The propagation of digital media and inexpensive technologies have had a negative impact on the revenues of the major record labels by enabling artists to inexpensively create content and distribute it to fans directly. The same technologies enable customers to locate, upload, and download content instantly through both legal and illegal means. This thesis will analyze the co-dependent relationship between piracy and the digital music industry and how, together, they have made the traditional business model of the recording industry obsolete, dramatically increased the accessibility of “useful arts,” and have raised a critical debate on the appropriate role and treatment of copyright in the digital world. Using the music industry as a case study, this thesis will objectively look at the effects digital media and piracy have on the music industry, and provide evidence that shows a society’s level of welfare and cultural richness fair better when a softer approach is taken to copyright enforcement in the digital world.
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1.0 Introduction

As digital distribution has become a way of life for many individuals in the U.S. and worldwide, the ability of products to be distributed freely online has prompted intense legal action and lobbying efforts by the Recording Industry Association of America (RIAA), the Motion Picture Association of America (MPAA), the Business Software Alliance (BSA) and other trade groups within the copyright industries. The RIAA, for example, quotes studies that claim music piracy results in annual economic losses of $12.5 billion and has resulted in a total of 70,000 lost jobs (RIAA 2012). Trade groups are very good at promoting the interests of the companies they represent, however there is strong evidence that consumers and producers of creative content have benefited from the development of digital file distribution despite claims from these highly monopolistic industries. If legislation is passed and major industries are given control to prosecute and/or shut down websites and internet service providers for any violation of copyright, and severely penalize those who have or share copyrighted content, it could fundamentally change the way people consume content and dramatically limit freedom of expression on the internet.

With the launch of Napster in 1999 and the emergence of technologies such as high speed internet access and increased capacity for storage of digital media, record labels and major organizations affiliated with the music industry have spent millions of dollars in enforcement, education, and lobbying campaigns in order to promote the idea that the use of peer-to-peer software (P2P) and other forms of media piracy have been the largest threat ever to the creative industries. Methods of calculating the actual overall losses to the industry and artists due to piracy involve various assumptions and extrapolations on limited sample data, however it is clear that the major labels have experienced staggering declines in overall revenues since the
emergence of P2P programs and the digital media revolution. This threat is derived from the potential and well documented abundance of copyright violations that have accompanied the emergence of technologies that allow the near instantaneous transfer and reproduction of any work in digitized format. This new form of information sharing has dramatically overshadowed prior problems of pirated physical goods in both impact on sales and rates of infringement.

Trade associations such as the RIAA and the MPAA have taken strides to enforce the copyright of many of these distributed works in what they claimed to be successful (although not profitable) enforcement campaigns. These primarily set examples to companies and individuals via heavy lawsuits, as well as highly active lobbying efforts toward legislatures to dramatically expand their power to prosecute and hold accountable online companies or internet service providers accused of direct infringement or allowing infringement to occur via their services. These efforts certainly show that some major players believe there is much to be gained from maintaining the status-quo model of controlling all forms of distribution.

The losses claimed by the major labels have been the result of creative destruction, via the introduction of technologies that allowed incredibly cheap means of production and free distribution of digital products. The major label oligopoly has foregone numerous opportunities to monetize off the dramatic rise in demand for digital media, and continuing to cling to their old model of industry dominance has caused them to fall behind the curve in monetizing digital content, as hundreds of other private companies have sprung up to take advantage of new opportunities. With fans empowered to choose from thousands of other talented artists, labels are losing their ability to force promote selected artists through mainstream distribution channels and, while many artists still dream of the fame that comes with promotion by a major label, their
business models must change in order to keep up modern trends or their profits will continue to dwindle.

This does not mean, however, that losses claimed by the major labels give a full picture of the state of “useful arts” in the United States or world-wide. In order to truly asses the damages (if any) of the digital age and free music, it is equally or more important to examine its impact on artists and consumers. As it turns out, when the industry’s data is examined, and other stakeholders are considered, the digital media revolution actually has multiple positive impacts for both the music industry and consumers.

This paper attempts to provide sufficient evidence to show that the digital media revolution has in fact brought on significant growth in the amount of music produced and consumed. Digital media has been primarily responsible for the growth in music culture and interest. It has also helped propagate the growth of technologies that provide new and cheaper means of artists becoming established, and created a multitude of channels for artists to be compensated and or monetize off of the various aspects of their profession. The overall effects and benefits can be shown by the rise in digital music consumption, higher ticket prices and sales, the amount of new artists and albums available, and the overall rise in royalties paid to artists. In addition, this paper will discuss the many ways artists and indie labels have taken advantage of the digital age to remain profitable despite piracy.

As major labels, independent labels, artists, and consumers have widely differing viewpoints on the impacts of digital media and its means of distribution, this paper examines numerous studies and surveys that have taken place over the last decade from independent research firms, academic institutions, governments, and widely cited industry sponsored research
in order to establish an unbiased and comprehensive understanding of the various effects the
digital era has had on the state of creative musical arts. In addition, data involving consumer
behavior, legal/illegal downloading trends, music and instrument sales, royalties, ticket sales, and
other artist revenue streams are analyzed in order to assess the state of artists and provide
suggestions for the most effective treatment of copyright toward digital media to promote the
progress of useful arts in the United States.

1.1 Copyright’s Purpose in the Creative Industries

The foundation for intellectual property laws was set forth in Article I, Section 8, Clause
8 of the United States Constitution. This clause empowers congress “To promote the Progress of
Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive
Right to their respective Writings and Discoveries.”

The word copyright literally means the “the right to copy,” and is granted under Title 17
of the United States Code to the legitimate author of works of literary, dramatic, musical,
architectural, cartographic, choreographic, audiovisual, pictorial, and graphic authorship.
Copyright is technically granted automatically upon the creation of an original work for their
lifetime plus 70 years, however the U.S. Copyright Office exists for authors to register and
provide proof of their copyright ownership in matters of payment (royalties), disputes, and
litigations, particularly when it comes to international trade agreements and usage. In addition to
the right to copy, authors also have the exclusive right to prepare derivative works (sampling), to
make available or perform the work publically, or to license others to perform their work via
contractual agreements (U.S. Copyright Office, Circular 1a 2012). There are two types of
limitations set for these exclusive rights under U.S. law. The doctrine of fair use allows for the
reproduction and creation of derivative works of copyright materials for things such as criticism, comment, news reporting, teaching, scholarship, or research. There is also an exception for reproduction by libraries and personal archives, if the redistribution is made without any purpose of commercial advantage, the collections are made public, and a notice of copyright is attached to the reproduction (U.S. Copyright Office, Circular 92 2011).

