

**Assessing the Economic Impacts of Copyright Reform on Performers  
and Producers of Sound Recordings in Canada**

**Dr. Ruth Towse**

**Report commissioned by Industry Canada**

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Final Report\*

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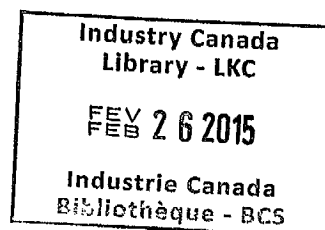
\* I am grateful to Michael Rushton and Christopher Maule for reading the draft version of this Report and to Keith Acheson for his very detailed comments. All errors and opinions are mine.

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## Executive Summary

1. The terms of reference for this project state that the criterion for assessing the expected effects of the changes to the Copyright Act that may be called for to implement the WIPO Internet Treaties should be net economic benefit to Canadians. The focus of the commissioned research was directed to consulting stakeholders on the production side only – the performers and sound recording makers – and their responses are set out in this *Report*. However, it is argued that intermediate users of sound recordings and particularly consumers should also be included in the consultation process, the more so as ‘perverse’ consumer behaviour is an important aspect of the problem that some of the proposed measures seek to rectify.
2. The institutional setting – sound recording in the music industry – is briefly set out and the point made that the industry has long enjoyed the protection of copyright law. It is therefore difficult to imagine how it would have developed economically without that protection. Performers were not always so well protected but have had similar treatment to the sound recording makers since 1997 when Canada joined the Rome Convention. Performers and sound recording makers share interests in common in creating and supplying recorded music, though the economic position of the former is mostly considerably weaker than that of the sound recording makers, who often have the superior bargaining position.
3. The underlying motive of the WIPO Treaties is the promotion of international trade in copyright material. The likely effect is that implementation could increase revenues to performers and sound recording makers but the revenues are likely to accrue mainly to non-Canadians.
4. There are different economic approaches to the analysis of the expected net effects of implementing the Treaties and several are used in the *Report*. However, it is unrealistic to believe that economics can provide simple answers to the complex legal aspects of implementation. In particular, there are no ‘magic’ numbers that can decide the issues. The *Report* therefore provides an analytical basis from which to consider the proposed changes in addition to some factual evidence.
5. The sound recording industry in Canada, in common with world wide trends, has seen a fall in sales of CDs over the last two years. This is now of the order of 10 per cent. The industry itself sees this as being due to organised piracy and lately due to increasing Internet downloads. Internet downloads undoubtedly have had some effect, but the full extent is difficult to establish by means of verifiable data. Figures on blank recording media show that sales have increased very markedly over the last few years. At the same time, incomes from licences have grown in the past 5 years.
6. Discussion of the detailed options for changing the Copyright Act reports the view of the Canadian Recording Industry Association (CRIA), Canadian Music Reproduction Rights Agency Ltd. (CMRRA) and Neighbouring Rights Collective of Canada (NRCC), the only organisations that responded with evidence. The proposed rights are discussed in the light of other relevant economic experience. However, in most cases it would appear that the choice of option should be

made essentially on legal grounds, taking into account broader economic considerations. The analysis suggests that it is undesirable to make changes that are overly strong and that could inhibit the development of markets, for example of Internet downloads of music. Copyright law should be technologically neutral and provide a balance between the interests of performers and sound recording makers, intermediate users of recorded music and consumers.

7. Implementing the WIPO Treaties necessitates changes in Canadian copyright in order to comply with international obligations and at the same time to protect Canadian rights in the digital era. Changes to the law are never costless as they redistribute benefits and costs between different groups of producers and between producers and consumers. International trade in copyright material makes this process more pressing and even more complex.

# Assessing the Economic Impacts of Copyright Reform on Performers and Producers of Sound Recordings in Canada

## 1. Introduction

### 1.1 The terms of reference of the project

The terms of reference from Industry Canada for this project were as follows:

“In 1997, the Canadian government signed two new international treaties, the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). These were the first intellectual property treaties to address the digital network environment, by setting out provisions to:

- create a new exclusive right in favour of copyright owners, including sound recording producers and performers, to make their works available on-line to the public;
- prohibit the circumvention of copyright protection; and,
- prohibit tampering with rights management information.

The primary purpose of this study is to assess the economic impact of a number of changes as specified in the WIPO treaties that can be made to the *Copyright Act*. In particular, we are interested in examining the economic impact by comparing status quo with the following changes (which are explained in greater detail in an appendix) for performers and producers of sound recordings in Canada:

- a. Introducing an explicit distribution right;
- Introducing a making available right for performers and producers of sound recordings;
- Introducing legal protection for technological protection measures;
- d. Introducing moral rights for audio performers;
- e. Extending a full reproduction right for performers;
- f. Extending term of protection for sound recordings;

There may be more than one possible means for achieving the specified changes and so some sensitivity analysis will be required to compare the economic impacts over a limited range of policy choices.

Assessment of the economic impact is to concentrate on how the specified change ensures net gains for Canadians. This will be achieved by focussing on stakeholders who are affected directly by the proposed changes listed above.

It is expected that economic analysis will identify and evaluate the economic impacts to stakeholders in Canada over both the short and intermediate terms.”

The specific policy options are laid out in Section 5 below.

## 1.2 Stakeholders

In common with the approach of WIPO, the stakeholders identified by Industry Canada are the performers and producers of sound recordings in Canada. Performers are represented in two ways: by performers' organisations, such as a Musicians' Union, and by collecting societies which administer copyright remuneration from sources other than fees or sales. In Canada, there are many such collecting societies, each administering different rights, and they are members of the Neighbouring Rights Collective of Canada (NRCC) as an umbrella organisation. Sound recording makers are represented by the Canadian Recording Industry Association (CRIA), whose membership is comprised of the major record companies, leading independent labels, and all manufacturers of compact discs and tapes. In all, they represent in excess of 95 per cent of the sound recordings that are manufactured and sold in Canada. On a worldwide basis, the sound recording industry is highly organised to lobby for stronger copyright legislation: CRIA is a member of the International Federation of Phonographic Industries (IFPI) and IFPI in turn is a member of the International Intellectual Property Alliance (IIPA), which is a coalition of cultural industry and software interests.

Defining stakeholders in term of producers ignores the impact of changes to copyright law on consumers. Consumers are a group who are in general under-represented (as is well-known in public choice theory) because the transaction costs of organising large numbers of individuals who each stands to gain or lose a relatively small amount is too great to be worthwhile. The government therefore must balance the interests of consumers against those of wealth generation by producers. It is clear from the terms of reference of the project that this is the intention of the Government of Canada:

"The Government is committed to ensuring that copyright law promotes both the creation and dissemination of works and to ensure appropriate access for all Canadians to works that enhance the cultural experience and enrich the Canadian social fabric".

The same viewpoint is expressed in the *Consultation Paper on Digital Copyright Issues* jointly issued in 2001 by Industry Canada and Canadian Heritage and the Government of Canada's 2002 consultation document *Supporting Culture and Innovation*. However, the effect of the proposed changes on consumer stakeholders was not part of the remit of this project. What is meant by 'access' may be complex and range from 'connectivity' to having sufficient education and training. In economic terms, 'access' is often interpreted as meaning that prices should not rise too much due to copyright. That will be discussed further below in relation to the economics of copyright.

In the case of the music industry, it is evident from recent behaviour by consumers that their needs have not been fully met by the sound recording industry and their response has been to acquire music from the Internet and from illegal sources.<sup>1</sup> Governments should consider the cause of this consumer behaviour, whether illegal or not: is it a protest, is it ignorance or is it an unexpressed consumer demand that the marketplace is not meeting? Consumer groups, such as Digital Consumer, do not advocate illegal behaviour but seek to promote consumer rights<sup>2</sup>. At present, the main source of

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<sup>1</sup> [www.digitalconsumer.org](http://www.digitalconsumer.org)

<sup>2</sup> See Department for Media, Culture and Sport (DCMS) (2000) *Consumers Call the Tune* Report of the impact of new technologies on the music industry.



information on this subject comes from the industry itself and independent verification has by and large not taken place.

There is an additional complexity because changes to copyright law do not only affect creators and consumers but also a range of 'intermediate' users, which are very important for revenues in the music industry - the host of shops, bars, radio and TV stations, sports halls, airlines and the rest - who use sound recordings in public performance as part of the service they provide to their customers. This is the 'secondary' market, as compared to the primary market of sales.

Payments in this market are administered by the collecting societies. Secondary users are usually represented by trade associations and performers and producers of sound recordings by collecting societies. Thus 'stakeholders' might also be interpreted as including the users' representatives. In Canada, tariffs are approved or set by the Copyright Board (see Section 3.3 on copyright collecting societies). It therefore may be deemed that the interests of this group of users are protected by the Board. This is a matter that Industry Canada should take into consideration.

### 1.3 Research methods

In researching the project, all the organisations and individuals listed as 'Stakeholders' in the brief from Industry Canada were contacted (see Appendix). An e-mail was sent to each and the main organisations were contacted by telephone with a short questionnaire. Replies were received from Brian Robertson and Ken Thompson, CRIA; Diana Barry of NRCC/SCGDV and David Basskin of CMRRA.

The organisations were asked to comment on the changes to the Copyright Act listed above and to provide any relevant data; they were asked specifically to provide data on revenues and costs that resulted from the 1997 changes to the Copyright Act. The present research involves estimating the expected net gains from the introduction of new rights and the situation with respect to the proposed changes under the WIPO Treaties was felt to be similar to those earlier changes. The approach taken in this *Report* is that adopted in my earlier research on the economics of performers' rights<sup>3</sup>. That research analysed the economic effects of the introduction of a new individual right to equitable remuneration from the public performance of sound recording to the UK, following adoption in the European Community of the so-called 1992 *Rental Directive*<sup>4</sup>. The Directive created a new source of income for non-featured audio performers, which was a measure of the value of the new right<sup>5</sup>. It is

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<sup>3</sup> Taylor and Towse (1998) "The Value of Performers' Rights" *Media, Culture and Society*, 20,4; 631-52.

<sup>4</sup> Council Directive 'on rental and lending rights and on certain rights related to copyright in the field of intellectual property (see J. Reinbothe and S. von Lewinski (1993) *The EC Directive on Rental and Lending Rights and on Piracy*, Sweet and Maxwell, London).

<sup>5</sup> We collected data on revenues from an interim distribution in the UK by the musicians' representative from a lump sum paid by the record industry collecting society. (A dedicated collecting society, PAMRA, now administers this right in the UK). We also analysed data from performers' collecting societies in Sweden and Denmark. In the event, it proved difficult to obtain any information on costs other than the charges of the collecting societies (which vary considerably as between the different rights and in different countries - see UK Monopolies and Mergers Commission (1996) *Performing Rights*); relevant information would have been the undoubtedly considerable cost of setting up a new database of

obviously difficult to anticipate future economic benefits and costs of alterations to copyright law, particularly in times of rapidly changing technologies and economic circumstances. The best guide is the outcome of recent legal changes and therefore the same methods seemed to be called for in relation to assessing the economic impacts of the present copyright reform.

