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*Shackling the Digital Economy means Less for
Everyone:
Why the Digital Economy Act is bad for the
music industry and the digital economy*

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The Intellectual Property Rights (IPR) elements of the DIME Network currently focus on research in the area of patents, copyrights and related rights. DIME's IPR research is at the forefront as it addresses and debates current political and controversial IPR issues that affect businesses, nations and societies today. These issues challenge state of the art thinking and the existing analytical frameworks that dominate theoretical IPR literature in the fields of economics, management, politics, law and regulation-theory.

Shackling the Digital Economy means Less for Everyone: Why the DIGITAL ECONOMY ACT is bad for the music industry and the digital economy

Manuscript based upon extracts from my Inaugural Lecture on 15 June 2010

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Abstract:

This article debates the policy measures designed to curb P2P file-sharing on the Internet. In doing this, the article challenges the Digital Economy Act which was passed through the UK Parliament April 8, and entered into force June 12, 2010.

Keywords: Digital Economy Act, P2P file-sharing, copyright, Internet, policy.

JEL: O25, O33, O34

Introduction

What if a government created obstacles for the entrepreneurs innovating in low cost railways and trains, simply to protect the stakeholders of water channels, steam-engine technology and barges? What if libraries were prohibited in order to protect stakeholders of book printing and book shops? And what if a government ‘criminalized’ the users of these services? As the railways and libraries have transformed our economies and societies, and as they are complements and not substitutes to our system of innovation, production and employment, this would seem like daft policies.

Similarly, new digital technology has the power to revitalize the cultural industries and the service economy, and to create more value for its businesses and its consumers. Through access to resources, low cost virtual premises, and worldwide exposure, it opens up opportunities for businesses (no matter how small or big) and individuals, who have the determination and ideas to do something, providing they understand digital technology.

However, these opportunities are now being threatened by the Digital Economy Act of the UK which Entered into force June 12, 2010. It was first introduced in the Queen’s speech on 18 Nov 2009. Originally, it was Lord Mandelson's plan to grant the government wide-ranging powers to tighten copyright law, especially to combat any forms of online piracy. For ‘serious offenders’ of file-sharing this includes limiting the speed or capacity of an individual's broadband service or temporarily suspending their service. For public wi-fi services, this include that the owner of a connection (e.g. cafe owners, universities, libraries) can be held liable, even if they are not personally responsible for downloading pirated material. The Labour government said that it wanted to protect the UK's creative industries, which it says is under threat from piracy. The Digital Economy Act was passed (8th April 2010) in the ‘wash up’ period before the General Election, where it was generally supported by the Conservatives, but not supported by the Liberal Democrats. The Digital Economy Act is supported by senior figures and forceful lobbyists from the music, film and television

industries as well as sports and union representatives. It is generally not supported by the Internet Service Providers, among others.

By ‘shackling’ (see article title) I mean how the governments in the UK and in many other countries (such as France which has adopted a file-sharing policy similar to the UK Digital Economy Act) believe that the solution for economic growth for the cultural industries in the digital economy is to be found in an increased privatization of our cultural assets, in the form of strong intellectual property rights, including strong copyrights, and strong enforcement regimes. However, in this article, I argue that there is a need for a policy approach which better balances the protection versus sharing of our intellectual property in the cultural industries. If we get the balance wrong, which I believe we are at the moment, there is ‘less for everyone’. By ‘less for everyone’ I mean reduced welfare effects throughout the digital economy,- weather we talk about producers, consumers, users or other stakeholders. More sharing and open access our intellectual property in the cultural industries will not only increase our value pie but also create opportunities for increased socio-economic equality. The evidence to support my argument follows below.

The power struggle across technological regimes

On the one hand we have the old economy dominant players whose business models are developed around content production for analogue distribution channels which they have been in a position to control and dominate for decades. Companies include the British Phonographic Industry (BPI) which is the British representation of Warner, Universal, EMI, and Sony, and they were forceful lobbyists in support of the Digital Economy Act in the way in which it is shaped today. These music industry majors control about 75% of the global music market, and have close ties with the International Federation of the Phonographic Industry (IFPI).

