the problem of cultural expansion of music for countries that have not succeeded in commercialising their music resources, and Section 5.2 discusses further whether the incentive system may be more designed for the venture capitalists than the musical authors.

### **3. ECONOMIC INCENTIVES FOR TRANSFERRING OWNERSHIP OR CONTROL OF MUSIC COPYRIGHTS, AS WELL AS INCENTIVES FOR TRANSFERRING REVENUE FROM MUSICAL WORKS**

Although the authors of music copyrights have the exclusive ownership and control over a bundle of rights (such as the right (a) to copy the work, (b) to issue copies of the work to the public (including to rent or lend the work to the public), (c) to perform, show or play the work in public, (d) to broadcast the work or include it in a cable programme service, (e) to make an adaptation of the work or do any of the above in relation to an adaptation, see 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. E.g. 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 commercialisation of the music product, one can argue that the music copyright almost always represents a complex case of joint ownership and joint control.

Finally, a situation can also emerge in which neither ownership or 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 to maximize rent through all best means of adding value to the musical composition (see 3.1). Another is the economics of complementary assets, rent seeking and risk management in volatile markets (see 3.2). A third is the rise of venture capital (see 3.3).

#### 3.1 Maximizing music value added for composite rent seeking

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. This can 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. Especially, as creative effort is divided between the original creators of the idea (i.e. 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, which is the one that deliver the music to its audience, has (in Towse 1992) been argued to represent a complex bundle of value added to the musical composition: “.. a singer represents a bundle of services – voice, voice type, stage presence, physical appearance, musicianship, ability to work with others – and a “talented” singer is the one with the right combination at the right time. The demand for singers is anyway derived from the demand for particular works and also depends on current taste or fashion for particular types of performance“.

Consequently, 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 idea. 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 resemble 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.

Thus, that each new component brings some value added to the original musical composition is one of the explanations for the transfer of ownership or control of music copyrights or transfer of revenue from musical works. This could in principle reflect a fair economic reward system, although this is very controversial (see Section 5 on possibility for exploitation). However, as explained in the following sections, the main economic incentives explaining why the copyright ownership becomes joint is the generation of composite rent and minimizing of risk as well as to raise venture capital.

### 3.2 Maximizing composite quasi-rent and minimizing risk

Section 3.1 argued that an incentive for joint effort to maximize music value added is 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 other), 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). Such rent can be established because the combination of specialized assets within an organized institutional arrangement

produce something so unique, so it could not have been produced by combining assets via the market. Basically, the organizing institutional arrangements guarantee the most effective use of the specialized assets, and through this the highest possible rents. As also noticed by Williamson (1985), asset specificity is among the most important factors when deciding how to arrange production.

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), 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.

However, 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 creation a new one, the fashion life cycle is often short lived and can change overnight, which in its turn leave music markets highly volatile as rents and incomes related to musical ideas can and do change abruptly over time. Another reason for volatile markets is illicit copying and imitation, which can reduce the potential size of the market (see section 5.1).

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 non-competitive or collaborate strategic networks all the way down the music supply chain. Such arrangements normally lead to transfer of ownership or control of music copyrights 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 copyrights, and its interaction with the strategies at the firm level.

### 3.3 Maximizing venture capital

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 one of the music copyright

case where the music copy rights 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 an idea into products for markets if the idea is covered by an intellectual property right, so with the copyright secured, fixed costs of production is covered (potentially) and minimum entrepreneurial potential risk is guaranteed.

Thus, an important incentive and function of the music copyright is basically to encourage venture capitalists to invest in commercialising copyright protected musical ideas. This economics of music copyrights rests on the assumption that musical ideas serve no *economic* purpose unless and until they are developed into commercial use, and that a venture capitalist (e.g. a recording company) would be unlikely to engage in the development of a music invention unless it own or controls the property rights (i.e. unless musical authors are in a position in which they can sell or license the their invention), or at least able to grab a share of the revenue from the musical works. The function of the copyright as a stimulus to the inventor's financier plays a major role in the commercial music industry.

#### **4. ORCHESTRATING COPYRIGHTS IN THE MUSIC INDUSTRY**

It should now be clear how copyrights provide both the legal and commercial foundations for the music industry. However, the performance of any copyright system (e.g. whether and how much income is generated from copyrights) 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. Thus, 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 (Besen, Kirby and Salop 1992). As it would be far beyond the majority of 'copyright holders' to negotiate and collect their own royalties, royalty collecting societies have evolved to perform this service. However, as illustrated in Section 4.1, the collecting societies also perform other important roles.