## **2. The institutional and analytical setting of the proposed changes**

### **2.1 The music industry: a story of technical change and copyright protection**

The music industry was one of the first of the cultural industries to develop mass production using new technologies and it has continued to be in the forefront of technological change. Successive technologies (only some of which are innovations emanating from the industry itself) determine the way music is created, produced and delivered to consumers and they profoundly affect the economic organisation of the industry. After literary publishing, music was one of the first of the cultural industries to be afforded protection through copyright law: already in the 19<sup>th</sup> century composers were protected by authors' rights under the Berne Convention and in the early years of the 20<sup>th</sup> century, music publishers and composers were granted mechanical rights in the so-called mechanical reproduction of music, at first by means of piano rolls and later through sound recording. Composers' synchronisation rights enable them also to control the use of their music on TV and in film and video. With the spread of radio ownership, the public performance of music led to copyright legislation that enabled composers and publishers to collect remuneration for the public performance of music from broadcasting and this right was later extended to sound recording makers. This also applies to other forms of public performance of music.

Performers have not always fared as well as authors in gaining legal protection for their work from copyright law. Performers have exclusive rights to control their performances but once they have made a sound recording, they have limited subsequent control over it. They have a related right of equitable remuneration for the public performance of sound recordings in many countries (but only for digital recording in the USA). Performers typically rely on sound recording makers – record labels – to record and distribute their performances. Featured artists usually sign royalty contracts, mostly option contracts that tie the performer to the label for a number of albums, and the top performers get a considerable advance on future royalties<sup>6</sup>. The Internet has not substantially changed this picture, though some performers now promote their own recordings via their websites. Non-featured performers, the 'backing' artists, do not have royalty contracts and usually work freelance, contracting with the sound recording maker for each studio session.

In general, performers and sound recording makers have a shared interest in seeking the maximum reward of fame and fortune from sales and other outlets of sound recordings. However, the record label is usually in a stronger economic position to bargain the terms of contracts than is the performer, the more so as there has been increasing merger activity of record label ownership over

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performers and their works and additional compliance costs, for example, requiring users to log of track-by-track usage of sound recordings.

<sup>6</sup> See R. Caves (2000) *Creative Industries*, Harvard University Press..

the industry's existence. Performers' rights have on occasion been strengthened to enable them to bargain on a more equal footing<sup>7</sup>. Nevertheless, performers have joined record companies in lobbying for stronger copyright protection and perceive this as mutually beneficial.

The development and spread of home ownership of record players and the development of shellac records started the post war consumer boom for sales of sound recordings in the USA, which later spread to all developed countries, so that most households came to own several sound carriers in one form or another, fuelling sales of sound recordings to a mass market. Meanwhile, music became a vital part of the emerging teenage culture since the 1950s and pop stars surfaced as cultural icons, promoted on radio and television. Music videos also came on the scene, originally as promotion for records but soon becoming an integral part of the music experience. Cassettes enabled consumers to play music outside the home and to record music from the radio themselves and the play of recorded music in public became part of almost every activity from travel to shopping. The story was the same for CDs but it was not until the 1990s that the development of digital technology and the Internet enabled consumers to access and record music 'on demand' for themselves. The new favoured format is DVD and DVD music sales are rapid rising, while sales of cassettes and CDs are falling.

Digital music can now be accessed in two general ways, downloading and streaming; examples of the growing legal subscription services are eMusic.com, MusicNet, Pressplay and Dotmusic on Demand ([www.dotmusic.com](http://www.dotmusic.com)), the British Phonographic Industry's online music service in partnership with BT (British Telecom). In Canada, MUSICMATCH and Bell Canada at the time of writing was scheduled to offer a Canadian Artist on Demand service through the Sympatico Internet service, following a licensing deal with the Canadian record labels that enables users to build playlists of streamed tunes from one artist. They offer a range of services previously only available on Napster-type illegal sites, such as Morpheus, Grokster and KaZaA. These peer-to-peer (P2P) networks enable millions of users to upload and share music files via the Internet and music can be downloaded on to CD burners (now incorporated in most PCs) that compress and store music (usually encoded as MP3 files) with little loss of quality. Users thereby create their own compilations of their favourite tracks, rather than replicate whole CDs. It is to combat these illegal uses and to promote the legal alternatives offered by the sound recording industry that give rise to the need for the proposed changes to copyright law mandated by the WIPO WCT and WPPT Treaties. Music is also streamed and accessed from radio broadcasts. Streaming may be interactive or non-interactive; if the latter, it is already covered by public performance rights. If it is interactive, it falls under the area of concern of the WIPO Treaties.

Thus, throughout its history, the sound recording industry has developed under the protection of copyright law so that it is now virtually impossible to ask the question what its economic organisation would otherwise have been. Some would say the industry has in recent years overly relied on obtaining the support of governments to adapt copyright law to changing technologies and their economic consequences rather than adapt its business methods. This is now increasingly acknowledged by the record industry<sup>8</sup> but its quest for ever greater copyright protection nevertheless continues. Governments have apparently ceased to worry too much about the anti-competitive effects

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<sup>7</sup> However, the success of legal protection depends upon market forces. See R. Towse (2001) *Creativity, Incentive and Reward*, Edward Elgar Publishing.

<sup>8</sup> Speech by Hilary Rosen, Chairman and CEO, Recording Industry Association of America, July 8, 2002.

of the copyrights themselves or what influence of copyright law has on industrial organisation. Curiously, there has been little work by economists on the economic structure of the music industry, though sociologists have done a number of studies on the cultural effects of concentration in the industry, for example, its effect on the number of titles and genres.

The crucial question that now has to be addressed is the extent to which the new technologies and accompanying consumer behaviour inflict long-term economic damage on the sound recording industry and from whose point of view this should be evaluated. After all, historically all technological progress has harmed some established industries and their workers but brought increasing wealth and well-being to society at large. Sound recording itself displaced thousands of live musicians, who even in the 1970s in the UK were waging a 'Live Music' campaign with broadcasters to limit 'needle time'. Moreover, the cultural industries have in the past resisted changes that they themselves did not initiate – the well-known VCR story, at the time of writing.<sup>9</sup> It is also somewhat confusing that the hardware for apparently illegal use of music is produced by one part of a corporation, the other arm of which is seeking remedies against its use. None of these points should be interpreted as being inimical to copyright law and the establishment and maintenance of property rights but they do suggest caution in implementing changes to copyright law based on industry demands.

It is, however, very difficult to measure the incremental benefits and costs of technological developments and the changes to copyright law that follow from them in the absence of econometric studies of demand and supply that would establish long term trends and the extent of complementarity or substitutability between, for example, music downloads and sales. These have not yet been done and until they are, anecdotal evidence and partial surveys have to be used instead.

## **2.2 The WIPO Internet Treaties**

The 1996 WIPO Copyright and Performances and Phonograms Treaties (the WIPO Treaties) are the latest in a series of international agreements to establish minimum standards of protection in national copyright laws throughout the world. They are part of the WIPO Digital Agenda, which 'sets out a series of guidelines and goals for WIPO in seeking to develop practical solutions to the challenges raised by the impact of new technologies on intellectual property rights' (WIPO website). Put simply, they seek to set standards for protecting copyright and related rights for digital technologies.

The process of internationalising copyright started in 1886 with the Berne Convention for the protection of literary and artistic works, which has been successively revised and updated. The purpose is to establish minimum standards for authors in all signatory countries and to enable them to obtain the same national treatment. This encourages international trade in goods embodying copyrightable material by protecting authors' rights.

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<sup>9</sup> It is a well-attested fact in the economics of innovation that the adoption of new inventions is frequently not achieved by incumbents in the industry and it is newcomers who demonstrate their wider uses. The film industry at first resisted the production of VCR machines and only later realised the potential for the sale of films in video format.

Neighbouring rights – rights related to copyright – have also been subject to the same process, though it began later and has not been as smooth as in the case of authors' rights. The Rome Convention of 1961 was the first international agreement on neighbouring rights. It provided for rewards to performers and sound recording makers on a reciprocal basis (rather than on a national treatment basis as with authors). Perhaps more than in the case of with authors' rights, the case for international agreement is especially motivated by the perceived benefits from international trade in the products of the cultural industries (the music, film, broadcasting industries and, more recently, computer and video games and multimedia goods industries). In these industries, the need for updating copyright (and other intellectual property law) has been strongly driven in recent years by the development of the Internet, digitalisation and of cheap copying devices, which have altered the market relationship between producers and consumers world wide. The WIPO Treaties have therefore to be seen as a continuation of these international agreements and of their driving force, international trade. By 2000, 171 countries were party to WIPO; since their adoption in May 2002, 41 countries had signed up to the Internet Treaties by April, 2003.

International trade was, however, far more explicitly the guiding principle for the WTO (World Trade Organisation) TRIPs Agreement finalised in 1994, which covers patents and trademarks besides copyrights. The TRIPs Treaty adopted the same rules for copyright as the Berne Convention (though moral rights were excluded) but made its own provisions for related (neighbouring) rights for performances, sound recordings and broadcasts and exempted moral rights. It is noteworthy that the USA is not a member of the Rome Convention (and only signed the Berne Convention in 1989); it wanted no part of the Rome Convention because it did not accept the material reciprocity provisions and eschewed the remuneration schemes in use by other Convention members, notably those relating to broadcasting. Unlike the Berne and Rome Conventions, which offer no real sanctions for failure to comply, the WTO has strong trade sanctions at its disposal for punishing infringement. TRIPs introduced more stringent requirements on countries' copyright regimes than the earlier Conventions and it certainly provided a stronger economic motive for conformity by requiring compliance with the 1971 revision of the Berne Convention (minus moral rights). Canada opposed the reduction in heterogeneity this implied. NAFTA has brought its own obligations for Canada.

Given the emphasis on the benefits to trade of the WIPO Treaties and TRIPs, a prime consideration in assessing the expected net value of the impact of the WIPO Treaties must be the extent of trade generated by cultural products. The USA, which dominates the world economy with respect to trade in copyright-based goods, played a dominant role in determining the terms of the TRIPs Agreement, undoubtedly with the motive of protecting its economic interests in these industries, especially the computer software, film and music industries. As a result, the cultural aspect of copyright law, originally perceived in the Berne Convention as being directed towards stimulating and protecting artistic creativity, is being led away from those roots and is now losing the in-built balance between the creator (author), the industries that reproduce and market the cultural content (publishers) and the citizens (consumers) on whose behalf the government grants statutory legal protection. It is noteworthy that the Government of Canada's 2002 Report *Supporting Culture and Innovation*, stresses the connection between copyright and culture and the balance that therefore has to be found in determining the public interest between the needs of international trade and domestic cultural production.

