Copyright Without Creators

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Copyright is typically justified by the rationale that profits induce authors and other artists to invest in cultural production. This rationale is vulnerable to the objection that some artists have intrinsic production incentives and do not require significant capital. Even accepting this objection, copyright is justified by an alternative rationale: it principally supports the profit-motivated intermediaries that bear the high costs and risks involved in evaluating, distributing and marketing content in mass-cultural markets. This “authorless” rationale is consistent with the intermediated structure of mass-cultural markets and accounts for long-standing features of copyright law that have conventionally been dismissed as unjustified transfers from consumers to media interests. The digital transformation of mass cultural markets, in which content is abundant but quality is variable, challenges and clarifies the intermediary-based rationale for copyright. Even in digitized content markets, robust copyright enables intermediaries to select from the full range of transactional structures for most efficiently bearing the costs and risks of screening, packaging, distributing and marketing content. Weak or zero copyright skews the market’s selection of organizational forms by compelling the use of intermediation structures that bundle unprotected content with excludable complementary goods. Preliminary evidence from the popular music market suggests that the effective decline in copyright protection has distorted the efficient selection of intermediation mechanisms.
“. . . [T]he author owes all rights to his exploiters, and by no means to his own futile appeals for justice, though these have always been made the pretext for the legislation which has established him as a person of property.”

--- Bernard Shaw (1933)

1. **INTRODUCTION**

It is commonly stated that copyright provides a profit incentive that elicits creative production by authors and other artists. This proposition obscures the core function of copyright law. Copyright is best conceived not as a system for incentivizing creation by authors and other artists; rather, it is best conceived as a system for incentivizing investment by the intermediaries\(^1\) responsible for undertaking the capital-intensive tasks required to deliver a creative work from an individual artist to a mass audience.\(^2\) This neglected function accounts for long-standing core features of copyright law that otherwise resist explanation and are commonly attributed to the rent-seeking efforts of large media and entertainment interests. The reason is simple. To generate, package, market and deliver a creative good to a mass audience necessitates both creative

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\(^1\) In the scholarly literature on copyright, the term “publishers” is often used to denote both literary publishers and a broader range of distribution intermediaries. I use the generic term “intermediaries” to cover the full range of screening, publishing, distribution and marketing entities in creative goods markets. Note further that I use the term “artists” interchangeably with “creators” or “authors” to denote individuals who are the source of creative inputs.

\(^2\) I am not the first to identify the role played by copyright in supporting distributors’ incentives, but to my knowledge it has never been fully elaborated as the primary justification for copyright without reference to authorial incentives. The sole exception is Mosoff (2013), who proposes a publisher-oriented approach to copyright (with a special application to scholarly publishing) that is similar to the approach advanced here. Nadel (2004) and Bambauer (2008) provide more extensive analysis of the connection between copyright and distribution incentives but conclude that copyright cannot be justified on that basis. Ku (2002) and Zimmerman (2003) recognize copyright’s role in supporting publisher’s incentives; however, Ku argues that this argument is now obsolete due to technological changes. For earlier relevant discussions, see Kaplan (1967 pp.8-9, 75); Goldstein (1990-91, pp. 109-113); Chafee (1945, pp.509-10). A familiar line of argument identifies large media interests as the primary beneficiary of copyright law but relies on that observation to argue that copyright law has been distorted so as to advance those private interests at the expense of the public. See *infra* note 5. Unlike these prior contributions (with the exception of Mosoff (2013)), I argue that (i) copyright can be justified on the basis of distributors’ (or more broadly, intermediaries’) incentives, (ii) intermediaries are not obsolete in digital content markets; and (iii) intermediaries’ interests are not inherently misaligned with the public interest.
activities—the predominant focus of copyright scholarship and jurisprudence—and a host of non-creative activities—the predominant focus of actual participants in mass-cultural markets. In the absence of some other equivalent and no-less-costly mechanism, intellectual property rights are required to generate the premia that incentivize rational investment by intermediaries, even if it were recognized that those rights would sometimes be excessive if only required to incentivize artists.

Scholars of copyright frequently express skepticism that copyright is necessary to induce participation in activities that deliver non-pecuniary benefits or do not require extensive capital investment (Zimmerman 2011; Benkler (2006 Chs. 3-4); Boyle (2003, pp.33, 45-46)). If making art is intrinsically satisfying and not especially costly, then copyright reduces to nothing more than an elaborate rent-seeking exercise. This skeptical view overlooks the peculiar economics of creative markets, and in particular the mundane but critical non-creative components of creative markets. Funding creative expression and then packaging and distributing it on a mass basis for commercial purposes are difficult tasks fraught with high cost and risk. In particular, any entity seeking to earn a positive return on the mass distribution of creative goods must overcome three formidable obstacles: (i) commercial outcomes in creative markets are extremely skewed and unpredictable; (ii) even successful releases depreciate rapidly in value; and (iii) given elements (i) and (ii), coupled with the difficulty in collateralizing intangible assets, accessing external capital to fund creative projects is difficult. These challenges explain the critical role played by large intermediaries—the movie studio, the record label, the book publisher—in every mature mass-cultural market. Functionally, those intermediaries act as financing and insurance entities that spread the costs and risks of capital-intensive cultural production and distribution by funding a large portfolio of creative properties that generates cash flow to offset losses on failed projects. These intermediaries’ much-maligned scale and scope support the financing and risk-

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3 For perhaps the original and best statement of copyright skepticism, see Plant (1934, reprinted 1974). For widely-cited modern examples, see Breyer (1970); Lessig (2004).
4 For exceptions, see Nadel (2004); Bambauer (2008); Schultz (2009). For briefer discussion, see Zimmerman (2003); Ku (2002).
diversification functions that fund cultural production and distribution without tax-based or philanthropic support.

An intermediary-based view suggests that the expansion of the subject matter, term, assignability, divisibility and scope of copyright entitlements—developments that have been subject to repeated criticism from the legal academy—enhance intermediaries’ incentives to invest in creative works that are costly and risky to identify, evaluate, produce, edit, market and distribute on a mass scale. Without robust copyright, publishers, record labels and movie studios would have difficulty capturing returns on the occasional “big hit” and cultivating revenue streams from a library of older successes. The free-riding threat is obvious. Imitators would lie in wait for the big hit, reaping profits on a single work without bearing the costs and risks involved in that work and the far greater number of terminated or losing projects that the originator had funded and developed. The successful operation of mass cultural markets does not only benefit dominant intermediaries but confers socially valuable benefits on other deserving stakeholders. Specifically, it provides an efficient production and distribution infrastructure for the artists who supply creative inputs to those intermediaries and delivers access to a continuous flow of creative goods for end-users.

Even if it were accepted that copyright has supported the mature mass-cultural markets of the 19th and 20th centuries, there is no intrinsic reason to believe that that proposition holds true for the digitized mass-cultural markets of the 21st century and beyond. It might be argued that the intermediary-based account only provides a historical account of the role played by copyright in a “pre-digital” period during which time it was costly to acquire the skills and equipment required to produce and distribute content on a mass scale. By implication, the intermediary-based case for copyright would appear to falter in an environment in which those costs have fallen and artists can often reach end-users without an intermediary. Closer scrutiny paints a more complex picture that preserves a fundamental role for intermediaries—and, by implication, copyright—even in contemporary mass-cultural markets. Contrary to popular views, the decline of copyright in digitized content markets does not result in
frictionless disintermediated markets in which the artist interacts directly with the audience. Rather, the decline in legal protections has resulted in re-intermediated markets. In particular, the viable point of intermediation has shifted from intermediaries that specialize in the stand-alone delivery of priced content to intermediaries that specialize in the delivery of unpriced content that is bundled with a complementary asset—principally, hardware and advertising or other services—to which access can be controlled. That shift in transactional form is not merely aesthetic. It inherently imposes a potential social welfare loss insofar as that shift is compelled by the inability to access the full range of transactional forms in environments that operate under weak copyright protections. Under strong copyright, all forms of intermediation—both bundled and unbundled—are available and, absent competitive distortions, the market efficiently selects from those forms; by contrast, under weak or zero copyright, the set of intermediation options is limited to bundled mechanisms, which may not coincide with the most efficient mechanisms for producing, packaging and delivering creative content on a mass scale.

Organization is as follows. In Part 2, I describe the traditional author-based approach to copyright and the traditional critique of that approach. In Part 3, I identify the key costs and risks of creative markets and the manner in which intermediaries bear those costs and risks. In Part 4, I articulate an intermediary-based approach to copyright and use it to account for key features of copyright law. In Part 5, I discuss how the digitization of content markets clarifies the intermediary-based case for copyright. In Part 6, I review preliminary evidence on the effects of weakened copyright protection in the popular music market. Part 7 concludes.

2. COPYRIGHT FOR CREATORS

2.1 The Standard Rationale

The conventional justification for copyright is well-known: copyright supplies a property-rights solution to a free-rider problem. Without some technological or legal means of
excluding unconsented users, any artist anticipates being unable to recoup his or her investment in the face of lower-cost imitators. By anticipation, the artist reallocates resources to other activities and creative output falls. That market failure is resolved by a property entitlement that deters unconsented usage and enables the artist to regulate and price access through market exchange.

2.2 The Standard Critique

The logic behind the author-based view of copyright runs into some challenges when assessed empirically. There are two potentially vulnerable points.

2.2.1 Art is Cheap

The author-based view assumes that production costs are considerable and therefore a significant premium is required to induce artists to bear those costs. However, production costs in some media are not especially great. A writer or composer requires a pen and paper, or today a moderately-priced laptop; an artist requires a canvas and paint; a musician requires a musical instrument; and so forth. That places in doubt the necessity for copyright—or, at least, strong versions of copyright—as a means of incentivizing cultural production. To be clear, this objection is far from fully persuasive. Most obviously, while the immediate out-of-pocket costs of producing a creative work may not be especially great, the total costs of producing that work can be exorbitant, taking into account the extensive training required to acquire the skills necessary to produce certain kinds of art and the opportunity costs incurred by any artist.

2.2.2 Artists are Romantic

The author-based view assumes that authors and other artists conform to a rationally self-interested model of human behavior. That model jars with the popular notion of the romantic artist who is driven by intrinsic motivations, in which case the necessity for
strong copyright becomes unclear. That objection too is far from fully persuasive. There exists ample evidence that artists are motivated at least in part by economic considerations (Caves (2002 p.43); Cowen (1998 pp.18-19); Frey & Pommerehne (1989, p11)) and even apparently “romantic” behavior can be explained on the basis of a chronic overestimate of, rather than indifference to, the chance of commercial success (Towse 2001). Most persuasively, artists respond to changes in profit opportunities as would be expected by economic rationality. In Victorian England, the popularity of poetry in the publishing market prompted large volumes of poetry submissions to publishing companies (Erickson (1996, pp51-52)). In the 1920s, the most talented songwriters suddenly moved en masse from working for Broadway in New York to working for Hollywood in Los Angeles, for the unsurprising reason that the studios offered better terms (Sanjek (1983 p.16)). The list can go on. Nonetheless, even if we adopt a more nuanced view that artists are motivated by a mix of profit and non-profit-based objectives (Caves (2000 p.536)), the conventional case for copyright (or, at least, strong forms of it) still stands in some doubt.