##### 4.1. Royalty management by the collecting societies:

The first collecting societies emerged in Europe in the middle of the nineteenth century and proliferated in the early decades of the twentieth century. They are essentially non-profit making monopolies controlled by their members, and whose function is

- to license musical work of their members for specific uses (the licensing is based upon a pay-for-use principle which requires that for each of every use of each of every copyright, owners' work is identified and paid for),
- to monitor use of copyrightable material and collect revenue, and
- 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 possibility<sup>1</sup>, and the new information and communication technology (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 copyrightable 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, etc.

The structure of collective societies differ significantly across countries, in terms of their size (i.e. numbers of members and affiliates (e.g. publishers), total revenue, number of employees); their internal organisation, 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 organisation, including methods of licensing, structure of tariff agreements, international collaboration. The possible for conflict in some of those royalty management procedures by the collecting societies are discussed in Section 5.3.

Royalties are managed on the bases of their copyrights (as identified in Section 2.1). In the UK we find one of the most formalised and dis-aggregated monopolistic management-structures of royalties with four collecting societies managing different music rights exclusively for different right holders. Firstly there is the Performing Right Society (PRS) which collects license fees for the public performance and broadcast of musical works. The PRS represent the authors (composers, lyric authors, songwriters, or other) and 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 onto many different formats. These formats include audio CDs, VHS videos, mobile phone ringtones, audio visual and broadcast material. Basically, MCPS's principal function is to function as a collecting licensing body representing as a agent those who own, control or administer the rights in the UK to reproduce copyright musical works (i.e. master copies). Such rights are commonly knows as

---

<sup>1</sup> A leading government official of the music industry in the UK argued in an interview that the Mechanical Copyright Protection Society (MCPS) and the Performing Right Society (PRS) in the UK are the most efficient royalty processors in the world: MCPS uses 5% of revenue in processing and 95% are used for distribution to copyright owners whereas PRS uses only 10% of revenue in processing and uses 90 % for distribution to copyright owners.

mechanical rights. This is basically about licensing record companies when manufacturing musical works. The MCPS redistributes revenue flows of its royalties received on to its relevant members. MCPS currently (in 2004) has 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 information and communication technology and share and extend interactive databases (PRS News Archive 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 license fees from broadcast and public performance users on behalf of the record companies. This license 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 the Video Performance Limited (VPL) of the UK which is the collecting society set up by the record industry to grant licenses to users of music videos, e.g. broadcasters, programme-makers, video jukebox system suppliers. Whoever owns the rights in a music video can become a member, and the license fee income collected by VPL from users is paid out to their members (after deduction of admin costs). VPL currently (in 2004) has 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, only ‘one’ society exclusively manages all these rights exclusively, such as JASRAC in Japan and SACEM in France. In USA there are several societies managing the same rights non-exclusively, such as e.g. ASCAP and BMI both managing performing rights, while one other society, SESAC, manage several rights.

Collecting societies usually have reciprocal arrangements with other analogous organisations all over the world, in order to capture foreign payments from sources outside the countries of origin of music. Especially international collaboration in the external organisation of royalty collection societies is increasing, not only through royalty collecting agreements between societies but also in direct formal collaboration in collectively monitoring or merging databases. E.g. ASCAP of the US, 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 digital age (PRS Press Release 1999). This is only one example of several international initiatives, which, in addition to improve their services of the societies, also aim to have an impact on standardisation issues in relation to their services.

However, international collaboration is not only enforced at the collecting society level. It is also build into a range of international treaties. Because ideas can cross borders more easily than physical goods, copyrights were embodied in international legal treaties from a fairly early date. The first such treaty dates back to the Berne International Copyright Convention in 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 actors*. Rather than harmonising national legislations, 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 synchronisation rights in relation to sound recordings (in the absence of other reciprocal agreements). However, the US (i.e. world's biggest exporter of cultural products (films, TV and recorded music) has not signed the Rome Convention. Then there is the most recent Trade Related Aspects of the Intellectual Property Section (TRIPS) of the World Trade Organization (WTO) that came into force in 1994 as a part of the Uruguay Round to enforce IPRs world wide. 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 depending the on country's level of development. However, it is not uncommonly argued by critical economists that the TRIPS agreement are formed by the interaction of the roles and interests of the current IPR stakeholders and that the agreement undermines the less developing economies problems and interests (See Section 5.1 and 5.3 for further discussion on the problems of the less developed countries)

## 5. POSSIBILITY FOR CONFLICT

In Sections 2, 3 and 4 we have learned about the law, economics and management of value and rent creation from music copyrights. However, in this section we will show how the institutional underpinnings of music copyrights with respect to the copyright rationales, sectoral collaboration and royalty management can also open up for the possibility for conflicts and exploitation.