An important aspect of international trade in intangible rights covered by IP law is that signatories to international conventions are bound to offer equal protection to trading partners who are also signatories. Though there is not much hard evidence, it seems that almost no country is a net exporter of copyrighted material except the USA (the UK is, or rather was in 1995, a net exporter of musical goods and services broadly defined<sup>10</sup>). Few countries other than the USA, therefore, stand to gain from international trade in direct financial terms from adopting these (or other such) Treaties. In a Report for Canadian Heritage, "Economic Impact of Canadian WIPO Ratification on Private Copying", Rushton calculated that the expected doubling of inflows to Canada from the private copying levy would all be devoted to outflows to foreign authors and performers<sup>11</sup>. This is not in itself an argument against the benefits of adopting the Treaties; however, Rushton concludes that the cost of this bonanza will ultimately fall on Canadian consumers. A Discussion Paper on implementing the WIPO Treaties in Australia<sup>12</sup> (which, however, appears to have a much higher ratio of copyright payment inflows to outflows that does Canada) argues that even if that were the case, international trade is in itself a good thing. Acheson and Maule (1999) have strongly argued the case for free trade in cultural goods and services in Canada.<sup>13</sup>

Acheson and Maule also suggest that in a relatively small country, the net balance of payments rather than trade flows is the appropriate measure. The point is made as follows: for internationally traded goods, smaller countries will always consume less of their own production even when they are doing very well. As explained by Acheson<sup>14</sup>: "If Canada captures 5% of the English-speaking market for internationally attractive music recordings abroad that would generate as much or more of an inflow as the outflow from importing 95% of the same type of music in the relatively small Canadian market. This is demonstrated by Canada's balance of payments statistics for music during the most recent year, 2000. There is a negative balance but it gives a much better measure of the relative strength of Canadian music industry than the origin of records sold here or played on the radio. The audio visual trade measured in this manner is about in balance and has been in surplus." This is an important point for future research in this area. Table 1 has figures for 2000.

**Table 1: Canadian Exports and Imports of Music Recordings (\$m) 2000**

<b>Exports</b>	Music Video & Other Recordings	507.1
	Culture Services and IP	2120.3
<b>Imports</b>	Music Video & Other Recordings	1279.8
	Culture Services and IP	2333.4

**Source:** Statistics Canada Cultural Trade & Investment Project

<sup>10</sup> British Invisibles (1995) *Overseas Earnings of the Music Industry*, British Invisibles, London.

<sup>11</sup> [http://www.pch.gc.ca/progs/ac-ca/progs/pda-cpb/pubs/ompi-wipo/index\\_e.cfm](http://www.pch.gc.ca/progs/ac-ca/progs/pda-cpb/pubs/ompi-wipo/index_e.cfm)

<sup>12</sup> See M. Richardson, J. Gans, F. Hanks and P. Williams (2000) *The Benefits and Costs of Copyright*, Centre for Copyright Studies, Redfern, Australia

<sup>13</sup> K. Acheson and C. Maule (1999) *Much Ado About Culture: North American Trade Disputes*, University of Michigan Press, Ann Arbor. On this point especially, see Chapter 6.

<sup>14</sup> I am most grateful to Keith Acheson for explaining this point to me in more detail in connection with this *Report* and for providing the accompanying trade statistics.

Several inferences about the WIPO Treaties may be drawn from this discussion:

Their underlying rationale is economic

- They set international standards for copyright in international trade
- They emphasise the gains from international trade in general, though few countries other than the US are net exporters of copyright goods
- Countries that do not join do not obtain national treatment abroad for their performers and producers of sound recordings, who therefore are disadvantaged, even though there is a net outflow of royalty and remuneration payments.

These difficult cross currents lend themselves in principle to empirical investigation but in practice that would be exceedingly complex even if the appropriate data were available (which they are not to my knowledge anywhere). Accordingly, this *Report* concentrates on a limited area for which data have been obtained, while providing a wider setting for understanding the potential economic effects.

### 2.3 Economics and copyright

The analysis of the economic impact in Canada of the proposed changes to the Copyright Act – the introduction of specific rights of distribution and making available, moral rights for audio performers, the extension of a full reproduction right for performers and of the term of protection for sound recordings and the introduction of legal protection for technological protection measures – is derived from a more general analysis of the economic aspects of copyright. It is important to define at the outset the different approaches that may be taken. Often when policy-makers consult economists, it is because they hope to get some definite numbers on which to base choices. Economic life is rarely like that, and crystal ball-gazing is no easier for economists than for others. “If we were so smart, we would be rich!” and the economy would be better run.

There are several distinct topics under the heading economic aspects of copyright:

- The economic purpose of copyright
- The economic justification of copyright law
- The economic outcomes of copyright law on markets for copyright-based products
- The economic value of copyrights in GDP.

The economic **purpose** of copyright as an incentive hinges on the need for property rights as a precondition for trade. Information goods – intangible products embodying intellectual property – cannot be protected by contract alone as they are public goods and thus open to ‘third party’ free rider use. Without statutory protection, there would be market failure and under-production of information goods and cultural products<sup>15</sup>.

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<sup>15</sup> There is a large literature on this, the classic being K. Arrow (1962) ‘Economic welfare and the allocation of resources for invention’ in NBER *The Rate and Direction of Inventive Activity*, Princeton, NJ, Princeton University Press. See also articles in R. Towse and R. Holzhauser (eds) (2002) *Economics of Intellectual Property*, Volume 1.

The economic **justification** of copyright law and its several doctrines falls into the realm of law and economics. Key legal copyright doctrines – limited duration, derivative works, fair use, works for hire – are analysed using economic theory and their rationale explained in terms of economic efficiency<sup>16</sup>. Following this approach, changes to the law are justified in terms of net benefits, the objective identified by Industry Canada. The benefits to the whole of society – the social welfare or public interest - must be considered. Thus prices to consumers and other users, rewards to copyright holders and any external benefits to society, such as the generation of a creative economy or cultural identity and development, must be taken into account as positive or negative benefits. On the cost side, the costs to all parties of complying with the law, enforcing rights and transaction costs must be considered as private costs and any external effects, such as restriction of access for creators and consumers, constitute social costs<sup>17</sup>. The law and economics approach also includes the question of how courts calculate damages for infringement. However, this approach considers copyright as a whole bundle, rather than the separate rights that it gives rise to. It therefore provides a general framework for considering the changes to the rights with which this *Report* is concerned but no specific analysis of the individual rights under consideration.

The economic **outcomes** of copyright are the effect it has on markets. This can be thought of as the economic role copyright plays in determining costs and prices in individual markets for copyright-based goods and on market structures. The administration of copyright through collecting societies and other institutions, such as regulation by Copyright Boards and Tribunals, affects the working of markets, often replacing market prices with administered prices. Generally speaking, there is a strong presumption on the part of economists (and those in law and economics) in favour of price determination by the free market. This view favours treating copyright as property rules in preference to liability rules, such as remuneration rights and collective rights administration.<sup>18</sup>

The economic **value** of copyright in aggregate macroeconomic terms is often expressed as the economic impact of copyright. The term impact is a misnomer, however, as it implies a counterfactual situation in which it is possible to compare economies with and without copyright law. This is misleading, however, as the industries that are most dependent upon copyright law have typically developed under its protection. Moreover, the so-called impact is measured only as the size and, at best, growth of a set of industries for which it is assumed copyright was a crucial factor and in many cases, including 'secondary' industries with partial reliance on the 'primary' industries (thus broadcasting, for example, is assumed to rely on copyrights and therefore the production of television sets does too, since people would not have TV without broadcasting). This 'input-output' approach can lead to an infinite regress if it exaggerates inter-industry effects and ignores alternative uses of resources for production and alternative consumption possibilities for consumers. Notably, proponents of this exercise do not consider the impact on consumption, only on production.

<sup>16</sup> See R. Posner (1992) *Economic Analysis of the Law*, 4th ed. Little Brown and Company, Boston/Toronto/London. Also W. Landes and R. Posner (1989) 'An Economic analysis of Copyright Law', *Journal of Legal Studies*, 18; 325-66.

<sup>17</sup> The law and economics literature is not generally concerned with the impact of copyright on cultural development (but see W. Landes 'Copyright, Borrowed Images and Appropriation Art: an Economic Approach' in R. Towse (ed) (2002) *Copyright in the Cultural Industries*, Edward Elgar Publishing, Cheltenham, UK and Northampton, MA, USA; 9-31. Also R. Towse (2001); *op cit* chapters 1, 2 and 9.

<sup>18</sup> See R.P. Merges, (1996) 'Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations', *California Law Review*.



A number of countries<sup>19</sup> have estimated the contribution to GDP (and to exports) of 'industries based on copyright' and this approach is being promoted by WIPO for all countries, developed and less developed. The merit of this approach is that it takes an empirical approach to the economic role of copyright and it forces governments to take a hard look industry claims about its effect as they collect the necessary data. What might be termed 'counterfactual data' are the figures on piracy, the value of copyright lost through illegal trade (though economists have to point out that illegal trade also constitutes valuable economic activity).

The copyright industries in Canada were estimated to contribute \$65.9 billion (7.4 %) to GDP in 2000 and to be growing twice as fast as the rest of the economy<sup>20</sup>. That figure is high in relation to similar findings in other countries (4.3% of GDP in the USA, 5.5% in the Netherlands) but some of the difference no doubt depends upon the inclusion of 'copyright-related' and 'partial' copyright industries (the figure for the USA rises to 6.5% with the wider definition). There is as yet no standardised categorisation, though WIPO is preparing a *Handbook* with the aim of producing one. It should be noted that as copyright law spreads its scope to include more products and producers, that in itself apparently raises the growth of the copyright industries.

All these economic approaches are relevant to this *Report*.

This list is not exhaustive as it does not include the application of economics to the wider question of digitalisation and the Information economy, which, for example, raises questions about the appropriate economic analysis and business models to apply to information goods, including the products of the cultural industries, such as licensing and franchising<sup>21</sup>.

### **3. Economics and copyright administration in the music industry**

#### **3.1 Markets for music**

In the music industry, two markets operate side by side: the primary market for sales and the secondary market, in which products (printed music, sound recordings) reach the consumer through intermediaries, usually in conjunction with another service, such as broadcasting or as background music, in discos and so on. Both are important sources of revenue for composers and performers, though they are less important for sound recording makers. They also receive income from a levy on blank recording media (cassettes, CDs) to compensate them for the loss of sales that are displaced by home recording. These streams of income arise from the array of rights accorded to composers, performers and sound recording makers under copyright law.

