

## RESPONSE

### The Digital Economy Bill and the UK's creative industries: a perspective from China

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#### Introduction

As Birgitte Andersen points out, the Digital Economy Bill was heavily criticized by consumer organizations, Internet service providers and technology experts on the grounds that it would reduce the public's ability to access politically sensitive information, impinge on citizens' rights to privacy, threaten freedom of expression, and have a chilling effect on digital innovation. Its passage in spite of these criticisms reflects, among other things, the power of the rhetoric that has been employed by its proponents. Supporters of the Bill claimed that tougher copyright laws are needed to ensure the survival of the UK's copyright industries and to protect the livelihoods of those employed within them. New technologies have made it possible for audiences simply to ignore the formal distribution systems around which the copyright industries are organized. Therefore, legislation was needed to restore the capacity of copyright owners to decide who uses their work, and on what terms.

As far as it goes, the logic of these arguments is compelling. The core copyright industry business models that dominated the cultural economy of the United States and Western Europe during the twentieth century came into existence as a result of technologies that made the centralized mass distribution of cultural products possible, and intellectual property laws that allowed rights in particular works to be bought, sold and licensed. Technological limitations ensured that few private citizens had the physical means to violate the terms of use set down by copyright owners or to challenge the distribution monopolies enjoyed by firms in the copyright industries.

But digital technologies have greatly lowered the costs of production, copying and distribution – in some cases virtually to zero (Brown *et al.*, forthcoming). Widespread, affordable access to technologies for making, using and distributing audio-visual works on a global scale is transforming markets for creative products and services. In

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the process, new technological affordances really are challenging the existence of copyright industry business models organized around an ability to control the reproduction and distribution of creative works. As proponents of the Digital Economy Bill pointed out at great length, ensuring that twentieth century copyright industry business models and established film and music industry conglomerates remain dominant in the context of transformative technological change depends on the use of copyright to re-create analogue era monopolies.

But is attempting to wind back the technological clock by expanding copyright really such a good idea? Andersen argues that in promoting the interests of a few key players in the copyright industries, the Digital Economy Act prevents the full benefit of twenty-first century digital technologies from being realized. As the title of her paper puts it, 'shackling the digital economy means less for everyone'. I would add to Andersen's argument by pointing out that the Digital Economy Act's promotion of a very narrow range of copyright-based business models ignores key differences between the copyright industries of the twentieth century and the highly innovative *creative* industries demanded by the new technologies and global circulation of culture and content of the twenty-first. In ignoring these differences and creating structural disincentives for experimentation and innovation in business models, the Act is making it *less* likely that the UK's creative industries will be able to maintain a competitive edge in the global creative economy of a digital age.

Furthermore, the growth of industries such as film, music and fashion in China, where levels of copyright enforcement remain very low, highlights the fact that creative industries' firms adapt to the technological, social and regulatory environments they operate within. The PRC's first copyright law did not come into existence until 1990. This was the beginning of a decade in which digital technologies, personal computers, mobile communication and the Internet would transform cultural and communicative landscapes globally. The spread of new technologies for the copying, communication and use of content, and very low levels of copyright enforcement, have made it difficult for business models that rely on an ability to control unauthorized copying and distribution of physical media to take hold in China. As a result, many creative and cultural entrepreneurs have been prompted to explore new approaches to the value of creative products, and the ways in which their production might be financed and commercial returns generated. The success of these new approaches raises serious questions about widely accepted economic arguments for copyright protection and the impact of legislation, such as the Digital Economy Act, on processes of innovation and growth in the creative economy.

### **From copyright industries to creative industries**

In the second half of the twentieth century, 'core copyright industries', such as film and music, have been closely associated with a rhetoric that asserts that high levels of copyright protection are crucial to the existence of and economic contribution made by this sector of the economy (Boyle, 2004). Although the creative industries are much larger than the copyright industries alone, core copyright industries make up a significant proportion of the activities that now fall within creative industries' policy frameworks. Examples of activities that are considered to be part of both the creative industries and the copyright industries include film, television, music and publishing, as well as computer software and interactive games (Allen Consulting Group, 2001). This overlap between the creative industries and the copyright industries means that it

is tempting to conclude that arguments put forward for the expansion of copyright in order to promote growth in the copyright industries should also be applied to the creative industries as a whole.