3. Understanding the Economics of Creative Markets

Both advocates for, and opponents of, the author-based incentive case for copyright usually analyze a stylized environment that misses some of the most basic economic characteristics of the process by which creative goods are produced, packaged and distributed in mass-cultural markets. Those models typically envision a single act of authorial creation, which then generates a creative work immediately ready for consumption by the end-user. That is a gross simplification: myriad tasks are required to deliver creative inputs from the upstream point of creation to the downstream point of end-usage. That oversight means that even economically-informed discussions of

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5 See supra note 3. A related critique argues that the “romantic author” is a social construction that has been used strategically to support copyright protections that protect publishers’ interests (Patterson (1968, pp. 143, 147); Jaszi & Woodmansee (1994, p.6). My argument is consistent with this strategic view of the authorial figure but draws the normative conclusion that promoting publishers’ interests is often consistent with, or at least not necessarily inconsistent with, the social interest.

6 This is true, for example, of the leading economic model of copyright set forth in Landes and Posner (2003).
copyright use a model that overlooks key elements of the mass-cultural markets in which copyright has its primary real-world impact. In this Part, I correct this oversight. We cannot fairly assess the case for copyright until we appreciate the economic characteristics that are peculiar to mass-cultural markets.

3.1 The Total Costs of Creative Production
The standard case for and against copyright focuses on the initial act of authorial creation. But this overlooks all the non-creative tasks that must be undertaken to deliver a creative product to a mass market and earn a return on it. These tasks are far more capital-intensive than the initial act of creation, requires skills, equipment and infrastructure that are not always easily accessible, and are undertaken by entities that are primarily if not exclusively profit-motivated. The diagram below indicates these tasks and the types of entities that typically undertake these tasks.

![Figure I: The Creative Supply Chain](image-url)
3.1.1 Screening and Packaging Costs

Precisely because out-of-pocket creation costs are not always significant, and creative activity confers some intrinsic utility on the artist independent of any expected profit, creative output is abundant. For the same reason, however, the average quality of creative output is low. Search and evaluation costs required to filter out low-value output would be infeasible for any individual user to bear. Total output that reaches cultural markets, which far exceeds the volume of output submitted to intermediaries for potential distribution, is immense. In 2011, approximately 347,178 books, 610 feature films, and 76,875 albums were released in the U.S. domestic market. The accumulated pool of content is even more daunting. Gracenote, the most comprehensive digital database of musical tracks, holds over 100 million musical tracks from more than 400,000 artists. To efficiently search and evaluate this vast pool of creative works, cultural markets are typically populated by specialized agents—for example, talent agents, literary agents or record and film producers—that develop skills and maintain an infrastructure for this purpose. Relatedly, these agents perform a critical “packaging” function by assembling creative and human assets into a final product for end-user consumption, such as a Broadway show, a Hollywood movie, or a record album (Caves (2002)). Identifying those inputs, assembling them into a single package, and negotiating the terms on which each contributor’s input is integrated into the package, is a time-intensive and skill-intensive activity for which market rates of compensation must be paid.

3.1.2 Production, Marketing and Distribution Costs

The remaining tasks required to deliver a creative good to market typically entail the largest capital expenditures. I will examine these costs in three primary content industries: motion pictures, music and book publishing.

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7 On books, see Bowker (2012); on films, see MPAA (2011); on albums, see The Nielsen Co. (2012).
3.1.2.1 Motion Pictures

It may be a relatively low-cost activity to write a screenplay but it is far more capital-intensive to assemble a cast and technical crew to produce a film based on the screenplay, hire technical staff to edit the film, produce prints of the film, distribute the film to exhibitors and other distribution channels, and market the film to millions of potential viewers. As of 2007 (the last year in which the Motion Picture Association of America collected this information from its members), the total average budget for a feature film release was almost $107 million, of which $32 million (almost 30% of the total budget) was constituted by marketing and advertising costs (Verrier 2009). Today blockbuster feature films commonly have budgets in excess of $200 million.\(^9\) Note that those figures do not include the overhead costs incurred by a studio to maintain an infrastructure that can disseminate content across domestic and foreign markets and all types of media at short notice.

3.1.2.2 Music

The costs required to fund a new artist’s album include recording costs, development costs, promotional costs, and the “signing advance” paid to the artist prior to production. These costs are substantial, with marketing expenses being the single greatest expense as a share of industry revenue (26.3% in 2012) (IBIS World 2012)). Based on information collected by the International Federation of the Phonographic Industry, these costs break down as follows on average in the case of a new artist: (i) $200,000 cash advance; (ii) $200,000 in recording costs; (iii) $200,000 for music videos; (iv) $100,000 to support a promotional tour; and (v) $300,000 in other promotional expenses, which sum to $1,000,000 (IFPI 2011).\(^10\) In the case of a star artist, who can demand greater production quality and marketing efforts, the total rises on average to

\(^9\) For example: Avengers, released in 2012, had a reported budget of $220 million (Stewart 2012); The Dark Knight, released in 2012, had a reported budget of $230 million (Fritz & Kaufman 2012); Disney’s John Carter had a $250 million budget and met a similar fate (Graser 2012).

\(^10\) For similar figures, see Vogel (2011) (stating that marketing costs can rise to $100,000 for a standard release and exceed $500,000 for a major artist); Allen (2010, p201)(stating that a label’s costs to “market and promote a single easily reach $1 million”).
$4,650,000 (IFPI 2011, p9). Those marketing efforts are directed in part to securing radio play, which remains the most important factor in attracting an audience and ultimately generating sales through physical or digital purchases (Krasilovsky & Shemel 2010; Thomson (2009, p.9); Vogel (2011, p.163); Caves (2002, p.149); Gordon (2011, p.143); Strobl & Tucker (2000); or, indirectly, concert ticket sales (Pitt 2010a, p.44)).

Additionally, assuming there is distribution into the physical market, some entity must bear the significant costs of manufacturing, warehousing, and distributing CDs to thousands of retailers (Hull et al. (2012, p.64)). Following industry custom, the distributors bear the risk of product failure since unsold items are usually returned to the label at full credit to the retailer (which historically occurs on average about 20% of the time) (Hull et al. (2012, p281)).

3.1.2.3 Books

For all books, printing, development, marketing and distribution costs require a large infrastructure for printing, warehousing and transporting physical copies. For books that enjoy significant promotional support, the publisher must incur additional material costs. The publisher must pay non-refundable advances to secure the author’s services, with no assurance that that investment will ultimately yield commensurate sales (Caves 2002, pp.143-36). To elicit interest from booksellers, the publisher must devote extensive resources to maintaining a large sales force and promoting books at national and regional book shows (Greco 2005, pp.177-84, 193). A full campaign to promote a new book through advertising, sales representatives, author appearances and securing book reviews and other press coverage can run between $500,000 and $750,000 (Caves 2000, pp.151-52). As in the music industry, the publisher usually bears the risk of product failure, given industry custom allowing booksellers to return to the publisher all unsold books at full credit (Caves 2002, p.149).

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11 Waldfogel (2012b) offers a dissenting view, arguing that artists are increasingly able to secure sales through exposure as a result of internet radio play and online social media.

12 These costs are significant: for every dollar spent on wages, a major label spends $40.37 in capital equipment (IBIS World 2012).
3.1.3 Financing Costs

All the activities mentioned above must be financed by the intermediary out of some combination of internal and external capital. External financing is not easy to obtain in cultural markets. The difficulty is two-fold: (i) there is little objective basis on which a production or distribution entity can commit to any expected rate of return or provide any reasonable assurance against project failure; and (ii) there are few tangible assets (other than intellectual property rights) that could be offered as collateral to secure outside financing. Illustrating these difficulties, independent film production companies often can only secure financing through a complex combination of secured receivables transactions (“foreign presales” that sell an interest in future expected income from theatrical exhibition or video sales in specific foreign territories) and high-cost loans from specialized lenders to fill the funding gap until release (Vogel (2011, pp.121, 155-56)). The cost and complexity of those types of transactions favor financing creative production through internal capital.

3.2 Production Risk

Virtually any creative goods market is a “hits market”: that is, the vast majority of products released are flops that result in a significant to complete loss while a small portion are hits that result in hefty profits, but, even in that case, usually do so only over a limited seasonal period. The most extensive empirical study of film releases finds that, for the period 1984-1996, only 22% of feature film releases (in the U.S. and Canada) were profitable; among the minority of profitable movies, 35% earned 80% of total profits; and, in the aggregate, 6.3% of all movies earned 80% of total profits (De Vany & Walls 2004, pp.1035-37). Similarly skewed ratios characterize the commercial fortunes of record albums. Based on Nielsen/Soundscan reports, out of 44,000 new albums released in 2008, the top 100 titles (equivalent to .2% of all releases) constituted 50% of total sales and the top 700 (equivalent to 1.5% of all releases) constituted 80% of total sales; out of the total pool of new releases, 81% sold fewer than 1,000 titles (Brae
(2009)). The same skewness characterizes the fortunes of new books and Broadway shows (Caves 2002, p119). These data drive toward a single conclusion. Any investor who elects to fund a commercial creative production is adopting a low risk of extremely high returns and a high risk of a complete loss. Critically, that means that, for all but the most risk-loving entities, an investment in any single creative production is economically irrational—that is, it promises a return that is less than normal expected profits.

3.3. Consumption Risk

Just as an investor in a creative production faces a high risk of production failure, a consumer who “invests” in a creative good faces a high risk of consumption failure. This derives from the fact that creative goods are experience goods—meaning, the value of the good is only revealed after consumption. To address this dilemma, intermediaries invest extensively in marketing, advertising and other promotional efforts to overcome consumers’ rational wariness concerning the claimed quality of any new release.

