

## PROPOSITION

### Shackling the digital economy means less for everyone: the impact on the music industry

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*This proposition paper debates the policy measures designed to curb P2P file sharing on the Internet. In doing this, the paper challenges the Digital Economy Act, which passed through the UK Parliament on 8 April, and entered into force on 12 June 2010.*

## Introduction

What if government had created obstacles to entrepreneurs innovating in railways and trains, simply to protect stakeholders in canals and barges? What if libraries were prohibited in order to protect stakeholders in book printing and book shops? And what if government criminalized the users of these services? As the railways and libraries have transformed our economies and societies as complements and not substitutes in our system of innovation, production and employment, this would seem quite daft.

Similarly, new digital technology has the power to revitalize the cultural industries and the service economy, and to create more value for its businesses and its consumers. Through access to resources, low cost virtual premises, and worldwide exposure, it opens up opportunities for businesses (no matter how small or big) and individuals, who have the determination and ideas to do something, providing they understand digital technology.

However, these opportunities are now being threatened by the Digital Economy Act of the UK, which entered into force on 12 June 2010. It was first introduced in the Queen's Speech on 18 November 2009. Originally, it was Lord Mandelson's plan to grant the government wide-ranging powers to tighten copyright law, and especially to combat any form of online piracy. File sharing is targeted, with serious offenders having the speed or capacity of their broadband service limited or temporarily suspended. This means that the owner of a connection (e.g. cafe owners, universities, libraries) can be held liable, even if the owner is not personally responsible for downloading pirated material. The Labour government said that it wanted to protect the UK's creative industries, which are apparently under threat from piracy. The Digital

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Economy Act was passed on 8 April 2010, in what is known as the ‘wash up’ period before a general election, where it was generally favoured by the Conservatives, but not by the Liberal Democrats. The Digital Economy Act is very much supported by senior figures and forceful lobbyists from the music, film and television industries, as well as by sports and union representatives. It is generally not supported by Internet service providers, among others.

By ‘shackling’ (as in this paper’s title) I mean how the governments in the UK and in many other countries (such as France, which has adopted a file-sharing policy similar to the UK Digital Economy Act) believe that the solution for economic growth for the cultural industries in the digital economy is to be found in an increased privatization of our cultural assets, in the form of strong intellectual property rights, including strong copyright laws, and strong enforcement regimes. However, in this paper, I argue that there is a need for a policy approach which better balances the protection with the sharing of our intellectual property in the cultural industries. If we get the balance wrong, which I believe is the case at the moment, there is less for everyone. By less for everyone, I mean reduced welfare effects throughout the digital economy, whether we talk about producers, consumers, users or other stakeholders. More sharing and open access to our intellectual property in the cultural industries will not only increase our value pie, but also create opportunities for greater socio-economic equality.

### **The power struggle across technological regimes**

On the one hand we have the dominant players of the old economy whose business models are developed around content production for analogue distribution channels which they have been in a position to control and dominate for decades. Companies include Warner Music Group, EMI, Sony Music Entertainment, and Universal Music Group and they are represented by the British Phonographic Industry (BPI). These four music majors control about 75% of the global music market, and have close ties with the International Federation of the Phonographic Industry (IFPI). They were forceful lobbyists in support of the Digital Economy Act.

On the other hand, we have the Internet service providers who have grown up with digitalization and the Internet. They are not developing content or products but rather selling services using the technological and business opportunities of digitalization. They include Google, Facebook, Yahoo, eBay, TalkTalk and BT, and have acted as a forceful interest group against the Digital Economy Act in its current form, even being joined by the British Library. Other new Internet service providers for the music industry that have grown up with digitalization include Spotify, MySpace, and YouTube. As they become established, more musicians and artists are signing up with these new Internet service providers.

The new Internet service providers are also able to add more value for consumers by providing a broad range of material at a low price, while promoting a range of musicians and artists, giving everyone a chance of exposure and true competition. Analogue broadcasting and distribution via fixed format (CD, LP, and tape) have been around for ages, but they are limited in how much data they can carry, and they make for expensive business models. Venture capital is required to cover risk in volatile music markets, which is one of the reasons why the music majors (Warner, Universal, EMI, Sony) achieve control over artists and markets (radio, clubs, retail, etc.) and are able to sell cultural services to listeners at high price.