### 5.1 Possibility for conflict when music copyrights regulate the industry

A central factor in the existence of a commercial music industry is the existence of a copyright; see Section 2. However, we will now show how there is a possibility for conflict and sometimes exploitation when copyright rationales regulate value creation and income for the global music industry.

#### *Cultural narrowing*

It is now well established that music copyrights create incentives and means for market creation and subsequent profit purposes. However, 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' musical ideas. 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 data base protection in research communities, it can similarly be argued how musical ideas 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 ideas 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 invest in idea creation 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 at an early state to ensure a sustainable industry, but that free exploration is needed shortly after to ensure a rich musical culture. This would argue for a shorter time span of music copyrights.

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 within *'Majors and minors in the global music industry'* within Section 5.2), but it is also a cultural problem. Basically, those record companies do not only control markets of 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.

#### *Unequal development and enforcement systems*

Unequal economic development combined with poor copyright enforcement systems in some regions of the world can lead to exploitation. We see how regions of the world (such as the Brazil, India, the Caribbean regions and Africa) that are rich in musical talent are not able to create value and profit from such on a larger regional and global scale due to industrial underdevelopment and poor or inefficient copyright enforcement systems. Basically, a sign of their underdevelopment is that there are no industrial and institutional support systems underpinning their music culture. E.g. in most developing countries, collecting societies are missing or very weak. Thus exploitation may occur, as local music creators have no option but to sell their music ideas below their value (see also *'Bargaining the ownership or control or revenue of music copyrights'* within section 5.2). It is a general problem for less developed economies that their traditional knowledge so easily become exploited in bargaining situations by companies rooted in the developed world who are institutional underpinned by a successful organization of sectoral structures and copyright systems. 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 developing economies problems and interests. (For further discussion see '*Problems and opportunities for the less developed countries*' within Section 5.2)

This put into context the rationales for copyrights, and in particular the TRIPS agreement (reviewed in Section 4.1). It has been argued that we need to put 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 reflect 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 (TRIPS being one of them). They maintain that the key moments in the history of IPRs are not final improvement to legislation governing IPRs or the culmination of a history of legal rationalisation. 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.

#### *The problems of piracy and volatile music markets*

However, copyright owners (rich or poor) also face the problem of exploitation of their effort invested in the music industry. The most essential feature of the various copyright right rationales in the above Section 2 is that it is about making intangible ideas (such as music) scarce and expensive. Where a musical idea is provided as a service through a live performance, the problems of joint consumption and (imperfect) excludability are reasonably easy to manage. The market is restricted and because reputation is itself established through direct creative expression, the musical idea is reasonably secure.

However, as the cultural idea acquires the properties of a non-rival product, this opens up the possibility for widespread copying and imitation when music is reproduced (on magnetic tapes, LP, CD, music files) via use of modern technology. The low cost of (re)producing an idea means that its market can be uncertain and fragile, quickly undermined by copying. This makes any investments in activities that rely heavily on ideas 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 means profitability relies on explosive but ephemeral market growth.

Thus, despite the effort for 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 bodies even claimed that one of 3 recordings sold in the world is based on piracy (BPI Statistical Handbook 1997). 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 copyrights, as well as various non-legal norms against it. Also, Eamon Shackleton (Director of Services, Irish Music Rights Organization, IMRO) questions in an interview we did (in Dublin, December 1999) whether the commonly great claims of global piracy is necessarily market distorting. That is, sometimes, he argues, piracy might create music markets in poorer regions where most cannot afford entering the 'legal' music market in the first place, and secondly, in such situation, piracy may function as a diffusion mechanism of the social or political culture to 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 information and communication technology of the common population. CD writers etc. are easy to access at almost any school, university, and workplace, and they are also relatively cheap to buy. In such situations a discussion has raised concerning an introduction of levies on copying equipment and material as corrective for the impossibility of charging for home taping and the like (Besen, Kirby and Salop 1992). This new type of digital piracy is about market substitution, as it is done by those who potentially could pay for the music. Thus, it seems as, although the music industry has become global, regions differ when understanding the causes, effects and impact of piracy. Therefore global regions need to be governed differently with respect to coming to terms with piracy issues.