3.3.1. Imitative Consumption

Let’s distinguish between two types of consumers: (i) the naïve consumer who believes she has no independent means of assessing the value of a creative good, and (ii) the sophisticated consumer who believes she has such means. The interaction between these two consumer types drives the “bandwagon effects” often observed in cultural markets: the most sophisticated consumer group sets a consumption trend, which may be imitated by somewhat less sophisticated consumers, until the new fashion disseminates to the broadest and most naïve portions of the consumer pool. While most familiar in fashion apparel, these types of bandwagon effects have been identified

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13 In 1986, out of a total population of approximately 25,000 new hardbound trade titles, there were less than 200 best-sellers, which generated an estimated nearly $1 billion in sales out of a total of $1.7 billion. Put differently: less than 1% of all trade books published in 1986 accounted for almost 60% of total sales (Liebowitz & Margolis (2003)).

14 Since the value of the good is not objectively verifiable, this dilemma cannot be resolved by a warranty contract that would refund payment subject to consumer satisfaction (obviously, that contract would never result in a payment being owed by consumers, who would always claim to be dissatisfied).

15 For similar views, see Caves (2002, pp178-80, 185-86). For application of this type of model to the fashion market, see Barnett (2005).
in the case of record sales (Chung & Cox 1994) and film releases (De Vany & Walls 1996). The imperative to demonstrate the value of any new cultural good, and precipitate a bandwagon effect, explains the critical role played by marketing agents as well as independent third-party certifiers such as critics, best-seller lists in publishing, the “charts” in popular music, and awards ceremonies in all markets (Oscar’s in film, Grammy’s in music, Pulitzer’s in publishing, etc.).\footnote{For extensive discussion, see Caves (2002, pp189-200).}

3.3.2 The Star Vehicle

The “star” actor, director or other talent is a constant feature since the inception of mass-cultural markets. While cultural explanations abound, there is a simple economic explanation for the star’s persistence in mass-cultural markets. Suppose a consumer has no information with respect to the quality of two new movies, A and B. Suppose that movie A’s cast includes several stars who have previously appeared in high-quality films and movie B’s cast includes no stars. So long as the consumer associates the presence of a star with an increased likelihood of film quality (and the films are offered at the same price), she will select movie A. The consumer could use the star as a proxy for film quality on various grounds: (i) the presence of a star indicates a greater likelihood of film quality; (ii) the presence of a highly-compensated star indicates a strong belief by the studio in film quality; or (iii) the presence of a star with a large stock of reputational capital indicates a strong belief by the star in film quality. Whatever the underlying set of supporting beliefs, consumers’ use of the star as a proxy for the quality of the underlying creative good\footnote{The extent to which the presence of a star actually improves the likelihood of a successful release remains unresolved. Using a sample of 2000 films released from 1984 to 1996, De Vany (2004 §§ 4.3.2, 4.5.1, 4.5.2) finds that, on average, a star significantly increases a movie’s higher least revenue (that is, a star constrains the lower tail portion of the revenue distribution) and slightly increases a movie’s chance of making a profit, in each case relative to a movie without a star. This is consistent with other findings in the empirical literature showing that actors positively impact opening performance (Elberse (2007, p102, 120)), as well as popular observations in Hollywood that “stars help the movie to open”.} requires that the producer or distributor spend effort in acquiring the expensive services of star talent as a signal of project quality.
3.4 Why Creative Markets Are Always Intermediated

The high costs and risks of creative production account for a structural regularity of mature cultural markets: namely, a concentrated group of leading intermediaries that accumulate large portfolios of creative goods and dominate the financing and distribution of those goods. Conventional wisdom tends to ascribe this outcome to entry barriers or interfirm collusion. This skeptical view overlooks the efficiency role played by the large intermediary. The large intermediary performs three functions that are critical to the efficient operation of mass-cultural markets. First, economies of scale and learning in production, marketing and distribution favor locating those functions in entities that repeatedly undertake the non-creative tasks required to deliver a creative good to market, do so over a large volume of releases, and have bargaining leverage to obtain favorable terms from third-party suppliers of required inputs. Second, holding a broad portfolio of creative properties improves the likelihood of a positive aggregate return by setting off the losses on flops against the gains on a few hits. By contrast, an artist holds an undiversified portfolio of creative properties (Landes & Posner 2003, p.38). It is instructive to note that, prior to the development of mass markets for book publishing, authors were often required to secure subscriptions in advance of a print run (Erickson (1996)), suggesting that no intermediary was sufficiently large or diversified to assume the risk of commercial failure. Third, large entities that generate internal cash flow from a copyright portfolio can finance future creative productions at a lower cost relative to any source of external capital, which is challenged by the informational uncertainty inherent to any individual creative project. Intermediaries that successfully execute these functions are richly rewarded and, at the same time, generate revenues that sustain professional artists who deliver a rich array of cultural products to millions of users through the intermediary’s distribution and marketing pipeline. For purposes of illustrating these arguments, I examine below three paradigm cultural intermediaries: the movie studio, the record label and the book publisher.

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18 For a fuller discussion, see Caves (2002, pp.157-160).
19 For other evidence that U.S. publishing suffered from a lack of capital and risk-bearing capacities, see Charvat (1959, pp42-43).
3.4.1 The Movie Studio

From the inception of the Hollywood film industry, large studios have occupied a central position in the industry’s production and distribution infrastructure. In 2011, six major studios (Warner Bros., Disney, Twentieth-Century Fox, Sony, Paramount and Universal) accounted for an estimated 90% of domestic box office revenues (Vogel 2011); in 1939, five major studios and three smaller studios accounted for 85% of the feature films released that year (Huettig (1944, p.87). The persistence of the large studio is neither nefarious nor accidental. The scale and scope of the Hollywood studio enhances its ability to fund the costs of film production through internally-generated cash flow or external financing secured by the studio’s intellectual property portfolio, to generate economies of scale in distribution and marketing, and to hedge against the risk of failure on any individual project.\(^{20}\) Additionally, the major studios are subsidiaries or divisions of larger parent organizations, which can further diversify the risk of project failure. This combined cost-spreading, financing and risk-diversification function reached its apex during the studio system (roughly, the late 1920s through the late 1940s), at which time the studios were fully integrated from talent through theatrical exhibition. While the studios are no longer active in exhibition and do not typically enter into long-term contracts with talent, they continue to dominate distribution and fund a portfolio of projects that diversify the risk of failure on any single project.

3.4.2 The Record Label

From the 1930s through the present, a handful of major firms have usually dominated the sound recording market (Hull et al. 2011, pp.171-72). In 1948, the top eight firms accounted for 95%, and the top four firms accounted for 81%, of all releases that placed in the “weekly top 10” Billboard singles charts, although these figures had declined, respectively, to 58% and 34% by 1959 (a consequence of the “rock and roll revolution”

\(^{20}\) This hedging effect is reflected literally by cross-collateralization clauses in producers’ contracts, which sometimes specify that a producer is only entitled to a share of the profits once the film’s revenues have been allocated to cover both the costs of that particular film as well as a certain portion of the costs attributed to other films (Vogel 2011, p.123).
During the 1960s and 1970s, the industry re-consolidated so that, as of 1980, the top four firms accounted for 76.5% of the Billboard “Top 100” album charts; as of 1998, the Big Four (Warner Music, Sony Music, EMI and Universal) controlled 89.4% of the album charts; and, as of 2008, the Big Four controlled 70.3% (Hull et al. 2011, p.171). Since the merger between Universal and the recorded-music division of EMI in 2012, the remaining “Big Three” now control 89% of revenues from recorded music in the U.S. market\textsuperscript{21} and are responsible for the promotion and distribution of nearly every major recording artist (Krasilovsky & Shemel 2010, p.277; Compaine & Gomery 2000, pp.340-44). Like the movie studio, the record label enjoys scale economies, access to capital (Pitt 2010a, p.11); risk-diversification (Shultz 2009), and unique know-how in production, marketing and distribution (Compaine & Gomery 2000, p.327)\textsuperscript{22} and is usually an affiliate of a larger parent organization that offers supplemental risk-diversification and financing capacities.

3.4.3 The Book Publisher

Historically the book publishing industry has not exhibited the same concentration levels observed in other creative markets, although concentration has still been significant. Since the early 1960s, consolidation has accelerated so that, as of 2006, the six largest U.S. trade book publishers accounted for almost 90% of total sales and the top four accounted for almost 75% of that total (Arris & Bughin (2009, p.84, Tbl 5.1)). Today that leading group has been reduced to five large publishing houses (each of which is part of a larger media conglomerate) (Pfannier & Chozick 2002). As in the film and music industries, publishers maintain a large inventory of previously released works (the “backlist”) (Greco 2005, p.121). The scale and cash reserves of a large publishing operation assist in supporting the capital-intensive printing, marketing and distribution efforts required to produce a best-seller. Those efforts include: (i) the capital required to bear the cost and risk of an initial large printing, which provides a signal of confidence to the market in generating initial sales; (ii) the large and non-refundable cash advances

\textsuperscript{21} Author’s calculations based on year-end 2011 data, see BusinessWire.com (2012).
\textsuperscript{22} On record labels’ ability to pool risk, see Schultz (2009).
required to attract best-selling authors; and (iii) the efforts made to secure attractive display space or other favorable terms from a limited group of national retail booksellers (Compaine & Gomery 2000).

4. Copyright Without Creators
The traditional critique argues that copyright law does not take into account the non-profit-motivated incentives of some or even most artists. If that were true, then the copyright system chronically overrewards cultural production. While evidence for the “romantic artist” proposition is tenuous, I will provisionally accept it and show that there nonetheless remains a robust economic case for copyright as an instrument for supporting mass-cultural markets. (*A fortiori* the “true” case for copyright is even stronger if a more nuanced behavioral model were adopted that attributed some profit-seeking motivation to artists.) Assuming for the sake of argument that artists require no significant monetary inducement to invest in creative production, it still is the case that copyright supports investment by intermediaries who supply critical services to fund and commercialize creative works on a mass scale.