As the debate for copyright reform rages on due to the dramatic changes in how works can be distributed since the digitization of authored works and the growth of the internet, it is important to understand the fundamental purpose and use of copyright law and to take it for what it is, a piece of legislation written by man in order to benefit society. Until the 1970s, there was no common view by the courts that copyright gave authors an absolute right to preventing others from using their works, and Thomas Jefferson even made this comment on the idea of copyright:

*Society may give an exclusive right to the profits arising from them, as an encouragement to men to pursue ideas which may produce utility, but this may or may not be done, according to the will and convenience of the society, without claim or complaint from anybody, Accordingly, it is a fact, as far as I am informed, that England was, until we copied her, the only country on earth which ever, by a general law, gave a legal right to the exclusive use of an idea. In some other countries it is sometimes done, in a great case, and by a special and personal act, but, generally speaking, other nations have thought that these monopolies produce more embarrassment than advantage to society; and it may be observed that the nations which refuse monopolies of invention, are as fruitful as England in new and useful devices.* – Thomas Jefferson, letter to Isaac McPherson, August 13, 1813 (Carpenter 2006).
The U.S. Supreme Court has ruled and explains the legal justification for copyright law in Feist. v. Rural, 499 U.S. 340 (1991) where Justice O’Connor stated, “The primary objective of copyright is not to reward the labor of authors, but to promote the Progress of Science and useful Arts.” As society changes, as it so rapidly has in the last decade, it is only logical that the legislation should change with it. It seems however, that the importance of compensating right’s holders for the public’s infringement on their right has been more important than ensuring the actual progress of the arts. There are many who advocate that the solution to piracy and savior of the creative industries is to reform copyright in a way that increases enforcement and allows outside interests (copyright holders and distributors) the power to shut down and punish violators, as taking the hundreds of millions of violators to court is not profitable, nor possible.

This argument is almost solely from lobbyists that come from major organizations such as the RIAA, the MPAA, and BSA in the U.S. and IPA in the European countries. The hundreds of millions spent on these lobbying efforts aside, the primary argument that generates sympathy from congress and the public alike is the common question of, “if works are distributed freely, how will artists get paid?” and doomsday-like warnings that if copyright is not enforced, there will be no more incentive for authors to create, leading to no films, movies, documentaries, books, games, or music! This highly simplistic yet irrational claim frightens many in the industry and appeals to the moral conscience of consumers who most assuredly feel their favorite authors deserve to be compensated for their efforts. Unfortunately, this argument is highly effective and any use of logic to counter it is simply ignored or infuriates copyright supporters who hold it as a morally sacred principle. In order to determine the effectiveness of copyright use and enforcement in the digital world, this paper will look at the state of the music industry since
piracy to show that weak copyright enforcement for online infringement has been a net benefit for society.

1.2 Development of Digital Piracy

Past technological developments such as radio and TV began as perceived threats to recorded music sales, both of which turned out to be great promotional and sales tools that expanded the industry. The same threat mindset was present at the advent of the VHS player/recorder, but later the Motion Picture Association of America (MPAA) and Hollywood saw VHS/DVD sales emerge as their largest revenue stream. These developments resulted in the expansion and creation of new income streams for the industry by providing additional products and services (such as rentals) that consumers could use to enjoy recorded media.

Recent developments in technology have made the creation and duplication of recorded works highly cost effective and instantaneous. This was accompanied by a massive decline in the cost of digital storage, and the expansion of high speed internet service. The same technology also began the decline in the cost of music production, which in present day can be done in a professional studio for a few thousand dollars, in cheap home studios, or by using free software which can be utilized on most any home computer. What was even more dramatic in lowering the overall cost of music production, however, was the opening of channels whereby music could be distributed online for no cost at all.

The term piracy originally described the theft or reproduction of physical products which were sold in black markets. As the legality of file sharing was brought into question, the term has since been kept by copyright industries to describe violations of intellectual property (IP) rights of digital products as well. Illegitimate markets for both physical and digital goods exist because
low reproduction costs and high retail prices allow traffickers to offer the product to consumers at a lower cost (or free digitally) than the legal alternatives. Although the fairness of the terms “piracy” and “theft” to describe digital activity is debatable, they are still extensively used by the industry. There are several important distinctions between digital and physical piracy, however, which need to be considered in any discussion of copyright law and enforcement methods for digital piracy and copyright infringement. These distinctions are shown in the following table.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Physical Piracy (Counterfeit)</th>
<th>Digital Piracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intention(s):</td>
<td>1. Primarily occurs with the intention to sell commercially, as the counterfeiter must incur some production/distribution costs. 2. Sharing with friends, mixed-tapes etc.</td>
<td>1. Primarily occurs for personal use, but also frequently shared (uploaded) and made available to the public. 2. Can occur inadvertently in many online activities (clicking a link)</td>
</tr>
<tr>
<td>Motivation/Incentives</td>
<td>Typical black market: High retail prices and low reproduction costs = High profit margins.</td>
<td>The $0 price point and convenience drives downloads, availability however primarily not driven by a monetary gain, but by sense of community (P2P sharing), communicating and sharing interests with others.</td>
</tr>
<tr>
<td>Criminal Affiliations &amp; Consumer Risk:</td>
<td>Often run by organized crime, revenue from counterfeit and pirated goods, often traced to terrorist groups. Risk bodily harm and losing money from purchase.</td>
<td>No common link to large criminal enterprises.</td>
</tr>
<tr>
<td>Location:</td>
<td>In person at: Parking lots, flea markets, a dealer’s home, face to face interactions</td>
<td>Potentially anywhere online (blogs, media streaming/download sites), but primarily through P2P software and file sharing sites, many of which have no central location or single contributor of the file</td>
</tr>
<tr>
<td>Measureable Monetary Damages (loss of sales)</td>
<td>Strong argument for loss of sales, as transaction implies a</td>
<td>Generally does not involve a monetary transaction, and</td>
</tr>
</tbody>
</table>
willingness to purchase by the consumer. Generally doesn’t equate to a willingness to pay.

### Claimed monetary damages to the industry:

| Market for pirated disks estimated at $4.5 billion globally (Kenedy 2006) | $55 billion claimed based on “future projections” of sales prior to digital piracy. |

### Legal Penalties of Copyright Infringement:

| Up to 5 years jail time, civil lawsuits, criminal penalties-up to $150,000 per work infringed (Purdue 2009). | The same as physical piracy. In either case, the penalties are more severe than child abduction, or stealing the physical product from a retailer. |

### Enforcement/Prevention:

| Undercover law enforcement, confiscation of goods and cash, customs screenings, education and public awareness (don’t copy that floppy!). | Secretly traced files to identify (through IP address) individual infringers, confiscation of storage drives/computer, education, shutting down/targeting primary instigators: KaZaa, the Piratebay etc. |

In 1999, both the launch of Napster (P2P file sharing software), and the issuance of recorded music in a digital, MP3 format enabled users to take full advantage of this culmination of technology and sparked a massive rise in demand for it. With access to music for little or no cost, digital piracy became a real threat to the recording industry’s revenues, making up an estimated 23 percent of all internet activity (Resnikoff 2011a).

Although formats prior to the digital MP3 provided the problem of physical piracy, the losses were not large enough to the recording industry to outweigh the increases in revenues from embracing the new developments. Additionally, the industry could count on the efforts of law enforcement to help curb the problem by confiscating goods and penalizing offenders. Digital piracy on the other hand is much more difficult to track, and it is hard to identify the human behind the action. In addition, digital piracy takes place almost instantaneously, with generally no money trail. Unique visits to piracy related web sites are estimated to be around 146
million times per day, or 21 billion visits per year, compared to 87 million visits per year to online retailers of counterfeit goods. Sixty seven percent of these sites are hosted in North America or Europe (MarkMonitor 2011).

While digital media formats and the internet have made way for the innovation and development of many new industries, and have allowed consumers the most inexpensive and efficient means of consuming music and other media, the recording industry has primarily excluded itself from the online explosion of digital music services and products for an obvious reason. The “Big three” (Record Companies), still rely on physical album sales to generate 70% of their revenues (ALDE ADLE 2011). With such heavy reliance on the physical distribution chain, and ownership of 90% of the recording industry’s market share, embracing these innovations would have been extremely risky, and no doubt would have exponentially grown the rate at which digital downloads replaced physical sales. Therefore, the recording industry has made only minimal efforts (except out of necessity), to take part in the digital market online.

