

Alexander Dolgin

The Economics of Symbolic Exchange

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Professor Alexander Dolgin
Fund for Scientific Studies
Bolshaya Akademicheskaya
Str. 5, Bldg. 1
Moscow
Russia 127299
dolgin@artpragmatica.ru

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Foreword

Alexander Dolgin's *Economics of Symbolic Exchange* is in reality not one but three books, and although these semantic layers are interlinked, the reader will need to choose between the different vectors and modalities.

One clearly evident dimension is research. Certain authors introduce quite new intellectual approaches into scientific debate. This requires a special frame of mind and a searching curiosity about social reality. Carl Gustav Jung identified a phenomenon which he called systematic blindness: when a science reaches a stage of maturity and equilibrium, it categorically refuses, from a sense of self-preservation, to note certain facts and phenomena which it finds inconvenient. In Alexander Dolgin's book whole complexes of such "non-canonical" material are to be found. Here are just a few examples: file exchange networks, through which digital works of art are spread through the Internet; bargain sales of fashionable clothing; the paradox of equal pricing of cultural goods of varying quality; and a discussion of whether patronage or business has the more productive influence on creativity. Obviously, not all the issues Volgin raises are totally new, but brought together and examined within an elegant logical framework of informational economics, they pose a challenge to scientific thinking.

Such challenges are by no means immediately or, in some cases, ever acclaimed by the scientific establishment. J.K. Galbraith, for example, a great American economist, whose works are read throughout the world, who introduced a whole range of crucially important concepts, the director of John F. Kennedy's election campaign, did not live to see either universal scholarly acclaim or the award of the Nobel Prize.

Alexander Dolgin's book brings together an immense amount of material relating to the cultural marketplace, among which I discovered a great deal of interest to myself. I found his researches into segments of the grey economy particularly engrossing—the activity of ticket touts, semi-legal file exchange services which possible downloading of music and videos from the Internet free of charge, etc. His excursions into the territory of the grey economy enable us to see gaps in "white" markets and to disprove a great many myths. In particular, one can argue endlessly that uniform price for cultural goods is the only principle possible, until it is pointed out that touts have no problem in differentiating prices. This simply does not fit with the view traditional among economists. Stereotypes crumble and we are obliged to take a new look at the situation. The material which the author has assembled by gives us a new perspective on many aspects of contemporary culture, altering our perceptions. This in itself would be sufficient justification for the present book.

The second dimension of this volume is an attempt at scholarly systematisation. The non-professional reader may have difficulties with a scholarly manner of exposition which approaches the same problem several times on different levels, in different contexts, and using different premises. One of the topics central to the research is adverse selection, and this is viewed variously as a topic relevant to the music industry, then more broadly within the framework of digital products in general, then

on examples of physical works of art. The reader unfamiliar with scholarly ways may find this disrupts the rhythm of the narrative, but professional scholars will be undismayed. The author constructs a system on several planes which advances from cultural economics to a new theory of institutional economics and interpretation of the economics of wellbeing.

By embarking on this new path, Volgin lays himself open to attack on a wide front by theoreticians regarding the precision with which particular concepts are used: for example, the extent to which adverse selection differs from other forms of pre- or post-contractual opportunistic behaviour. I would vigorously defend him against such charges. One could try to analyse adverse selection by pedantically filling in a table of theoretical concepts and agonising over what should be entered in which box, but let us remember that was not by any means the way in which Akerlof came to win the Nobel Prize for his work. His achievement was not in splitting hairs or engaging in intellectual calligraphy, but in identifying and clarifying matters which were extremely hard to pin down. Even before Akerlof, some economists had been uneasy about the idea that competition was invariably beneficial. Other scholars had raised doubts more than once, but it was Akerlof who identified the crucial factor that, if the consumer is not in a position to assess the true quality of a product or service, competition may produce a negative effect. Writing about the secondhand car market, he demonstrated how superior products were forced out of the market. The article caused a worldwide sensation 15 years ago. Akerlof received widespread recognition for his work and eventually, in 2001, the Nobel Prize.