<sup>19</sup> S. Siweck (2002) *Copyright Industries in the US Economy The 2002 Report*, Economists Inc, Washington, DC; The Allen Consultancy Group (2001) *The Economic Contribution of Australia's Copyright Industries*, Melbourne; *The Economic Importance of Copyright in the Netherlands 2001*, SEO, University of Amsterdam; Finnish Copyright Institute (2000) *Economic Importance of Copyright Industries in Finland 2000*, Finnish Copyright Institute, Helsinki; T. Toivonen and R. Picard (2002) *Economic Importance of Copyright Industries in Norway*, Finnish Copyright Institute, Helsinki.

<sup>20</sup> *Supporting Culture and Innovation: Report on the Provisions and Operation of the Copyright Act* (2002).

<sup>21</sup> The most widely quoted book on this is C. Shapiro and H. Varian (1999) *Information Rules*, Harvard Business School Press, Boston, MA.

Copyrights underlie the good or service that is sold or otherwise delivered to the consumer: consumers buy a product or service containing the rights but they do not purchase those rights, only a licence to use them in connection with the product. Most products of the cultural industries embody rights of several creators that are bundled together to enable exploitation to take place. The returns from sales and licence fees from other forms of exploitation are distributed to the rights owners either as royalties or remuneration.

Royalties on sales of recorded music are paid to contracted artists by the record label. Licence fees from the secondary market are mostly collected and distributed by collecting societies.

### **3.2 Copyrights and related rights in sound recordings**

The composer of the music and the writer of lyrics (in the case of songs) have copyright (authors' rights) in their works. The copyright gives to the author the exclusive right to authorise others to use the protected works. These rights are the right of reproduction, adaptation and arrangement, public performance, broadcasting, communication to the public, distribution and rental<sup>22</sup>. When a musical work is published, the music publisher contracts with the composer (and lyricist) to acquire publication and distribution rights of works and agrees in exchange to pay a royalty based on the value of sales. Mechanical rights are rights of the composer/music publisher in the so-called mechanical reproduction of music (the term originated with piano rolls), that is, in sound recording. In Canada, mechanical rights are administered by the Canadian Musical Reproduction Rights Agency Ltd. (CMRRA). CMRRA is a non-profit music licensing agency, which represents the vast majority of music copyright owners (usually called music publishers) doing business in Canada<sup>23</sup>. On their behalf, CMRRA issues licenses to users of the reproduction right in copyrighted music. These licenses authorize the reproduction of music in CDs and cassettes (usually called 'mechanical' licensing) and in films, television programs and other audio-visual productions ('synchronization' licensing). Licensees pay royalties pursuant to these licenses to CMRRA and, in turn, CMRRA distributes the proceeds to its publisher clients. The publisher in turn distributes the composer's and songwriter's portion of such revenues to the individual concerned. CMRRA is funded by commission on the proceeds of its licensing.

The above are the so-called economic rights; authors also have moral rights (rights of attribution and integrity). In Canada, copyright lasts for 50 years after the death of the author (70 years in the USA and in the European Union). It is worth noting that though copyright law is national law and the Treaties offer national treatment in signatory countries, contracts need to specify the territory over which rights are assigned or licensed. The financial value of rights depends on there being an active market for them. For example, rental rights are only valuable where there is an active rental market, say, for sound recordings, as in Japan.

Performers and sound recording makers in Canada have had Rome Convention rights (neighbouring rights) since 1997. Performers have sole rights in their performances to control communication to the

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<sup>22</sup> This list follows the language of the Berne Convention and of the WIPO Copyright Treaty.

<sup>23</sup> From the CMRRA website.

public, reproduction and rental and to be compensated for communication to the public by telecommunication and public performance of their sound recordings. These rights last 50 years from the first fixation. Performers fall into two categories for the purpose of analysing their rewards from sound recording: featured artists have a contract with the record company and receive royalties on sales; non-featured artists (backing musicians) are paid a fee under a one-off studio contract – a standard contract agreed between the record industry and the musicians' representatives - that avoids subsequent royalty payments (that would be very expensive to administer) by buying out their rights connected to the sale of recordings. Both groups, however, have the right to remuneration from public performance and broadcasting, which they exercise via collecting societies<sup>24</sup>.

Makers of sound recordings have rights in the sound recording. In addition, from the economic point of view, they act as the agent of the performers featured on the sound recording, producing the product (the CD, DVD etc) that is packaged, marketed and sold to the consumer. The relationship between the sound recording maker and the performer was for a long time a synergetic one – the performer performed the music and the record label recorded it, originally in its own studios. Gradually over the last 30 years, the record company has increasingly played the role of providing the capital and marketing expertise with performers able to make their own sound recordings and music videos. However, a fundamental role is also 'Artist and Repertoire' research, seeking out and nurturing new and inexperienced talent, a risky activity considering that on average nine out of every ten records does not break even<sup>25</sup>. It has been conjectured that this relationship will change (is changing) fundamentally with digitalisation and delivery of sound recordings over the Internet. Some artists have seized the chance to break with their record label and claim to be better off financially and artistically. It remains to be seen whether new artists can make their own way on the Internet.

Delivery of music via digital downloads with a permanent copy are likely to become increasingly popular as legal means of purchasing sound recordings. For this, sound recording makers claim to need digital rights such as have been established under the US Digital Millennium Copyright Act (DMCA). For streamed music, sound recording makers now control the exclusive right to make recordings available<sup>26</sup>.

### 3.3 Economics of copyright collecting societies

Copyright collecting societies are membership collectives that administer specific rights accorded to authors and publishers under copyright law, which they do by licensing rights to users and distributing the revenues to their members. They usually do this by issuing a blanket licence for the repertoire of all the works of their members, which allows the user unlimited use of the whole repertoire assigned to (or licensed by) the collecting society for the duration of the licence. Collecting societies world wide form a network of cross-national agreements for licensing each

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<sup>24</sup> The situation described here is a general one. In some countries, for example all those in the EU, the collecting society designated under the law to collect this remuneration must be specially set up to do so.

<sup>25</sup> See R. Caves (2000) *op cit*. Evidence provided by the 'majors' to the UK Monopolies and Mergers Commission in the enquiry on the price of CDs was that 50 per cent of their A&R expenditures were recouped in 1993 (see Towse, 2001).

<sup>26</sup> See Einhorn (2002) 'Musical Licensing in the Digital Age' in R. Towse (2002) *op cit*; 165-77.

others' members' works and thus form an international mutual network that vastly reduces costs of international copyright transactions. Collecting societies therefore pool transaction costs for rights owners that would otherwise be prohibitively expensive for individuals to exercise and reduce costs for licensees, who would otherwise have to trace and contract with a multitude of rights owners worldwide.

But though the licence is across the board, revenues are distributed to individual members in accordance with the use made of their works on a 'pay-per-use' basis. That requires information from licensees as to their use of individual works, for example, the play time on the radio of a particular track of a sound recording. This information is logged by the user and transferred to the collecting society, which then pays the rights owner according to the appropriate tariff. The database of the collecting society enables it to provide the service to its members and it is the main reason why a collecting society is a natural monopoly<sup>27</sup>.

With the use of electronic databases, collecting societies are finding it worthwhile to share databases in order to reduce costs (for example, Gramex in the Scandinavian countries has done this for a number of years; the Performing Rights Society and the Mechanical Copyright Protection Society now share a database in the UK). Digital rights management (DRM) is also increasingly being used but that requires the implant of data, for example, using an ISRC code, possibly in conjunction with the IFPI's Grid (Global Release identifier<sup>28</sup>) which can be done for new sound recordings but does not solve the problem of managing rights for earlier works (with up to 50 years' of copyright duration)<sup>29</sup>. It has been suggested that DRM could lead to international mergers of collecting societies, creating a formidable monopoly (that could confront multinational corporations in the media industries).

Collecting societies are set up in somewhat different ways in different countries. In the UK, they are private, non-profit organisations and are free to set their tariffs by contract with users; disputes are heard by the Copyright Tribunal. In European countries and Japan, collecting societies are set up by a state grant of monopoly and rates (both the licence tariffs and the administrative charge) may be determined by the government. In Canada, the collecting societies are regulated by the Copyright Board, which must approve agreed tariffs or set them in case of dispute. It would seem that the Copyright Board frequently is responsible for rate-setting. This incurs high administrative costs for all parties and leads to formulaic administered pricing removed from market signals.

There is a sparse and dispersed literature on the economics of setting the tariff by collecting societies for various rights and uses<sup>30</sup>. Evidence for specific negotiations from expert witnesses to the Copyright Board in Canada provides detailed case-by-case analysis.

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<sup>27</sup> The Monopolies and Mergers Commission in the UK (now known as the Competition Authority) has accepted the natural monopoly of collecting societies for particular rights. In the USA, as is well known, ASCAP and BMI compete (see Caves, chapter 19). The German collecting society GEMA has also been subject to anti monopoly enquiry. For governance of collecting societies, see Kretschmer (2002).

<sup>28</sup> [www.ifpi.org/grid](http://www.ifpi.org/grid).

<sup>29</sup> See S. Matsumoto 'Performers in the Digital Era', in R. Towse (ed) (2002); 196-209.

<sup>30</sup> See, for example, S. Besen, S. Kirkby and S. Salop (1992) 'An Economic analysis of Copyright Collectives', *Virginia Law Review*, 78; 383-441. Also Einhorn (2002); S. Liebowitz (2002) 'Record Sales, MP3 Downloads and the Annihilation Hypothesis', mimeo.

Collecting societies may charge members a fee for collection or deduct a percentage of its revenues to cover its costs. Revenues are usually split between authors and publishers on a 50/50 basis. This is a convention that has been enshrined in law in many countries. In the case of sound recordings in Canada, there is a 50/50 division of revenues from equitable remuneration for sound recordings between (all) performers and the sound recording makers.

The Neighbouring Rights Collective of Canada (NRCC) is a non-profit umbrella collective, created in 1997 to administer equitable remuneration rights in Canada. The NRCC represents performers and makers of sound recordings through five member collectives: The American Federation of Musicians of the United States and Canada (AFM); Actra Performers' Rights Society (APRS); La société de gestion collective de l'Union des artistes (UDA) (ARTIST!); Audio Video Licensing Agency (AVLA); and La société de gestion collective des droits des producteurs de phonogrammes et de vidéogrammes du Québec (SOPROQ). Payments to individual performers and makers (i.e. phonogram producers) are made by NRCC's member collectives.

NRCC is also itself a member of the Canadian Private Copying Collective (CPSS), the non-profit organization established to administer the levy on blank recording media in Canada on behalf of authors/publishers, performers, and makers.

## **4. Assessing the economic impact of copyright reform on performers and producers of sound recordings in Canada**

### **4.1 Valuing copyrights in sound recording**

The overwhelming problem with valuing copyrights is that they are sold in goods that contain a bundle of different rights, making it impossible to assign individual value to one right or the other. What is the value-added of the performers' and the makers' contribution to the final CD price? We know that featured artists typically get 10-15% royalty on sales<sup>31</sup> and the studio fee paid to non-featured performers but that does not tell us what their earnings are in total or what individuals earn. Information periodically appears about superstar earnings but it is also well known from studies of performers' earnings that the distribution is very uneven, with the few superstars having very high earnings and the 'average' performer earning modest or even low earnings<sup>32</sup>.