1.3 The Debate in Literature

The continued demonization of file sharing and digital piracy by the recording industry and IP rights organizations has caused the majority of academic research to be quite narrow in the debate on piracy and how IP rights should be treated online. The academic literature has primarily focused on determining the effects of piracy on physical album sales, with little discussion regarding the state of cultural industries as a whole. Instead, when looking at literature both sides agree that 1. Physical sales have been on the decline along the lines of what the RIAA and the industry claims, and 2. Determining the level of contribution piracy has had on these declining sales is the primary question to answer in the debate.
This has broken the debate into two sides. The first is the industry’s argument that piracy is the key driving force behind the decline in album sales and therefore, its continued prevalence will ultimately lead to no incentives for creators and the death of the creative industries. The second side of the debate comes from research done outside the industry’s funding circle by academic institutions, non-profit organizations, and various small organizations who believe that the evidence that piracy has had a role in the sales declines is small or negligible. Instead they claim that there are a variety of more important factors that have caused the sales declines.

While determining piracy’s impact on music sales is an important question to answer, limiting the argument to the effects of piracy on sales ignores the effects of piracy and file sharing on society’s level of “cultural richness.” It does not fully address whether or not artists, consumers, or society have benefited from piracy/digital music, regardless of the declines in album sales. A second key limitation within the academic debate is a lack of guidance on what policies would be best for all stakeholders. It seems both sides are determining what is best for the recording industry rather than framing the debate in what is the best treatment of IP rights online, in order to maximize social welfare. This is what can be referred to as “the cultural side” of the debate.

The arguments in the cultural side of the debate look at copyright in two distinct ways. The first and more common side supports freedom on the internet, and looks at what the substantive outcomes (effectiveness) of copyright’s goal of promoting the development and creation of “useful arts” has been, despite whether or not compensation has been equitably provided. In other words, in order to look at whether a policy change for IP rights should occur, the policy should ensure that it maximizes welfare to society and not simply the minority of rights holders.
The second side of the cultural argument comes from the industry representatives themselves, some very wealthy musicians (usually the older generations), and those who have been “educated” to take sympathy with industry’s stance. This side of the debate focuses on the importance of the procedural aspects of IP law, and believes that the moral side of copyright/IP enforcement for the sake of fairly compensating creators is more important than the overall welfare to society. However, this side heavily relies on the perceived notion that artists will have no incentive to create without being guaranteed an income, the belief that piracy does equate to declines in actual sales and artist revenues, and the belief that compensating creators of IP works is a core value in our society.

What is highly important when examining these two arguments is that neither side believes that piracy can be entirely eliminated, regardless of the regulations or amount of enforcement in place. In addition, these arguments do not hold IP laws as an unchanging constant, and instead look at these laws for what they are, laws made by man to achieve an outcome based on what was known about the issue at the time. Therefore, the more evidence there is regarding the overall music industry, not just the “recording industry,” and the amount of “cultural richness” in society, the better we can come to a reasonable solution that can maintain a high level of social welfare while at the same time ensuring that artists are receiving compensation in a way that fairly represents their contributed value to society.

1.4 Revenues for Major Labels

The term recording industry in this paper is used to define the three major record companies who hold the intellectual property, and the associations such as the RIAA that represent them. In 2011 their market shares consisted of Universal Music Group (UMG) at
29.85%, Warner Music Group at 19.13%, and in 2012 Sony Music Group (29.29%) merged with EMI (10.19%) to take over 40% of the market share in the recording industry, leaving other represented right’s holders at 12.11 percent (Nielsen and Billboard 2012). RIAA data is therefore 90 percent reflective of these three companies and 10 percent reflective of others. The sales data provided by the RIAA, although not wholly transparent, is considered to be accurate by this paper and the majority of analysts on either side of the debate.

The following figures, derived from the RIAA statistics database, show both the rapid increase in real revenues and their subsequent decline of physical sales, and the inadequacy of digital sales revenue in replacing declining physical sales. The data also shows how large the revenue disparity is between these sources of sales.

**Figure 1.** Dollar Amount of Units Shipped – In millions (2011 Dollars)

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1It is important to note that, due to anti-trust laws, significant efforts had to be undertaken in order for the merger to be legally granted. Since the merger, using Nielsen market share data, the Herfindahl index for the recording industry has shifted from 22.1 percent in 2011 to 27.7 percent in 2012, which is considered highly concentrated both by U.S. and European standards, suggesting high potential for monopolistic behaviors in the industry.
This chart shows that there is in fact an underlying problem in profitability within the industry; however, their numbers also show in Figure 2 that this decline in revenue coincides with a dramatic upswing in demand and consumption at levels higher than ever seen in the music world. The Nielsen and Billboard 2011 Music Industry Report even noted the 1.6 billion in overall music sales as an industry first, and all-time record.

**Figure 2.** Units Shipped All Products (millions) 1973 – 2011
Figure 3. Average Price of Physical and Digital Music (Author’s Calculations of RIAA data)

![Average Price of Physical and Digital Music](image)

Looking at sales volume (Figure 2) and average prices (Figure 3) together shows that the majority of revenue declines have been from downward pressure on prices rather than units sold, which has increased. This has been shown particularly by the incredible growth in demand for singles, which until this point had a drastically high margin relative to the price of the entire album. This suggests that prior to digitization, the market for music acted as a monopoly, with prices set artificially high. This would have been done through entry barriers for competing firms on the production side and control of the distribution channels to consumers. Under the physical sales model, an individual album cost consumers between $18 and $20, with 2011 purchasing power, the entire decade before digital sales were finally accepted by recording companies in 2004.

Still, the recording industry blames the revenue drop not on increased “fair” competition, but on the prevalence of digital piracy. While demand for legal purchases is ironically up, they
claim that the decline of physical sales is directly caused by digital piracy and peer-to-peer (P2P) infringement. They argue that had piracy not existed, instead of declining from an average of 5 to 3.5 album sales per person, it would have grown from 5 to 7 albums per person by 2008. The difference between what they actually sold and what they hoped they would sell equates to around $55 billion in foregone revenue (Steinberg 2011). It is quite an assertion to claim that piracy is the sole factor in reduced sales and revenue declines; however, this thinking is foundational to the vast majority of research that the industry uses as the basis for their claims. This type of claim ignores the fact that CD’s and other mediums go on cycle, and there is no way it would have continued to grow at that rate as new formats to distribute music emerge.

There are multiple contributing factors to the decline in album sales post 1998, and there is a fair amount of evidence to suggest file sharing had little or nothing to do with it. In fact, after overcharging consumers $480 million between 1997 and 2000 alone, former Federal Trade Comission (FTC) chairman, Robert Pitofsky predicted a $5 per CD price drop due to the industry refraining from its “minimum-advertised pricing” strategy of the 1990’s and a settlement of $67.4 million and $75.7 million in CDs to be distributed back to the public (Lieberman).

2.0 The Economics of Piracy and the Music Industry

2.1 The Industry’s Analysis of Piracy

The most frequently cited claims by both the recording industry and government enforcement agencies are in the ballpark of 750,000 lost U.S. jobs and $250 billion in annual economic losses to piracy when all IP industries are taken into account. Although frequently cited to this day, it has been traced back as far as 1986 to former Commerce Secretary Malcom Baldrige, who estimated jobs lost to counterfeiting U.S. goods to be anywhere from 130,000 to
Additionally, the $200-250 billion claim often cited from the International Anti-Counterfeiting Coalition, came from the October 1993 issue of Forbes that stated counterfeit merchandise is a $200 billion global industry, which comes close to $250 billion after inflation adjustments (Sanchez 2008). These figures are highly out of date and could in no way be considered a reliably accurate predictor of piracy costs in the last decade. In addition, such dramatic claims seem ridiculous when considering the losses equate to nearly $800 for every person in America, and twice as many lost jobs as exist in the entire 2010 motion picture industry (Raustiala and Springman 2012).