On the other hand we have the Internet service providers who have grown up with digitalization and the Internet and who are not developing content or products but selling services using the technological and business opportunities of digitalization. They include Google, Facebook, Yahoo, eBay, TalkTalk and BT. They have acted as a forceful interest group against the Digital Economy Act in its current form, and they are even joined by the British Library in this respect. Other new Internet service providers for the music industry and who have grown up with digitalization include Spotify, MySpace, and You Tube and other. As they are becoming established service providers, more musicians and artists are signing up with these new Internet service providers.

The new Internet service providers are also able to add more value to consumers by providing a broader range of material at a low price, while promoting a broader range of musicians and artists in a bottom up forum and giving everyone a chance of exposure and true competition. Analogue broadcasting and distribution via fixed format (CD, LP, vinyl, tape) have been around for ages but they involve size limitations as to how much data they can carry, and they are expensive business models. High venture capital is required to cover risk in volatile music markets, which is one of the reasons why the music majors (Warner, Universal, Times, Sony) achieved control over artists and markets (radio, clubs, retail, etc.) and were able to sell cultural services to listeners at a reasonable high price.

However, the music labels are now threatened by having to face true competition from the new Internet service providers, whose revolutionary business models exploit the business opportunities of the new digital technology. They operate radically different from models around analogue technology, as they are based upon inclusiveness, interaction and competition through exposure between artists, as well as high variety and low price for users. The business models are spurred by access, participation and low copyright protection (soft or no intellectual property rights). Their direct and indirect economic effects can be huge, and they open our cultures up.

This can only be an improvement of our outdated' business models developed around analogue technology which are spurred by a narrow selection of artists and expressions (usually pop and mainstream) which are over-exposed and played to death on the radio (so very little competition), and a highly copyright protected content (mainly owned by the labels) in order to make the expensive business model work. If copyright is infringed, the industry can experience institutional market failure, so a costly enforcement system of royalty collecting societies and court cases has to be implemented to make the business work. The result is a narrow range of products at a high price, and closing of our cultures.

As digitalization has moved the edge of the competitive game to the digital service providers, the labels push hard to switch it back to the content providers. They do this by providing limited access to their content, though high enforcement of strong copyrights, and by making it difficult for Internet service providers and software writers (e.g. bit-torrent software writers) to launch new competitive business models based upon the technological opportunities of digitalization, as they easily fall into dispute with the law as soon as content arrives to their electronic or Internet implemented sites. The Digital Economy Act's institutional attack on wi-fi services by making them legally liable, even if they are not personally responsible for downloading pirated material, can be regarded as a tool in this direction.

While keenly lobbying for clauses in the Digital Economy Act (especially clause 17) when it was discussed in parliament, the BPI and IFPI also made sure they had the loudest voice outside parliament, i.e. in national newspaper publicity. They uncritically publish their claims, numbers, and reported effects of P2P file-sharing. Numbers coming from IFPI include a study of Jupiter Research claiming that between 2007 to 2012 the cumulative cost for the industry of illegal file-sharing to music companies will be £1.2bn, and the BPI website states that copyright infringement costs the UK music sector an estimated £200m in 2009. In such claims there only a mentioning of a substitution effect of P2P file-sharing (for discussion, see below section "What if we wrongly blame the P2P file-sharers?") and there is no mentioning on how money in the new business models are made elsewhere in the value chain than directly from pre-recorded music (for discussion, see below section on "Witchhunt on P2P file-sharers").

To move from the old economy into the digital economy it is important that content producers and service providers speak and collaborate. It is therefore disappointing to see that the Digital Economy Act does not encourage such collaboration, but instead empowers the old economy analogue content providers' expensive business models spurred by strong copyrights, and thereby discourages investment in new digital entrepreneurship.

Witch hunt on P2P file-sharers

What strikes me is that the general public do not understand copyright law, the rationales for copyrights, and their rights. It is easy to pay for TV and radio licence and the licence fee is also incorporated in the CD price, so no consumer education is needed. However, when the wine pours down the digital highway and it is not protected by the bottle, then it is difficult to trace which drops are copyright protected and which are not or are free. How the system works online is not transparent. That we live in a gift-economy where mobile telephones, computers, TV free-view, software, computer games, and more, are totally free when we subscribe to certain services (sometimes for free) does not make it less confusing. Transparency is one of the key elements for a marketplace to work, and when this is gone it is commonly argued within economics that institutional market failure is to be expected. We cannot victimize file-sharers because the industry has lost control of transparency in the marketplace. Music lovers simply then follow their instincts, and sometime this means tripping or stumbling over copyright protected music including pre-releases.

