

Napster and Intellectual Property

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Introduction

- Discussion of Napster and the broader goals of protecting intellectual property
- Perspective: role of innovation in fostering growth and prosperity
- Economist view: broader technical notion of welfare encompassing growth, prosperity and other issues

Follow the Money

- to understand arguments about economic policy: understand the motives of the parties
- imagine a mind-reading device
- every time you listen to a bit of music (even in your mind) your credit card is automatically be billed for the exact level of enjoyment you receive
- suppose this device is controlled by the same five music “majors:” AOL-Time Warner, EMI, Sony, BMG, and Universal that currently control 85% of the market for music
- Who would benefit from such a device?

Shareholder, Top Executives

- Every penny of benefit from listening to or imagining music would accrue to the producers
- most of this would show up as increased profits to the majors who hold the monopoly
- little benefit to employees of the majors, or contractors such as sound editors, engineers, lawyers and promoters – their salaries are determined in the competitive labor market
- an enormous windfall to existing shareholders, especially since current stock prices reflect the fact that such a device or even a near facsimile is unlikely ever to exist; worse the majors have effectively lost the rights to any music ever released on CD
- the windfall would be great. CEO's and other top executives, whose lives, careers and fortunes depend crucially on the stock price of their companies would equally benefit
- this windfall would serve no good economic purpose

Artists

- most artists and songwriters face an extremely competitive market
- bound to long-term contracts with the majors to whom they effectively cede the copyright to their creations
- for a few very top artists no close substitute for their creations so these very top artists too would share in the monopoly profit

Society

- consumers would receive no benefit from music at all
- more insidious social consequences:
- copyright for an imitation that is superficially different than the original
- with the mind reading device copyright is very lucrative, so the incentive (technically “rent-seeking behavior”) to produce an imitation and share the windfall is great
- truly original creators cannot be compensated for all the imitation their original work spawns
- example: Chuck Berry today is relatively poor; his many imitators, including the Beach Boys and the Beatles are quite wealthy
- we would expect that too many imitation works would be produced, and too few genuine innovations
- stepping away from the music industry, consider of textbooks - instead of a few good books we have many mediocre ones

Not a Surprise

we expect top music executives, music company shareholders and a few top artists to favor the mind-reading device

other people in the music industry neutral

pretty much everyone else to be against

pretty much describes the parties to the modern conflict over copyright

heads of major corporations, supported by a few top artists argue in favor of stronger protection of their intellectual property

these corporations have vast financial resources so can mount an effective lobbying effort

their opposition is diffuse and scattered and much less able to lobby (and buy) politicians.

Surprises

- (not much of a surprise) strong copyright protection appears to have virtually no support in the music industry beyond a few top executives and artists
- people I know involved in the recording industry and internet discussion by people in the recording industry: “Napster isn’t wrong”
- some top artists “Napster isn’t wrong.”
- possibly a calculation that there are promotional benefits
- appears to go beyond that: recognition of reality that their work has no value without fans, appear to be willing to give up a share of their own wealth in favor of the fans who made them reach and famous
- apparently irrational vehemence with which some artists appear to dislike Napster - genuine anger at the thought of someone listening to their music without paying even if those people would never have paid to listen to their music in the first place (Dog-in-Manger)

Goals of Public Policy

- US constitution allows copyright only in order to “promote the progress of science and the useful arts.”
- Economic theory provides similar rationale
- producers must be compensated for their work, or creative works will not be produced
- neither the constitution nor economic theory argues that producers of intellectual property should be privileged over other producers unless there are social benefits to compensate for the costs of special treatment
- the constitution explicitly rejects the view of some artists, and the view widespread in Europe, that creators are uniquely entitled to control of their own creations.