4.1 Theory
The intermediary-based theory of copyright follows a simple logical sequence. Intermediaries incur significant capital costs and risks in funding cultural production and distribution on a mass basis. Intermediaries are clearly profit-motivated. Without the ability to secure supracompetitive profits on the few hits in a portfolio constituted mostly by losses, the intermediary will decline to fund those costs and bear those risks and will shift some or all of its resources to other activities. Without the intermediary, a critical gap therefore arises in mass-cultural markets. There is then no entity willing or able to fund the non-creative and capital-intensive tasks required to deliver a creative good to market. Even if it were conceded for the sake of argument that artists require little profit incentive and incur limited capital costs, the conventional incentive case for copyright remains robust.
4.2 Re-Understanding Copyright Law

The intermediary-based theory of copyright might seem to run counter to the stated objectives as well as the history of the copyright system. The founding documents of the modern statutory forms of English and U.S. copyright law—respectively, the Statute of Anne (1710) and the Intellectual Property Clause of the U.S. Constitution (1787)—explicitly provide for legal protections for “Authors” and, in the case of the Statute of Anne, explicitly shift those legal protections from a publishing monopoly (the Stationers’ Company) to authors. If we “back-date” the modern copyright system to the charter granted to the Stationers’ Company in 1557 (effectively, a form of collective copyright), then this tension between history and theory diminishes. That tension largely disappears if we adopt the view of Coase (1960) that, subject to transaction-cost constraints, the initial distribution of property rights is immaterial from an efficiency perspective. Whatever the initial allocation, property rights will migrate through contractual and other private agreements to the most highly-valuing users. So too with copyright. So long as copyrights are freely assignable, the fact that copyright initially vests in an individual author will have little effect on the ultimate allocation of those copyrights, subject to transaction-cost frictions.23 Given the risk-diversification and internal-financing imperatives that characterize mass-cultural markets, it would be expected that authors would transfer some if not all of their interests to intermediaries who are best-positioned to finance the non-creative tasks required to realize the commercial value of the underlying creative works through dissemination in the market. Even assuming a romantic author who is solely interested in fame or broad distribution, we would expect that any such transfer of rights would be demanded by an intermediary, who would be unwilling to incur the distribution and other costs without having secured ownership rights in the various elements making up the creative work. That is of course the case: musicians contract with record labels, screenwriters contract with studios, authors contract with publishers, and so on. The result: the large

23 For similar thoughts, see Hardy (1988, pp.183-85); Birnhack (2009, pp.133-34).
intermediaries that cultivate and promote creative works on a mass scale usually hold full or partial interests in the copyrights relating to those works.

The intermediary-based theory of copyright delivers explanations for certain features of copyright law that otherwise resist explanation from a public-interest perspective. Given that inexplicability, copyright scholars tend to conclude that those features have little social justification and largely reflect the political influence of large media interests. But the case is not so clear. At a minimum, there is a plausible optimistic interpretation of copyright history: an increasing expansion of the copyright system starting in the mid-19th century secured intermediaries’ ability to amass portfolios that insure against the vagaries, and self-finance the costs, of mass-cultural production and distribution. Even the most holder-friendly elements of the copyright regime can be justified as a necessary tool for inducing intermediaries to perform the non-creative functions without which a mass-cultural market cannot achieve the broad access to a mass market sought by artists and the broad access to cultural output sought by users. It is true that these same elements enable intermediaries to earn rents over and above the variable costs required to deliver a single creative work into the market. But those rents only count as a “true” social cost provided there is some less socially-costly mechanism to induce those intermediaries or some other entity to fulfill the required set of financing, production and distribution functions. Mature markets overcome the high risk, and bear the high costs, of mass-cultural production through a portfolio-diversification and self-financing strategy secured by a combination of copyright and technological means to establish exclusivity over the underlying pool of creative works. The result is not just the generation of rents for the intermediaries who hold and manage these copyright portfolios, which rewards them for bearing those risks and costs, but a screening, production and distribution infrastructure that has cultivated and disseminated cultural products to an extent never previously imaginable.
4.2.1 Subject Matter

As shown below, the federal copyright system has been extended over time to an increasingly large number of media. From an intermediary-based perspective, this often-maligned expansionary trend appears presumptively to be an efficient development. Any capital-intensive technology of mass cultural production, distribution and marketing requires that some entity bear the costs and risks of screening, producing and distributing cultural content. It would therefore be expected that the intermediary’s private interest in influencing the state to expand copyright to cover a novel production or distribution technology and the public’s interest in financing and bearing the costs and risks of producing and distributing content through that technology at the lowest cost possible would go hand in hand. Maximizing the intermediary’s incentives to finance, and insure against the risk of, cultural production and distribution on a mass scale promotes artists’ ability to disseminate cultural output as well as the public’s access to that output.

Table I: Historical Expansion of Federal Copyright

<table>
<thead>
<tr>
<th>Year</th>
<th>Extension</th>
</tr>
</thead>
<tbody>
<tr>
<td>1831</td>
<td>Musical compositions</td>
</tr>
<tr>
<td>1856</td>
<td>Dramatic works</td>
</tr>
<tr>
<td>1865</td>
<td>Photographs</td>
</tr>
<tr>
<td>1870</td>
<td>Paintings, statues, certain designs</td>
</tr>
<tr>
<td>1909</td>
<td>Phonorecords (subject to compulsory license)</td>
</tr>
<tr>
<td>1912</td>
<td>Motion pictures</td>
</tr>
<tr>
<td>1972</td>
<td>Sound recordings</td>
</tr>
</tbody>
</table>

Following a good deal of conventional wisdom, any expansion of intellectual property rights is a zero-sum event that expands copyright holders’ pricing power to the

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detriment of users who then have limited access to the underlying pool of cultural works. While that is certainly a possible outcome, it is not a necessary outcome. Whenever copyright is the least-cost means of appropriating returns on the production and distribution of creative output, it can result in incremental output gains that far exceed any incremental limitations on access to the underlying pool of creative works. A well-documented but little-known episode illustrates this possibility. In Western Europe, musical compositions were unprotected by copyright until the early 18th century in England and as late as the early 19th century in Germany and Austria, then centers of classical music composition (Scherer 2004). Concurrently with those changes in copyright protection, composers shifted their allocation of time and labor in a manner that increased public access to musical works. Prior to the extension of copyright, leading composers had tended to focus on operatic production for a small elite population. This cultural choice had an economic rationale. Unlike musical compositions that could be (and were) freely copied, a live performance is an inherently excludable good to which composers could regulate access and extract a premium. Following the extension of copyright to musical compositions, composers could move safely into the broader market and (as befits a profit-maximizing artist) shifted their efforts to the production of chamber music that could be sold as sheet music to the far broader population of consumers who played music at home (Scherer 2004). The result: extending copyright altered the allocation of creative labor in a manner that improved access, thereby yielding both efficiency and distributive gains. While expanding property rights happened to promote the economic interests of composers and the sheet-music publishers, it resulted in an almost certain net welfare improvement for the broader listening public.

4.2.2 Duration

The long, and periodically extended, term of copyright has been the object of much critique. Currently that term is set at the life of the author plus 70 years for any work created after January 1, 1998 (17 U.S.C. § 302 (2006)). Legal scholars and economists
have persuasively argued that, using a discounted present-value analysis, the current term cannot have any plausible marginal incentive effect on creative production as compared to a significantly shorter term (Brief of George Akerlof et al. 2002). But this critique does not address the “hit market” characteristics of a creative goods market and the portfolio strategy that is required to sustain big-budget investment under a low probability of project-specific success. Recall the predicament of an intermediary who accumulates a diversified portfolio of creative properties: it must generate sufficient returns on a small number of successful creative releases in order to cover the losses on a much larger number of unsuccessful releases. Among those hits, there is an even smaller population of releases that are “classics” for which demand persists beyond a single season. Classics (or, in industry terms, the “backlist”) promote a risk-diversification strategy by delivering a reliable income stream that can be used to fund new creative projects, cultivate related projects inspired by classic releases, and offset the losses on new unrelated projects. Given that fact, any extension of copyright protection inherently reduces intermediaries’ cost of capital, thereby improving intermediaries’ capacity to fund, distribute and market new creative projects. This is not to say that term extensions necessarily result in a net welfare improvement, but it is not an inherently implausible contingency as has been almost universally alleged. While a long duration has little justification if construed as a mechanism for inducing marginal investments by a single author in preparing a single artistic work, it can be plausibly justified if construed as a mechanism for inducing investment by an intermediary in

25 The paucity of classics is reflected in part by the fact that, when renewals were required to maintain the term of a copyright, only a small percentage of works were renewed despite a low fee (Rappaport (1998)).
26 One report finds that record labels’ catalogs can generate expected cash returns of 7-20% annually (Satariano 2009).
27 This concern was particularly salient at the time of the most recent extension of copyright—the Sonny Bono Copyright Term Extension Act, enacted in 1998. As evidenced in the legislative history, one of the stated motivations behind the extension was to enable U.S. copyright holders to enjoy a recent term extension under European copyright law. U.S. copyright holders would not have been protected in Europe after expiration of the then-shorter term under U.S. copyright law. The U.S. term extension therefore both directly and indirectly enhanced the internal financing capacities of U.S. distribution intermediaries, who derive a large portion of their revenues from foreign markets. I thank Paul Goldstein for bringing this point to my attention.
28 For exceptions, see Liebowitz & Margolis (2003); Landes & Posner (2002).
accumulating a portfolio of artistic works from multiple sources to insure against project failure and generate cash flows that fund future production and distribution activities.

4.2.3 Derivative Rights

The costs and risks of cultural production can be mitigated both temporally, by extending the term, and spatially, by expanding the cultural territory over which a property right extends. Spatial risk-diversification is enabled most directly by Section 106(2) of the Copyright Act, which entitles the copyright owner to claim infringement with respect to derivative works “based upon” the copyrighted work. The derivative works provision gives copyright holders a potentially wide territory over which to assert their copyright, including abridgements and sequels as well as a loosely defined body of adaptations of the original work. The derivative right is probably a close runner-up to the extended term for the most vilified feature in the U.S. copyright system. Following an author-based view of copyright, the derivative right seems to result in excessive windfalls to lucky authors and prompt queries such as: did J.K. Rowling really write the original Harry Potter novel because she foresaw the ability to license the Harry Potter property to Warner Bros. for a film, to Disney for a Harry Potter amusement park ride, and to Mattel for Harry Potter action figures?29 No, she almost certainly did not. If that is the case, then the derivative right is an unjustified transfer of rents from consumers to authors that could be scaled back or eliminated consistent with copyright’s incentive function. But the relevant question is: did the publishers of the Harry Potter novel, the makers of the Harry Potter movie, and the merchandisers of the Harry Potter action figures foresee those possibilities? Of course, those intermediaries clearly did foresee those extensions and would not have funded those capital-intensive undertakings without the ability to secure exclusivity over those extensions of the original work.

From an intermediary-based perspective, it makes perfect sense that derivative rights expanded in tandem with the historical expansion of markets for the mass distribution of creative content. Starting in the mid-19th century, courts began crafting

29 This type of objection is pursued at length in Balganesh (2009, pp.1589-91).
a common-law derivative right\(^{30}\), which was later codified by amendments to the copyright statute in 1870\(^{31}\) and, most dramatically, in 1909\(^{32}\), followed by clarifying language added in 1976.\(^{33}\) The 1909 Act, situated right at the inception of modern mass cultural markets, allocated to the copyright holder the right to control translations, dramatizations of nondramatic works, novelizations of dramatic works, and arrangements of musical works, among other adaptations.\(^{34}\) As capital requirements and financial risk increase, intermediaries demand derivative rights to spread those costs and risks by applying any successful creative work in various media and extending it in sequels and other variations, each of which contributes to the aggregate revenue stream flowing from the occasional successful release.\(^{35}\) Contrary to commonly-expressed views that the derivative right overrewards creators and stifles innovation (Nadel (2004); Balganesh (2009, pp.1590-91)), it provides an incentive for profit-motivated intermediaries to undertake the costs and risks of developing, marketing and distributing a large pool of original and follow-on products.