More recent industry estimates, such as those put forth by, Steven Siwek, at The Institute for Policy Innovation, claim music piracy results in annual economic losses of $12.5 billion and has resulted in a total of 70,000 lost jobs (Siwek 2007). As with much of the industry research, flawed assumptions and double counting are used to inflate the economic impacts of piracy. The fundamental problem with most studies cited by IP rights groups, is that they ignore the fact that when a dollar is saved by consumers it is still spent elsewhere in the economy. This provides the tax revenues, income, and jobs for and from people who are not direct stakeholders in the recording industry. Even the Government Accountability Office (GAO) noted that certain stakeholders may experience positive economic effects from piracy, and acknowledged that major estimates sourced to U.S. agencies cannot be substantiated, and that many assumptions must be used to compensate for the lack of available data (GAO 2010). Additionally, enforcement costs are incurred by multiple government agencies that could be using their resources for other purposes. Due to the Pro-IP Act of 2008, these costs will increase by $429 million between 2009 and 2013, but this number represents only a fraction of the total indirect and direct enforcement costs that occur every year (Congressional Budget Office 2008).
The methodologies behind the assumptions that underlie much of the industry’s research are questionable and have several major limitations, including the ability to determine an accurate substitution effect, and disregard for the importance of countervailing benefits piracy has on the economy. This suggests the importance of actually considering piracy as part of an economy rather than simply a drain on it (Karganis 13). The substitution effect, which describes the value (loss) that one pirated good represents in lost industry revenue, is critical to calculating the economic effects of piracy. While the industry loves to use a 1:1 substitution rate, where each pirated good represents a loss of the full retail value of the product, Siwek’s 2007 report used a more reasonable rate of 20 percent for digital piracy, where one in five illegal downloads is considered a lost sale due to piracy. As evidence on consumer’s and pirate’s behaviors will show, however, this rate is still quite high as piracy can actually result in higher music sales, and certainly correlates with higher spending in other sectors of the music industry.

2.2 Demand and Consumer Behaviors

CD sales plunged as internet service providers (ISPs) began to offer high speed services to nearly every community which, along with the advent of the digital MP3, made the concept of a compact disk purchase less enticing. Peer-to-peer (P2P) software programs allowed individuals to share music, facilitating an explosion of music consumption limited only by the speed of the internet connection and capacity of the hard drive. The promotional mechanisms available via the web, such as social media sites, streaming sites, blogs, band websites, and virtual magazines to name a few, brought forth more music than any one person had the time to actually listen to. At the same time, they opened up a vast array of new music niche styles or genres that could be discovered and marketed towards fans of particular demographics. There appeared to be more music and more musicians than ever before, and any person with a basic
computer at home could create and upload their own music with programs that cost a few hundred dollars or less.

This is not to say that people are not willing to pay for music or that it has less value, as the industry often claims. There is strong evidence that people are willing to pay for music once exposed to it. This actually makes a good deal of sense, for the reason that those who do have the highest interest in music, movies, etc., are more likely to max out their wallet share allotted to entertainment spending and still desire more, leaving downloading the only option to meet their demand. They are also more likely than the average consumer to anticipate new media releases and to go online to find it earlier. This is especially a problem when release dates for the same product vary from country to country. This means that in order to determine what the industry is actually losing due to piracy, estimates must be made as to what substitution rate should be used to calculate damages. In other words, the amount of sales displacement that occurs from the existence of markets offering the product free and illegally.

The main problem with determining a proper substitution rate is that only the infringing activity is taken into the equation. That is to say that the behavior of piracy is observed as apart from other consumer activities, rather than a behavior that may compliment or coincide with other legal behaviors that benefit artists or the overall industry. There are numerous studies that suggest that pirates are also the most frequent purchasers of music. A study by the University of Amsterdam found 68 percent of file sharers also purchase music, and are as equally likely to buy music as other people, but also are significantly more likely to spend money on merchandise and attend concerts more frequently. In addition, the study found 63 percent of music downloaders were likely to buy the music they already got for free, with 50 percent of those people wishing to support the artist as the motive, and one third marked owning the physical CD due to its
presentation and higher audio quality as the primary motivation for purchasing what they already have (Eijk, Poort, and Rutten, 2010). Another Study by BI Norwegian School of Management concluded pirates buy ten times more music than non-pirates (Moya 2009). A third study, by Industry Canada, found that roughly half of P2P tracks were transferred due to individuals wanting to hear songs before buying them, and that for every 12 P2P downloaded songs, music purchases increased by .44 CDs (Moya 2007). As the actual attainment of the music requires allocation of personal bandwidth and hard drive space, streaming appears to more frequently be the initial step in the music discovery process.

The EMI Insight report “Streaming Goes Global,” found the total subscribers to paid music streaming services was about 16.4 million people. An estimated 20 percent of these users have since bought more downloads and 55 percent of users enjoy the service as a way of discovering new artists (Mulligan 2012). Upon discovering several good tracks by an artist, P2P software or other piracy services are utilized to obtain a larger sampling of the artist’s material. In the event that the rest of the artist’s music is found satisfying, then the artist’s activities can be followed, leading to higher concert attendance, sales of merchandise, and the higher probability that the next release by the artist will actually be purchased legally by the new fan. However, if other tracks are not found to be of similar quality the pirated music is either deleted or, even more frequently, sits unused in the consumer’s archived collection.

These trends could also explain why, in a survey conducted by Bas Grasmayer, 60 percent agreed with the statement “downloading music illegally is not as bad as the music industry makes it out to be,” and only 18.5 percent opposed to it (Grasmayer 2011). If pirates know that their purchasing trends have not been hindered by their behaviors, or have even resulted in them spending more money, there is no reason why they should be experiencing any
guilt about their behaviors. Individuals know their own purchasing habits better than the industry does, and they also know how often they actually use their downloaded music. The mere presence of a pirated digital file on the computer would have little impact on the consumer’s conscious as they are not preventing the use of the file by anyone else, and if they never listen to it, they would not feel the need to compensate the creator. While major collections are acquired quickly through P2P software or transferring large collections between friends, data suggests that the vast majority of music collections are never utilized. A study by Music With Me determined that the average iTunes library has 5,409 songs, of which 4,195 or 81 percent have never been played (Resnikoff 2011b). A 2009 survey of 1,800 young people in the United Kingdom found that the average digital library contained 8,000 songs, with 1,800 on the average iPod (Bahanovich and Collopy 2009). Up to two-thirds of songs in these collections have never been played (Karganis 36). If it is true that only between 19 and 44 percent of collections are played, and assuming the portion that is played was pirated, the generally accepted 1 in 5 substitution rate to calculate piracy damages is still quite high, and assumes that virtually every song that has been played in a collection would have otherwise been purchased. These trends suggest that digital piracy does not occur solely due to the free price point, but also as a matter of convenience. The Swedish Performing Rights Society conducted a study that found 86 percent of over 1,100 surveyed would be willing to pay monthly fees ranging between $6 and $17 for a legal P2P service (Peoples 2009).