The music Labels are now threatened by true competition from the new Internet service providers, whose revolutionary business models exploit the business opportunities of the new digital technology. Their business models are based upon inclusiveness, interaction and competition through exposure of many artists, as well as high variety and low price for users. The business models are spurred by access, participation and low copyright protection (soft intellectual property rights or no IPR enforcement). Their direct and indirect economic effects can be huge, and they open up our cultures.

This can only be an improvement on our outdated business models developed around analogue technology and a narrow selection of artists and expressions (usually pop and mainstream) and a strong copyright-protected content (mainly owned by the Labels) in order to make the expensive business model work. If copyright is infringed, the industry can experience institutional market failure, so a costly enforcement system of royalty collecting societies and court cases has to be implemented. The result is a narrow range of products at a high price, and closing of our cultures.

As digitalization has moved the edge of the competitive game to the digital service providers, the Labels push hard to switch it back to the content providers. They do this by providing limited access to their content, through enforcement of strong copyrights, and by making it difficult for Internet service providers and software writers (e.g. bit-torrent software writers) to launch new competitive business models based upon the technological opportunities of digitalization. The Digital Economy Act's institutional attack on wi-fi services by making them legally liable, even if they are not personally responsible for downloading pirated material, can be regarded as a tool in this direction.

While keenly lobbying for clauses in the Digital Economy Act when it was discussed in Parliament, the BPI and IFPI also made sure they had the loudest voice outside Parliament (for example, in national newspaper publicity). They uncritically publish their claims, numbers, and reported effects of P2P file sharing. Numbers coming from IFPI include a study by Jupiter Research claiming that between 2007 and 2012 the cumulative cost of illegal file sharing to music companies will be £1.2bn. The BPI website states that copyright infringement cost the UK music sector an estimated £200m in 2009. In such claims there is only one mention of a substitution effect of P2P file sharing and there is no mention of how money in the new business models is made elsewhere in the value chain rather than directly from pre-recorded music.

To move from the old economy into the digital economy, it is important that content producers and service providers speak and collaborate. It is disappointing to see that the Digital Economy Act does not encourage such collaboration, but instead empowers the expensive business models of the old analogue economy, supported by strong copyright, and thereby discourages investment in new digital entrepreneurship.

### **Witch hunt of P2P file sharers**

The general public does not understand copyright law, nor the rationale for copyright. It is easy to pay for the TV and the radio licence, and a licence fee is incorporated in the CD price, so no consumer education is needed. However, when the wine pours down the digital highway and it is not protected by the bottle, then it is difficult to trace which drops are copyright protected and which are not. How the system works online is not transparent. That we live in a gift economy where mobile telephones, computers, TV freeview, software, computer games, and more, are totally free when

we subscribe to certain services (sometimes for free) does not make life less confusing. Transparency is needed if a market is to work. We cannot victimize file sharers because the industry deprives the market of transparency. Music lovers simply follow their instincts, and sometime this means tripping or stumbling over copyright-protected music.

Although the Digital Economy Act is not supposed to criminalize P2P file sharers and will allow disconnection of the broadband of only serious P2P file sharers, this is not how it will work in practice. P2P file sharers attending court are to be charged with fraud or copyright infringement offences of one or just a few singles or albums. They will face prison sentences of several years if they lose. It is not about how *much* you share, but about if you share a *particular* music file. The cases are random in the sense that almost one in three households engages in P2P file sharing of free music (Andersen and Frenz, 2007). Anyone could clash with the law. Those who do are just unlucky.

Government helps to facilitate these court cases, as the victims are often arrested by the police, prosecuted by the government, and the taxpayer pays for the hearing. For example, I have been involved as a defence witness in two such cases. Oink's Pink Palace (frequently written as OiNK) was a prominent BitTorrent tracker which operated from 2004 to 2007. Following a joint operation (codenamed Operation Ark Royal) between Interpol, the International Federation of the Phonographic Industry (IFPI), the British Phonographic Industry (BPI), and other organizations, the site was closed on 23 October 2007. The site's creator, software engineer Alan Ellis (24 years old), was arrested by both British police and Dutch police. He was found not guilty of conspiracy to defraud (a common law criminal offence which carries no maximum custodial sentence) on 15 January 2010. Furthermore, Matthew Wyatt (just 17 years old) was arrested in 2007. He was charged with distributing copyright material that would prejudice the copyright holders, a criminal offence that carries a maximum 10-year custodial sentence. Again, he was prosecuted by the state, and the case was paid for by the taxpayer. With the trial fixed for June 2010, the case was dropped by Teesside Crown Prosecution Service in March 2010. There were at least three other such cases in 2008 (they pleaded guilty and were sentenced to community service and payment of court costs).