\(^{31}\) Act of July 8, 1870, ch. 230, §86, 16 Stat. 198, 212 (extending copyright to dramatizations and translations); Act of Mar. 3, 1891, ch. 565, 26 Stat. 1106 (clarifying that copyright extends to dramatizations).

\(^{32}\) Copyright Act of 1909, c. 320, §1(b), 35 Stat. 1075.


\(^{34}\) 17 U.S.C. §1(b) (repealed 1976).

\(^{35}\) Nadel (2004) argues that the derivative right, and the associated expansion in expected profits on a blockbuster hit, induces copyright holders to favor popular works over more “economically marginal” works. There are three vulnerabilities in this argument. First, it is unclear why reducing total expected returns (by weakening copyright) would lead producers to favor “economically marginal” works. The opposite would seem to be the case given that producers would then favor the lowest-risk projects that appeal to the broadest population; conversely, expanding expected returns (by increasing copyright) provides producers with additional profits that can be invested in higher-risk “artistic” projects that appeal to niche audiences. For similar views, see Goldstein (1990-91, p113). Second, the winner-take-all nature of mass-cultural markets would persist even in the absence of copyright, given that it is largely attributable to low-cost reproduction technologies (which undermine the commercial value of all “runner-up” artists) and the evaluation difficulties inherent to experience goods (which induce consumers to use stars as a proxy for quality). Third, available evidence largely rejects the widely-shared intuition that concentration suppresses cultural diversity. See Alexander (1996) (finding that moderately concentrated creative markets exhibit greater product diversity relative to both more and less concentrated markets); Alexander (1997) (same); Einstein (1994) (finding that programming diversity in network television remained largely unchanged after repeal of the “financial interest and syndication” rules, which resulted in further industry consolidation); Lopes (1992) (finding no relationship between market concentration and product diversity in the popular music market).
4.2.4 Corporate Ownership

The copyright regime deviates most sharply from an author-based view of copyright, and is most consistent with an intermediary-based view of copyright, in its ownership provisions. In particular, the copyright act provides that ownership of a copyright initially vests in an individual author (or authors) (17 U.S.C. § 201(a)) but then qualifies it in three respects that facilitate the assertion and transfer of ownership interests in copyright by corporate (or other “non-author”) entities. There are three avenues by which a corporate entity can assert ownership over a copyright: (i) in the case of an author who is acting within “the scope of employment”, the employer-firm is deemed to be the author; (ii) in the case of a work that is prepared by an independent contractor for a client-firm and falls into certain enumerated categories, the firm is deemed to be the author so long as the author recognizes that fact in writing (a so-called “work-made-for-hire” acknowledgement); or (iii) the firm is the assignee if the individual author assigns his or her copyright interest to the firm (17 U.S.C.s. 201). Following an author-based view of copyright, these provisions might be viewed as evidence of the distortionary influence of media interests that enable intermediaries to wrest control from artists and amass intellectual-property holdings that stifle subsequent creation. Under an intermediary-based approach, this interpretation is almost entirely reversed. Facilitating the ability of corporate entities to acquire secure ownership interests in creative properties facilitates intermediaries’ ability to acquire portfolios that spread the costs and risks of mass cultural production.

In an under-discussed article, Prof. I. Trotter Hardy showed how this rationale drove the holder-friendly approach to ownership under the 1909 Act, which established employer ownership as a presumption. Even after the qualified work-made-for-hire provision described above was adopted by the 1976 Act, courts in disputed-ownership

36 For similar observations, see Bracha (2008, pp.248-49); Lemley (1996, pp.882-83).
37 For a description of this type of criticism expressed during deliberations over the 1976 revision to the Copyright Act, see Van Houweling (2010, p.606).
38 For related thoughts, see Birnhack (2009, pp.128-31).
39 Historical research shows that the 1909 Act’s presumption codified judicial tendencies that predate the Act (Fisk (2003)).
cases tended to side with the larger entity that was in the best position to exploit the copyright (Hardy 1988).\footnote{Note that Hardy’s study was limited to cases adjudicated through 1987. The governing decisions on joint authorship in the prominent Second and Ninth Circuits, both of which have been issued since the period covered by Hardy’s study, are consistent with this trend: both set standards that generally assist large intermediaries in defending against claims of joint authorship by non-employee contributors. \textit{See Aalmuhammad v. Lee}, 202 F.3d 1227 (9th Cir. 1999); \textit{Childress v Taylor}, 945 F.2d 500 (2d Cir. 1991).} The intermediary’s interest in being able to cultivate a creative release also explains why the enumerated categories in which a corporate entity can establish ownership through the “work made for hire” option under the 1976 Act are all multi-component works (e.g., a motion picture) with respect to which a firm could be exposed to opportunistic hold-up claims by contributors of minor elements that cannot be easily removed from a larger creative package.\footnote{17 U.S.C. §101 (2006) (defining “work made for hire” as “a work specially ordered or commissioned for use (1) as a contribution to a collective work; (2) as a part of a motion picture or other audiovisual work; (3) as a translation; (4) as a supplementary work; (5) as a compilation . . . “). On the manner in which the work-made-for-hire provision enables publishers to avoid fragmentation of rights over a single creative work, see Van Houweling (2010, p.598).} Rather than transferring rents to corporations to the detriment of any plausible social interest, the ownership provisions in the copyright statute discourage hold-up by individual contributors and reduce the transaction costs incurred by intermediaries in assembling a diversified portfolio of cultural properties.

### 4.2.5 Divisibility and Assignability

The most robust form of a property entitlement has two fundamental features: (i) it excludes all unauthorized uses; and (ii) it is freely assignable to any other party. Under the 1909 Act, copyright law had implicitly restricted the divisibility and assignability of copyright by (i) treating as a license any assignment that covered less than the full bundle of “copyrights” pertaining to a particular work, and (ii) providing that a licensee had no independent standing to sue for infringement of the licensed interest.\footnote{See Act of Mar. 4, 1909, ch. 320, s 42, 35 Stat. 1075, 1084; see also 3 Nimmer & Nimmer §10.01 [A] (2010) (stating that the rules on assignment and divisibility made it “impossible to assign anything less than the totality of rights commanded by copyright”).} Although ameliorated by judicial modifications (3 Nimmer & Nimmer §10.01[A] (2010)), those limitations inflated the cost of acquiring copyrights and drastically limited
transactional freedom by effectively coercing sellers and buyers to transact in bundled creative assets in order for transferees to acquire maximal certainty of legal ownership. The 1976 Act liberalized the market for creative properties through two principal changes. First, it established the principles of “unlimited alienability of copyright” and “divisibility of copyright” (17 U.S.C. §201(d)(1)-(2); 101), thereby enabling the free assignment of any interest, whether full or partial, in a copyright-protected property. Second, it clarified that exclusive assignees were deemed to be owners with the ability to bring an infringement cause of action (17 U.S.C. §101 (2005); §201(d) (2005)).

The free assignability and divisibility of copyright interests is an overlooked and vital ingredient behind the copyright system’s contribution to the formation and functioning of efficient markets for creative works. To appreciate this point, it is important to observe that mass-cultural works are often multi-component products that must be assembled by combining cultural inputs from various sources. This packaging task is undertaken by the brokers, agents, producers, managers and attorneys employed or retained by distribution and production intermediaries in mass-cultural markets. For this purpose, the exclusivity assured through robust copyright is critical. In particular, the unqualified assignability and divisibility of copyright interests enhance intermediaries’ ability to maximize the commercial value of a creative property by segmenting it into multiple interests and then distributing those interests over different time-periods, in different media, and over different geographic territories.

These segmentation strategies have three functions. First, as illustrated by the film industry, breaking up a creative work into multiple interests facilitates external financing by enabling an intermediary to “pre-sell” those interests to outside equity investors, distributors and other parties. Second, these strategies “smooth” the revenue stream flowing to an intermediary by extending the life of a creative work from the point of initial distribution through subsequent iterations. Third, these strategies segment the total consumer population and enable the intermediary to extract consumer surplus at each point on the demand curve. That not only benefits the

intermediary but operates to the potential advantage of two groups: (i) artists, because intermediaries then have greater funds available to fund new projects\textsuperscript{44} and (ii) lower-income users. While price-discrimination operates to the disadvantage of the highest-valuation (and usually, wealthier) consumers at the top end of the demand curve (from whom consumer surplus is transferred and converted to producer surplus), it tends to advantage lower-valuation (and usually, poorer) consumers at the bottom end of the demand curve, to whom content would otherwise not be supplied at all if only a single uniform price were charged.

5. Do Intermediaries Still Matter?

Even if all of the foregoing is accepted, the intermediary-based approach could be dismissed as an adequate but mostly historical explanation for a model of cultural production that prevailed in a “post-Gutenberg” but “pre-digital” technological environment. Much of the evidence described above to support an intermediary-based approach to copyright describes a physical production and distribution infrastructure that has been partially bypassed by digital production and distribution technologies. Production and distribution costs have fallen dramatically in some media (with a notable exception being the motion picture industry) and the skills required to produce and distribute creative goods are more widely distributed due to revolutionary advances in editing, copying and dissemination technologies. Based on those developments, some commentators have asserted that the conventional role of the financing and distribution intermediary in creative markets is diminished or even obsolete (Ku 2002; Zimmerman 2003; Price 2012). If the production and distribution functions formerly carried out by intermediaries are no longer capital-intensive or skills-intensive, then artists can carry out those functions independently at a feasible cost and the conventional intermediary’s distribution and financing functions are redundant. If that is the case, then the intermediary-based case for copyright (or at least, strong copyright) reduces to

\textsuperscript{44} For similar thoughts, see Landes & Posner (2003, p.39); Fisher (1998, pp.1237-39).
a largely academic account of an important but limited period in the history of cultural production. I call this argument the “disintermediation thesis”.

In this Part, I show that the intermediary-based case for copyright survives the advent of low-cost, high-quality digital technologies for cultural production and distribution, but with some important qualifications that usefully clarify the proper scope of that argument.

