COPYRIGHTS, COMPETITION AND DEVELOPMENT:

The Case of the Music Industry

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The Case of the Music Industry

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The economic importance of copyright industries in developed market economies has been well documented. Although less important in developing countries, this is likely to change with the growing weight of the service sector in these economies and its importance for their closer integration into the global market economy. This paper analyses the relationship between the copyright and income generation in the audio-visual sector, in particular music, and argues that the appropriate copyright administration is essential in creating the conditions for a viable music industry in developing countries. However, an effective copyright regime is not, by itself, sufficient to guarantee a flourishing music industry, and other institutional arrangements will be needed in countries looking to better exploit their musical resources.

Music is spiritual. The
music business is not.

Van Morrison

Introduction

The economic importance of copyright industries in developed market economies has been amply documented, and these are becoming all the more important with the rise of the knowledge-based economy.[1] According to recent estimates, the core copyright industries[2] in the United States contribute $260 billion dollars to the economy and already generate over $60 billion in foreign exchange earning (Daley, 1999; RIAA, 1999). Although such industries are less significant in developing countries, this is likely to change with the growing weight of the knowledge-based service sector in these countries and its importance for their closer integration into the global market economy.

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1 On the copyright industries specifically see Jehoram (1989) and Silberston (1998). On the nature and growing importance of the knowledge economy see: OECD (1996); Carayanis and Alexander (1999); and Thurow (1999).

2 The core includes printing and publishing industries, computer industry, radio, recording, music, televisions, and advertising. In this paper, audio-visual and cultural industries will be used, interchangeably, to refer to this group of industries.

The music industry is one of the fastest growing export sectors of the global service economy (UNCTAD, 1999). Because it is based on creative expression and related intangible assets, intellectual property plays a critical role in determining its performance. The export potential of music is already recognized in some developing countries, such as Brazil and India, in addition to its complementary links countries) and its role in the promotion of national culture. However, in most developing countries the music industry remains under-researched with insufficient information or reliable data on its economic performance, and in many countries policy makers are still reluctant to accord it the status given to more traditional industries.

Redressing this situation has not been helped by the treatment of copyrights in the economic literature, subsumed under the more general discussion of technological change (Archibugi, 1992; Bainbridge, 1996). Although recent efforts to move beyond the conventional neo-classical approach to technological change have incorporated learning, the tacit dimension of knowledge and a more interactive relation between the producers and users of technological knowledge – all features of relevance to cultural industries – the focus has remained on the role of intellectual property in industrial research and development, where patents play a key role.[3]

The primary object of this paper is to show that because the production and distribution of audio-visual products is more closely tied to the creation of rents than is the case with traditional manufacturing products, specific institutional mechanisms, and in particular the copyright, play an integral role in organizing these industries. Where the required institutions associated with the copyright are weak or missing, as in most developing economies, the chances of becoming competitive in this sector are greatly diminished. The paper examines this organizing role of the copyright with specific reference to the music industry, paying particular attention to the interplay of legal, technological and economic factors. This further helps to understand the distinct institutional foundations of a competitive music industry. We conclude that creating a successful music industry is as much related to institutional capabilities as to the presence of music potential or talent.

The next chapter examines the links between ideas, rents and industrial organization. In particular, it shows that in industries where ideas are used as a key resource the need to bring together highly specialized assets and to create very large markets for the product lead to composite quasi rents, whose vulnerability means distinct institutional structures, including the copyright, are needed to organize an effective industry. Chapter II describes these structures in the global music industry. Chapter III looks at the links between copyrights and income generation in the music industry. In light of weak copyright regimes in many developing countries, the final chapter examines how copyright regimes have evolved as well as some of their institutional features, in particular the important role of collecting societies.

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3 For an excellent discussion of the new approach to technological change and its differences with the standard neo-classical model see David (1992).

I. TALENT, RENTS AND COMPETITION

The 1990s have witnessed the arrival of a more liberal global trading environment and a shift towards a new technological paradigm based on widespread diffusion of information and digital technologies. These developments coincide with ongoing structural changes in the developed market economies, particularly the steady rise of the service economy. Together these trends point to a much more important role for ideas and other intangible resources in underpinning competitive processes in today's globalizing world. Assessment of that role is complicated by long-standing conceptual and measurement problems surrounding the size and contribution of service activities in a market economy,[4] as well as by significant differences among these activities. But it is made all the more difficult by the peculiar economic nature of ideas.

The fact that an idea can be consumed jointly and that its production often involves significant fixed costs means that it has some of the qualities of a public good.[5] However, unlike a public good, it is possible for the creator of an idea to exclude others from using it, opening the possibility for wider commercial exploitation. Property rights for ideas must, as Romer (1992: 71) noted, mean a market price higher than its marginal cost (which tends to zero) giving rise to rents. At the same time, because the value of non-rival goods depends on the size of their market, there is an incessant drive to expand the market for ideas so as to realize greater rents. However, the larger the market for a particular idea, the greater the threat from copying; and the more so, the lower the marginal cost of reproducing and distributing the idea.