To take another example: for 30 years there was a debate about the formulation of the Coase theorem. (Coase himself wisely kept out of it, commenting on it only later, in the Foreword to a re-publication of his classic articles.) It seems to me that, in the early stages, it is not essential that formulations should be beyond reproach. Coase was the first to point clearly to the importance of transaction costs, and after that it was difficult for anyone else to ignore them. An intellectual revolution had occurred. It was realised that, in the course of their existence, social and economic systems overcome a resistance which can be made evident using the concept of transaction costs. Before Coase, economics was blind to that and found itself helpless in a number of areas.

Chiselling out the fine detail of formulations is undoubtedly an important activity. If the present volume leaves room for further work in this direction, its treatment of adverse selection conveys the gist of Akerlof's theory impeccably: in the absence of particular institutions, competition can have negative results. In culture the problem is all the more acute because reaching consensus on quality is, arguably, more difficult here than anywhere else. One could seek endlessly to perfect the treatment of adverse selection. It is even possible to doubt whether it occurs in culture, although I personally think its presence is absolutely clear. It seems equally clear that what influences the price of a ticket to the movies is more the quality of the seats and the availability of popcorn than the action on the screen. That being so, it is unimportant whether adverse selection is evident in every segment of culture or only in some of them, whether it operates all the time or not. An antidote needs to be found, and this, ultimately, is the task our author has set himself.

This brings us to the third and, for me, most important dimension of the book. The devising and creating of institutions is little recognised, unsung, but historically essential. It is an activity which often goes unnoticed because theoretical economists popularly suppose that institutions appear of their own accord: if a demand arises, a corresponding supply will automatically appear to satisfy it. This is by no means the case. The names of pioneers are routinely forgotten, and it everything is believed to have come through spontaneous generation. How many people, for example, realise that the day nursery for pre-school children did not just happen but was invented by Robert Owen and his followers? They dreamed up and tried out a great many things, some of which were successful while others did not take. The same is true of profit-sharing by workers in the enterprise where they work, implemented for the first time by Owen's admirers in England. Another example is the system of self-service, thought up in the first half of the twentieth century in a Swedish consumers' co-operative and destined to spread throughout the world. These institutions did not just happen: they were originated by particular individuals. Their inventors have to make considerable efforts, both in terms of technology and of social engineering, before they take off and develop to a stage where society can take them up.

Alexander Dolgin has produced something of this kind, which may ultimately cause a new institution to appear. This, I have no doubt, is the most important dimension of the book. He has brought together two innovative ideas of collaborative filtration and gratuity payment for cultural goods. Both are expressed in monetary terms but amount to little on their own. Together they promise an important reform.

From the outset I was intrigued by Alexander Dolgin's experiments. When he conducting the Theatron and Cinema projects to test two-stage payment for cinema showings and theatre performances, I feared the results for the theatre might be quite different from those in the cinema and that the idea would prove applicable only to mass culture. The theatre is an intimate, labour-intensive art form, and in such individually crafted work there is a different, more immediate feedback from the consumer to the provider. In fact, much the same results were obtained, which suggests that collaborative filtration can be successfully applied in different spheres. Clearly, the concept of using collaborative filtration and gratuity payments by consumers as a defence from adverse selection in culture deserves to be looked at very closely.

I believe the author could have limited himself to publishing his basic concept and describing these experiments. He needed only to add a description of the precedents of collaborative filtration, and to show how and why big business subordinated the innovation to its own interests, emasculating it in the process. As soon as the new system showed signs of success and growing appeal, the dominant institutions turned it to their own advantage. In order to prevent this from happening again in the future, means need to be built in of protecting the institution, primarily by ensuring that it is financially self-sufficient.