## 5.2 Possibility for conflict when collaborating around music copyrights

A central factor in the existence of a music industry is the release of the copyright (in term of ownership or control) by the original creator all the way down the music supply chain, or negotiating the share of profit from musical works; see Section 3. However, whilst this arrangement opens the possibility to maximize rents, problems can arise from the fact that these benefits are not necessarily shared evenly.

### *Bargaining the ownership or control or revenue of music copyrights*

It is interesting to see how the transaction, and hence location of copyrights and royalties (which is 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. Towse (1999) and Kretschmer, Klimis and Wallis (1999) have illustrated how different incentives and interests as well as asymmetry in information and risk evolves 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 income generation in the music industry, it certainly does not reduce the variation in income determined by accumulated rent from sales and performances (MMC 1996: 57). MMC (1996) which conducted one of the most detailed studies of the income distribution within the music industry using data from the Performance Right Society (PRS), showed how 80% of those who own performance rights earned less than £1000 from performance royalties for 1993 while 10% of owners received 90% of the total distribution.

Already by the mid 20<sup>th</sup> century Fritz Machlup and Edith Penrose (1950) also noted that in many situations inventors find themselves in a bargaining situation where they have no option but to sell their patents [or copyrights in our case] at a price below their value. These bargaining situations often go against the moral rights to reward rationale of the IPR system (addressed in Section 2.3). Therefore, in the words of Fritz Machlup and Edith Penrose (1950): “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.”

This suggests that copyrights are not a mean to provide fair income to the music creators and their local cultural communities, but it is for the grandness of commercial exploitation. 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 the copyright system provide opportunities for maximizing revenue and rent from musical ideas, then it is a problem if this revenue it not spread in a way that all participants in the commercialisation of a musical idea are not rewarded in accordance with their value added. 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 feedback into (i) the poor sub-cultures of artists and musicians, and (ii) 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 a have lost one of their key opportunities in taking advantage of their traditional knowledge.

### *Majors and minors in the global music industry*

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 longstanding 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 (Neagus

1992). Particularly since the late 1980s, the industry has become even more concentrated (Alexander 1994). Currently it is estimated that approximately 75 per cent of the global market is controlled by five media giants: Sony, Universal, EMI, Warner, BMG. All but one (i.e. 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 1998)

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 (Neagus 1999). 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: 41). Only EMI, the smallest of the 'majors' remains primarily focused on music.

The various oligopolistic practices 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 been around whether exploitation of the rights of music composers by multinational firms (especially the record companies) undermine the moral and long-run 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. With respect to the latter; the Monopolies and Mergers Commission (1994) of the UK made 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.

Despite the financial dominance of the majors, the industry continues to support a galaxy of smaller independent firms characterized by an enormous heterogeneity and offering a diverse range of services and products (Fink 1989). Independent record companies have been able to survive often by specializing in market niches (classical, rhythm&blues, country&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 ingredients 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, e.g. between artist and producer (Fink 1989: 58). 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.

#### *Problems and opportunities for the less developed countries*

Although we have just learned that 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 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* (“I Hate World Music”, 3 October 1999), David Byrne, formally 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 world, and it is also a problem that the section containing ‘world music’ is always very small and usually located in the back of the music retailer shops.

Developing countries, despite being large in population, only account for 10-15% 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 United States. Latin America and Asia fell somewhere between these figures although for Africa, the figure is below one-third. This regionalisation 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 un-quantified 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 make 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 8000 people directly and a further 55000 indirectly, through retail trade, publishing, radio broadcasting, etc.) has built a strong local repertoire which accounted for three quarters of their sales in 1998, compared with a little more than one quarter a decade earlier. Still the five majors (Sony, Universal, EMI, Warner, BMG), controls over a quarter of the Brazilian market and is the leader 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 large proved unsuccessful.

India with a music market of \$460million 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 enormous 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 four leading companies all Indian owned 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 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, provide some possible focus for policy makers in developing countries concerned to build a more effective music industry and improve the trading opportunities from to its music resources.

Moreover, as relative newcomers, developing countries may have the most to gain from new technologies such as the Internet.