2.3 The Artists and Overall Music Industry

The net effects of piracy, while potentially harming the primary stakeholders in the recording industry, do not have the same impact on the overall economy. Unless the saved disposable income is burned, it is obvious that it will instead be spent elsewhere in the economy,
which would generate the taxes, wages, and jobs in other industries that would purportedly have been lost in the recording industry. In fact, the advent of digital media and the ability for consumers to meet their music demand at a lower cost will then provide a net gain to society by altering consumer spending to industries that both better provide the satisfaction of consumer needs and promote growth and innovation within those industries to better meet those needs over time. Put another way, by Joe Karganis of the Social Science Research Council, “to make a case for national economic harms rather than narrower sectorial ones, the potential uses of lost revenue need to be compared: the foregone investment in the affected industries needs to represent a better potential economic outcome than the consumer surplus generated by piracy” (Karganis 16). This is the definition of progress. Of course with the U.S.’s primary dominance in the IP industries, this consumer surplus is more readily gained from piracy by countries we export IP products to. For example, a government commissioned study in the Netherlands found the consumer surplus related to piracy vs. the domestic losses to IP industries in the Netherlands to generate a gain of €100 million per year (Huygen et. al 2009).

Findings from the book and piracy study, “Media Piracy in Emerging economies,” describes the state of the music industry in this way, “The CD’s sharp decline in the United States has been offset by the growth in digital sales and concert revenues: the latter more than tripled, from $1.3 billion in 1998 to $4.2 billion in 2008. Such numbers point to a shift from a high-margin industry dominated by CD sales, the album format, and the big four labels to a lower-margin business with more emphasis on performance and related rights” (Karganis 43).

Growth in live performance revenues did not stop in 2008. According to Pollstar in 2011 ticket prices rose 10 percent while the top 100 venues in North America improved revenues by 16 percent and saw a 5 percent increase in attendance (Resnikoff 2011c). The reduced value of
digital music which can be copied endlessly has then increased the value of what is more scarce, such as the experience and connection fans have with artists. With higher disposable income from saving on music purchases, they can now better enjoy themselves by using their money to go to shows, purchase merchandise, or create a connection with the artist in other ways.

If piracy has been infringing on sales, then it would be expected that royalty payments would either decrease or remain constant, however royalty payments have been at an all-time high for the industry. Payments in 2011 were 17 percent higher than in 2010 with SoundExchange, the royalty collection agency in the U.S., distributing $292 million to artists and rights holders in 2011, and registering an additional 15,300 new artists, labels, and rights holders in 2011 (Houghton 2012). The International Confederation of Authors and Composers Societies (CISAC), has also noted significant increases in royalty payments over the last several years, reaching a new peak of €7.5 billion in 2011 and growing at rates faster than world GDP for 2010. At the beginning of 2012, they noted that the only recent dip in royalty collections occurred in 2008, and they have since more than rebounded, and climbed steadily overall in the last 7 years. The largest collections (73 percent) come from public performance revenues, and while growth in the digital sector rose 22 percent in 2010 alone, it still has not yet made up for the decline in royalties from physical sales (Patissier 2012).

As far as individual artists are concerned, the actual impacts to their personal income can vary greatly depending on what contracts they have in place, and what aspects their business strategy emphasizes. While there are certainly musicians such as Lars Ulrich from Metallica, and Gene Simmons from Kiss, who feel they have been financially hurt by changes in the music industry, it has been found that while the recording industry is making less from declining sales, artists are making more overall from the mirrored gain in performance revenues and a variety of
other less traditional income streams. The utilization of these non-traditional revenue streams has increased total artist incomes as much as 66 percent since the advent of digital music, according to a study conducted by the BI Norwegian School of Management in 2010. The findings were explained primarily by the growth in sectors of the music industry that pay out a larger share to the artist. For example, on average artists receive only 15 percent of album sales revenue, yet they receive an average of 50 and 80 percent of revenue collected from concerts and remunerations (Moya 2010). In fact, a study by the Future of Music Coalition identified 42 sources of funding and revenue streams for musicians, ranging from various types of royalties, live performance revenues, and merchandise sales, to more creative methods such as ad revenue, YouTube Partner Program, persona licensing, product endorsements, grants, fan funding, sponsorships and many more (Future of Music Coalition 2012). While this study on artist incomes has not been conducted in the past to provide a basis for comparison, the average gross income from music related activities for over 5,000 sampled artists was $34,455, and the 1,589 artists who are considered full time musicians made an average of $62,757 per year (Thomson 2012).

2.4 Economic Growth

Examining the output levels of creative works as well as the underlying incentives is essential in determining the effectiveness of copyright in the digital world, and contrary to what the industry’s representatives would have people believe, it has been a prosperous decade for the copyright industries. Film, software, book publishing, video games, and music revenues all increased through 2008, and are projected to rise even further for the foreseeable future. According to ongoing research by Oberholzer-Gee and Strumpf (2010), new book publications rose 66 percent between 2002 and 2007, and since 2000, film production rose 30 percent and the
number of new album releases more than doubled, from 35,516 in 2000 to 79,695 in 2007. Even Nielsen Soundscan has reported significant growth in the number of new albums released, showing production rose from 38,000 in 2003 to 75,000 in 2010, after reaching a height of 106,000 in 2008. In addition, many music distributors are not counted in SoundScan reports, which may under represent as much as half of the total yearly releases. The Gracenote database, which has existed for ten years grew, its collection from 11 million songs in 2001 to over 100 million in 2011, growth which has far exceeded the rate at which old songs needed to be added. While these numbers don’t give any direct information about the number of legal purchases of these products, it does indicate that artists have sufficient or increased incentive to produce more works (Masnick and Ho 2012).

Evidence that digital media has supported growth in the creative industries does not end here. Analysis of data from a wide range of sources is presented in the Masnick and Ho (2012) report, “The Sky is Rising,” which estimates the worldwide entertainment industry to have grown in value from $449 billion in 1999 to $745 billion in 2010. During this decade and the rapid growth of e-commerce, internet services, and digital content, total household spending on entertainment grew from 4.9 percent of household income in 2000 to 5.62 percent in 2008. There was also a 20 percent increase in entertainment sector employment from 1998 to 2008, which was largely due to a 43 percent increase in independent artists. The amount of overall content available has also grown tremendously. Even since 2006 to 2010, and through the great recession, worldwide box office revenues increased by 25 percent and overall industry revenues grew 6 percent 2005-2010. The number of films produced globally in 1995 was only 1700 compared to 5,635 produced in 2005, and 7,193 produced in 2009. The book industry has also grown about 9 percent in total value from 2004 through 2010, although estimating the exact
growth in self-published new works is difficult to directly quantify. Consumer spending for video games and related hardware has grown from $20 billion in 2000 to $70 billion in 2011, and has been providing formidable competition to the other industries over consumer’s discretionary dollars (Masnick and Ho 2012).

The electronics industry is one area that has provided vast competition for consumers’ wallet share, and directly compliments consumer behaviors of mass digital media consumption. While the recording industry has pulled in under $6 billion in revenues during 2011 and has spent over $100 million on lobbying efforts since 2000, the Consumer Electronics Association had expected growth of nearly $6 billion in 2011, and a total $186 billion for the industry (Resnikoff 2011d). Without consumer electronics, there would be no way for consumers to enjoy any of their recorded media, regardless of the format, and the rapid growth in this industry indicates the huge economic advantages of massive digital media consumption. The cell phone has also become a source of consumer entertainment and a new medium which has seen significant growth as a music market. The mobile music market, which virtually did not exist in 1999, has now developed into an industry worth over $14 billion in 2010, through the use of ringtones, ringback tones, full song downloads, and music streaming. In addition the availability of music applications for download has also exploded from only 496 in 2009 to nearly 14,000 in January 2011 in the Apple App store alone (Informa 2011). Additionally, worldwide subscription, download, and personalization services are expected to grow from a combined $5.9 billion industry in 2010 to a $7.7 billion industry by 2015 as these services are made more readily available in other regions of the world (McGuire and Baghdassarian 2011).