It is apparent from the general tone of the book that Alexander Dolgin's main concern is to see the establishment of a widely ramified, independent testing institution. Let us hope his project brings about its creation. Because he has not restricted himself to explaining the thinking behind this institution, but has chosen

also to show how it fits into and modifies existing economic theory, there is some risk that theoreticians will be able to find fault with the scholarly system and delay large-scale experimentation. This could set back the development of the necessary institutions by a further 20 years or so, and lead to their appearing not in Russia but somewhere in India, not in the early twenty-first century, but in mid-century. In the meantime, more cultural creative energy will be sucked down into the vortex of adverse selection.

Without a series of test projects, nobody can say today for sure whether introducing post factum gratuity payments for cultural products on a large scale is a practical possibility, or what benefits it might bring. At first sight this might seem utopian, but many impractical ideas are found, on closer acquaintance, to be entirely realistic. A good deal is said in the book, for example about the prospects for establishing gratuity payments as a norm in society. Here it may be useful to look at the place of charitable giving in today's world. In many countries this is widespread. Donations are made to help children in Africa, or to encourage the development of alternative sources of energy. In Canada a youth volunteer corps movement is expanding, for young people in England it is almost the norm after leaving school to work for a time in a developing country. There is no law compelling them to do this. It is not an alternative to national service, but there is a sense of social obligation. That is, it has become the norm to make a contribution, and not to do so might be viewed askance.

The book describes attempts to introduce voluntary payments in practice. In some cases this was successful, in others, for particular reasons, it failed. There is a need to extrapolate from this experience, and to work systematically in the future, adjusting the approach step by step in the light of the results obtained. If these analytical and practical approaches are combined, there is a high probability that the new institution will take off successfully. I say it again: we pay no attention to how new institutions appear, but they arise as the result of the actions of particular individuals, of 'mad' experimenters, and subsequently become the norm. "What is this nonsense?" people exclaim, later conceding "There may be something in that," before finally expostulating, "Oh, everybody knows *that*."

A further interesting approach is the attempt to take an individual's cognitive and time resources into account, alongside the resources which economics traditionally looks at. Little attention is currently paid to these, with the result that they are not used to best advantage. At first view, the idea seems impracticable, but economics has, after all, long operated with a multiplicity of resources which are difficult to quantify. Indeed, the only readily countable resource is money. We start introducing such concepts as 'conventional fuel', 'conventional coal', or 'conventional bread'. The German Ministry of the Economy began using such concepts back in the 1930s. Nowadays we are trying to deal with much subtler and less easily defined resources. Take, for example, transaction costs. Analysing these is no simple matter when applied to a straightforward business firm. How much more is this the case when we turn to the cultural sphere. In principle, however, we can quantify the time top managers of enterprises lose standing in queues to see officials, and equally the time wasted viewing an indifferent film. Naturally, these costs differ from one person

to another depending on their levels of income and self-esteem or, more precisely, on the value one person places on an hour of his time. Economics long ago began operating with resources it was difficult to pinpoint exactly. This is unsurprising, because the age of complete rationality when the sciences could be neatly divided into disciplines has passed. That approach worked for centuries, but it is breaking down now and something else needs to be found.

Whether Symbolic Exchange Economics will become established as a new branch of scholarly enquiry is a question to which the reader will learn the answer only in 10 or 20 years' time. At present we can already see that behind the vision propounded here there is an intuition expressed in the language of economics. That intuition will need to be further developed and proven. The most important thing for now, however, is for the practical aspects of Symbolic Exchange Economics to become established, for the institutions and practices it envisages to come into being. Further scrutiny of the premises can be a matter for the future.

There have been works which operated in different dimensions in the past. Karl Marx's *Capital* is an outstanding example. It contains both a new idea, a new approach, a new system, a re-evaluation of earlier systems, and an attempt to build the future. Such works can lodge in people's minds in different ways: one aspect in the minds of the academic community, a different aspect in the mind of revolutionaries, and something else again in the minds of ordinary people. There is even the possibility of a complete travesty, of the kind which brought Marx to complain, "If that is Marxism, I am not a Marxist!"