The revenue from record sales provides the size of the 'pie' that is divided between featured performers, songwriters and composer and the sound recording maker. The division is highly complex and it is not necessary to go into it here<sup>33</sup>. What is an issue, though, is the question of whether the award of new rights to one group is at the expense of others. That must be the case; however, it was obscured for quite some time by the growth of sales revenues. Einhorn and Kurlantzick (2003) cite examples of conflicts among the actors in the digital music industry (and even within groups) in the USA – composers, publishers, record companies, performing artists,

<sup>31</sup> This is often only on 85% of sales revenue, however. See Vogel (2001) pp. 157-170.

<sup>32</sup> See Towse (2001). Also, Matsumoto *op cit*.

<sup>33</sup> See D. Passman (1998) *All You Need to Know About the Music Business*, Prentice Hall, New York.

website operators and online music retailers – and argue that the complexity of rights administration is to blame for these problems. The division of remuneration income from secondary sources is typically regulated to a 50/50 split. Nevertheless, concern about the multiplication of rights and of authorisations for the use of one product only (sound recording) in the digital environment were expressed in the (Canadian) 2002 Copyright Board Pay Audio decision<sup>34</sup>. Another issue is whether having remuneration schemes leads to a reduction in the payments due to performers under their contracts, that is if record labels reduce royalties knowing that performers will be compensated elsewhere.<sup>35</sup>

Turning to the value of sound recording makers' rights, the question arises how should they be measured – by profits? by sales revenues? by the present value of copyright assets over 50 years (suitably discounted for the probability that the recording is still available for sale over the duration of the copyright)? Figures on the value of copyright assets periodically appear; "Happy Birthday to You" was reportedly bought by Warner Communications for US\$ 28m. in 1988 (with the copyright due to expire in 2010, though that may now be prolonged in a considerable windfall gain)<sup>36</sup>. The record industry itself appears to favour sales as a measure of its value, since that is the figure it uses to estimate losses from piracy<sup>37</sup>. Statistics Canada data 'Profile of the Sound Recording Industry' give both sales and other revenue figures as well as profits before tax for the years 1991-1998, distinguishing Canadian and foreign content. Profits before taxes rose considerably over the period (the period, however, predates the onset of the decline in sales).

#### 4.2 The sound recording industry world wide and in Canada

Sound recording is a globalised industry and was estimated to have world wide sales of \$US 37 billion (thousand million) in 2000. More than 80 per cent of the world market is controlled by the five 'majors' – EMI, BMG, The Warner Music Group, Sony Music Entertainment and Universal/Polygram. In 2000, the USA had 38% of world sales; Japan 18%; the UK 8% and with sales of \$US 819m., Canada had 2%<sup>38</sup>.

World record sales grew rapidly up to the 1990s at a real rate of 7 per cent per annum from 1986-96 and then declined in the last years of the century<sup>39</sup>. Several reasons have been put forward for this decline – the slow down of CD sales as consumers replaced their LPs with CDs, the world recession, the growth of Internet downloading and piracy.

The trends in Canada may be seen in Tables 2 and 3. Table 2 shows that from 1999–2001, there was a fall in real dollar terms. Table 3 shows that DVD and singles sales in Canada increased from 2001-2 but other sound carriers, notably cassettes, fell (differences in the chosen form of sound carrier

<sup>34</sup> [www.cb-cda.gc.ca/decisions/m15032002-b.pdf](http://www.cb-cda.gc.ca/decisions/m15032002-b.pdf)

<sup>35</sup> See Acheson and Maule, *op cit* p. 269; also Towse (2001), chapter 5.

<sup>36</sup> Reported in Caves (2000); Chapter 19 of this book is recommended reading on the economics of copyright and its institutional arrangements in the USA.

<sup>37</sup> See IFPI 2002 Piracy Report, International Federation of Phonographic Industries, London.

<sup>38</sup> Calculated from D. Throsby (2002) *The Music Industry in the New Millennium: Global and Local Perspectives*. UNESCO Paris. Throsby uses IFPI data.

<sup>39</sup> See Throsby (2002) p. 4.

world wide are quite marked – North America favours CDs whilst Asia prefers cassettes). Overall, the value of sales expressed in Canadian dollars fell by 5%, in line with the fall in sales world wide (and IFPI now revises this to 10 % for 2002).

**Table 2: Recorded Music Sales 1997-2001** (figures in millions)

	Units				Retail Value			Market Trends %				
	Singles	MCs	CDs	Total (a)	US\$ Fixed	US\$ Variable	Local Currency	Unit Growth	CD Growth	LC Value Growth	Inflation	Real Growth
1997	2.9	15.3	70.4	86.6	876.1	980.0	1356.8	8.5	12.3	12.1	1.7	-
1998	1.0	11.3	77.4	89.0	930.8	971.7	1441.5	2.8	10.0	6.2	1.0	7.0
1999	0.9	7.1	71.9	79.2	849.8	885.8	1316.1	-11.0	- 7.2	- 8.7	1.7	- 7.8
2000	0.5	3.5	65.6	68.9	730.1	761.4	1130.7	-13.0	- 8.8	- 14.1	2.7	-14.2
2001	0.5	1.5	60.7	62.3	659.9	659.9	1022.0	- 9.6	-7.5	- 9.6	2.6	-11.9

Note (a) 3 singles= 1 album

Source: CRIA.

**Table 3: Changes in sales of Sound Recordings in Canada 2001-2** (Units and Canadian dollars expressed in thousands)

	2002	2001	% change	2002	2001	% change
	Units shipped			Net value of sales		
VHS	1071	1327	- 19	9624	11986	- 20
DVD	1446	887	63	25310	16643	52
Total music videos	2517	2214	14	34934	28629	22
Total singles	608	477	27	1993	2504	- 20
Cassettes	988	1383	- 29	4431	7103	- 38
CD	50880	54005	- 6	609514	645810	- 6
Total albums	51868	55388	- 6	613945	652913	- 6
<b>Grand Total</b>	<b>54993</b>	<b>58079</b>	<b>- 5</b>	<b>\$ 650872</b>	<b>\$684046</b>	<b>- 5</b>

Source: CRIA website, January, 2003

Local artists increased their share of worldwide music from 58 to 68 per cent over the 1990s<sup>40</sup>. Canada, however, had a significantly lower proportion of sales of domestically-produced sound recordings, 12% in 2000, compared to 92% in the USA, 78% in Japan, 50 % in the UK and 28% in Australia, even though Canadian recording artists accounted for three of the top ten of the decade on *SoundScan's* top ten albums of the era list, including the numbers one and two spots.

<sup>40</sup> Reported by Throsby *op cit*.

### 4.3 Piracy and downloads in Canada

The IFPI makes a clear distinction between illegal sales of pirated CDs and downloading of music via P2P files and other means. International data on piracy are used to calculate lost revenue to sound recording makers by obtaining the number of units sold multiplied by local pirate CD prices and in this way calculate that in 2002 piracy cost the industry US\$ 4.3 billion<sup>41</sup>. No such estimates have been made for access to MP3 files and downloads. There are several reasons why the latter are difficult to calculate: whereas the pirate CD market is highly organised and visible, downloads are difficult to measure and so far are only estimated from figures of use of illegal sites, such as KaZaa and Grokster, and from surveys; these figures, however, are ambiguous about the effect on the market since some users sample music and later purchase legal CDs and others, for example, children, would not otherwise purchase music they had to pay for. We can expect that information will eventually improve so that more accurate figures can be used to demonstrate the negative impact on sales but that requires economic calculations that have not yet been done. The 2001 Ipsos-Reid survey showed that 76 per cent of Canadian Internet users aged 18-34 downloaded music files from the Internet.

Figures are, however, available on CD-R and CDR/RW Writer sales and they are indicative of the scale of downloading and the loss of sales under certain assumptions.

**Table 4: Sales of CD-R and CRR/RW Writers in Canada 1999-2002**

Year	Legitimate CD Sales	CD-R Sales	CDR/RW Writer
1999	67,266,000	45,460,000	N/a
2000	61,978,000	94,700,000	790,000
2001	58,079,000	115,000,000	852,000
*2002	55,175,000	155,000,000	1,450,000

\* Projected numbers - Legitimate CD sales are projected at 5% decrease per year

NB. There is disparity in the numbers between the sales of recorded music in Table 2 above which are published annually in the IFPI's Recording Industry in Numbers (RIN) because the RIN includes record club and non-member sales, while the CD burning table reflects CRIA member net shipment totals only.

Source: CRIA ( from "The Flexible Media Industry for Data Recordings", Santa Clare Consulting Group, April, 2001. Updated figures for 2001 by CD Tracker, January 2002 and CRIA Industry Statistics )

Based on the assumption of one CD only per individual who admitted to having bought or received a CD-R of infringing copies of sound recordings created by using a CD burner, estimated lost retail sales were reported by CRIA as \$33,163,260. These copies do not reflect legitimately copied sound recordings made for private use. There is no information to verify this assumption, which has been challenged, for example, by Liebowitz.<sup>42</sup>

<sup>41</sup> IFPI (2002) *Music Piracy Report*.

<sup>42</sup> S. Liebowitz (2002).



#### 4.4 Revenues from equitable remuneration rights of sound recordings in Canada

Sound recordings are widely used in a secondary market consisting of radio and TV broadcasts, in films and videos, advertising, discos and dance halls and to provide background music for a large number of services in hotels, restaurants, bars, air planes and so on. Sound recording makers and performers in Canada are entitled to equitable remuneration for these uses. Figures supplied by NRCC on payment for equitable remuneration for the public performance and broadcast of sound recordings provide additional information on the value of sound recordings to performers and makers.

Several criteria must be met for a sound recording to be eligible for equitable remuneration in Canada, as follows:

- The sound recording must be published, meaning that copies must be available to the public for sale or as a giveaway.
- The sound recording must be less than 50 years old.
- The sound recording must be:
  - a) made by a corporation that is headquartered in Canada or in a Rome Convention country, or by an individual who is a citizen or permanent resident of Canada or of a Rome Convention country, OR
  - b) all the fixations done for the sound recording occurred in Canada or in a Rome Convention country.
- Performers on eligible sound recordings are entitled to Neighbouring Rights payments irrespective of their nationality or country of residence. The Minister may extend cover on a reciprocal basis to countries that are not signatories to the Rome Convention.<sup>43</sup>

Table 5 has figures on distributed revenues for equitable remuneration rights (excluding pay audio). Because the pay audio tariff was certified only in 2002 and all payments for 1998-2001 were made in 2002, a break down by year is not available. The estimated amount of the Pay Audio tariff from 1998 - 2002 is \$2,056,250 (\$1,028,125 on a 50/50 split to makers and performers)<sup>44</sup>.