Such court cases should be unlawful because of lack of transparency, randomness in prosecution, and because there is no evidence that the individuals have caused direct harm to the industry (Andersen and Frenz, 2007, 2010; Oberholzer-Gee and Strumpf, 2007). The cases throw an unflattering light on the behaviour of the authorities and the music industry in fighting illegal file sharing. These are modern witch hunts in which random people are randomly selected to be blamed for a drop in revenue from pre-recorded music (mainly because of the demise of the CD format). However, the overall income to the industry has increased as a result of diversification of the ways in which music markets work in the digital age. For example, in 2008, the UK music industry was worth £3.6bn, and income was reported to be up 4.7% from 2007 (Page, 2009). Although income from pre-recorded music is down, income from performance rights, live concerts, subscriptions, master-tones, advertisement, sponsorship etc. is up.

The adverse social and economic consequences of the Digital Economy Act criminalizing P2P file sharers could be huge. Uneducated individuals or households who do not really understand how the online music industry works, may choose to abstain from music on the Internet in order to avoid coming into conflict with the new law. Also, potential or existing public wi-fi services (i.e. owners of connections, including cafes, youth clubs, housing estates and so on) could stop connecting people if they are

held liable, even if they are not personally responsible, for downloading pirated material. It is here that we need to keep in mind that e-commerce would not thrive if people did not trade online. This will not only damage music businesses online, but will also leave individuals, households and businesses on the wrong side of the digital divide.

### **What if we wrongly blame the P2P file sharers?**

If we wrongly blame the P2P file sharers for the market struggle the music industry majors are facing, then policy can only fail. An independent report produced for Industry Canada (Andersen and Frenz, 2007) shows that free music downloading, including P2P file sharing, is neutral to CD purchase. This means that there is no difference in propensity to buy CDs between those who file share and those who do not. The analysis was carried out for 2100 Canadian households and the data are representative of the Canadian population age 15 and above. Furthermore, focusing only on the behaviour within the P2P file-sharing group, it found that the more people engage in P2P file sharing, the more music they purchase. And this is even after adjustment for the effect of 'music interest' so the result does not simply reflect the fact that music lovers engaging in more P2P file sharing also buy more music.

People explore when they engage in P2P file sharing, and this leads to subsequent purchases in a 'hear before buying' effect. Another significant market creation effect is that people look for music which is not available elsewhere (e.g. in the mainstream outlets). Another result of people engaging in P2P file sharing is a market segmentation effect, i.e. people wish to buy a single digital file rather than the whole album. The increase in music purchases of more active P2P file sharers was explained by the fact that the (statistically significant) market creation effect of P2P file sharing outweighs a (statistically significant) market substitution effect, where people download freely as they are unwilling to pay.

There seems to be an obsession in the industry and among the politicians supporting the Digital Economy Act with focusing on the substitution effect of P2P file sharing. The situation is very complex and this is not acknowledged in the claims of the BPI and IFPI. As described above, for each individual various behaviours result from P2P file sharing. It is the combination of these effects which must figure in the debate on the effect of P2P file sharing on music markets.

A key problem with the claims of the BPI and IFPI is that they compare macro data in terms of music sales (or revenue), finding that CD sales have dropped and MP3 sales have not taken off in terms of the money the industry used to make from pre-recorded music. They simply *assume* that this is caused by P2P file sharing. An added problem is that the industry treats file sharing as if it automatically means that less music will be purchased. For example, the IFPI claims that 95% of music downloads are unauthorized, with no payment to artists and producers (IFPI, 2009b), which shows just how out of touch the music industry is with online communities. The statement also suggests that all downloaded material automatically means less music sold and therefore less income. Those who manage music businesses should know more about how consumers follow their interests in the new digital economy, and should implement this in their business models. Results from the survey of the Canadian population also indicate a change in technological paradigm explaining the fall in CD sales (Andersen and Frenz, 2007). For example, people who own MP3 players are less likely to purchase CDs, and more likely to purchase electronically delivered music.