Although the Digital Economy Act mentions that they do not criminalize P2P file-sharers and that they will only allow the disconnection of broadband to serious P2P file-sharers, then this is not how it works in practice. There is no evidence that court cases especially involve serious P2P file-sharers. P2P file-shares attending court are charged with fraud or copyright infringement offenses of one or just a few singles or albums, and prison sentences for copyright if they lose can be several years. It is not about how *much* you share, but about if you share a *particular* music file. The cases are random in the sense that almost one in three households engages in P2P file-sharing of free music (Andersen and Frenz 2007) so anyone could come in conflict with the law, but some people are just unlucky to be noticed.

Government helps to facilitate these court cases, as the victims are often arrested by the police, prosecuted by the government, and the tax payers pays for the hearing. For example, I have been involved as defence witness in two such cases: Oink's Pink Palace (frequently written as OiNK) was a prominent BitTorrent tracker which operated from 2004 to 2007. Following a joint operation codenamed Operation Ark Royal, between Interpol, the International Federation of the Phonographic Industry (IFPI), the British Phonographic Industry (BPI), and some other organisations, on 23 October 2007 the site was closed. The site's creator, software engineer Alan Ellis (24 years old at time of arrest), was arrested by British police and Dutch police. He was being prosecuted by the state (Regina -v- Alan Ellis), and the case was paid by the tax payers. He was found not guilty of conspiracy to defraud (a common law criminal offence which carries no maximum custodial sentence) on 15 January 2010. Furthermore, Matthew Wyatt was arrested in 2007 (17 years old at the time). He was charged with distributing copyrighted material that would prejudice the copyright holders, a criminal offence that carries a maximum 10-year custodial sentence. He was being prosecuted by the state (Regina -v- Matthew Wyatt), and the case was paid by the tax payers. With a trial fixed for June 2010, the case was dropped by Teesside Crown Prosecution Service 30th of March 2010. There are at least three such other cases from 2008.

In my view such court cases should be unlawful due to lack of transparency, randomness in prosecution, and there is no evidence that the individuals have caused direct harm to the industry (Andersen and Frenz 2007, 2010, Oberholzer-Gee and Strumpf 2007; For discussion, see also below section "What if we wrongly blame the P2P file-sharers"). The cases throw an unflattering light on the behaviour of the authorities and the music industry in fighting illegal file-sharing. They can be compared to modern-time witch-hunts where random people are

being blamed for the drop in revenue to the labels from pre-recorded music (mainly due to the demise of the CD format).

However, the overall income to the industry has increased as a whole due diversification of the ways in which music markets work in the digital age. For example in 2008, the UK music industry was worth £3.6bn, and a record income was reported to be up 4.7% from 2007 (Page, PRS Music 2009). Although income from pre-recorded music is down, income from performance rights, live concerts, subscriptions, master-tones, advertisement, sponsorship etc, is up.

The adverse social and economic consequences of the Digital Economy Act criminalizing P2P file-sharers could be huge. Uneducated individuals or households who do not really understand how the online music industry works, may decide to chose a strategy to abstain from music on the Internet in order to avoid coming into conflict with the new law underpinned by the Digital Economy Act (just as many households do abstain from purchasing, banking, etc., on the internet due to lack of trust of credit card fraud and security). Also, potential or existing public wi-fi services (i.e. owners of connections, including cafes, youth-clubs, housing-estates and other) could stop connecting people if they are held liable, even if they are not personally responsible, for downloading pirated material. It is here that we need to keep in mind that e-commerce would not thrive if people did not trade online. This will not only damage music businesses online, where file-sharing is generally not unlawful, but also leave individuals, households and businesses on the wrong side of the digital divide.

What if we wrongly blame the P2P file-sharers?

If we wrongly blame the P2P file-sharers for the market struggle the music industry majors are facing, then policy can only fail.