#### *The technological shaping factor*

The way in which various information and communication technology and software-based technologies (designing the ‘paradigm’ of how music is developed, delivered in the form of music carriers, and used) is also central when understanding the economic and social effects from copyrights. We see how the record companies experienced their heydays under the CD technological paradigm, while their market positioning becomes under threat as the digital revolution sets in. Basically, technological shocks have not stopped from 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 entirely bypass traditional retailers, with significant implications for the cost structure and configuration of the present industry. The five major music companies are extremely concerned about the latest developments in entertainment technologies and are already preparing themselves for 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 information and communication technology systems), as digitalisation is challenging the tracing of music flow. Digitalisation has worried royalty managers, because when information is no longer tied to a tangible good (carriers like tapes, CD, cassettes) that can be 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 poor sampling practices by the collecting societies today (see Section 5.3), it might be possible to trace a larger percentages of the music flow on-line if proper technology is put in place, so the digitalisation might be a blessing for the royalty management of the industry in the long run. Only time will show.

### 5.3 Possibility for conflict in royalty management procedures by the collecting societies

As explained in Section 4, the royalty collecting societies conduct the negotiate agreements between music users and copyright owners or controllers in most mature economies. Furthermore, the royalty collecting societies distribute the royalties collected to the complex structure of copyright owners and controllers. However, both processes open up the possibility for conflict.

#### *Bargaining agreements between music users and owners o controllers*

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 5.2), but the size of the royalties paid by music users to copyright owners or controllers are based upon similar bargaining pressures within a complex system of tariffs and licensing agreements. For example, the UK Performance Right Society (PRS), now allied with the Mechanical Copyright Protection Society (MCPS), negotiate licenses 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 orders of the Copyright Tribunal of the UK. Finally, there are ‘special arrangements’ between the PRS for 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 for controversial prices in bargaining situations.

#### *Collection and distribution rules set by the boards within the collecting societies matters*

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 fame and income, and they may even have different opinions of 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. A third issue is (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 the

their members have no (or very few) alternative collecting bodies to take care of their interests. (MMC 1996). Yet, the monopolies and Mergers Commission of the UK has found that such monopolies exists in favour of their members and is not against the public interest (MMC 1996: 9). To provide an example of such debates within collecting societies, we will now elaborate upon above-mentioned issues (ie. (i), (ii) and (iii)) with respect to the Performing Right Society (PRS).

Regarding (i): As it is impossible to monitor *all* music played in the country in which the collecting society operates, collecting societies samples a smaller percentages of the music played and use this as the representative 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 too biased against their interests.

Regarding (ii): As the payment of the operation of the PRS is income based (so the high income owners in form of royalties pay more than the low income owners), the PRS also tends to have a distribution policy which favour the high-income owners. The idea is that the PRS makes it possible for new low-income members to become member. In that sense the organization seems more democratic. However, it is not uncommon that the low-income groups complain that the distribution rules are too biased against their interests. The trade-off is basically how much support should be given for new musical entrepreneurs of free collecting and distribution services (i.e. 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 up 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 e.g. 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 (e.g. 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 interests. Finally, it is motivated by attempts to redress perceived imbalances in income as the collecting rules (see (i) above) favour the mainstream music. Also here, the situation open up for conflicts.

## **6. CONCLUSION**

In this paper we have illustrated how creating a successful music industry is as much related to

institutional capabilities and governance structures of copyrights and collaboration of individuals and firms as opposed to the presence of exceptional musical talent or market forces.

In this context we have in Section 2 focused on the role of the copyright and related neighbouring rights in providing a meaningful and important economic justification for the music industry. Without the copyright, the economic reward from original creative work is threatened and income flows greatly reduced. We showed how copyrights (i) facilitate music markets for commercial exploitation, (ii) facilitate sustainable development of a commercial music industry, and how they by providing prospects for reward (iii) pushes innovation enhanced competition and (iv) function as an incentive system by driving incentives to invest in commercial music creation and marketing of such ideas.

We then, in Section 3, illustrated how copyright provides a common platform for bringing specific complementary specific assets within the sectoral system of music creation and appropriation together. Basically, there are several economic incentives for copyright authors to transfer ownership or control of music copyrights, or to transferring revenue of musical works, to other parties within the music industry. That is, although, the author of a copyright has the exclusive control over a bundle of rights (such as the right to perform, reproduce and distribute the copyrighted work) these rights (either separately or together) may be transferred to another party, mainly in order to get the music product to the market. The reasons for this transfer of ownership or control or revenue is to maximize rent through (i) the economics of complementary assets which include all best means of adding value to the musical composition, (ii) risk management in volatile markets and (iii) as a mean to rise venture capital.