Readers are free to take from the book whatever aspect most interests them. The contents makes it possible to concentrate on different aspects. Some may be more interested in altering people's outlook, in which case there is a need to popularise the specific reforms proposed here which people have not yet heard of. I suspect that for those sympathetic to this cause the scholarly underpinning may be of less interest. A different approach would be to perfect a scholarly model and defend it against academic opponents, but that tends to leave little time over for social experimentation. It will be for both the author and his readers to make their choice. My own preference is for the path of action. Those who introduce new institutions are encountered in history far more rarely than encyclopaedists and pure theoreticians. That is a rare gift, and to follow in the footsteps of Robert Owen demands a special intellect and a very special spirit.

Alexander Auzan

Preface

Several years ago my friends urged me to write a weighty tome on practical aspects of culture. At the time I didn't think of weightiness in terms of self-sacrifice, risking my reputation, and games theory, as I am inclined to now and for which I hope my reader will also develop a taste and a readiness. I instinctively put my trust in this recommendation, although I realised even then that the work would demand complete dedication. I was concerned that the said weighty tome might be doomed to obscurity, because in our days the format is not that popular. People grudge the time to study great folios. Bulkiness is acceptable nowadays only for serial reading, where the eyes speed over the lines like an express train. Is there any surer way of frightening off those who enjoy reading while travelling than philosophising about culture? For all that, a lavishly manufactured intellectual product fits admirably into our idea of luxury, and a good third of the book is devoted to the economics of luxury.

I finally decided to write the book when the distinguished art historian, Grigorii Revzin persuaded me that I would get nowhere writing piecemeal articles. I had already made a number of not unduly successful attempts to sound off on individual aspects of my topic. The fragments didn't look like adding up particularly by being put together in a brochure, and in general didn't fit happily into a small format. I would try to put two or three dozen exciting ideas into an article, but there was no way I could put across the topic which mattered most—the need to place money at the service of culture.

After I had more or less decided on the genre of the work, I received assistance from the most diverse, insightful, talented, highly erudite experts working in economics, culture, the media, middle-sized and big business. Many well-known philosophers, economists, specialists in cultural studies and those involved practically in cultural matters pointed me in the direction of important avenues of enquiry in the material and provided valuable guidelines. Among my intellectual creditors were some who gave no particular weight to their advice and demanded no particularly high commission for it, but who nevertheless gave me extremely valuable assistance. I am particularly indebted to Valerii Podoroga, Vladimir Avtonomov, Yaroslav Kuzminov, and Vitalii Naishul.

My colleagues at the Pragmatics of Culture Foundation have been immediately involved in preparing the book: at first Valerii Anashvili and Sergey Trukhachev, later Elena Lvova and Gleb Morev. I owe a particularly large debt to Yekaterina Men. Polina Giverts and Irina Leontieva excelled in collecting analytical material and marketing research. I would have been lost without them.

I particularly valued meetings with a number of foreign academics: David Throsby, William J. Baumol, and others.

There have also been people whose interest induced a state of productive thinking. These include acclaimed thinkers like the Nobel Prize winner in Economics,

Vernon L. Smith, who responded enthusiastically to my ideas, and those conventionally regarded simply as belonging to the cultural community. It is for the latter, actually, that this book is intended. In five-minute conversations struck up by chance, I had an opportunity to explain the basic ideas behind collaborative filtration and how much could be achieved by putting money into it—thing it is not always possible to put across to every professor in thrall to conventional ideas. The concept itself is relatively straightforward, and sometimes it seems that only an excess of education prevents people from seeing (or admitting) that there is something in it.

I am grateful also to all those whose consultations helped me to structure a great mass of information on many planes, and primarily to Dmitry Itskovich and M. Mayatsky who made a long-term contribution to my intellectual ferment.

A special contribution was made by Boris Dolgin, my father, a daring engineer who passed on to me a happy knack to be seriously and persistently enthused.