**Table 5: NRCC total distributions to its member collectives in relation to equitable remuneration rights (a) in dollars 1998-2001**

	Maker Collectives	Performer Collectives
1998	1,139,831	1,139,831
1999	2,303,353	2,303,353
2000	3,673,569	3,673,569
2001	3,754,366	3,754,366

**Source:** Data provided by NRCC. (a) Not including pay audio.

<sup>43</sup> Information supplied by NRCC.

<sup>44</sup> Information supplied by CRIA.

**NB** These figures are not for distributions in Canada only but also include funds due to foreign collecting societies. NRCC was unable to give specific information for Canadian performers and makers.

The Copyright Act requires that equitable remuneration rights be split 50/50 between the performers and makers, which NRCC has implemented by distributing 50% of royalties via its member collectives representing sound recording makers and 50% via its member collectives representing performers. For the administration of neighbouring rights, NRCC retains an administrative fee of 12.5% on neighbouring rights revenue it has collected. This administrative fee has been in effect since NRCC began receiving revenue.

Table 5 shows that revenues rose by 2.2 per cent from 2000-1. This is in contrast to the fall in sales revenues reported in Tables 2 and 3. These trends are to be observed in European countries too.

Levies on blank recording media are a means of compensating copyrights holders for the loss of sales income due to private copying of sound recordings. Table 6 shows payments to be made by the Canadian Private Copying Collective (CPCC) to member collectives representing performers, makers, and authors/publishers are as follows:

**Table 6: Blank recording media levy revenues**

	<u>Makers</u>	<u>Performers</u>	<u>Authors</u>
2000	\$ 553,394	\$ 670,929	\$ 3,678,968
2001	\$3,500,899	\$4,381,919	\$15,301,941

Source: NRCC

The divisions between the various groups of rights holders are the result of differences in the eligibility criteria for makers and performers versus authors/publishers as specified in the Copyright Act. CPCC has presented evidence as to the eligible repertoire in use in Canada to the Copyright Board in the process of tariff hearings that have resulted in the specific divisions between the rights holders. The NRCC administrative fee is 6% for the administration of Producers' and Performers' portion of the private copying levy<sup>45</sup>.

Figures from Tables 5 and 6 show that, in 2001, in addition to sales income, sound recording makers received \$7.3 million and audio performers received \$8.1m, from sources connected to secondary use of sound recordings, not including the pay audio income.

## **5. The specific measures under consideration**

Industry Canada has proposed several options for each of the items necessary for reforming the Copyright Act to comply with the WPPO Treaties. They are listed below. The economic criteria informing the choice were discussed at length above but it is useful to reiterate the main points here. It must be emphasised that the choice of options cannot be made by recourse to data findings.

<sup>45</sup> Information supplied by NRCC.

The general criterion of achieving net benefit requires that there are financial gains or other benefits in excess of costs for all concerned - industry stakeholders, intermediate users and consumers. The gains would be the strengthening of the incentive to performers and record labels to supply sound recordings that the public wants to listen to and is willing to pay for and improving consumer choice. The costs include reduced access due to increased consumer prices, loss of income to rights holders and the costs of administering, monitoring and enforcing copyrights. It is almost inevitable that, even where there is overall net benefit, some parties are made better off at the expense of others; then the choice of policy option requires judgement as to whether the gainers can compensate the losers. Even if economists were able to provide evidence of clear net benefit (which is not possible in the case under consideration), this judgement is a legal and political one.

A general point that is relevant to several of the proposed policy options is that economists mostly favour situations in which prices are determined by market forces (supply and demand) rather than by an administrative agency, such as the Copyright Board. This implies that exclusive rights are to be chosen in preference to rights of remuneration and statutory licensing because the former are valued through the market while the latter are determined administratively. However, transaction costs must also be taken into account and they may be greater for exclusive rights, whose value is individually negotiated, than if a remuneration right is awarded on the basis of collective management, for example, by a copyright collecting society. But while transaction costs may thus be reduced, the incentive to individual producers is altered by the use of blanket licensing, the source of administration cost savings. Copyright law must balance these counteracting economic features.

Several of the proposed options consider retrospective award of rights. There is no economic incentive argument for this and it is certain to increase transaction costs. Having collecting societies administer the rights can lead to problems of reciprocal treatment in retrospect, such as knowing how much should go to performers in other countries under previous agreements, and whether other countries were signatories to the Rome Convention at the time, and so on. Such options can therefore be ruled out on economic grounds, though in some cases they are required in order to comply with the WPPT.

## **5.1 Introducing an explicit distribution right**

Industry Canada has identified these options for the distribution right to conform to the WIPO Treaties:

- the status quo;
- create a right of first publication for performers;
- create a full domestic distribution right in all copies;
- create a right of first publication for performers but to state that the right must be administered collectively;
- create a right of first publication for performers but to state that if the purchaser has lawful exclusive possession, he (or she) will be deemed to be the owner.

CRIA expressed this view: "The right of distribution in Article 12 of the WPPT applies to originals and copies that are tangible objects capable of being put into circulation in the market place. The right can be limited by applying the exhaustion principle but only after the first sale or other transfer of the original or copies. The distribution right should be subject only to national exhaustion, i.e. the right will not apply to the transfer of ownership of copies that have previously been lawfully put on the market *in Canada* with the right holders' consent. Looking at the global developments, this has recently also been affirmed by the 2001 EU Copyright Directive (in application to the EU internal market). Applying national exhaustion encourages production of domestic recordings by domestic performers and provides the basis for effective enforcement as well as flexible marketing of releases to best serve the demands on any national market". The UK Music Industry Taskforce also argued for an exclusive distribution right on the grounds that it encourages competition (DCMS, 2000).

It is worthwhile asking who is likely in practice to benefit from this right. If the right is valuable to a performer without a recording contract, it is then necessary to know many performers are releasing their own recordings but here is no evidence on that. From casual observation it seems that performers mostly have to work with a record label to be successful. Thus the right, if it has any value (and if it does not, why have it?) would essentially benefit the recording industry unless it is collectively administered. Collective administration would presumably be by blanket licensing at rates determined by (or subject to) the Copyright Board. As stated earlier, collective licensing blunts the economic incentive to the individual (in this case, the performer)<sup>46</sup> and the mediation of the Copyright Board raises transaction costs. And although in general collective licensing reduces transaction costs to users who cannot (or cannot easily) contract with the right holder, in this case the performer is already contracting with the record label so that may not to be an advantage in this case.

Industry Canada has asked if it is possible to differentiate among the options based on: whether or how they inhibit the development of markets; potential redistribution of benefits and costs; and competitiveness of Canadian performers with performers based elsewhere. From the available information, it is not possible to make a firm judgement on these economic grounds. If it is deemed that the Copyright Law requires amending to comply with the WPPT, then the second and third options seem preferable to the other two because they appear to offer more freedom of choice.

## **5.2 The right of making available**

With regard to the making available right, Industry Canada has proposed the following policy options:

- (a) As part of the exclusive remuneration right in respect of communication to the public, carve-out an exclusive right for on-demand communication.
- (b) As with (a), but include an exclusive communication right covering near-on-demand communication as well as on-demand communication.

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<sup>46</sup> See M.Kretschmer (2002) 'Copyright Societies do not Administer Individual Rights' in R. Towse (ed) (2002) *Copyright in the Cultural Industries*, Edward Elgar, Cheltenham, UK and Northampton, Mass.; 140-164.

(c) A stand-alone distinct making available right.

The purpose of the making available right in the WIPO Treaties is, in legal terms, to ensure that copyright law applies to digital services on demand, that is musical works and sound recordings available at a time and place selected interactively by the consumer. In economic terms, it has the same purpose as for other rights, that is, to act as an incentive to writers, performers and sound recording makers to develop 'on-line' services and enable them to prevent erosion of the market by illegal and unauthorised competitors. According to CRIA, "Economic returns from a right of making available will benefit growth in the domestic market, which will translate into greater investment in local artists". It should also raise the profitability of record labels.

Having such a right would be mandated by economic logic if it were necessary in order to establish a property right. That conforms to the general economic arguments for property rights and copyright. However, there does not seem to be any economic reason to favour one option over another: the matter is a legal question. Nevertheless, some general economic analysis may be helpful to guide the choice of options.

Taking economic efficiency as the criterion, the right should not favour one method of delivery over another, that is, it should be technologically neutral. In addition, it should aim to minimise transaction costs by reducing administrative costs of licensing. Nor should it give rise to the possibility of licensing fees being set that distort the relative price of one form of delivery over another, for example, so that CDs cost more or less than downloads. It would therefore seem that greater economic efficiency would be achieved if all 'making available' downloads were integrated for licensing and distribution purposes. According to Einhorn and Kurlantzick (2003), the proposed arrangements in the USA by the Copyright Office, which are also the same as those of the European Union 2001 Directive *on the harmonisation of certain aspects of copyrights and related rights in the information society*, would administer the making available under two regimes: interactive streaming being treated in the domain of the performance right and downloading in the domain of the mechanical right. This exacerbates co-ordination problems and may also lead to the distortion of relative prices.

### 5.3 Introducing moral rights for audio performers

According to Industry Canada, one policy option is to extend moral rights prospectively only (i.e., to performances fixed after the date of joining the WPPT); a second option is to extend these rights retrospectively (i.e., to include all fixations of performances made in the previous fifty years).

Moral rights of attribution (paternity) and integrity were included in the Berne Convention in 1928. Accorded an important role in civil law countries' authors rights, especially in France, they have also been introduced latterly into copyright law in common law tradition countries as part of the harmonisation programme. Moral rights are usually inalienable but waivable. Moral rights are usually distinguished from so-called economic rights but the extent to which moral rights have

pecuniary value is debated<sup>47</sup>. Reputation clearly has financial value. The power to hold-up production influences the author's bargaining power in contracting, though that is determined by the extent to which alienability and waiving the moral right is permitted.

Authors and performers tend to work in rather different circumstances: authors often work alone as self-employed freelancers, whereas performers often work in teams, sometimes with employment contracts. Audio performers in bands, orchestras, choirs, groups and other ensembles work as teams. If they have contracts for employment, it could make moral rights difficult to apply.

The economic effect of introducing a moral right for audio performers would rest on the performer's power to hold-up production. The financial effect would depend upon the value of the held-up product and the number of others whose work is affected. This cannot be generalised. It would also depend upon the scope for alienating and waiving the moral right and on the strength of the party's bargaining power. In general, performers are in a weak bargaining position by virtue of excess supply on artists' labour markets. A moral right could strengthen their position but it could equally deprive others of the ability to make income.

In some legal systems, alternative ways of protecting reputation are available. I do not know if that is the case in Canada.