Volume sales of full-length albums 1973–2008 reported in the IFPI *Handbook* (2009a) also show a change in format. The LP markets peaked around 1980, magnetic tape around 1990, and CD markets around 2000. Data reported in the IFPI *Handbook* also show how *online* electronic music markets (reported in volume) are growing speedily, and that consumers now prefer music singles rather than full-length albums. In addition, BPI (2009) data show how music purchased via *mobiles* accounts for about 42% of all single sales. Unfortunately, the change in technological paradigm in the music industry is associated with a digital divide. People who report greater Internet skills and younger age groups are more likely to purchase electronically delivered music and to engage in P2P file sharing. However, there is no gender related digital divide; women are as active as men online (Andersen and Frenz, 2007).

Finally, it should be mentioned that music is acquired freely in many different ways. Results for the Canadian population show that 29% engage in P2P file sharing, 29% are ripping music from CDs, 23% are downloading free music from promotional websites, and 9% are downloading free music from private websites. Finally, 21% of the population is acquiring free music by copying electronic music files (e.g. MP3) from other people (Andersen and Frenz, 2007).

### Disconnecting the networked economy

The Digital Economy Act, permitting the slowing down or temporary suspension of broadband connections to households, will surely have adverse effects throughout our entire national system of innovation, production and employment. Households use the Internet for other things than downloading music unlawfully. There is a positive relationship between P2P file sharing and the purchase of other entertainment products, such as videogames, cinema tickets, and concert tickets (Andersen and Frenz, 2007). PRS Music confirms that live concert revenue is up 13% from 2007 (Page, 2009), and a huge increase in revenue from live concerts is also evident in Sweden (Johansson and Larsson, 2009). By ignoring such network effects from P2P file sharing, the government is surely shackling our national system of innovation, production and employment.

In general, besides P2P file sharing, the Internet is used for a range of different activities, such as purchasing online (electronically delivered music, travel, books, CDs, DVDs, food), online auctions, email, surfing, homework and education, social networking, working from home, playing or downloading computer games, watching TV, telebanking and paying bills, making tax returns, and more. Do we really want a situation where a mother cannot prepare for an important meeting, or a father cannot look up important health information or do his self-assessment tax return online, because their daughter has engaged in P2P file sharing, or where children cannot do homework because of their parents' behaviour?

Also, people engage in downloading activities at work, schools, Internet cafes, while visiting friends or relatives, so logging off individuals or households engaging in serious and unauthorized P2P file sharing is unrealistic. Furthermore, targeting wi-fi services (or connection hubs) would exaggerate even wider social welfare problems. In this way, the Digital Economy Act surely runs the risk of over regulation. Disenabling a section of the UK economy, as a copyright enforcement tool for the Labels, will paralyse the digital revolution and create less for everybody. Rather, we need to invest in better and stronger broadband connections to all households, better mobile networks, closing the



digital divide, and not spend public resources disciplining society. This will be hugely expensive in terms of monitoring online behaviour, disconnecting and then reconnecting households, policing and random prosecution.

### **The question of rights, but whose rights?**

The supporters of the Digital Economy Act assume a lot of rights for holders and controllers of copyright, but seem to forget a whole range of other rights. P2P file sharers have rights. When they purchase more music, and more of other entertainment products, they create more value for the copyright holders. Thus, it makes sense that they (and their households or the places they have operated from) have the right not to have their Internet service slowed down or suspended. Furthermore, to inhibit all members of households from participating in the digital economy by making them victims of the crime of other household members can only infringe basic human rights.

And what about users' rights in general? For example, as consumers we have the right to high variety (more choice), high quality and low price of music, if we are in a position where this can be achieved. The digital revolution supplies us with new business models that can do just this. Also, if we have already purchased an expensive CD, record or tape (often the same music is already purchased by the same individuals in several music formats), what is wrong with downloading a replacement copy online, given that the marginal cost of reproduction of digital products is zero?