Growth in musical instrument sales also reflects an increased interest in “useful arts” and promotes cultural richness, as higher sales indicate that more people are taking interest in music
as an art form, regardless of whether they expect to make it as a musician. By 1999 the musical instrument industry was worth about $6 billion after growing throughout the 1990’s. Demand for certain areas, particularly electronic instruments, exploded shortly thereafter. Guitar Center, for example, more than tripled its value in two years after the release of its IPO in 1997. The demand for guitars grew by 20 percent in 2006 and by 41 percent in 2007, and by 2009 more than 2.9 million guitars were sold to consumers (Highbeam Business 2012).

Although the benefits to the creative industries themselves can be quantified, there are even more important potential benefits of having weak copyright enforcement and regulation in the digital world. News, entertainment, and education were very different services provided, and naturally segregated through their own distinct mediums and respective industries. The internet itself has now merged the way we consume knowledge, education, news and entertainment and is constantly evolving the ways we communicate this information. Websites such as youtube and Wikipedia have been under attack for allowing copyright infringement to occur, however both of these companies, and many others, are means of providing all these forms of information, and they have often blurred the lines between fair use and infringement. Supporters of an open internet and Creative Commons licenses would argue that the well accepted concept of the public library is no different than file sharing databases, where people publically share knowledge and entertainment, except there is no cost to taxpayers and no limit to the amount of loans available. In the context of paying $1 for a song or getting it for free, the argument for lax copyright enforcement is rather weak, however allowing for the free pursuit of knowledge online and the continued education of millions without budgetary limits provides dramatic benefits to society.
3.0 Changes in the Music Business

3.1 Label Profitability

Understanding the true scope of benefits that have been established since the onset of digital media and the economy gains made by the industry despite piracy, then raises the question as to why the industry would be fighting so hard and spending so much money to deter piracy. The recording industry has been able to successfully rely on copyright law to adequately protect their IP rights in the past, and it has become a fundamental part of their business model. It also relies on highly systematic, yet effective, promotional campaigns through mass media outlets. There are very high production costs involved in producing an album and distributing it to the numerous brick-and-mortar retailers, and a very high investment in each new artist. In other words, in order to spend the money required to promote a new artist, they must ensure that the artist will be a success from the get go. This involves knowing what audience will be targeted, and hiring a professional team to write and produce the music for the artist. These costs add up to about $78,000 to make the track and to pay the writing camp, producer, songwriter, vocal producer, the mixer, and then an additional $1,000,000 in expenses to promote the song to the public (Resnikoff 2011e). In addition to the high costs, revenues are also dispersed among the many people involved in the production and distribution chain. After the label and the distributor is paid, only 13 percent is left to divvy up amongst the band team, which often includes the personal and business managers, lawyers, producer, and the individual members of the band. In a four member band, this means that the average musician makes only $23.4 out of every $1,000 in music sold (Wilson 2010).
A fundamental aspect of an artist’s profitability for a label was their ability to generate full album sales. Once an artist was signed it was common practice for the label to require them to perform a song written and mixed by professionals hired by the label. This track, often a ballad, would then be played through popular mainstream channels of radio and television, and enticed consumers to buy the whole album for very high retail prices. The hit track would inevitably sound different from the works created by the band and would lead to consumers being disappointed with the rest of the tracks on the album, and artists who would often become famous for songs they were contractually forced to play. The success of CD sales with only the single track, even at retail prices as high as $6, shows that consumers had very low expectations of the rest of the album, and can in part explain the disproportionate success in single track downloads and streaming services.

Such a production chain is simply too expensive to sustainably compete with services, either legal or illegal, that offer the same music for free, or sell it for a price point that has remained around the $1/track mark. The digital market has also forced labels and artists to focus on the quality of each individual tracks, as “fillers” would simply not be downloaded. The downward pressure on prices has forced labels to look into other means of revenue generation. One way labels have begun to try to take advantage of the more profitable side of the music business is to offer or demand 360 degree contracts. These go beyond the traditional right to produce, sell, and distribute the physical album, and include roles such as merchandise and live performance management as well. This has not, however, been generally accepted by the majority of artists who would rather keep these other areas of their business to themselves, or to the band’s management, who are generally considered to have the artist’s long term interests in mind (Economist 2007).
3.2 New Mindsets and Methods of Monetization

In traditional contracts, expenses are deducted by the label from future royalty payments to the artist. This includes promotional, recording, and distribution costs associated with the album; in addition, the signing bonus or advance given to the artist at the beginning of the contract must also be paid back through these future royalties (Karubian 2008). As it turns out, only the very most successful artists ever produce a record successful enough that their rate of $.09 per song will pay back the many thousands of dollars owed back to the label. As artist Mike Errico put it, “I’ve only been broke – truly, guitar-selling broke- twice. The first time was when I was on a label. The second was when I licensed a record to a different label” (Cross 2012). To add further clarification to those in support of the free music culture, successful musician, writer and label owner Zac Shaw describes the issue in the following way,

“Should listeners feel guilty for having free access to music? Of course not. It’s the best thing ever to happen to the music lover… You realize that price point had nothing to do with compensating artists right? That ridiculous number [$20 per CD] was the product of illegal price fixing, obscene recoupments, payola, unethical breakage fees and keeping statutory royalty rates for artists low…” (Shaw 2012).

It is this mindset that has been the ultimate driving force behind the hatred of corporate labels by many fans, and the popularity of indie and subsidiary labels that help mask their larger corporate identity. This attitude has also been shown by the huge success of artists who have broken away from the traditional model and have encouraged the free consumption of their products. Comedian Lous C.K. personally made over $1 million in sales, over the first few days, for releasing his standup without any copy restrictions for a $5 download on his website rather
than shopping it to HBO or another major broadcaster (Gadino 2012). This success is echoed through the results of Radiohead’s and Trent Reznor’s experiments with free music. In 2007 Radiohead released their album “In Rainbow,” on the basis of pay what you want, which was initially considered a failure with only 48 percent of downloaders choosing to pay. A year later however, the album still managed to sell 1.75 million physical copies, 100,000 box-set versions at £40 each, and sold 1.2 million concert tickets (Geere 2008). Trent Reznor generated similar success, and over $750,000 in sales within the first three days, using a similar model of offering different versions of the album ranging in price from $0 to $300 deluxe versions/packages (Anderson 2008). Without the expenses of a label, this profit incentive has been attributed to the growing popularity of Creative Common’s licenses, which allow artists to select their own terms of their copyright (such as permitting personal copying and sampling), and places their work in the public domain.