However, the history of copyright law is one of contestation and debate over the extent to which granting a monopoly right to 'authors' produces either economic or social benefits (an excellent discussion of this history can be found in Deazly (2006)). A growing body of literature on the economics of intellectual property suggests that the expansion of intellectual property rights suppresses innovation and favours the interests of a few players within the creative economy at the expense of the majority.<sup>1</sup> Furthermore, today's creative businesses have little choice but to find ways to operate in the context of global flows of information, content and ideas.

The Internet, personal computers and new technologies for creating, sharing and using content have changed the environment within which creative works are traded and consumed. These transformative technological changes are an important source of new opportunities and dynamism for both creative producers and consumers, but they also have powerful consequences for creative industries' business models and bring to the fore tensions between widely accepted economic arguments for copyright protection and the realities of creative innovation in a digital age.

### **Dynamic business models**

The co-evolution of physical technologies, legal institutions and business models is nothing new. The capacity of firms to adapt as new technologies become available and new commercial opportunities appear is a key aspect of entrepreneurship and a driving force in processes of economic evolution and growth (Potts, 2003). Though this is especially true in the creative industries, it is often ignored in debates about the role of copyright. In the context of claims that high levels of copyright protection are a vital incentive to the existence of commercial creative industries, it becomes useful to explore how cultural and creative industries are developing in China, where the cultural, economic, political and technological landscape is evolving rapidly, and where copyright enforcement cannot be taken for granted.

The co-evolution of business models, physical technologies and legal institutions is clearly illustrated when the development of the recorded music industry in China is compared with its development in the United States. In the early days of recorded music in the United States, highly specialized equipment was required to turn sounds into physical products that could be sold in a mass market. Making multiple copies required hardware that was not widely available. As a result, it was relatively inexpensive to control and monitor the production and distribution of music products (Gronow and Saunio, 1999). The creation of neighbouring rights made it possible for firms to own the copyright in sound recordings they had commissioned (Laing, 2002). Developments in physical technology, the existence of intellectual property rights, and an ability to enforce these rights efficiently created commercial opportunities for businesses willing to invest in the production and promotion of music that could be sold to a mass market.

The dominant business model in the recorded music industry in the second half of the twentieth century reflected the technological and institutional environment within which businesses had been formed and developed. Record labels provided artists with access to recording equipment, mass production and distribution channels, marketing and promotion services, and remunerated them on a royalty basis. Artists received

(and still do) income from royalties generated each time a copy of a recording was sold or broadcast. Although developments in physical technology, such as cassette tapes and recorders, presented challenges to the industry's ability to control copying, these changes occurred *after* markets, industry structures, professional organizations and group collection infrastructures had become established. As such, the recorded music industry was generally able to respond in a systematic way and incremental developments in analogue technologies of copying did little to disrupt its overall structure (Frith, 2004).

In China, on the other hand, technologies for mass reproduction and consumption of recorded music became available in the absence of copyright law, an organized domestic music industry, or clear legitimate channels for the distribution of most foreign content. These technologies also became available as China was changing from a planned economy to a market system. High levels of demand for popular music, combined with readily available technologies for mass reproduction and consumption and an absence of legitimate distribution channels, contributed significantly to the rise of a black market in music products and highly sophisticated illegal distribution networks (de Kloet, 2002). The Internet, personal computers and cheap MP3 players have compounded the difficulties associated with controlling distribution: technologies that are challenging approaches to the control and monetization of content globally.

Almost all of the music downloaded from the Internet onto personal computers or portable devices, such as MP3 players, in China occurs without permission from, or payment to, copyright owners (Daniel, 2007; Music 2.0, 2008). Not only are new technologies being adopted with enormous speed across China, they are also being embraced fastest by groups traditionally considered most likely to pay for music. Young, educated city-dwellers with relatively high disposable incomes are now the group most likely to have access to broadband Internet connections, MP3 players and next-generation mobile devices (Kuo, 2007 ; CNNIC, 2008).

The Chinese government has been reluctant to abandon cultural policies that place heavy emphasis on the pedagogical and political role of cultural activities. In spite of this, opportunities for commercially driven cultural industries are increasing (Liao, 2006). However, while political sensitivities are still a factor, people are making and consuming music widely, and businesses are finding ways to generate income around these activities. Policies originally intended to control heterodox content have had another important effect: they have created barriers to the legitimate domestic market for foreign content producers, increasing incentives for the production of domestic content and reducing foreign competition. Although the structures that define China's commercial music industry are still crystallizing, it is already possible to see important differences between the business models and industry structures that evolved in the United States and those that are emerging in China.