An independent report produced for Industry Canada prepared by myself and Frenz (2007) shows that free music downloading, including P2P file sharing, is neutral to CD purchase. That means that there is no difference in CD purchase between those who file-share and those who do not. The analysis was carried out for 2100 Canadian households and the data are representative of the Canadian population age 15 and above. Furthermore, focusing only on the behaviour within the P2P file-sharing group, we found that the more people engage with P2P file-sharing, the more music they purchase. And this is even after we adjust for the effect of ‘music interest’ so the result do not simply reflect the fact that music lovers engaging in more P2P file-sharing also buy more music.

In particular we found that people engage in P2P file-sharing because they explore, and this leads to subsequent purchases due to a ‘hear before buying’ effect. Another significant market creation effect is that people look for music which is ‘not available elsewhere’ (e.g. in the mainstream outlets) boosting new markets. Other reason for people to engage in P2P file-sharing is a market segmentation effect, i.e. that people are ‘wishing to not to buy ‘whole album’, but prefer the single digital file. We found that the increase in music purchases of more active P2P file-sharers was explained by the fact that the ‘market creation effect’ of P2P file-sharing outweighs the ‘market substitution effect’, where people download freely as they are unwilling to pay.

There seems to be a misguided obsession by the industry and the politicians supporting the Digital Economy Act with focusing on the substitution effect of P2P file-sharing. I believe that everyone can agree that the better and more diverse data we examine, the closer we come to uncover true economic relationships with respect to the market effect of P2P file-sharing of free music. The situation is very complex and this is not acknowledged in many industry claims from the BPI and IFPI. As described above, for each individual various behaviours result from P2P file-sharing, for example music purchase. It is the combination of these effects, which have to set the scene in the debate on the complex effect of P2P file-sharing on music markets.

A key problem with the claims from the BPI and IFPI is that they compare macro data in terms of music sale (or revenue) finding that CD sale has dropped and MP3 sale not taken off in terms of the money the industry used to make from pre-recorded music, and they simply *assume* that this is caused by P2P file-sharing. An added problem is that the industry treats file-sharing as it automatically means music less purchased. For example the IFPI claim that 95 per cent of music downloads are unauthorised, with no payment to artists and producers (IFPI Digital Music Report, 16th January 2009) shows how out of touch the music industry is with the online communities. The statement also suggests that all downloaded material automatically means music less sold and therefore less income. Instead, it should be of interest for those who manage music businesses to know more about how consumers follow their interests in the new digital economy, and implement this into their forward looking business models.

Looking at the sale of pre-recorded music in isolation our results of the Canadian population (Andersen and Frenz 2007) also indicate a change in technological paradigm explaining the fall in CD sale. For example, we found that people who purchase online electronic music are less likely to purchase CDs and that people who own MP3 players are less likely to purchase CDs.

Volume sale of full-length albums 1973 – 2008 reported in the IFPI Handbook (2009) also show a change in format. LP markets peaked around 1980, magnetic tape around 1990, and CD markets around 2000. Data reported in IFPI Handbook (2009) also shows how *online* electronic music markets (reported in volume) are growing speedily, and that consumers now prefer music singles rather than full-length albums. Their data do not include music singles sold via mobile, but BPI Handbook (2009) show how music purchase via mobile sale accounts for about 42% of all single sales.

Unfortunately, the change in technological paradigm in the music industry is associated with a digital divide. People who report greater internet-skills and younger age groups are more likely to purchase electronically delivered music and to engage in P2P file-sharing. However, there is no gender related digital divide, as we found that women are as active as men online. (Andersen and Frenz 2007)

Finally, it should be mentioned that music is acquired freely in many different ways. Our results of the Canadian population show that 29% of the population engage in P2P file-sharing, 29% are ripping music from CDs, 23% are downloading free music from promotional websites, and 9% are downloading free music from private websites. Finally, 21% of the population are acquiring free music by copying electronic music files (e.g. MP3) from other people. (Andersen and Frenz 2007)

Disconnecting the networked economy

The Digital Economy Act permitting the slowing down or temporary suspension of broadband connections to households will surely have adverse effects throughout our entire national system of innovation, production and employment.

Households use the internet for other things than downloading music unlawfully. The study by myself and Frenz (2007) on the effect of P2P file-sharing found that there is a positive relationship between P2P file-sharing and purchase of other entertainment products, such as videogames, cinema tickets, and concert tickets. PRS Music has also confirmed that live concert revenue is up 13% from previous year (Page, PRS Music 2009), and a huge increase in revenue from live concerts is also confirmed in Sweden (Johansson and Larsson 2009). By ignoring such network effects from P2P file-sharing the government is surely shackling our national system of innovation, production and employment.