These innovations are part of a new business concept called the long-tail theory. This concept describes the economic idea that a new artist with 1,000 dedicated fans can generate a livable income by providing $50 per year of paid content directly to fans. Or put another way, by generating a fan base of 10,000 who spend an average of $5 per year on artist content, whatever the format. Such a small fan base could never have supported an artist if production and distribution costs remained at the high industry standards. Instead the ability to generate and distribute the content directly to the consumer, and low production costs, allows artists to keep the vast majority of earned revenues without sharing it with label middle men. The thousands of artists potentially operating under the long-tail concept represent the form of increased competition the industry is facing. The potential for this concept is astounding. Artists Ben Folds and Amanda Palmer generated $20,000 in 2 days through direct to fan sales, and Amanda Palmer
later raised over $133,000 to support the costs of touring through Kickstarter (Martin 2012). This shows that fans are more than willing to compensate an artist when they know that their purchases go directly to the artist and can help ensure their favorite artists continue to perform, making the fans a driving force behind their success. Such success simply adds credibility to surveys, such as the one conducted by Bas Gasmayer, where 56.1 percent of respondents agreed they are more likely to buy an artist’s music if they have exchanged words with them either in person, or via the internet (Gasmayer 2011). Although forking out $1,000,000 to promote a song or artist still gives major labels a large advantage in the industry, the presence of do-it-yourself (DIY) artists has also resulted in smaller incomes for the biggest names and decreased time at the top of the charts, as music spending is dispersed through the thousands of indie artists and labels.

3.3 Coping with Creative Destruction: The IP Defense Industry

The concept of creative destruction, popularized by Austrian economist Joseph Schumpeter, accurately describes what is happening in the music industry. The analogy of the refrigeration industry can be used to describe the creative destruction process (Engström and Falkvinge 91). As refrigerators were adopted by households in the 1920’s and 1930’s, the ice distribution industry and role of ice delivery men became obsolete as the delivery of chunks of ice to keep food stored safely was no longer necessary or cost effective. The problem of the recording industry essentially relies on the profitability of distributing CDs (ice) to consumers who have the ability to attain the product (ice) themselves via the internet. Although the icemen lost their jobs and had to find new occupations, their industry was not given a monopoly by law to continue the distribution of the service, nor where they compensated for “damages” incurred by consumers producing their own ice. It seems however, that the presence of copyright
legislation protecting the music distribution industry has distorted what would otherwise be a simple and straightforward concept.

Industry trends show that finding creative solutions to coping with piracy can pay off for artists and benefit consumers at an individual level, but major labels have taken a different approach. Instead of embracing the new movement to digital media, music industry representatives and other intellectual property (IP) rights groups have been using their time and hundreds of millions of dollars to curb digital piracy. Efforts have been displayed through intensely publicized and harsh legal campaigns against individual infringers and major companies that facilitated it, through education efforts, and most importantly, intense lobbying efforts for legislations that would make stricter penalties for infringements. They also have lobbied to give owners of IP rights more power to legally locate, stop, and prosecute individuals, to shut down web domains where infringement occurs, and to shut down ISP providers that don’t take measures to monitor and stop infringement through their services. The efforts made by IP rights groups are described in Adrian John’s book *Piracy: The Intellectual Property Wars from Gutenberg to Gates* (498), as the IP defense industry. This IP defense industry began its evolution in the 1970’s and has since developed and mutated to take on surveillance, policing, and military roles to protect the IP rights, primarily within the media, pharmaceuticals, and agriculture industries. There is no doubt big money in the IP defense industry. According to its IRS filings, the tax-exempt RIAA paid out $16.2 million in salaries and benefits in 2009, netting six figure incomes to over 10 of its employees, and over $3.1 million in compensation for the president and $1.6 million to its CEO (Resnikoff 2011f).

Numerous companies developed methods to profit off of the digital distribution model despite ongoing digital piracy, but the litigation efforts against major file sharing companies such
as the original Napster and Kazaa, and the occasional individual, are often viewed as a last ditch effort by the major labels to frighten consumers back into traditional purchasing habits. This means no claim of damages could ever be considered too large by the industry. In 2011, in a lawsuit against LimeWire, the RIAA and 13 record companies claimed copyright infringement damages ranging from $400 billion to $75 trillion. The basis in reality for such damages lies solely on the belief one upload of copyrighted material is then downloaded thousands of times, and that compensation should be awarded in the form of damages for each download. While claiming damages larger than the entire value of the U.S. economy does not seem absurd to the recording industry, the court did find the damages to be absurd and found Limewire to be liable for $6,585,000 in damages, which was still enough to put the company in bankruptcy (Purewal 2011).

To dismiss the behaviors of the copyright industries as ridiculous and out of desperation would be naïve. Upon closer analysis their goals and strategy is actually quite clever and reveals efforts to not simply save the industry, but to expand its power in dramatically new ways. For example the guise of child pornography has been used as a stepping stone to persuade legislators to be more open to internet censorship. A speaker at the May 27th, 2007 “Sweeden- A Safe Haven for Pirates?” seminar organized by the American Chamber of Commerce in Stockholm publically stated, “Child pornography is great! It’s great because politicians understand child pornography. By playing that card, we can get them to act, and start blocking sites. And once they have done that, we can get them to start blocking file sharing sites” (Engström and Falkvinge 14).

Recently however, IP groups have no longer felt the need to operate covertly. The recent public attention of bills such as Stop Online Piracy Act (SOPA) and the Protect IP Act (PIPA)
brought to light the extensive lobbying efforts by IP rights groups such as the RIAA, International Federation of the Phonograph Industries (IFP), and the International Intellectual Property Alliance (IIPA), and the serious implications of their demands. While SOPA and PIPA did not pass in 2011, similar bills are constantly being negotiated and crafted with the collaborative input of thousands of IP rights lobbyists behind the scenes of congress, the Office of the U.S. Trade Representatives, and in international conventions. While the technical aspects of each bill vary, the overarching theme of all of these legislations is that something must be done to protect the interests of holders of IP rights, and that this will be done by giving rights’ holders more power to monitor infringement, halting payments to providers of pirated goods, and higher penalties for the guilty parties.

The extent of the powers that would be granted in these legislations has included forcing IP’s to watch and cut off their user’s access if found to be violating IP rights from downloads/uploads; several years of jail time for one IP infringement offense; fines per infringement in the thousands to hundreds of thousands of dollars; and allowing IP holders the ability to shut down an online entity suspected of an infringement until litigation is completed or a settlement is reached. Such powers have been successfully granted to IP holders in other countries. France, for instance, passed the Hadopi law which requires ISPs to shut down the internet connection for users who have received two warnings of suspected file sharing by copyright holders. In Italy, which has openly welcomed fascism in the past, a single accusation of copyright infringement can get anyone banned from the internet. The vast reliance people have on the internet in modern society has caused many groups to protest these types of legislations as human rights violations (Masnick 2011). The banning of internet use does not only restrict one from media access, but also cuts them off from communicating with friends and
family, makes running their own business and finding or keeping employment highly difficult, and cuts them off from all sorts of access to further education and personal development.

No conclusive evidence exists to suggest that the overall piracy rates have declined through various changes in enforcement measures, regulations, and education. Therefore, it seems rational to conclude that the goal of the intellectual property defense industry will be to make the litigation and damage recoupment process more profitable. In fact, when IFPI and MPA representatives were asked if they could give any evidence or experience that illegal file sharing in a country had been eliminated or greatly reduced by sanctions and information campaigns, representatives explained that the approach has been unsuccessful because “rights holders are forced to go through the courts to punish illegal file sharers, which severely restricts the number of cases they can pursue” (Engström and Falkvinge 29-31). However, the work provided to thousands of lawyers ironically remains excluded from the industry’s economic evaluation of piracy.