Copyright Law

- right of first sale – the right of the creator to sell his work
- “downstream licensing protection” purchasers of the work are limited in the use they may make of it; most important they cannot copy and resell it (or even give copies away for free, apparently)
- copyright law gives producers of intellectual property the unusual right of not having to compete with their own customers.
- Economic theory demands that creators have the right of first sale, otherwise no market for intellectual products, and fewer works produced
- unless compelling evidence that “intellectual products” have a special nature there should be no broad right for producers and distributors of such products not to compete with their own customers

Economics of copyright

- Economic research has not shown that products of intellectual activity enjoy a special nature.
- Only in the unlikely circumstance that there is no cost from monopoly does economic theory suggest that producers of intellectual property (or of any other) should have an unfettered monopoly
- Work by Michele and myself has shown that the absence of any copyright beyond the right of first sale is likely to outperform (from a social point of view) unfettered monopoly

Issue of property rights (producer vs. consumer)

- Ultimately bargaining between producer and consumer
- Consumer doesn't like restrictions, doesn't have to buy
- Producers doesn't like restrictions, doesn't have to produce
- Without transaction cost, does not matter (Coase)
- Otherwise minimize transaction costs – putting a spy camera in every household does not achieve this

Empirical evidence on copyright

- massive unplanned experiment with absence of copyright in the music industry during the last several years
- since the advent of Napster, virtually all music ever recorded has been available for the cost of a download without any payment to the producers

Results?

- music industry sales went up, and profits increased
- producers argued that their profits would have increased even more in the absence of Napster (we agree)
- neither the constitution nor economic theory demands that music producers receive the maximum possible profit, only that science and useful art be promoted. Justice Sandra Day O’Conner writes

“The primary objective of copyright is not to reward the labor of authors, but ‘to promote the progress of science and useful art.’ To this end, copyright assures authors the right to their original express, but encourages others to build freely upon the ideas and information conveyed by a work. This result is neither unfair nor unfortunate. It is the means by which copyright advances the progress of science and art.” Justice Sandra Day O’Conner, 1991 decision (488 US 340,349).

Constitutional and economic questions

- during the Napster era was less music produced?
- Was it of lower quality?
- Was there unemployment among artists, sound engineers and others involved in the production of music?
- Not as far as we can tell, nor has the music industry argued that this is the case
- The sky hardly fell

Nature of the experiment

- not an experiment with the actual absence of copyright protection
- without copyright Napster users would have not only been able to give away music, but to sell it
- Would this hurt producers?
- On the contrary – if music on Napster carried a higher price, consumers would be less inclined to obtain it from Napster and more inclined to purchase from producers; plus they would be willing to pay a higher price to producers, since they can resell it

Monitoring and encryption; fair use in law and in practice

- Impossibility of stopping the black market
- Undesirability of black market
- Computers as multiple use devices – costs of mandating encryption
- Computers versus vcrs

Wither Intellectual Property?

Successful Case Studies of Intellectual Property without Copyright

- News, Newspapers, Magazines and Radio

advertising supported; not much benefit from copyright; Email a friend

- Pornography

“There is no slump in sex sites, says Robert P. Libbon of American Demographics Magazine. He cites a report from sextracker.com that the number of free adult Web sites grew from 22,100 in 1997 to 280,300 last year. Sex-for-pay sites grew from 230 to 1,100 during the same period.” [reported on Slashdot April 5, 2001]

- Baen
- Movie Shorts

largely available online; market near non-existent prior to internet

Mixed Success

- Scientific Publication

monopolists have so far suppressed innovation

commercial journals online presence is pathetic

what possible excuse for charging money to see scientific articles which were produced by authors subsidized by the state, and who aren't paid for their authorship except through university promotion

given underlying non-profit nature of the enterprise, probably a short-run phenomenon (i.e. the market can cope with or without copyright law).

- Music/Napster

widely available online; adequate profit; black-market; constant litigation

- Computer software

Open source versus encrypted distribution & elaborate licensing

Unsuccessful Models

- Books

largely unavailable online; innovation suppressed through copyright law; some litigation (Harlan Ellison, Robert Heinlein)

- Full length movie/tv

largely unavailable; bandwidth problem; innovation suppressed through copyright law (recordtv.com; there was something else like this rebroadcasting stations from one location to another)