5.1 The Disintermediation Thesis
The disintermediation thesis relies on the assertion that the costs incurred to produce and deliver a creative good to market have fallen dramatically. Precisely, it requires that artists can execute each required task in the creative supply chain at a lower cost relative to paying the implicit fee demanded by a conventional intermediary for executing that task. Closer scrutiny shows a more complex picture. Production and commercialization costs have fallen to different extents across different media and, within each medium, at different stages of the production, distribution and marketing process through which a cultural good travels from artist to market. Even in markets where production and distribution costs have fallen significantly, there is no decline, and arguably an increase, in the screening and marketing costs required to identify high-value content and to persuade end-users of the value of consuming those items.

5.1.1 Production and Distribution Costs
The extent to which production and distribution costs (where the latter is defined narrowly to exclude marketing or other promotional costs) have fallen as a result of digital technologies varies considerably across different media and even within the same medium.

5.1.1.1 Motion Pictures.
In the case of film, production costs remain high for motion pictures intended for broad theatrical exhibition, which continue to require multi-million dollar budgets that are
beyond the wherewithal of an individual and often, even a single production company. Currently, the trade press regularly reports that major feature films have production and distribution budgets at or exceeding $200 million (for example, *Iron Man 3*, released in 2013 ($200 million), or *Pirates of the Caribbean: At World’s End*, released in 2012 ($300 million)).

5.1.1.2. *Music.*

In the case of music, production and distribution costs for some genres now fall within the budget of many artists. Reasonably high-quality recording and editing of musical works can be achieved using equipment and software costing approximately $1000 (Davis & Laing 2006). The recording can then be distributed either (i) at no cost, through an online intermediary without a sales function (e.g., YouTube) or (ii) on a commission basis through an online intermediary for purposes of sales (e.g., CD Baby or Tunecore), which then distributes it through heavy-traffic internet intermediaries such as iTunes or Amazon. While these services enable the artist to distribute directly without the services of a traditional record label, this is hardly a costless option. The artist must forfeit the majority of all revenues to the “wholesale” and “retail” intermediaries: 25% to an upstream distribution service such as CD Baby or Tunecore plus 30-40% to a downstream intermediary such as iTunes. Additionally, without the cash advance funded by a traditional record label, the artist must cover the cost of musical instruments and, even assuming a “romantic” behavioral profile, the artist’s cost of living assuming no other source of income.

45 Source: Box Office Mojo.com.

46 Some sources indicate that recording costs are higher in genres that involve complex arrangements that necessitate the assistance of a professional production engineer (Gordon (2011, p.280)).

47 The commission assessed by end-user internet intermediaries (e.g., iTunes) depends on the distributor counterparty. Trade commentary often mentions that iTunes and similar websites give preferential terms to major labels (see, e.g., Christman 2011).
5.1.1.3 Books.
The costs of publishing and distributing a book in electronic or print format through a self-publishing service are manageable and, so long as the print run is small, probably fall within the budget of many authors (Carnoy 2012). These observations must be qualified by several cost categories. First, costs remain high for a large-scale print distribution, which continues to require the physical infrastructure of a major publisher and retail bookseller. Second, even assuming a romantic behavioral profile, the author’s cost of living must be covered assuming no other source of income. Third, as Mosoff (2013) shows, editing and other logistical costs remain significant for academic journals, which rely on an extensive editing and distribution infrastructure established and maintained at considerable cost by the publisher. That point can be generalized to other textual genres that demand significant editing costs to ensure accuracy, achieve certain levels of visual presentation or other quality-control reasons.

5.1.2. Screening and Marketing Costs
Suppose that in a given market production and distribution costs have fallen sufficiently such that an individual artist has no reason to use the services of a conventional intermediary—or at least, would only be willing to do so at an appropriately discounted rate to reflect the narrowed gap between external and self-production and distribution. The disintermediation thesis still stands in doubt. That is because it ignores a cost category that is not altered, and is arguably exacerbated, in a digital environment. Even assuming zero distribution costs (as could be the case for an online-only distribution outside of film), the artist must still attract consumer interest that could be diverted to the millions of other works available for online consumption. The overwhelming majority of artists fail to do so. This fate is especially likely to befall a new artist who has no brand capital by which to signal quality to uninformed consumers.\footnote{Zimmerman (2003) similarly recognizes that, even in digital publishing markets, intermediaries are required to “match readers willing to pay with authors willing to write”.
} Accumulating brand capital requires funding to undertake the necessary marketing activities, which explains why even the most successful independent production companies in film and
music must contract with the “majors” for these services (Carnoy (2012); and, with respect to music, Statement of Martin Mills (2012); and Pitt (2010a, p.153)). A record label undertakes promotional tasks that are beyond the wherewithal of an individual or smaller entity: marketing expenditures often approach $100,000 for a standard musical release and can exceed $500,000 for a major artist (Vogel 2011, p.260). In particular, as smaller labels ruefully observe, the major label continues to exhibit an unequaled capacity in securing radio play (and, as a result, major labels were the source of 75%-85% of the songs played on the radio during 2005-08) (Thomson 2009, pp14, 20-21).

Both the film and music markets repeat past and current experiences of self-published authors in the literary market: even when a self-published author made an initial breakthrough, contracting with a large publisher was ultimately required to achieve the marketing exposure that catapulted the author to stardom in the broader market. This reliance on a capital-intensive marketing infrastructure is not an accidental peculiarity of mass entertainment markets—as I argue immediately below, it derives logically from the economic characteristics of cultural markets and is exacerbated in digitized cultural markets.

5.2 The Persistence of the Superstar Effect

A much-discussed thesis proposes that “superstar” effects—that is, the dominance of a small number of hits in cultural markets—would decline in online cultural markets. That

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49 These promotional tasks include: (i) producing a music video (which involves costs beyond the budget of most individuals (Davis & Laing (2006, p.210)); (ii) promoting music to music critics, and hundreds of radio shows and other media outlets; (iii) bulk buying of advertising on television; and (iv) negotiating on a bulk basis with online retailers and other online distribution services (Statement of Martin Mills 2012).

50 The percentage share of large labels approaches 90% in the “AAA Commercial” programming format—that is, commercial “pop” music stations. The percentage share for non-major (“indie”) labels only declines relative to the average in the Country and AAA Noncommercial (e.g., college radio stations) formats (Thomson 2009). Waldfogel (2012b) finds that independent labels have garnered an increasing share of radio play on Internet radio stations for the period 2006-2011.

51 For a current example, see Grossman (2009) (reporting that unknown author attracted attention by self-publishing and then secured contract with a traditional publisher to promote the book heavily). For older examples, see Bowker (1996, p.30) (describing success of Christmas Story and The Celestine Prophecy, best-sellers that were self-published in 1993 and 1994, respectively, and then widely distributed by conventional publishers in 1995).
thesis predicts that low-cost technologies for digital distribution would generate a “long tail” effect that enables marginal cultural products to secure an audience, as contrasted with the dominance of a small number of hits in historical cultural markets mediated by conventional intermediaries (Anderson 2006). The logic seems cogent: infinite “shelf space” in digital environments expands the choices available to consumers, who then select niche products that had formerly been neglected by the major labels and retailers. But evidence to date is not supportive. While the number of titles available to users increases, the clustering of users around a small number of hits is just as, and sometimes even more, skewed in digital environments as compared to the physical market.

Several studies reach this result in different media. Based on data of online video sales, Elberse & Oberholzer-Gee (2007) found that, for the period 2000-2005, there was a modest “long tail” effect in the home video market insofar as the number of titles that sell only a few copies each week almost doubled; however, the number of titles that never sell a single copy quadrupled and there was a powerful superstar effect insofar as an even smaller number accounted for the best-performing titles. Another study reviewed sales data from Nielsen SoundScan, which gathers information on weekly purchases of music through online and physical retailers, the online music service Rhapsody, and the Australian DVD-by-mail service Quickflix (Elberse 2008). The result in every market: demand for blockbuster releases showed strong growth while demand for niche products remained weak.52 Another study examined royalty fees paid by ASCAP during the first quarter of 2007 to publishers and composers for public performances of their work; it found that the skewed distribution of royalty payments in favor of a small number of top-selling copyright holders had persisted during the online period.53 Other studies of paid music consumption on iTunes and unpaid music consumption through file-sharing networks find a dominant superstar

52 To be precise, the findings tend to indicate that the “tail” of the demand curve lengthens but flattens – that is, there are more purchases of niche products but those products are usually only purchased once or twice – while the “head” of the curve becomes even “fatter” – that is, there is even more intense clustering around a small number of hits (Elberse 2008).

53 See Pitt (2010a, pp. 112, 116-117); Pitt (2010b).
effect in which a small portion of total music files represent the bulk of all downloads while the vast majority is never purchased or listened to at all.\textsuperscript{54}

Why would the superstar effect persist and even intensify in markets in which the costs borne by users to access lesser-known releases, and the costs borne by retail distributors to hold those releases in inventory, would seem to have been reduced? This paradoxical result can be attributed to the abundance of content and the scarcity of consumers’ time and ability to evaluate the quality of that content. In a digital environment, consumers’ screening and evaluation burden rises given the abundance of content, which increases due to (i) the reduction in production and distribution costs, and (ii) the ability to enter the market without obtaining funding from, and thereby undergoing screening by, a sponsoring intermediary. In short: lower entry costs for artists imply higher search and evaluation costs for users. Contrary to the expectations of the long tail thesis, those cognitive costs inflate the importance of star properties in digitized content markets. Consuming star properties that are implicitly endorsed by other consumers is an efficient means by which to reduce search and evaluation costs in an environment in which content is abundant and quality is difficult to evaluate. Users’ increased cognitive burden in digitized content markets preserves and even expands the screening and persuasion function of cultural intermediaries. A sponsoring intermediary enjoys economies of scale and learning in filtering the undifferentiated mass of creative content. As such, it efficiently relieves the informational burden borne by uninformed consumers, and therefore relieves the marketing burden borne by the unknown artist or even the known artist with respect to any new creative good.\textsuperscript{55} Far from being obsolete, the intermediary retains a critical function in digital content markets.

\textsuperscript{54} See Michaels (2008) (reporting a study of iTunes downloads in the United Kingdom in 2008 by the UK collective licensing agency, which found that 85\% of total inventory did not sell at all and the bulk of all downloads derived from a small group of hits); Page & Garland (2007) (finding that, in peer-to-peer file sharing, there is a dominant superstar effect, insofar as most users cluster around a small number of tracks (the top 5\% of downloads constitute 80\% of all downloads), and a weak long-tail effect, insofar as the vast remainder of tracks are swapped at least once but still do not attract significant attention).