In Section 4 we found how monitoring and administering copyrights by the royalty collecting societies highlight an essential role in the enforcement and functioning of the copyright regime underpinning the music industry. Such bodies are often central agents standing halfway between the legal and financial systems, and cover both the national institutional and sectoral aspects of the music industry.

Finally, Section 5 discussed how the institutional underpinnings of music copyrights with respect to the copyright rationales, sectoral collaboration and competition, and royalty management by the collecting societies, can also open up for the possibility for conflicts and exploitation. It is not incorrect to argue that the copyright system can also undermine many problems and interests of many of those participating in the global music industry or forming part of musical communities. Thus, the copyright system is not *by design* a blessing.

Most fundamentally, the problem of piracy undermines copyrights rationales in volatile music markets. A different point is that, when music copyrights regulate the industry it may lead to cultural narrowing as it may produce a trade-off between musical expansion and music for profit, of which the latter is enforcing the mainstream music communities. Furthermore, when collaborating and competing around ownership or control of music copyrights we illustrated how there is a possibility for conflict and exploitation when bargaining power set the rules, and how

the ‘majors’ in the industry seem to hold the bargaining power. We also illustrated how there is a possibility for conflict in the royalty management procedures by the collecting societies with respect to the bargaining agreements between music users and copyright owners or controllers and with respect to the collection and distribution rules set by the boards within the collecting societies. Finally, a global copyright based music industry may lead to unequal development across countries due to unequal copyright enforcement systems and unequal levels of development. Talent alone is not sufficient to build a competitive music industry, and in most developing countries the music industry has suffered from weak institutional and political support, low levels of entrepreneurial capability, low value-added to and over-dependence on foreign manufacturing and distribution, and massive copyright infringement. Hence, earnings are far below the potential were the industry more effectively organized.

With all the possibility for conflict and exploitation one can of course question the worth of the copyrights system if it only takes into account the problems and interests of some selected participants in the music system. On the other hand, one can also argue that musicians have always been poor, so is it right to blame the copyright system? With respect to the former question we would 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. However, we do encourage an alternative copyright design, or more research on alternative systems, that are able to obtain similar policy goals of creating a music industry for sustainable development, at the same time as rewarding musical talent throughout society and facilitating cultural expansion. Whereas the copyright system in its current form is good in facilitating income and rent creation from musical ideas, we must recognize the problem that it is enormously bad in creating a ‘fair’ income distribution, and also extremely bad in generating cultural expansion. This brings us to the latter question, where we do recognize that it is a serious problem that many musicians and musical communities are so poor, as the copyright system, in principles, should have provided them with the opportunities to create income.

## References

- Alexander, P. (1994), “Entry Barriers, Release Behaviour and Multi-Product Firms in the Music Recording Industry”, Review of Industrial Organizations, Vol. 9.
- Andersen, B (2004). If ‘intellectual property rights’ is the answer, what is the question? Revisiting the patent controversies. Economics of Innovation and New Technology, Vol 15(5), 417-442.
- Associação Brasileira dos Produtores de Discos, ABPD (2000) Market statistics: <http://www.abpd.org.br/>
- Baskerville D. (1995). Music Business Handbook and Career Guide. Thousand Oaks, CA, Sage Publishing.
- Besen, S., Kirby, S., and Salop, S. (1992). An Economic Analysis of Copyright Collectives, Virginia Law Review. Virginia Law Review Vol 78, No.1, 383-411.
- Besen, S and Rasking, L (1991). An Introduction to the Law and Economics of Intellectual