With statutory damage rates of $150,000 per infringement and potential incarceration, IP organizations and companies they contract with to detect infringement could easily generate vast revenues from out of court settlements. Further powers to detect and hold infringers liable without going through long litigation processes would allow for the mass mailings of settlement charges of several thousand dollars, which would be vastly lower for pirates than the costs associated with battling the claim in court, or risking higher damages. There has been no conclusive evidence that education or enforcement have any significant effect on deterring digital piracy. In fact the majority of evidence indicates that the “problem” will persist regardless. In a survey conducted in response to the Digital Economy Act by the British ISP BE Broadband, 85 percent of users said they currently partake in file sharing. Only 1 percent of
respondents said they would stop file sharing altogether and only 4 percent said they would reduce the behavior. In addition, 47 percent said they would take steps to better hide their identity and 32 percent said they would not alter their behavior in any way (Resnikoff 2011g). With millions of individual infringers to go after, profitability would simply be a factor of mailing out settlements and collecting checks at values far higher than retail values of pirated content.

This process of organized blackmail, as described by supporters of the Pirate Party, is illustrated by the case of Jammie Thomas, who was sued for $3.6 million and offered a settlement out of court for only $2,000. It would be costly and foolish for most not to take the deal, as US record companies have been accused of trying to sue and settle with 80-year old grandmothers, people without computers, and long dead people, by simply mailing out threats based on perceived ISP customer behaviors (Engström and Falkvinge 21).

The Anti-Counterfeiting Trade Agreement (ACTA), a treaty put forth by the U.S. which was shot down by 92 percent of the European Parliament, fundamentally underscores the importance of having accurate facts regarding the state of creative industries (EFF 2012). This act determines the amount of damages regarding intellectual property rights infringement by any legitimate measure of value the right holder submits, including lost profits or the value of goods and services measured by the market or suggested retail price. This legislation would even ignore the concept of estimating what amount of pirated goods would have actually been paid for and awarding damages based on retail value. Therefore IP groups would have the grounds to sue a teenager who has a half million songs on his hard drive for half a million dollars, and if these tracks were found in an external drive and his internal hard drive, he would then be liable for the full million, and even more if he placed them on a MP3 player etc. With the inability to
financially afford to go through the defense process (and private companies are enabled to handle these cases outside of court), the principle of due process is essentially eliminated.

To make matters worse, the current legal penalties in place, and the call for even stricter penalties, are completely out of line with the public’s perception of the crime. In a U.S. survey of adults who have music files, around 80 percent felt it was reasonable to share files with family and 60 percent found it reasonable to share with friends (Karganis 2012a). What is more notable, among the 2030 adults surveyed, only 51 support any penalties for copyright infringement. Of those that do support penalties, 68 percent believe the fine for a pirated movie should be under $100, and 75 percent support fines of less than $100 for a pirated song. Disconnection from the internet or jail time received support by only 16 and 12 percent of adults respectively (Karganis 2012b). To describe the tragedy related to the enforcement rights of monopolies and the reality of disproportionate penalties, the historical example from Eli Heckscher’s Merkantilismen can shed light on the true costs of intellectual property. In 18th century France, the King sold monopoly rights to specific popular fabric patterns to generate additional funds for the Crown. Yet since these patterns were then sold at high prices, and the common folk had the ability to create the pattern themselves, infringement of the monopoly’s rights were rampant, despite incredibly harsh penalties by today’s standards.

*The policy is considered to have cost 16,000 people their lives, through executions and armed clashes, plus the yet uncounted who were sentenced to slavery on galleys and other punishments. In Valence, on one single occasion, 77 people were sentenced to hang, 58 to be broken on the wheel and 631 to the galleys, one was acquitted, and none were pardoned. But this was so far from effective, that the use of printed calico spread*
through all social groups during this period, in France and elsewhere”- Eli Heckscher, *Merkantilismen* (Engström and Falkvinge 33-34).

The popular discussion of copyright and its enforcement in the digital world tends to exclude the big picture view of the issue. The free market and innovative artists have already allowed for higher production, consumption, and overall growth in the creative industries. People will produce art whether there is a monetary incentive or not, and in the music world, the personal connection between the musician and the listener has proven to be where consumers hold the greatest value, and the monetization potential from this connection is limitless. Whether the industry wants to accept it or not, culturally music has shifted its role from a commodity to a service industry. Just as political notoriety can make a president rich on speaking fees, so too is music’s role in providing notoriety for the artist and acts as a foundation for the value of their other services. In order for the industry to survive, it too must find ways to assist artists in monetizing their other services, primarily through analyzing market trends and providing consultation and management advice. Major labels have and will continue to account for the vast majority of revenues due to availability of funds to invest in the promotion of artists; however, it is simply not feasible that reliance on the copyright of the music itself will be enough to continue its operations in its traditional way.

Other than looking at the respective market shares of the 3 major labels and their 90 percent controlling interest over the music industry, the fact that the recording industry is a monopoly can be seen simply through the application of copyrights. While commonly described as property rights, they are actually a limitation of rights on the property purchased by the consumer. In a usual transaction, the purchase of a good transfers entire ownership and any conceivable rights with the property. In a historical and practical sense, copyright has always had
to be granted and enforced by a government entity because consumer behaviors with that good must also be monitored and regulated even after “ownership” is transferred. It is obvious then that supporting these limited rights will hinder innovation in the industry (and others) if copyright could be fully enforced. In its entire literal sense, even singing a song out loud, or telling your parents about what you learned from a textbook would be considered violation of copyright. It is simply common sense that the more ideas and information that the public has access to, the more there is potential for the intellectual and cultural development in society. If the incentive for creation is present (as it is now), with no mandate for compensation (as there isn’t now), what compelling interest would there be for a government to guarantee such compensation at the sake of prosecuting thousands of individuals and dramatically limiting freedom of communication and potential innovation in the digital world?

4.0 Conclusion

While we are a nation founded primarily on the principles of sound procedural laws, it is my argument that in the world of the non-linear internet, a substantive approach to IP is dramatically more beneficial to society than transferring the same procedures and penalties for physical piracy to the digital world. It is economically sound that higher levels of consumption and production of cultural works, in this case music, means that overall incentives, including compensation, is at least more sufficient since the advent of digital piracy in 1999. While it is still not entirely clear whether this increased production would be greater in a market that had both free competition and no piracy, the fact is that a free market did not exist prior to digital piracy’s creation, and that no level of enforcement could eliminate digital piracy. It is then clear that the current soft approach to IP rights online is much better for both artists and society than any proposed alternative for the sake of IP right’s incumbents.
What is most important is that lawmakers keep the focus on fulfilling copyright’s constitutional purpose, which essentially states that the only justification for a copyright monopoly is if it maximizes the amount of culture and knowledge available to society, making the public the only legitimate stakeholder. The process of attributing credit to the authors, writers, composers and other responsible parties is already established as a moral principle in society. People have a genuine interest in knowing who the original creator of a work was both for further research into their materials, moral satisfaction, or to provide credibility to their own derivative works. Simply decriminalizing copyright infringement on the net for non-commercial purposes would still ensure we continue to remember the principle but also allow the industry to prosper with artists who are creative enough to take the concept of free music as a given and thrive in other ways. Digital piracy functions, and is viewed as positively as, the public library by a large part of society, the majority of which are internet users. Piracy will continue despite the punishment, and greater enforcement will only push forth innovations in the copyright removal technology and piracy industries and advance methods used to be anonymous online. Not conforming to changes in mindset about copyright in society, and forcing the monopoly on citizens through legislative penalties, will only result in an eventual Merkantilismen-like tragedy of the modern day.
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