#### **5.4 Introducing legal protection for technological protection measures**

With regard to Technological Protection Measures (TPM), Industry Canada suggests the following policy options:

- a. Amend the Canadian Copyright Act to prohibit the act of circumvention of TPMs done for the purpose of infringing copyright. This prohibition would not apply to circumvention done pursuant to an exception or with respect to material in the public domain.
- b. As in option (a), but do not allow circumvention for the purposes of private copying under s. 80 of the Copyright Act.
- c. Prohibit not only the circumvention of TPMs, but also the manufacture and trade of devices that may be used to circumvent.
- d. As in option (c) but include an obligation to make the works or means to access or use the works available to users who benefit from specific exceptions or where the work is in the public domain.
- e. Remedy Options: Possible remedies include:
  - (i) civil remedy;

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<sup>47</sup> See M. Rushton (1998) 'The Moral Rights of Artists: *Droit Moral ou Droit Pecuniaire*', *Journal of Cultural Economics*, 22,1;15-32.

- (ii) criminal remedy; or
  - (iii) civil sanctions with the possibility of criminal sanctions if large-scale infringement or infringement done for commercial purposes.
- f. Regardless of the approach above, provide an exception from liability that would apply in respect of bona fide activities that affect TPMs, which are carried out for the purposes of ensuring inter-operability, reverse engineering and security testing.

While economics clearly mandates the protection of property rights in digital as well as in analogue form, there is no economic evidence that can discriminate between one policy option and another.

The general answer to the question of the economic value of giving legal protection for technological protection measures (TPMs) is that it depends upon how much it is worthwhile spending on prosecuting infringers. Economists would see that as being equal to the economic rent gained from having the protection. The position is the same for piracy. Similarly, infringers will spend an amount of money in tampering with protection devices that is equal to the benefit from infringement minus the cost of the punishment, taking into account the probability of being caught. The punishment, for its part, must not be so great as to cause moral hazard problems – ‘being hung for a sheep as for a lamb’, that is, giving the felon the incentive to infringe more by virtue of the strength of the sentence<sup>48</sup>. Thus the cost and trouble of legal proceedings plays a very important role in this question and that could be a determining factor in the choice of policy option.

The sound recording industry has spent over US \$2 billion on trying to develop safe legal online services, according to information from IFPI. This is a long-term investment that has so far shown no financial return. The industry has so far not successfully competed with illegal P2P sites and, moreover, legal downloads cost more than CD tracks. It is estimated that it costs US \$50 to download a CD, which far exceeds the sale price. The legal licence fee per track appears to be settling at around \$1.

At present, it is cheaper for the record industry to close down illegal sites than to compete (and existing law already enables closure). This makes it difficult to assess the strength of the incentive to develop online delivery that TPMs can provide to sound recording makers: it might be a nice weapon to have in the arsenal but how much will it be used? Also, a strong TPM regime might act as a disincentive to further technological development and business models – the moral hazard argument again. This is a cost benefit calculation that it is very hard to make for the future. What does *not* appear to be a safe basis for calculating potential benefits is that TPMs will restore the value of sales at present being lost to piracy and downloading: as explained above in relation to CD burning, we simply do not know the full explanation for the fall in CD sales.

Digital Rights Management (DRM) is another aspect of TPMs and here the expected direct economic effects are the reduction of transaction costs of rights management and the gain of revenues from

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<sup>48</sup> The classic reference on the economics of crime is Becker (1969) “Crime and Punishment: an economic approach”, *Journal of Political Economy*, 76,2;169-217. See also Posner *op cit*. A further consideration is the concern that overly strong protection of copyright encourages inefficiency in production; a potential infringer may be capable of making more profit than the legal owner lost, suggesting the need for licensing. If that were denied, there would be a welfare loss.

licensing fees and other remuneration for collecting societies. Economists have expressed wider concerns about the indirect effects that DRM may cause. The 'digital black market' in general and the 'Napster Case' in particular have spawned a large literature, including some by economists.<sup>49</sup>

In law and economics terms, there is a concern about limitation of access to copyright material for 'fair use' ('fair dealing' in the UK, Australia, and Canada) by consumers and other users, including creators. Much depends upon the economic interpretation of fair use. The 'classic' article on this by Gordon on the *Betamax Case* argued that fair use is a response to market failure, by which she meant the difficulty of a market spontaneously developing when there are numerous consumers with a very low willingness to pay but where their combined consumption would be valuable and cause considerable losses to the supplier.<sup>50</sup> Other economists have argued that fair use is giving way to 'fared use' with DRM that overcomes market failure in the Gordon sense and facilitates the capture of the whole consumers' surplus by price discrimination and so erodes fair use.<sup>51</sup>

The perceived erosion of fair use - 'the second enclosure movement' as it has been called<sup>52</sup> - is a topic that concerns many writing on the law and economics of copyright. Landes and Posner bring another, fundamental view to the economics of fair use - what they call the cost of creation. Taking the view that creators 'stand on the shoulders of giants', they distinguish 'productive' from 'reproductive' fair use, the former being necessary for the creation of new works. Over-strong copyright protection limits productive fair use and raises the cost of creation (transaction costs of checking on what is copyright material, tracing owners for permissions, etc.) and reduces freedom of expression and free speech. Excessive reproductive fair use, however, reduces the value of copyrights and blunts the incentive to create. They claim that the balance is maintained in copyright law allowing fair use that does not significantly reduce the value of the copyright and by the limited duration of copyright (and this balance is upset by extension of the duration). Although this analysis predates discussions about DRM technology, the general principle is surely still applicable. These concerns were raised by objectors to the US DMCA Anti-Circumvention provisions<sup>53</sup>.

It can be seen from this discussion, that this is a vast topic that involves the whole of copyright law and its cultural and economic rationale. It would be manifestly difficult to place economic value on fundamentals such as creativity, freedom of expression, freedom of speech, respect for the law and suchlike. There are also public choice issues here of representation for many small gainers versus a few powerful and well organised interest groups. These are questions governments have to resolve on political as well as economic grounds.

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<sup>49</sup> For example, B. Klein, A. Lerner and K. Murphy (2002) "The Economics of Copyright 'Fair Use' in a Networked World", *American Economic Review*, Vol. 92,2, May: 205-8.

<sup>50</sup> W. Gordon (1982) "Fair Use As Market Failure: A Structural and Economic Analysis of the *Betamax Case* and its Predecessors", *Columbia Law Review*, 82,8, December; 1600-657.

<sup>51</sup> See, for example, Bell (1998) "Fair Use vs. Fared Use: The Impact of Automated Rights Management on Copyright's Fair Use Doctrine", *North Carolina Law Review*, 761, 558-619

<sup>52</sup> Boyle's phrase; see <http://james-boyle.com>

<sup>53</sup> See, for example, National Research Council (2000) *The Digital Dilemma. Intellectual Property in the Information Age*, Committee on Intellectual Property Rights and the Emerging Information Infrastructure of the Computer Science and Telecommunications Board.



## 5.5 Extending a full reproduction right for performers

Industry Canada's statement of the proposed changes is that:

"To comply with the WPPT, the existing reproduction right under the Act would need to be amended to apply to all performances fixed in the preceding 50 years".

To grant the full reproduction right for performers, meaning an exclusive right on a par with authors, detailed proposals are either:

- to grant the right (retrospectively);
- to grant the right but to state that the rights of performers must be administered collectively; or
- to state that performers are deemed not to have transferred any exclusive right which existed in previously fixed recordings unless the agreement specifically provided for the transfer.

CRIA's view is that "extending the right of reproduction might not require an amendment of the Copyright Act as the right of reproduction currently enjoyed by performers may adequately comply with Article 7 of the WPPT. If however it is not compliant any amendment will need to be accompanied by a saving clause to preserve the functioning of recording contracts that were made prior to the amendment".

As with other rights under discussion, there can be no economic justification for retrospective granting because that merely acts as an unanticipated windfall gain rather than as an incentive. However, given the inevitable gap in time between the development of the technologies that give rise to the need to update the Copyright Act and its revision, some performers' contracts no doubt will have anticipated in such cases the possibility of change to the law and therefore financial gain could not be said to be unanticipated. As contracts between featured performers and record labels are drawn up individually, there is unlikely to be conformity as to the date at which contracts began to recognise the potential of new technologies. Transaction costs of verification could be very considerable.

For non-featured performers, transaction costs of tracing performers granted retrospective rights (and their heirs?) who did not expect to be paid except at the door of the recording studio are exceedingly high. This problem was experienced in the UK by PAMRA (Performing Artists Media Rights Association) after 1996 when the right to equitable remuneration from the public performance of sound recordings was made retrospective. As the complete information of performers' participation in sound recordings did not exist, their right to payment could not be verified and of those whose names were known, many could not be traced (witness the hundreds of notices in performers' organisation publications trying to contact performers of yesteryear)<sup>54</sup>.

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<sup>54</sup> A new website [www.royaltiesreunited.co.uk](http://www.royaltiesreunited.co.uk) was launched on 1st February 2003 listing the names of over 5,000 performers who have airplay royalties waiting for them. The initiative has been set up by the performers' collecting societies and other organizations. This is an indication of the scope of the problem.

The choice of options falls on the third option because the loss of incentive in some cases is likely to be considerably outweighed by the high cost of administering retrospective rights.

## **5.6 Extending the term of protection for sound recordings**

Article 17 of the WPPT will extend the term of copyright only in respect of unpublished sound recordings (i.e. recordings that have not been released into the market place). The extension applies if the recording is published in a year subsequent to the year of fixation and then the term is 50 years from publication (instead of 50 years from the date of fixation). Industry Canada sees the issue as being whether to:

- extend the term for sound recordings;
- extend the term for sound recordings and to extend the term for performances contained in those sound recordings.

Performers should certainly be awarded the same term of protection as sound recording makers as that would minimise transaction costs of rights administration.

## **6 General comments on extending the term of copyright protection**

David Basskin (CMRRA) has put the point neatly:

"It is hard not to conclude, after taking into account the criticisms of term extension made by academics that no cogent, convincing or well-researched arguments have been made in its favour, and that it represents little more than a search for windfall earnings for corporate right owners. On the other hand, as new and rapidly advancing technologies are giving old works new life – and particularly as the inexhaustible appetite of multimedia creators for raw material continues to grow – it is by no means certain that long-dormant works will not acquire new value."<sup>55</sup>

The second part of this quotation clearly shows the industry view of hedging its bets. But who is it that 'creates' that new value? Is putting old wine in new bottles the kind of creativity that copyright is designed to encourage? This raises questions about the economic purpose of copyright: it is an incentive to create not merely protection for commercial value-creation. This distinction seems to be in danger of being obscured by the ever-increasing extensions to the scope and duration of copyright law. The extension of the term of copyright in the USA has spawned a considerable comment by economists, even by those who are staunch advocates of copyright. Landes has made the simple economic point on this: a 95 year term cannot substantially increase the incentive to create and invest in greater production as the present value of extra years' income (assuming reasonable discount rates) make little financial difference. With a discount rate of 10%, around 95% of the value of a copyright

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<sup>55</sup> D. Basskin (1999) "Coming to Terms: extending the duration of copyright" 16 *Can. Int. Prop. Rev.* 227.

asset would be received in 30 years<sup>56</sup>. So the real purpose of the extension appears to be corporations' control rather than financial incentive.