- Property, Journal of Economic Perspectives, Vol.5, No.1, 3-27.
- British Phonographic Industry Limited (1998), BPI Statistical Handbook 1998, London.
- Burke, A.E. (1996). How Effective Are International Copyright Conventions in the Music Market?. Journal of Cultural Economics, 20, 51-66.
- Burke, A.E. (2000). Legal structure and strategic regulation of intellectual property: Who pays for R&D in arts markets ? Louvain Economic Review 66(1), 193-211.
- David, P. (2001) Will building ‘good fences’ really make ‘good neighbors’ in Science. Report to European Commission (DG-Research) STRATA-ETAN workshop on IPR aspects of internal collaborations.
- Frith S (1993) Introduction, S. Frith, ed, Music and the Copyright, Edinburgh University Press.
- Hurt R (1966) The Economic rationale of the copyright, American Economic Review, vol 56.
- International Federation of the Phonographic Industry - IFPI, (1998), Statistical Handbook, Various Years, London.
- Jehoram, H.C., (1989), “Critical Reflections on the Economic Importance of Copyright”, VCH, Verlagsgesellschaft MBH, No.4/1989
- Kretschmer, M., Klimis, G.M. and Wallis, R. (1999): “The changing location of intellectual property rights in music: A study of music publishers, collection societies and media conglomerates”, Prometheus, Vol.17, No.2.
- Landes, W.M. and Posner, R., (1989), “An Economic Analysis of Copyright Law”, Journal of Legal Studies, vol XVIII, June.
- Machlup, F. and Penrose, E. (1950): ‘The patent controversy in the nineteenth century’, Journal of Economic History, 10 (1), 1-29.
- Macmillan, F. (1998), Copyright, Culture and Private Power, Prometheus, 16, 305-316
- Marshall, A. (1890), Principles of Economics, (8th Edition), Macmillan, London, 1952.
- Monopolies and Mergers Commission, MMC (1994): The Supply of Recorded Music: A report on the supply in the UK of pre-recorded compact discs, vinyl discs and tapes containing music, London: HMSO
- Monopolies and Mergers Commission, MMC (1996): Performing Rights: A report on the supply in the UK of the services of administering performing rights and film synchronisation rights, London: HMSO
- Neagus K (1992) Producing Pop: Culture and Conflict in the Popular Music Industry, Edward Elgar, London.
- North, D. (1981). Structure and Change in Economic History, NY: W.W.Norton & Company.
- Performing Right Society (PRS) UK (1998): “Music Industry Combines to Develop World’s Most Advanced Music Database” PRS News Archive, 8<sup>th</sup> January.
- Performing Right Society (PRS) (1999): "World Rights Societies Announce Landmark Joint Venture", PRS Press Release, 17th March.
- Posner, R. (1992). ‘The economic theory of property rights: static and dynamic aspects’, Extracts from Property in R. Posner, Economic Analysis of Law, 4<sup>th</sup> edition, Toronto: Little, Brown and Company, 32-39
- Recording Industry Association of America (RIIA) (1999), Annual Report, Washington, DC.
- Sened, I. (1997). The Political Institution of Private Property. Cambridge: Cambridge University Press

- Schumpeter, J.A. (1912). *The Theory of Economic Development*, Trans. Redvers Opie, Cambridge, Mass.: Harvard University Press, 1934
- Sell, S. and May, C. (2001). Moments in law: Contestation and settlement in the history of intellectual property. *Review of International Political Economy* 8:3: 467-500
- Smith, A., (1776), An Inquiry into the Nature and Causes of the Wealth of Nations, Modern Library New York, 1937.
- Teece, D. (1986). Profiting from technological innovation: Implications for integration, collaboration, licensing and public policy' *Research Policy* 15, 285-305.
- Rivera-Batiz. L. and Romer, P. (1991). Economic Integration and Endogenous Growth, The Quarterly Journal of Economics, 2: 531-55
- Taylor, M. and Towse, R. (1998): "The Value of Performers' Rights: An Economic Approach", Media, Culture and Society, Vol.20: 631-652.
- Thurrow, L. (1999), Building Wealth, Harper Collins, Publication, New York
- Torremans, P. (1998), Holyoak and Torremans on Intellectual Property Law, London: Butterworths, 2nd ed
- Towse, R. (1992), "The earnings of singers: An economic analysis", in R. Towse and A. Khakee, eds, Cultural Economics, Springer-Verlag, Berlin.
- Towse, R. (1999), "Copyright and Economic Incentives: An Application to Performers' Rights in the Music Industry", Kyklos, vol. 52 .
- UNCTAD (1999), Jamaica: The Science, Technology and Innovation Policy Review, United Nations, New York and Geneva.
- Vogel, H. (1998), Entertainment Industry Economics, Cambridge University Press: Cambridge.
- Williamson, O. E. (1985), The Economic Institutions of Capitalism, Free Press, New York.