One strategy for making money in the absence of strong copyright has been to rely on personal appearances by artists, which cannot be replicated. As a result, there is less emphasis on producing popular albums, and more emphasis on gaining popularity and profile through single hits that lead to lucrative product endorsement and live appearance or performance deals (Wang, 2004). However, even for Chinese labels, relying on personal appearance and advertising revenue presents practical problems, including limited scalability and continuing sensitivity over large popular music events (China Music Radar, 2008). Furthermore, advertising and personal appearance are difficult to reconcile with the 'long tail' approach, which, in other markets, allows

back catalogues to continue generating revenue for labels and artists long after the artist has been eclipsed by the latest trend.

As a result, the distribution of music to mobile devices is quickly coming to dominate the recorded music industry in China (Yao, 2007). Just as analogue technologies allowed a limited number of firms in Europe and the United States to control the physical production and mass distribution of music for much of the twentieth century, mobile networks are making it possible for a few key players to control the distribution of content to mobile devices and the collection of payments for the use of mobile music services. Record labels emerged as the most powerful group in the Western recorded music industry, controlling access to capital, production of physical music products and distribution channels. In China, mobile operators are on track to play a similar role. The formal copyright law has limited impact on the strategies being employed by firms seeking to capitalize on consumer demand for music. However, the use of physical technologies for channelling access and managing micro-payment collection are proving far more influential.

### **The role of copying in innovation**

As the growth of a commercial music industry in China demonstrates, creative industries' business models can, and do, adapt to the technological, cultural and legal environments within which they operate. And while the co-evolution of physical technologies, social technologies and business models is clearly illustrated in the case of China's music industry, it is a process that is deeply connected to entrepreneurship, innovation and economic growth far beyond either the music industry, or China. The rise of a new market for mobile music in China also underlines the importance of an overwhelming, but often ignored, driver of innovation and value in the creative industries: the reuse of content, ideas and technologies in new contexts.

Proponents of copyright's expansion in order to prevent the unauthorized distribution and use of creative works via the Internet argue that a strong copyright system is a vital incentive for investments in the expensive and time-consuming processes of creativity and innovation. These arguments reflect standard theoretical approaches to the economics of intellectual property, which focus on intellectual property's role in providing incentives for value creation driven by the *origination of new ideas*. Widely accepted economic approaches to copyright suggest that new ideas produce social benefits, but because it is less costly to copy ideas than to produce innovations, new ideas are undersupplied in competitive markets (Hirshleifer, 1971). Thus, intellectual property rights are seen as a mechanism through which market failure can be addressed and the supply of new ideas increased.

On the face of it, reuse might appear to be little more than a form of replication that, in a dynamic system, leads to standardization as the most popular ideas dominate the market. However, in reality each instance of reuse in the creative industries occurs within a unique context that includes complex networks of other ideas. The net result is that reusing a particular instantiation of an idea in new contexts and in conjunction with new combinations of other works and ideas *increases* variety. And with that comes exploration of entrepreneurial opportunity space, which is simultaneously a private and public good. This variety-increasing reuse is deeply ingrained in the creative industries: jazz improvisation, the editing and re-mixing of video content associated with YouTube and the fashion consumer's selection of a 'fashionable' ensemble are just three examples.

Although it is possible to imagine new inventions that might be brought to the market in a form that never needs to be revised or adapted for new uses or contexts (for example, in pharmacology or biotechnology), this kind of knowledge production is rare. In the creative industries, in particular, it is much more common for new ideas to be made available, taken up, revised, applied to new contexts and revised again. The challenge for firms operating in the creative industries is not an undersupply of creativity and new ideas, as economic theories of intellectual property assume, but of identifying the products, services and business models that are best suited to the highly connected, global markets of the twenty-first century knowledge economy. The diffusion of ideas and their adaptation to suit the specific context in which they might be applied are important factors in value creation. An ability to access, reuse and alter creative works is a vital component of these processes of innovation and knowledge growth.