\textsuperscript{55} Consistent with this assertion, Elberse (2008) finds that the long-tail effect in music downloads is most pronounced in the case of high-intensity users, which correspond to informed consumers (who presumably do not require the star proxy to assess product quality). Given uninformed consumers’ rational preference to imitate the consumption habits of other better-informed consumers, which are
5.3 Summary

While academics and other commentators doubt the necessity of cultural intermediaries in a digital environment, professional artists apparently do not. If intermediaries were redundant, then artists would avoid them and be successful when doing so. Neither prediction is supported. There is little evidence showing that independent unsigned artists in the music market, who could feasibly bear out-of-pocket recording and online distribution costs, experience success in reaching listeners directly without the assistance of a major label’s marketing infrastructure.\(^{56}\) While there exist digital services that enable unsigned artists to distribute music directly through iTunes or other digital downloading or streaming sites (often at a hefty commission paid to those “costless” intermediaries), these do not provide a meaningful stand-alone income source even for extremely popular artists. The reason is the absence of a marketing infrastructure by which to elicit interest by consumers who are deluged by an abundance of creative content. Even a contemporary star artist who had previously elected to operate without a label later elected to return to label sponsorship in order to enjoy the label’s marketing expertise and other support services (Digital Music News 2012). Consistent with this behavior, trade commentators recommend that individual artists retain the promotional, distribution and other support services of a record label (Guardian (2011); Taylor (2008)).\(^{57}\) This is well-grounded advice: major-affiliated artists receive greater promotional efforts (Strobl & Tucker 2000) and outsell artists affiliated with independent labels by a large margin (Hammond 2012). If

\(^{56}\) Copyright skeptics sometimes point to current star popular artists like Justin Bieber, who initially garnered attention through a YouTube video, or Adele, who is represented by an independent label, to “demonstrate” that the support of a major label is unnecessary. But even that anecdotal evidence is faulty: those artists were subsequently signed by, or indirectly contracted with, major record labels, who provided the necessary marketing, distribution and tour support to catapult these artists to stardom. For multiple examples, see Levine (2011, pp.51-53).

\(^{57}\) For other sources, see Gordon (2011, p.188) (interview with independent label executive) and 252 (interview with artist manager stating that a major is required to secure radio play) and 278 (interview with president of independent record label); King (2009, p.153) (stating that funding a commercial radio campaign can cost approximately $500,000 and is therefore beyond the budget of an individual artist).
intermediaries were as redundant as some academic and popular commentators eagerly assert, then artists would bypass them and be successful in doing so. Neither statement seems to be true.

6. The Digital Challenge

Based on the foregoing argument, it might be argued that copyright remains necessary because it secures exclusivity, and therefore a revenue stream, for intermediaries who are required to fund the screening and promotional costs that persist and even increase in digital content markets. But there is an important objection to this argument. Namely: this argument only supports the narrow proposition that copyright is a necessary precondition for the ability of conventional intermediaries to cover those costs. Those intermediaries share a common transactional structure: they all earn returns directly on the stand-alone delivery of creative works, to which access is then regulated and priced based on market competition. But there may be other transactional structures that could bear the costs and risks of production and distribution even in the absence of copyright. Given that there is no intrinsic social interest in preserving the book publisher, studio or record label as the dominant intermediary types in mass-cultural markets, even this limited proposition therefore provides a weak ground for robust copyright in a digital environment.58 Both new and

58 This point is emphasized correctly by Lemley (2011). My argument departs from Prof. Lemley’s insofar as he takes the view that commercialization incentives are unlikely to be a persuasive basis for intellectual property rights. The logic is that, assuming the underlying content has already been produced, conferring legal exclusivity on the commercializing entity constitutes an unjustified subsidy that is inconsistent with an efficiency-minded framework that relies on market forces to allocate social resources. At least in the context of creative markets, there are three responses to this argument. First, without the ability to exert exclusivity over the underlying content, the distributor is exposed to an inherent free-rider problem: third parties will allow the distributor to expend costs on marketing a large pool of unsuccessful releases until the occasional hit arises. The original distributor will then be underpriced and unable to recover its aggregate costs expended on the entire portfolio; by anticipation, it declines to invest (or, as discussed subsequently in the context of the music market, will favor simultaneous forms of content consumption). Second, legal or technological exclusivity is required to “make” markets in trading and allocating content rights (including financing commitments secured by state-issued property rights), which in turn drive creative properties toward the most efficient set of commercializing entities. Third, as I argue subsequently above, even if there exists some revenue model under which production, distribution and marketing costs could be supported without legal exclusivity, there is no assurance that that model is the most efficient option. With robust (but waivable) copyright,
old cultural markets evidence the possibility that some or all of the core intermediation activities can sometimes be carried out by entities that do not rely on the stand-alone delivery of cultural goods to earn the revenue required to support those activities. To fully assess the merits of an intermediary-based economic case for copyright, it is vital to appreciate and take into account the heterogeneity of revenue-capture models in content markets.

6.1 Giveaway Structures

“Open” or “semi-open” revenue-capture models in cultural markets all share a common bundled structure that partially or entirely forfeits access to a cultural good but more tightly regulates access to a complementary excludable good or service. Broadly speaking, two types of “giveaway” structures are observed.

6.1.1 Two-Sided Giveaway Structure

Some entities in cultural markets rely on a two-sided structure in which a cultural good is given away to a certain population of end-users while access to an excludable good is provided at a positive cost to another population. This is illustrated by the left-hand side of the Figure below. This model will be viable whenever the value of the excludable complementary good is increasing as a function of the number (and quality) of the consumers of the giveaway cultural good. This is the advertising-based model used historically by radio and broadcast television, used (in modified form) by the newspaper and magazine industry (which only recovers a minority of costs from sale prices charged to readers), and used currently by internet search engines (such as Google), video distribution sites (such as YouTube) and social networking services (such as Facebook). None of these entities assess positive charges for user access but assess both implicit positive charges to users in the form of forfeited information and explicit positive charges to advertisers for access to users (a portion of which is ultimately borne by

the market’s transactional choices are maximized. In a net social welfare analysis, these efficiency gains attributable to transactional choice must then be weighed against the transaction costs and other efficiency losses conventionally attributed to any incremental expansion of copyright protection.
consumers in general in the form of increased sales prices). It is important to note (as is often overlooked) that all these viable giveaway models are only partial giveaway models: while access to the cultural good is unrestricted for individual end-users, access is restricted for intermediate users. That is: the NBC television network gives away its content to viewers but regulates access to that content by other networks or other distributors and producers of content.

6.1.2 One-Sided Giveaway Structure

Some entities in cultural markets rely on a single-sided market mechanism in which a cultural good is given away to a certain population but access to a complementary good is provided to that same population at a positive price. This is shown on the right-hand side of the Figure below. Currently this model is used in the internet browser market, where entities such as Microsoft give away the browser application (among other applications) in order to incentivize sales of the operating system in which it occupies a dominant position. The same model is used in the open-source software market, where firms such as IBM subsidize the production and maintenance of zero-priced operating system and software platforms (such as Linux) in order to incentivize the sale of hardware products in which they hold a dominant position (Mann 2006; Barnett 2011). That same model re-appears in the portable media player market (e.g., the iPod), where hardware manufacturers implicitly subsidize the sale of content (available at zero or “below-market” prices) in order to promote the sale of a complementary excludable good. The revenue-capture mechanism in all these markets is the same. Even without any technological or legal protection against unauthorized usage of the relevant informational asset, the intermediary retains an incentive to produce, distribute and market that asset if doing so sufficiently enhances revenues on sales of a complementary asset over which the intermediary can assert exclusivity.
Figure II: Giveaway Structures for Cultural Distribution

**Two-Sided Structure**

- **INTERMEDIARY**
  - Priced complementary good
  - Unpriced content

- **ARTIST**
  - Content

- **ADVERTISERS, OTHERS**

**One-Sided Structure**

- **INTERMEDIARY**
  - Priced content
  - Unpriced content

- **INTERMEDIARY**
  - Priced complementary good

- **USERS**

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6.2 The Revised Intermediary-Based Case for Copyright

The existence of giveaway intermediation models in content markets precludes any strong proposition that copyright is a necessary condition for supporting intermediation efforts in all mass cultural markets. In response, a weak proposition could be adopted: namely, copyright is only a necessary condition for unbundled stand-alone models of cultural intermediation. That would relegate the intermediary-based case for copyright to a narrow account of pre-digital mass-cultural markets and unbundled content-delivery models in contemporary mass-cultural markets. But we can safely go further. The co-existence of bundled and unbundled content-delivery models across different cultural markets, or even within the same market, supports a semi-strong intermediary-based case for copyright. Namely: in the absence of a technological substitute, copyright (or some form of intellectual property) is necessary to support the efficient selection of intermediation mechanisms in mass cultural markets.

6.2.1 Copyright and Transactional Agnosticism

A priori we have no information by which to evaluate whether the closed intermediary, such as cable television, satellite radio, a record label or movie studio, has superior
capacity to evaluate creative content, package that content, and cultivate the choices of consumers, as compared to a semi-open intermediary, such as broadcast television, terrestrial radio, or a search engine. (Note that, in the absence of tax-funded or philanthropic transfers, cultural markets almost never rely on entirely open content-delivery models (Barnett 2010).) A legislator, judge or other policymaker has little to no information by which to select efficiently among the possible set of transactional forms—both because the total set of forms is unknown and, even if it were known, the efficient member of that set would still be unknown. Even if it all that could be achieved (entirely implausible), we would have to further assume that the policymaker could accurately and feasibly update the socially optimal combination of content-delivery models on a continuous basis in response to changing environmental factors. The fundamental social value of strong copyright lies in the fact that it is transactionally agnostic: that is, it enables market participants to select through the force of competition, and the trial-and-error of experimentation, the most efficient transactional structure for the generation and delivery of creative content. And, unlike a state-based “command and control” system, it enables market participants to continuously adapt the combination of transactional structures in response to environmental changes.

Strong copyright is transactionally agnostic because (i) it supplies the predicate condition for the viability of closed intermediaries, which rely on the secure protection of content as a stand-alone unbundled good, and (ii) it does not preclude any other less closed forms of intermediation, since any intermediary can elect to give away content in order to promote sales of a bundled complementary good. As Merges (2004) emphasizes, intellectual property rights merely provide the option to assert exclusivity over the protected good. That option is often declined (Merges 2008). For example, since 2007, the major record labels have relaxed “DRM” copy-restrictions on musical tracks distributed as permanent downloads through online retailers. That policy effectively grants users the right to make multiple copies of a purchased musical track and forfeits some of the protections for which the labels had lobbied in achieving

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inclusion of the “anti-circumvention provisions” of the Digital Millennium Copyright Act of 1998. Robust copyright provides nothing more than the option to incur the costs required to secure, at a certain likelihood of success, legal exclusivity with respect to certain uses of a certain creative good. By contrast, a weak or nonexistent copyright regime removes that option and compels giveaway strategies to capture returns on creative works, limits the feasible set of intermediation mechanisms and potentially distorts the market’s selection of the most efficient mechanisms for the production and distribution of creative content.