The contribution of E. Lebedeva, who has edited the book, has been invaluable: I can think of nobody who could have done the work better than she. Her phenomenal professionalism has improved my style and the book has, I hope, become accessible to a wider circle of readers as a result.

I am immensely grateful to Alexander Auzan, A. Dobrokhotov, and Alexander Lebedev who ungrudgingly found the time in their busy schedules to review and discuss the book.

1 September 2006
Moscow

Alexander Dolgin

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Introduction

Why is money so inefficient in the realm of culture, and what can be done about it? How can money be made to serve culture?¹ To date we have no satisfactory answers, and that is why this book has been written.

The conventional wisdom is extremely negative on the subject, and sees money and culture as antitheses. Theodor Adorno and the adherents of the Frankfurt School have written at length on the pernicious influence of the market on culture.² Business, they argue, when it subjects culture to the logic of the cash nexus, cripples it. The winners are the slick operators; those who lose out are the genuinely talented.

The role of money may be contentious, but can we imagine culture without business? Nobody has yet come up with a viable alternative to market mechanisms. Nobody who has taken the trouble to find out how this sector functions will argue that culture can do without money. Many are in a great hurry to conclude that money always debases culture, but a less prejudiced approach will find that it facilitates culture, for example in the field of mass communication. So let us hold our fire for the time being.

There is a problem, in that most markets improve the quality of goods, but not, apparently, the markets of culture.³ In other sectors, quality and capital go hand in hand, but not in culture. In more mundane markets, the consumer sees clearly where his interests lie and is prepared to pay above the odds for what is objectively better. The manufacturer, accordingly, has an interest in offering goods of higher quality. It is a peculiarity of culture as an economic sector that objective criteria of quality are lacking,⁴ and the difference in price between good and bad products may be minimal or non-existent. Accordingly, business has no incentive to improve quality, and makes its profits by following the line of least resistance.

¹'Culture' is understood as everything that relates directly to the production and circulation of artistic products: primarily the products themselves, the individuals and institutions involved in their creation, consumption, and evaluation. In a number of cases the term is used in its widest sense, as will be evident from the context.

²See Max Horkheimer, Theodor W. Adorno, *Dialectic Of Enlightenment: Philosophical Fragments*, tr. Edmund Jephcott, Stanford University Press, 2002.

³The markets of culture cover all aspects of the exchange of artistic products on a commercial basis, namely:

- art works distributed on physical media or digitally—movies, television programmes, literature, music recordings, computer games, etc.;
- works of fine art, sculpture, design, and architecture;
- the entire realm of performance (theatre, opera, dance, the circus, concert entertainment);
- products of the fashion, luxury and lifestyle industries.

Even mini-creative output like blogs (personal diary entries on the Internet) can be counted as a cultural market to the extent that writing them produces revenue of some description.

⁴To a certain extent this is applicable also to scholarship, particularly in the humanities.

Where the interests of business and the consumer of culture come together, economic logic prevails. Business is the better player because its aim of making money is clearly defined and measurable, while the goals of the consumer of culture are much less clearcut. Creative artists, critics, the public, the state, have no option but to take their lead from business.

There are a number of reasons why business wields such power, not least because artists, naturally enough, would like to secure a comfortable lifestyle and fame through their creative work. With a few exceptions, they are fairly hopeless at marketing themselves and have no system for publicising their work. The market is effectively closed to them. Cue the appearance of the market's agents in culture, middlemen who know what is in demand and who are adept at distribution. Without them cultural exchange extends no further than those with whom the artist is in immediate contact. The consumers of culture need middlemen too. No matter how eloquently artists extol their own works, readers, audiences or listeners are going to want an unprejudiced intermediary capable of selecting on their behalf.