The heavy downloading of free music suggests that the general public has no moral problems with the activity, but focuses on its perceived rights. When celebrity artists back the Labels in their curbing of P2P file sharing and in the promotion of the Digital Economy Act in its current form, they are truly out of touch with their fans and the views of the general public. All artists (and not just the few artists favoured by the Labels) have the right to be promoted and enter competition, and the new technology gives everyone an opportunity. Artists making their career through online music or networking sites can make a living from their talent independent of a major Label. Artists who do not agree that P2P file sharing harms the music industry (such as Nick Mason (Pink Floyd), Ed O'Brien (Radiohead), Dave Rowntree (Blur), and Billy Bragg) also see new business models based upon the opportunities offered by digitalization as opportunities for independence.

In turn, new business models, allowing more artists to enter competition, could also lead to more equal income distribution. The current situation is that empirical studies of cultural markets consistently show a highly skewed distribution of earnings. For example, the Monopoly and Mergers Commission's (1996) study of PRS, the UK collecting society, reveals that the top 10% of composers/songwriters earn over 80% of total earnings. This is confirmed by Kretschmer and Hardwick's (2007) comparative survey of 25,000 British and German literary authors, which shows that the top 10% of writers earn about 70% of total earnings. Similarly, a recent study of the Swedish music industry shows how music revenue (especially from live concerts) has increased overall (Johansson and Larsson, 2009).

Finally, the Internet service providers have the right to challenge the old technology, to challenge established markets, and the right to challenge established business models. They are in a position to improve our services and create higher welfare effects and socio-economic equality. It seems as if the Labels are content for the music

industry to restrict the size of the music pie as long as they take the biggest slice. Their traditional rights have become privileges via the Digital Economy Act, because the technological and business opportunities in the digital economy offer better solutions. The digital economy allows the music pie to grow rapidly, and many more artists and entrepreneurs to take a slice of the pie.

### **... and what about globalization?**

It is not difficult to understand why the BPI is lobbying to enforce the market position of its members when they find it difficult to exploit the business opportunities of the digital economy. However, in this power struggle between the old (analogue) and the new (digital) economy, it is disappointing to see how the IFPI (which represents 1400 companies across the globe) seems to lobby for the interests of the Labels. Many poor regions of the world are not poor in cultural expressions and work hard developing music industries independent of the Labels. Music industry figures from these regions have discussed for years how the Internet and the new digital technology could enable them to become independent of the major music labels and how this would stimulate local development, local employment and wealth through global connections (United Nations, 2001). However, poor regions need to develop capabilities in order to do this. Only 8% of online music services (of so-called 'world music') identified by IFPI is hosted in developing countries, and this should be of concern to the IFPI.

Despite being the 'home' of world music, developing countries are for the most part unable to provide the production and promotion capacities expected by rising stars. As a result, revenues are mostly channelled through record companies in Europe and the United States, and very little trickles down to the countries of origin. (Labbé, 2009)

As Daba Sarr, coordinator of the Export Bureau for African Music in Dakar, puts it, 'Either African artists are signed up by the big labels in Europe and the US, or they struggle to get noticed and make a living' (cited in Labbé, 2009). The situation could be changed in the online world, but this is not happening. Of course, pop concerts supported by IFPI and the Labels are useful in creating awareness of the suffering in poor countries. However, they are not facilitating proper long term economic development; nor are they finding ways of maximizing the economic contribution music can make in poor economies (often rich in music talent) in a digital world in which music is produced, shared, and consumed in new ways. The Digital Economy Act in the UK could have seized the opportunity to set a precedent for greater inclusiveness. Instead, it ignores the possibilities.

### **Shackling the digital economy means less for everyone**

Wealth creation in the digital economy is based upon sharing and access. It is a paradox that while digitalization has allowed sharing of information, we are constraining the opportunities this offers with strong intellectual property rights. Such IPR policies are based upon orthodox theories (or belief systems) or 'intuition' rather than research and evidence. It is also a paradox that while policies are making our IPR stronger and more exclusive, practices embedded in modern organizations in the new digital economy are creating wealth via non-proprietary business models. Supporters of the Digital Economy Act seem to have no feel for the power of the Internet. If the



new LibDem–Conservative coalition government has any business sense, it will recognize that failure to embrace the digital economy will mean shackling British businesses, innovation, skills and markets so that there will be less for everyone in the future.

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