Reuse is also connected to the growth of knowledge through the transfer of ideas and information between different industries. This may occur when ideas developed in one domain, for example chemistry, are applied in another domain, such as biology. This can be an essential driver in the development and commercialization of transformative technologies, such as the Internet. It also occurs in relation to creative works; for example, when one piece of visual art is reused or re-contextualized in the creation of new art; or when content from one domain is used in another, such as when visual art is reused in advertising or when music is used in film. In some instances, changing the format in which content is available creates new markets; for example, the market for live music as distinct from a market for musical ringtone services for mobile devices, or the market for Dickens in a format suitable for an iPad as distinct from the sale of printed serial instalments.

Processes of value creation through reuse are especially important in the context of digital technologies. Opportunities to build on the creative works of others, to draw on global pools of content and to explore creative and entrepreneurial spaces made possible by developments in networked technologies are potentially the most powerful benefits of the Internet for creative workers, industries and consumers. While there can, of course, be no reuse of an idea without an idea's initial creation, legal and economic conceptualizations of the value of new ideas often fail to recognize that economic value is not simply created at the point of origination. Rather, it accrues through an ongoing process of adoption and adaptation (Dopfer and Potts, 2008) in which the value of an idea is realized as it is combined with other ideas, placed in new contexts and used in new ways.

New possibilities for interaction with creative and cultural products, digital technologies and instant communication are allowing users to become active participants in processes of production, distribution, creative experimentation and the selection of talent that were previously the domain of firms and commercially driven entrepreneurs. Amateur users and creators are being prompted to invest time and thought in choosing what and how to consume, and actively seeking out skills, information and creative resources that allow them to derive maximum benefit from their consumption choices. It is also becoming possible for creativity to be sourced and coordinated among whole populations, rather than depending on more centralized processes of creation and distribution.

The explosion in online creative content since the launch of the World Wide Web in 1990 has demonstrated very clearly that creativity is not in short supply. The enthusiasm with which the creative potential of new technologies has been taken up



by Internet users is evident. Many write blogs, upload photographs, share content and participate in online communities without any hope of direct financial reward. The ample supply of creative content and new ideas made available through the Internet is a result of the shifting opportunity costs of creative behaviour associated with rising incomes and the mass adoption of tools for creative production, rather than incentives for innovation provided by intellectual property law (Towse, 2001). This suggests that creativity is not incentive-constrained under perfect competition and that the standard market failure model of creative supply is seriously flawed, at least in relation to the creative industries.

Because innovation and value generation in the creative industries are so closely linked to reuse, legislation that focuses on ensuring that copyright owners are able to control the ways in which creative works are reused at the expense of opportunities for creative communities, users, entrepreneurs and firms to explore how such works might be applied poses a real threat to the realization of the economic and social value of the creative industries in a digital age. By extending the monopoly rights of copyright owners, the Digital Economy Act exaggerates the market distortion effects of existing copyright laws, making it more expensive, risky and difficult for the value of content to be explored and realized in the rapidly evolving context of digital technologies.

### **The challenge of global markets**

The Digital Economy Act also ignores the fact that in the creative industries most firms and consumers produce or consume (or both) in *global* markets. Yet, in doing so, they are governed by national laws. Although efforts have been made to harmonize intellectual property regimes globally, enforcement depends on nation-based authorities and infrastructure (Liu, 2006). While globalization provides opportunities for value creation in production collaboration and specialization (along with the general benefits of large markets), it also means that creative industries' businesses are unable to avoid the dissemination of their products within markets with weak intellectual property systems, where enforcing intellectual property rights may be prohibitively complex or expensive.

As a result, firms operating in global markets are often unable to formulate strategies and business models based on uniformly high levels of intellectual property protection. Business models that depend on a firm's ability to enforce their intellectual property rights quickly and cheaply are cost-effective only in markets in which these conditions exist. This means that the global reach of businesses that rely on high levels of intellectual property protection is limited, particularly in relation to key emerging markets, such as China. One response to this situation has been an attempt by developed economies with strong intellectual property systems to create global frameworks for the protection of intellectual property rights and to require nations seeking access to international communities of trade to strengthen national intellectual property systems (Maskus, 2000; Wang, 2003; Miller *et al.*, 2005).