The upshot is that the creative artist (director, writer, painter) and the businessman (producer, publisher, agent) enter into a partnership in which they both have a stake. They need a basis on which to share out rights and recompense, and the institution devised for this purpose is copyright. The creator of a work is its primary owner and, if he so chooses, nobody else need ever hear about it. Alternatively, he may choose to publish the work himself, but it usually makes better sense to share this right with a commercial partner. The latter takes financial risks, and in return demands certain undertakings. If the work is a commercial disaster, the investor loses his money. If it is a success, some of the profit is rightly his. The businessman also needs assurances that, if it is a success, the primary owner of rights, the creative artist, will not dump him for a different commercial partner on more advantageous terms.

Accordingly, the creative artist, when he takes his work to market, hands over certain economic rights to his entrepreneurial partner. More than that, however, when he (and the same is true of culture generally) ventures on to the territory of business, he has to play by its rules. What happens next is fairly inevitable: the artist must respect the business interests of his partner and play along in developing commercial success. As soon as the artist, willingly and in full knowledge of what he is doing, or in desperation and without a clue as to the consequences, takes his place in the businessman's harness, the latter has a right to make demands of him and his work. The time comes when it is no longer simply a matter of existing works circulating in accordance with the laws of commerce, but of works being created at the outset with an eye to their commercial potential. For most creative work that is a disaster.

This is a schematic description of how business comes to dominate culture. Another important factor is that the crude directness of the language of money drowns out the subtle and diverse languages of the various arts. All the other criteria, evaluations, communications and critical assessments which influence culture are subjective. Groups with different interests have great difficulty in reaching agreement, while the language of money, although extraneous to culture, is a universal language, and this equips it to mediate agreement. Money is harmful to culture not because

it is intrinsically evil, but because it gives too much power to the party controlling it, whose main goals are extraneous to culture. Cultural production finds itself being subordinated to an alien logic. The overarching concern of this book is how to correct the present situation, how to give the arts back their rights without trying to sever their link with money, which would be pure utopianism.

But why should the consumer of cultural products take the slightest interest in all these arcana? His only interest would seem to be to pay a fair price and get commensurate enjoyment in return. The problem is that he too often pays his money and gets very little indeed in return. There is a fashion for comparing culture to a supermarket, with goods to suit every taste and pocket.⁵ It might, however, be more accurate to liken it to a showroom where specimen products are on display. In a real showroom you can examine and touch the items, but in culture this kind of scrutiny is difficult, if not impossible. In culture, touching is often tantamount to using, and it is hard to allow these to be combined and continue to make money. Until you have paid your money, you are generally invited to view, not goods with recognisable characteristics, but colourful labels masking a wide divergence of quality. Trading like this makes it all too easy for the seller to mislead the purchaser, but the consumer's discomfiture does not always result from deliberate mischief-making.⁶ It may result quite simply from the way the market is structured, as will be discussed in detail. This is cold comfort for the consumer. The artistic works he is seeking may well exist, but only rarely reach their target audience. The consumer of culture has to take what everyone else is getting, the products of mass culture. The tastes of many strata of consumers remain unsatisfied, and they are left with a nagging sense that all is not well with culture. A way needs to be found of making it profitable to create high-quality products for smaller interest groups and, no less importantly, of letting them know where to find them. Your author believes that *consumer navigation* is the overriding problem of present-day culture, and it is a central preoccupation of this book.

The reader will have registered that 'symbolic exchange economics' is not an established discipline,⁷ and indeed we are proposing a new offshoot of economic theory. The branch from which it grows is institutional economics of culture, a rel-

⁵See, for example, John Seabrook, *Nowbrow: The Culture of Marketing, the Marketing of Culture*, New York: Knopf, 2000.

⁶When complaining about the market, scholars usually seek culprits. Thus, in a book with the resounding title of *Who Killed Classical Music?* (Secaucus, NJ: Carol Publishing Group, 1997) Norman Lebrecht considers it self-evident that vested interests have brought this segment to the brink of ruin. The only question is, whose vested interests? The author, full of righteous indignation, has no trouble in blaming greedy producers, mercenary stars, music businessmen, and a lazy public. They are all culpably selfish. Lebrecht does not address the question of where better agents might be found, or how the existing ones might be redeemed.