In general, and besides P2P file-sharing, the internet is used for a full range of different activities, such as purchasing online (electronically delivered music, travel, books, CDs, DVDs, food), online auctions, email, surfing, homework and education, obtaining information (e.g. related to health or hobby), social networking, working from home, playing or downloading computer games, watching TV, telephone via skype, telebanking and paying bills, doing tax returns, and more. Do we really want a situation where a mother cannot prepare an important work-meeting for the next day, or a father cannot look up important health information or do his self-assessment tax return online, because their daughter has engaged in P2P file-sharing, or that children cannot do homework because of their parents' behaviour?

Also, people engage in downloading activities at work, schools, internet-cafes, while visiting friends or grandparents' house, so the targeted enforcement of logging off individuals or households engaging in serious and unauthorized P2P file-sharing is unrealistic. Furthermore, targeting wi-fi services (or connection hubs) would exaggerate even wider social welfare problems, as discussed at the end of above section on "Witch hunt on P2P file-sharers".

In that way, the Digital Economy Act surely provides a danger of over-regulation. Disabling a section of the UK economy, as a copyright enforcement tool for the labels, will paralyse the digital revolution and create less for everybody. Rather, we need to invest in better and stronger broadband connections to all households, better mobile networks, closing the digital divide, and not spend public resources disciplining society which will be hugely expensive in terms of monitoring online behaviour, dis- and reconnecting households, continuation of policing and random court cases, etc.. However, one can only presume that the Houses of Parliament are not subject to this proposed law, to ensure this institution does not become disconnected from the world (that is, in the sense of the Internet).

The question of rights, but whose rights?

The supporters of the Digital Economy Act assumes a lot of rights for holders and controllers of copyright, but seem to forget a whole range of other rights.

Firstly, P2P file-sharers do have rights. When they purchase more music, and more of other entertainment products, than they substitute on average (see above section of “What if we wrongly blame the P2P file-sharers?”), they create more value to the copyright holders on average. Thus, it makes sense that they (and their households or the places they have operated from) have the right not to have their Internet service slowed down or suspended. Furthermore, to inhibit all members of households from participating in the digital economy (including education of school children via online services, etc.), by making them victims of the crime of other household members (via a general slowing-down or temporarily disconnecting of households), can only be against the principles of basic human rights.

Also, what about the users’ rights in general? For example, as consumers we have right to high variety (more choice), high quality and low price of music, if we are in a position where this can be achieved. The digital revolution supplies us with new business models that can do just that. Also, if we have already purchased an expensive CD, record or tape (often the same music is already purchased by the same individuals in several music formats), what’s wrong with downloading a replacement copy online, given the marginal cost of reproduction of digital products is zero?

The heavy downloading of free music could also demonstrate that the general public have no moral problems with their activities, but focuses on their perceived rights. When the over-exposed celebrity-artists, such as Lili Allen, James Blunt, Gary Barlow (Take That), Gary Kemp (Spandau Ballet) and other, back the labels in their style of curbing P2P file-sharing and in the promotion of the Digital Economy Act in its current form, they are truly out of touch with their fans and the views of the general public. Their voices, which once connected with music lovers, are becoming associated with ignorance and self-interest over community.

Also, all artists (and not just the few over-exposed artists selected by the labels) have the right to be promoted and enter competition, and the new technology gives everyone an opportunity. E.g. artists which are discovered and making their career through online music or networking sites can now make a living from their talent independent of a major label. They are hired to give concerts and even selling their music online in many cases. There are also several recognized artists who are lining up against Government's stance on P2P file sharing, and who does not agree that P2P file-sharing necessarily harms the music industry, but see new business models based upon the opportunities offered by digitalization as opportunities for artists’ independence. They include artists as Nick Mason (Pink Floyd), Ed O'Brien (Radiohead), Dave Rowntree (Blur), Billy Bragg, and Mick Jones (The Clash).