This dilemma is particularly apparent with cultural ideas expressed in a tangible product, such as a sound recording, a book or a film. Such ideas tend to have a shorter product cycle than other ideas, and explosive market growth is often the key to successful rent creation. Specific investments made in establishing a particular artist and promoting their ideas underpin such growth. At the same time, because these ideas can often be easily and cheaply reproduced by others, the originator of the idea can be highly vulnerable to copying, which can prevent a return on investment sufficient to cover fixed costs and to compensate for the high degree of market uncertainty (Landes and Posner, 1989). Organizing an industry around effective responses to this dilemma is complicated by the externality problems arising from the intangible nature of ideas.[6] Given that the value of an idea (whether as an input into production or as a final product) is difficult to gauge without first looking at or hearing it but that disclosure can mean giving everything away, there are likely to be significant problems of information uncertainty and coordination. Thus, finding ways to establish and defend a reputation for creativity (without giving away specific ideas) is likely to be an important concern of cultural producers. At the same time, creating cultural ideas means

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[4] For discussions of these problems see Baumol et al. (1989), and Rowthorn (1992, 1999).

[5] This characteristic is usually referred to as the "expansible" or "non-rival" aspect of a public good. A true public good is also non-excludable.

[6] Romer (1992) unduly downplays this aspect of ideas in his discussion.

constant borrowing from and experimenting with existing ideas, allowing that this has to be part of the creative environment in which cultural ideas can flourish.

In the presence of joint consumption and (imperfect) excludability, scale economies and non-competitive pricing, along with considerable risks and uncertainty, are likely to be characteristic features of cultural industries. As a consequence, distinct institutional structures, including those relating to the copyright, play a pivotal role in shaping the performance of these industries. In part, such structures arise out of the need to reduce transaction costs, which can be particularly high when intangible resources are used extensively.[7] But it is the central importance of rents – never occupying a comfortable place in conventional economic analysis – which is the key to understanding the structure and dynamics of audio-visual industries.

The earliest discussions of rent concentrated on payments arising from the unique qualities of land. Ricardo demonstrated that because the supply of land was invariant to its price, differential rents would be earned on lands of varying quality, depending on the overall demand for agricultural products and the quality of the land employed to satisfy that demand (Ricardo, 1981). However, a rent could be earned even on land of equal quality due to specific attributes that augment its value over the next most valued use. In the case of land, location could give rise to such scarcity rents. But classical economists also recognized that a scarcity rent could arise with other resources:

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

Where the supply of such talent is fixed and the service highly specialized, all earnings would take the form of a scarcity rent whose size would be contingent on the extent of the market reached by the superior talent.

Subsequently, economists rejected the idea that land was a special factor of production, and the term quasi-rent was coined to suggest that, while the supply of most resources was invariant to price in the near term, they were usually augmentable over some longer period (Marshall, 1952). Consequently, while most resources can earn rents, these are likely to be temporary, competed away as new supplies enter the market. However, following Smith, Marshall recognized 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, 1952: 517).

[7] In the case of the music industry, pioneering work from a transaction cost perspective has been undertaken by Ruth Towse.

While Marshall had in mind the exceptional abilities of skilled labour and management in traditional manufacturing activities, in those industries, such as the audio-visual industries, where creative effort is not simply a complement to labour and capital but actually defines the nature of the product itself, rent creation is likely to take on a much more central role in shaping economic performance. This is very much the case where the talent produces a cultural idea.[8]

Where a cultural 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 remains limited and because reputation is itself established through direct creative expression, the cultural idea can be reasonably well protected from imitators and the rent earned is fairly secure. But even under these conditions, and particularly where the creative effort is divided between the creator of the idea and its performer, rent creation is less a matter of "natural" talent and more one of organizing multi-dimensional resources with a significant "social" component:

> ... 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 (Towse, 1992).

Consequently, rent creation in cultural services is likely to be a collective process where the "right combination" depends on the presence of various complementary skills to bring the best out of a performer. In their absence, the rent can be significantly diminished. At the same time discontinuities on the demand side due to changing tastes and fashion are likely to add to the uncertainty surrounding the size of the potential rent.

The economic status of the cultural idea changes once it can be separated from the individual creator and embodied in a tangible product, whose manufacture can become the focus of organizational and technological innovations.[9] Due to such innovations, the consumption of cultural ideas has been able to expand across both time and space. Under these conditions, nurturing and protecting artistic talent is much more closely tied to the organization and management of a growing market for the product. The advantage to the talented individual from this increased level of exposure is the potentially higher rents it can generate.