⁷By 'symbolic exchange' is meant communication by means of artistic works, involving personal and monetary costs. Culture is seen as symbolic language and is analysed primarily in terms of market logic.

atively young area of scholarship adjacent to our topic.⁸ Cultural economics, however, for all its achievements (to which considerable space is devoted in the book), has its limitations. The overall territory with which economics deals is rational distribution of resources in accordance with particular aims. This requires resources which are unambiguously definable, preferably quantifiable, and with at least some sense that they are in short supply. In the symbolic area, however, the situation is rather different: a substantial proportion of what is in play here is not currently seen as economic resources at all. Informational (cognitive), emotional and, to some extent, temporal assets, both of consumers and of creators, have been wholly or partly ignored by economics because of the difficulty of quantifying them. In particular, no way has yet been devised of quantifying creative outlays, talent, or mental resources. The public are only just beginning to see these assets as resources, in particular by starting to value their free time. When hitherto ignored personal resources of this kind are taken into consideration, the situation will alter drastically. The concluding section of the book looks at ways in which this can be brought about, enabling economics to aspire to a better understanding of culture, and perhaps bringing about significant changes in culture itself.

Money, then, has a role to play in symbolic exchange, but it is not the whole story. It can reflect the value of the physical medium of an aesthetic object, but is not always able to measure the aesthetic value of a particular cultural product⁹; hence the paradox of uniform prices for books, music discs, and videos (analysed in detail in the book's first Chapter).

Contemporary economics cannot explain what quality is in culture. Cultural experts themselves struggle to come up with a definition. The result is that economics has to judge quality on the basis of what people pay money for. The majority of people, however, long ago ceased to recognise quality in culture, and money is spent irrationally. Since, in addition, it fails to take account of symbolic outlays (for example, psychological and emotional investments), money cannot possibly present a full picture. When it addresses itself to cultural issues, economic analysis is inaccurate and often out of its depth. How could it be otherwise if some of the resources of culture are being overlooked, and its goals are not understood?

Economists evade this problem. They ignore the fact that the price-ranking does not correlate with the value-ranking of consumers, although some researchers have conceded this disjunction and questioned the efficacy of an economic approach to culture at all. At their instigation, the problem has become the focus of a small but intense debate.¹⁰ On the other side have been those keen to champion the univer-

⁸The birth of cultural economics is traditionally associated with the work of William J. Baumol, notably *The Performing Arts: The Economic Dilemma*, with W.G. Bowen, New York: Twentieth Century Fund, 1966.

⁹If economics is the science of scarcity, what kind of scarcity does an electronic file possess?

¹⁰See, for example, David Throsby, *Economics and Culture*, Cambridge: Cambridge University Press, 2001; and Tyler Cowen, "Are All Tastes Constant and Identical? A Critique of Stigler and Becker", *Journal of Economic Behavior and Organization*, 11 (1989), 127–135.

sality of economic theory.¹¹ The end result has been that the prevailing paradigm remains in place.

The problem of the efficiency of money in culture is the major issue dealt with in the book. Let me put my chips on the table: I do not believe there is currently a consistent correlation between price and symbolic value (the quality of cultural goods and services). Acknowledgment of this fact is the basic premise of symbolic exchange economics. Investigating the gap between symbolic value and its monetary expression, and devising ways to remove it, is the discipline's main task.

Economic calculations are based on money, with the result that economics behaves as if those aspects of culture not reflected in money do not exist. With this financial aspect to the fore, most economic research into culture addresses mainly a business audience. The present investigation is addressed in the first instance to the end user of culture. All problem areas are analysed from the viewpoint of personal efficiency and the quality of consumer choice. This entails a radical review of the postulates on which the science of economics is based.