In turn, new business models where more artists are able to enter competition, could also lead to a more equal income distribution. The current situation is that empirical studies of cultural markets consistently show a winner-take-all distribution of earnings. For example the Monopoly and Mergers Commission's study of the UK collecting society PRS (1996) revealed that the top 10% of composers/songwriters earn over 80% of total earnings. This was again confirmed more recently by Kretschmer and Hardwick's (2007) comparative survey of 25,000 British and German literary authors which showed that the top 10% of writers earn about 70% of total earnings. Similarly, a recent study of the Swedish music industry (2000-2008) show how both music revenue overall (and especially from live concerts) have increased, and so has the value pie to artists (Johansson and Larsson 2009).

Finally, the internet service providers (as Google, Facebook and other internet service providers) have the right to challenge the old technology, to challenge established markets, and the right to challenge established business models. This is especially so, when they are in position where they can improve our services and create higher welfare effects and socio-economic equality. It seems as the music labels are content for the music industry to restrict the size of the music pie as long as they take the biggest slice. Their once defended rights have turned into privileges via the Digital Economy Act, because the technological and business opportunities in the digital economy can offer better solutions. It allows the economic pie to grow rapidly and many more artists and entrepreneurs can take a slice of the pie. This is what normally would be considered as a progressive economy.

... and what about globalization?

It is of course not difficult to understand why the British Phonographic Industry - BPI (the British representation of Warner Music Group, EMI, Sony Music Entertainment, and Universal Music Group) are lobbying to enforce their market position if they find it difficult to develop new capabilities to exploit the business opportunities of the digital economy. However, in this power struggle between the old (analogue) and the new (digital) economy, it is disappointing to see how the International Federation of the Phonographic Industry - IFPI (who represents 1400 companies across the globe) only seem to lobby for the interests represented by the major labels, given many poor regions of the world are not poor on cultural expressions and work hard on developing a music industry which is independent from the labels. Music industry figures from the Caribbean, South America (e.g. Brazil), Africa, and Asia (e.g. India) have discussed for years (already at the UN Least Developing Countries (LDC)-III Conference in 2001 which I attended) how the Internet and the new digital technology could enable them to become independent from the major music labels and how this would stimulate local development, local employment and wealth through global connections. However, they need to develop capabilities in order to do just that. It is therefore a worry that only 8 per cent of online music services identified by IFPI are hosted in developing countries (International Trade Forum 2009), and this should be a concern of the IFPI.

Broadening of cultures and welfare in more regions of the world should really be on the agenda for IFPI. "Despite being the "home" of world music, developing countries are for the most part unable to provide the production and promotion capacities expected by rising stars. As a result, revenues are mostly channelled through record companies in Europe and the United States, and very little trickles down to the countries of origin" (Labbé, International Trade Forum 2009). As Daba Sarr, coordinator of the Export Bureau for African Music (BEMA) in Dakar, Senegal, puts it, "Either African artists are signed up by the big labels in Europe and the US, or they struggle to get noticed and make a living." This situation could be changed in the on-line world, but this is not happening. Of course pop-concerts (LiveAid and like) supported by IFPI and the labels are useful in creating awareness of the suffering in poor countries and financial aid. However, their role in facilitating proper long term economic development, and finding ways of maximising the economic contribution music can play to poor economies (who are rich in music talent) in a digital world where music is produced, shared, and consumed in new ways, seem not be on the agenda.

To correct for this failure of a true global representation of the music industry, The Digital Economy Act in the UK could have presented an opportunity to set a president for increased

inclusiveness and been looking forward in ever increasing digital global society. Instead, we are now shackling such welfare effects.

Shackling the Digital Economy means Less for Everyone

Wealth creation in the Digital Economy is based upon sharing and access.

It is a paradox that while digitalization has allowed sharing of information, that we are shackling this via strong intellectual property rights. Such policies are based upon orthodox theories, or belief systems of the rationales for IPRs, rather than evidence based research. It is also a paradox that while policies are making our IP stronger and more exclusive and with increased enforcement, - that practices embedded the new digital economy business-models and other modern organizations are governing IP in less exclusive environments and create wealth via non-proprietary models or by other means in the value chain.

Supporters of the Digital Economy Act, including Lord Mandelson who proposed it, have no idea of the power of the Internet. If the new LibDem-Conservative coalition government has any business sense, it will recognize that if we don't embrace the digital economy we will be shackling British businesses, innovation, skills and markets and there will be less for everyone in the future.

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