Extreme care is required in drawing normative implications from the observation that different content markets successfully use different revenue-capture mechanisms under different levels of copyright protection. The mere fact that a particular cultural market has devised (or could theoretically devise) alternative mechanisms by which to fund the costs of cultural production and distribution in the absence of copyright does not mean that those are the most efficient mechanisms by which to do so. Commentators that react with equanimity to, or praise, the effective decline of copyright protection in cultural markets that maintain apparently robust output overlook this point. Just because 19th-century U.S. publishers could earn returns on British bestsellers by first-to-market advantages that created a time-limited technological barrier to entry (a famous example discussed by Breyer (1970)) or 19th-century British authors could earn a return through serialized novels that similarly exploited the first-to-market advantage (Zimmerman (2003)) does not support the conclusion that those alternative means for establishing exclusivity are a more socially efficient mechanism relative to copyright. Or, to take a modern example: just because musicians can earn some income from live performance does not support the conclusion (as argued by Justice Breyer in his concurrence to the Supreme Court’s decision in MGM v. Groskter (545 U.S. 913, 961-62 (2005)) that significantly disabling copyright protections over recorded music results in no net social harm. The very absence or weakness of copyright protection in those markets precludes making any such assertion because it denies market participants the opportunity to elect to waive
copyright and adopt an alternative mechanism by which to capture returns on creative effort. It is true that there is no social interest in preserving unbundled “Old Media” models of recovering the costs of cultural production, distribution, packaging and marketing; but it is also true that there is no social interest in disadvantaging those models in favor of bundled “New Media” models. Whether or not the potential distortions in transactional form that can arise under a weak or nonexistent copyright regime generate “net” social inefficiencies relative to some stronger level of copyright protection is an open and difficult empirical question in any particular case.

6.2.2 Preliminary Evidence: Popular Music

The popular music market supplies preliminary evidence that reducing copyright protection can distort the market’s efficient selection of intermediation structures. Since the effective decline of copyright protections following the advent of widespread file-sharing in 1999 (the launch of the Napster service), artists have had limited ability to extract revenues through the stand-alone delivery of recorded music (sales of which have declined by approximately 53% since 1999, even taking into account the growth in paid digital music downloads). The chief alternative revenue-capture mechanism is live performance, an inherently excludable service, which now provides the bulk of an artist’s income. Note that this is a case of re-intermediation, not disintermediation: the transactional services of the record label are replaced by the transactional services of concert promoters, ticketing firms, and merchandisers, each of which assesses a fee to deliver content to market. That shift, however, has not been “revenue-neutral” for

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61 The following evidence is merely suggestive at this stage. In a work in progress, the evidence is being incorporated into a more complete study of the effects of digitization on the popular music industry.

62 It is sometimes argued that the vast majority of artists never received significant royalties on the sale of recorded music, and therefore always principally obtained revenues through live performance. This ignores the fact that, even if the sale of recorded music did not directly benefit a performing artist through royalty payments, the intermediary supplied an up-front cash advance and engaged in promotional efforts to sell records, which indirectly promoted the sale of concert tickets. Without significant revenues from recorded-music sales, the incentive to make those promotional efforts disappears.
the industry: as shown in the Figure below, concert revenues have not made up the shortfall in recorded-music revenues.

Figure III: Music Industry Revenues (1999-2011)

The shift in intermediation activities to the live-performance market is sometimes characterized as an unambiguous welfare gain: users obtain increased access to recorded music while artists can still earn income in the live-performance market (Benkler 2004). That shift may result in a net welfare gain; but reaching that conclusion requires a careful assessment of the gross social welfare losses that arise from the degradation of copyright and the reduced viability of stand-alone content-delivery models. At least as a theoretical matter, live performance is almost certainly a less efficient means by which to capture revenues on musical production as compared to recorded music: (i) it has limited economies of scale given the significant “one-off” expenditures involved in any given concert tour or other performance; (ii) it has limited risk-diversification capacities given the inherent constraints on the number of live-performance venues and the number of performances that can be held at those venues; and (iii) it has limited price-discrimination opportunities given the inherently lumpy

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63 Source: Recording Industry Association of America (recorded music); Pollstar (concert ticket sales). All figures adjusted for inflation using constant 2011 dollars.
quality of a live performance.\textsuperscript{64} Those factors may explain why the popular music industry historically elected to generate revenues primarily through the sale of recorded music, rather than concert tickets—an alternative intermediation model that has always been available to the industry.

Under a weak copyright regime, the popular music industry no longer has a choice: it is compelled to adopt live performance as the only remaining mechanism by which to capture significant returns on musical output. Again, to be perfectly rigorous, this is not necessarily a socially inefficient development: that may be the most efficient transactional structure given technological constraints—or it may not. The limitations on transactional choice under a weak copyright regime simply preclude any assurance that the market has converged on the most efficient content-delivery mechanism.

Whether or not the popular music market is operating under an optimal content-delivery and revenue-capture mechanism is difficult for any outside observer to assess. On the one hand, digitally recorded music is widely accessible at a zero price (a static efficiency gain given the near-zero marginal distribution costs in an online environment) and there is no indication that the output of recorded music has lagged (and, as measured by albums released, has increased for some years since the advent of digitization).\textsuperscript{65} On the other hand, concertgoers have simultaneously experienced stiff price increases. As shown in the Figure below, in the market consisting of the “top 100” grossing concert tours in North America, consumers have experienced significant increases in ticket prices (after accounting for inflation) and declines in the number of

\textsuperscript{64} For some of the reasons mentioned, above, Schultz (2009) and Day (2011) have similarly expressed skepticism with respect to the viability or optimality of a performance-based funding model for the music market.

\textsuperscript{65} Waldfogel (2012b) reports Nielsen data showing an increase in the number of albums released from 2000 through 2009 and a decline thereafter through 2010. Other data cited by Waldfogel (2012b) suggest that the increase is due to an increase in the number of albums that are either self-released (by the artist) or released by an independent label. There are three qualifications to this finding. First, for a large number of the releases, the entity type is unknown. Second, given contractual and ownership interests between major labels and certain “indies”, there is often considerable confusion over how to appropriately categorize an entity as an independent or a major. For further discussion, see Christman (2011). Third, a mere increase in the number of albums released does not necessarily translate into a welfare-improvement, given the fact that average quality or “production values” may have declined as barriers to entry into the distribution market have fallen. Waldfogel (2012a) proposes quality metrics to address this difficult point.
total tickets sold (from 37.1 million in 2000 to 34.74 million in 2011), resulting in a moderate increase in total gross revenues (Pollstar 2011). Paradoxically, in the age of "free" music, a popular music concert has been transformed into a luxury good.

The shift to live performance as the core revenue source has been accompanied by regressive effects borne by artists as well as concertgoers. While concert ticket prices have increased, the distribution of concert revenues during the same period is skewed significantly toward older star performers. As shown in the Figure below, among the top 20 grossing concert tours in North America during 2001-2012, 62% of the time the lead performer was over age 40 and only 12% of the acts released their first album in 2000 or later. While there are multiple explanations for this "aging"

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For more exhaustive analysis of this evidence, see Connolly & Krueger (2007); Connolly & Krueger (2006).

Sources: Pollstar (top 100 grossing concerts in North America); Recording Industry Association of America (physical albums). Figures adjusted for inflation using constant 2011 dollars.

Author’s calculations based on information provided by Pollstar (for concert revenues) and the Oxford Music Online database (for age of lead performer and year of first album). In a minority of cases, the age of the lead performer or year of first album was confirmed through other sources. Connolly & Krueger (2006, Figs. 4.3c, 4.4) provide data on the distribution of ticket revenues among top performers for 1982-2003. Consistent with the tendencies identified above, they find a similar increasing skew of concert ticket revenues to leading performers starting in the 1980s, accompanied by a jump in ticket prices approximately in 1999.
phenomenon that rewards superstars at the expense of all other artists, it is consistent with an intermediary-based understanding of the role of copyright. If copyright principally supports intermediaries’ incentives to cultivate and market content, then weakening copyright should weaken intermediaries’ incentives to identify, cultivate and promote new talent given the reduced expected profits to be earned from doing so. Contrary to the long-tail thesis, diversity threatens to decline in a digitized market: revenue streams flow principally to artists who accrued reputational capital under the promotional and marketing infrastructure that had been supported under the “pre-digital” copyright regime. Consistent with the enhanced “superstar effects” observed in digitized content markets\textsuperscript{69}, the lion’s share of monetary and reputational rewards in the live performance market appear to flow to a small population of well-established artists.

\textbf{Figure V: Distribution of Concert Ticket Revenues (“Top 20” North America Tours) by Age of Lead Performer (2001-2012)}

\begin{figure}[h]
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\end{figure}

\textsuperscript{69} \textit{See supra} notes 53-55 and accompanying notes.
7. Conclusion

Academic and judicial discussions of copyright typically proceed on the assumption that copyright’s principal justification lies in the profit incentives it provides to potential creators. That rationale is subject to the objection that a utilitarian model does not describe artists who have intrinsic incentives to engage in artistic production and do not require significant capital to do so. Even accepting this tenuous objection, the copyright regime is soundly justified as a means by which to support the profit-motivated intermediaries that most efficiently supply the capital-intensive financing, distribution and other services required to deliver content to a mass audience. A fortiori the “true” economic case for copyright is even stronger taking into account the significant portion of artists who are profit-motivated and media (like motion pictures) that do require significant capital investment. Elucidating the economic rationale behind copyright, and the socially valuable role it has played in supporting the intermediaries that operate the infrastructure behind mass cultural markets, clarifies copyright’s role in digitized cultural markets that have experienced significant reductions in production and distribution costs. Given the inherent intermediation of mass-cultural markets that produce abundant but costly-to-evaluate creative content, the economic case for copyright survives even in markets where there exist viable—but not necessarily optimal—mechanisms for securing returns on cultural production without exclusivity. In particular, while production and distribution costs have fallen dramatically in some cultural markets, screening and promotional costs remain constant or have increased, thereby necessitating the continued intervention of an intermediary that can bear those costs most efficiently. This is not to say that copyright is always a necessary precondition for reasonable levels of cultural output. Rather, in the absence of technological substitutes, copyright is always a precondition for enabling markets to select the most efficient set of intermediation structures for delivering creative content from artists to a mass audience.
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