Some of the WPPT stipulations, for example, extending the term of protection for sound recording appear on the face of it to be trivial, 'sensible' changes that neaten things up legally. However, such changes could be strategically exploited by sound recording makers and used to effectively extend the term of protection by the back door; what is to stop them from hoarding master copies of recordings and choosing a favourable moment to release them? If that were to happen, it would surely be detrimental to the interests of performers, who necessarily have a shorter time horizon for optimising their financial and reputational rewards than do record companies<sup>57</sup>.

The US extension of the term of copyright raises another matter: how will it impact on world trade in sound recordings and film when the rest of the world has works in the public domain that are in copyright in the USA? This is certainly a matter for concern in Canada.

## 7 Conclusion

In this *Report*, I have tried to balance the current concerns of Industry Canada with implementing the WIPO Treaties and the responses of the stakeholders with a broad perspective of relevant theory from the economics and law and economics literature on copyright. In the absence of compelling statistical data, this seems to be the most useful approach to take.

Copyright is an institution that causes consumers to pay for creativity and innovation. Unlike in the case of government subsidies financed out of taxes, which is another way of financing creativity, consumers ultimately vote with their purses by buying or not buying the goods and services embodying the works so created. However, the stipulations of copyright law can have a significant influence on the price of these products. Copyright law seeks a balance between its benefits and costs – the benefits of protection that are an incentive to create and publish cultural products and the costs of that protection to those who use the products, whether they be other creators and publishers, intermediate users or final consumers. Government policy seeks to strike a balance between the interests of all these parties within its national borders and to join international treaties that promote international trade to gain its benefits. The issues this project deals with are, simply put, the net benefits to Canada of the changes to the Copyright Act deemed necessary for compliance with the WIPO Treaties. It is moreover important to distinguish short term 'static' net benefits and long run 'dynamic' costs and benefits as technology and consumer tastes change. This *Report* shows that these are complex questions that are difficult to answer in general terms and ones for which adequate data do not exist and maybe, could never be had.

At the basis of the economic analysis of policy changes is the notion of there being some option that would improve the welfare of some without imposing costs on others – the possible 'free lunch' or, in formal economic terms, the Potential Pareto Improvement (a change moving in the direction of

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<sup>56</sup> Landes (2002) *op cit*.

<sup>57</sup> See Towse(2001) *op cit*.

Pareto Optimality). Research therefore begins by asking who benefits from the suggested changes and what costs would they lead to for others. If there were a costless potential change, it should be adopted unambiguously. The problems begin when the benefits to some cause costs to others, including those who are not directly involved in the trade concerned. An example of this would be Canadians who do not buy sound recordings or listen to music at all may nevertheless care about free speech. The first question that needs to be addressed, therefore is whom to regard as the stakeholders in consultations over the proposed changes – just those in the industry or the wider population? And as all information has its costs, how broad should the consultation process be? In a dynamic context, the costs and benefits of present legislation for future generations also have to be taken into account; the future benefits to copyright owners are protected by the (ever increasing) duration of copyright but those to future users and consumers are more difficult to fathom.

As some parties will benefit at the expense of others, it is necessary to understand the market mechanisms and institutional arrangements that determine the costs and benefits. The sound recording industry and performers seem likely to benefit from the proposed changes to the Copyright Act but that implies the money coming from somewhere. That somewhere may be higher prices for consumers, lower payments to composers and lyricists or inflow payments from net exports from abroad. In the case of the Canadian music industry, the last mentioned appears unlikely as the evidence points to Canada being a net importer of music. The Copyright Board of Canada no doubt considers the 'sharing of the pie' between different rights owners, though administered prices, such as the Board's tariffs, easily get bogged down in tried and workable formulas but ones that do not represent market values; indeed, they can insulate the parties from knowing their true worth. That is also a problem with blanket licensing – it does not convey true market signals to individual authors, though it is clearly justified on the grounds of efficient administration and saving on transaction costs. Excessive use of the Copyright Board is very costly, however. So is an excessive number of collecting societies, though the NRCC as an umbrella organisation does not charge higher administrative rates for its services than collecting societies in other countries. It has to be considered whether or not the introduction of digital rights necessitates the formation of a new collecting society.

The evidence provided here shows the value of certain neighbouring rights to the makers of sound recordings, measured as the value of sales and as income from secondary use and the value of the latter to performers. In common with trends throughout the world, sales revenue of all sound carriers except DVDs are falling while income from licensing is rising. The more licensing arrangements there are, the more this trend may be expected to continue. Revenues (including those arising from overseas agreements), should grow more as the administration of licensing improves and as digital rights management and Internet licensing develops. DRM is still in its early days and the institutional arrangements are not all in place, for example, international reciprocal agreements between national collecting societies.

What is abundantly clear is that further research is needed on the long-term trends of sales of sound carriers. Though claims are constantly being made that the value of falling sales is the appropriate measure of piracy and illegal downloading on the Internet, economists do not accept this simplistic analysis of 'the effects of piracy'. It is recognised that there is considerable damage done by these illegal behaviours but not that falling sales measure the cost of piracy. The record industry relied for a long time on its international anti-piracy campaign rather than on adopting technological protection

devices or reducing prices. It is now changing course on this. It is necessary that property rights are properly established and defended by law but that cannot be maintained indefinitely in the face of popular resistance. The dynamic problem is to persuade a generation of young free-riders that it is in every-one's long term interests for property rights to be respected. Research is also needed on digital supply of music and the returns from it to sound recording makers and to performers.

Finally, the international aspect of the changes to the Copyright Act is crucial, given the emphasis in the WIPO Treaties on international trade. To quote Acheson and Maule (1999): "Lack of conformity in copyright laws and their enforcement, together with increasing trade in copyrighted material, has led to a series of trade irritants between countries." (p. 258).

Canada has already been on the USTR Special 301 'Watch List' for four years for applying reciprocal rather than national treatment with respect to the eligibility of US artists to Canadian broadcasters' neighbouring rights payments and blank recording media levy payments. This seems to be a particular example of a trade irritant. Unfortunately, might seems to be right with respect to copyright and international trade. This poses particular difficulties for Canadians but with the reach of TRIPs and of WIPO Treaties, no country is immune from pressure to conform.

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## Appendix

### Industry Canada's List of Key Stakeholders

CRIA: Canadian Recording Industry Association  
Brian Robertson or Ken Thompson (416) 967-7272  
[Brobertson@cria.ca](mailto:Brobertson@cria.ca)  
<http://www.cria.ca>

CIRPA: Canadian Independent Record Producers Association  
Brian Chater: (416) 485-3152  
[cirpa@cirpa.ca](mailto:cirpa@cirpa.ca)  
<http://www.cirpa.ca>

AFM: American Federation of Musicians of the United States and Canada (collective)  
David Jandrisch (416) 391-5161  
[alanw@afm.org](mailto:alanw@afm.org)  
<http://www.afm.org>

UDA (Artist!): Union des Artistes (collective)  
<http://www.uniondesartistes.com>

CMRRA: Canadian Musical Reproduction Right Agency (collective)  
David Basskin  
<http://www.cmrra.ca>

NRCC: Neighbouring Rights Collective of Canada (collective whose members are: AFM, AVLA, SOPROQ, ACTRA PRS, UDA (Artist!))  
Executive Director: Diana Barry

SOPROQ (ADISQ): Société collective de gestion des droits des producteurs de phonogrammes et vidéogrammes du Québec (collective)  
Pierre Rodrigue or Solange Drouin: (514) 842-5147  
[adisq@mlink.net](mailto:adisq@mlink.net)  
<http://www.adisq.com>

SOGEDAM: Société de gestion des droits des artistes-musiciens (collective)  
Eric Lefebvre (450) 441-2424  
[elefeb@qc.aira.com](mailto:elefeb@qc.aira.com)

Canadian Musical Heritage Association  
Clifford Ford (613) 520-260  
[cmhs@ccs.carleton.ca](mailto:cmhs@ccs.carleton.ca)  
<http://www.cmhs.carleton.ca>

Canadian Country Music Association  
Sheila Hamilton (905) 850-1144  
[Sheila@ccma.org](mailto:Sheila@ccma.org)

Guilde des musiciens du Québec  
Emile Subirana (514) 842-2866  
[Guillemusiciens@hotmail.com](mailto:Guillemusiciens@hotmail.com)  
<http://www.guillemusiciens.com>

Union of British Columbia Performers  
John Juliani (604) 689-727

## **Information Requested from the Sound Recording Industry**

I would appreciate any information, references to publications, statistical sources, data sets on the following questions:

1. What do you see the economic advantages to be of introducing an explicit distribution right? Do you foresee any associated additional costs?
2. What do you see the economic advantages to be of introducing a making available right? Do you foresee any associated additional costs?
3. What do you see the economic advantages to be of extending the term of protection for sound recordings? Do you foresee any associated additional costs?
4. With respect to the economic advantages to be of introducing legal protection for technological protection measures, what do you think the associated costs to the industry would be?
5. Do you anticipate that introducing moral rights for audio performers and extending a full reproduction right for performers will add to costs of sound recording?
6. Do you have any information on the effect on the record industry of previous changes to performers' rights in Canada?
7. I have data on sales of sound carriers but would also like to have data on revenues from secondary use (equitable remuneration/ blank tape levies etc) and profit rates for the record industry if you are able to provide this information.
8. Licensing arrangements – compulsory licences, blanket licensing. Copies of standard contracts for performers would be particularly helpful.
9. Costs of administration of copyright licensing and other administration. Any experience of digital rights management in Canada.
10. How remuneration rates are set.
11. Any other information your organisation has that you think is relevant to the changes to copyright law under consideration.

Thank you.

### **Information requested from performers' organisations**

I would appreciate any information, references to publications, statistical sources, data sets on the following areas of the Canadian music industry:

1. The effect on performers' earnings when performers' rights were introduced. Payments to performers from royalties, equitable remuneration, blank tape levies, etc. for primary and secondary use.
2. The effect on phonogram producers when performers' rights were introduced. Division of payments to performers from royalties, equitable remuneration, blank tape levies, etc. for primary and secondary use.
3. Licensing arrangements – compulsory licences, blanket licensing. Copies of standard contracts for performers e.g. for recording work, would be particularly helpful.
4. Costs of administration of copyright licensing and other administration. Any experience of digital rights management in Canada.
5. How remuneration rates are set.
6. Performers' earnings from 'live' work in choirs, orchestras.
7. Any other information your organisation has that you think is relevant to the changes to copyright law under consideration.

Thank you.

## Assessing the economic impacts of copyright reform on performers and producers of sound recordings in Canada

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