However, as China demonstrates, developing an intellectual property system takes time. Although legislation can be created relatively quickly, enforcement is a much more complex challenge for both policymakers and copyright owners. China is far from the only nation in which globalization and new technologies are associated with rapidly increasing access to creative content, images, sounds and information, but levels of copyright protection remain very low. In effect, a constant state of

disequilibrium exists in the strength of intellectual property law operating in different national contexts. Therefore, it is economically rational for firms targeting global markets to formulate strategies based on an assumption that levels of intellectual property protection are low in *all* markets. Such strategies may involve an emphasis on an experience rather than the sale of physical products that can be easily copied; for example, live music performances, 3D films that are best enjoyed in a cinema, or multiplayer online games played on closed platforms in real time. They might also involve an emphasis of the status and identity associated with consuming products made by a particular firm or in a specific location, as in the purchase of a luxury branded handbag or consumption of French champagne.

This gives rise to a curious economic property of the interaction between intellectual property law, global markets and business strategies, namely that the presence of strong, effective and efficient intellectual property law in individual territories *may not benefit the creative industries*. This is because for businesses formulating strategies for global markets, strong intellectual property law matters only if it is available globally. If it is not available globally, then firms have little choice but to alter their business strategies in order to take advantage of opportunities in markets where high levels of intellectual property protection are absent. Because a state of constant disequilibrium exists in the levels of intellectual property protection that relate to global markets, effective global strategies must take into account the aggregate global costs of enforcing intellectual property rights.

Despite the lack of equilibrium in levels of intellectual property protection in the global marketplace, the creative industries are growing at about twice the rate of the aggregate economy (Potts and Cunningham, 2008). Recognition of the global nature of the creative industries and the national nature of intellectual property protection helps to explain why business models that have proven successful in the United States and Western Europe, such as those of the major record labels, have made so little headway in China. The failure of these business models is not a result of a causal connection between the growth of the creative industries and levels of intellectual property protection: China's creative industries are developing quickly. Rather, it relates specifically to the inability of business models that depend on high levels of intellectual property protection and enforcement to function effectively in truly global markets.

## Conclusion

Many of the arguments that have been put forward in favour of the Digital Economy Act rely on a tacit presumption that business models are parametric, like law. However, as the case of China's music industry demonstrates, business models in the creative industries are not parameters about which law should seek to form and solidify, but rather continually adaptive technologies that take particular structures of law as aspects of the business environment. As a result, although extending copyright in an attempt to prevent unauthorized reuse and distribution in a digital context is unlikely to increase growth or innovation in the creative industries, it is likely to discourage firms from developing business strategies that will assist them to capitalize on the dynamic opportunities of rapidly evolving global markets.

The growth of China's creative industries, in spite of very low levels of copyright enforcement, highlights serious flaws in widely accepted economic arguments for copyright's expansion. Rather than increasing the capacity of the UK's creative



businesses to compete in the global markets of the twenty-first century, overly restrictive copyright law creates structural disincentives for investments in content and business models that take full advantage of the creative and economic opportunities presented by new technologies. Legislation, such as the Digital Economy Act, also restricts access to the raw materials required for creative innovation in a digital context. In so doing, this law in fact makes it less likely that UK businesses will be able to maintain a competitive advantage in the global markets of the twenty-first century.

Efforts to protect the distribution monopolies around which the copyright industries are organized reflect important tensions between concepts of origination, ownership and value formed during an analogue era, and the economic and creative realities of the twenty-first century. Given the importance of innovation in maintaining a competitive edge in rapidly-changing landscapes of creative production and consumption of the twenty-first century, ensuring that intellectual property policies support rather than discourage business model innovation will be vital to the continuing prosperity of the UK's creative industries.

Because the Digital Economy Act protects firms with highly specific approaches to realizing the commercial value of creative content and reduces access to the raw materials of digital innovation, it raises the relative costs of developing new approaches to the business of culture in a digital age. At a moment in which the global balance of power is shifting East and rapidly developing economies, such as China, are making concerted efforts to embrace new technologies, foster the creative industries and encourage the growth of a creative society, legislation that increases the costs of creative innovation is a competitive disadvantage the UK can ill afford.

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### Note

1. Boldrin and Levine (2002, 2005, 2008), two highly respected economic theorists, argue that there is no economic justification in theory, or evidence for, the 'intellectual monopoly' created by copyright and patent law, and advocate the complete abolition of these systems. A similar line is taken by Van Schijndel and Smiers (2005), who propose a radical reformation of a copyright system that is systematically failing the creative producers it is intended to support.

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