Let us consider, as an example of the different approaches of cultural economics and symbolic economics, the matter of cinema box-office takings. To conventional economics, the best film is the film most people pay to see. By no means every cinema-goer, however, is going to agree that the ticket sales reflected the film's quality. We are talking here not about some abstract aesthetic quality, but about straightforward consumer quality. For the same money he may have experienced utter delight, or been bored out of his mind. Obviously, the total utility is different. Symbolic economics will note and take account of this difference, while cultural economics merely shrugs it off. This is the fundamental difference between the two approaches. Economics analyses the measurable aspects of the process and ignores an aspect invisible to it on the grounds that it must be insubstantial. For the cultural consumer, however, this is precisely the aspect which really matters. If he pays exactly the same money for a bad film as for a good film, in the latter case we are dealing what economics calls consumer surplus.¹² If our cinema-goer knew ahead of time how much he would enjoy the film, he would be prepared to pay a higher price. The price system of culture is not in general designed to reveal consumer surplus and turn it to the advantage of a producer of higher quality goods. The unsurprising consequence is a lowering of quality. The provider could possibly create a higher quality product, but does not do so since customers do not pay extra for quality, and there is always the risk of alienating the mass market. If he turns out a low quality product and markets it as a high quality product, his risk is minimal. The main loser is the consumer who would prefer to pay extra for quality and get it, than not pay extra and not get it.

Usually, if there is no market solution to a problem of insufficient production of a good (or production of goods of unsuitable quality), non-market forces, possibly

¹¹George Stigler and Gary Becker, "De Gustibus Non Est Disputandum", *American Economic Review*, 67 (1977), 76–90.

¹²Consumer surplus is the difference between how much the consumer is prepared to pay and how much he actually pays. That is, he would have been willing to pay more if asked.

the state, step in. The state, or some other institution, either assumes the burden of expenditure and concerns which are not advantageous to business (for example, by subsidising programmes), or introduces laws and regulations to prompt business to act in a manner beneficial to society. To be effective, however, the state needs to know what will or will not produce the desired effect, and to be capable of realising its intention. In culture, unfortunately, it is not sure-footed and does not have a good record. Attempts to influence culture by subsidising high quality providers prove fairly hit-and-miss. The state is not very successful at selecting the worthiest recipients of its largesse, and money of itself is not guaranteed to raise levels of creativity.¹³ It is not a particularly satisfactory way of rectifying the market's imperfections. Far better if the market could regulate matters itself, by becoming responsive to quality for the cultural consumer.

Let us consider a further example by supposing that in a certain community it is customary to barter texts, and that the criterion of value is purely the number of characters in a book or article, irrespective of content. Under such circumstances, producers of substantial, high-quality texts would have an incentive to make them longer, and to turn out a large number of similar books. This would be a natural response to imperfect rules of exchange which work to their disadvantage. Another section of the community, which produced less substantial texts, would respond by increasing numerical output.¹⁴ The resulting race would disadvantage everyone involved, except those who read nothing. If, however, recipients did not react negatively to excessive amounts of reading (possibly because they possessed a highly efficient content analyser), or they were unable to make their protests heard, or their voices were drowned out by those of speed readers, then the system could survive indefinitely without addressing its imperfections.¹⁵ A traditionally minded economist could declare that nothing was amiss, and continue to insist that the quantity of characters was an appropriate indicator of the value of a text. He would point out that those involved were reading and writing texts, which they evidently wished to do, and seemed overall to be content with the existing situation. "If that were not the case, they would not barter texts but do something else," our economist would say. The problem, however, is a lack of alternatives, which often means that people resign themselves to what they believe to be an insuperable evil. In the above example, the worth or otherwise of the content is a so-called 'external effect', that is, an effect not taken into account in the system of exchange (or a contract), despite its importance. Because money fails to reflect several factors in culture, much inevitably falls into this category of external effects, not least, the quality of the cultural product. The present work seeks to find ways of safeguarding that quality.

¹³See, for example, Bruno S. Frey, "State Support and Creativity in the Arts: Some New Considerations", *Journal of Cultural Economics*, 23 (1–2, 1999), 71–85.

¹⁴This is not without parallel in the situation existing within the academic community.

¹⁵Those bartering could, no doubt, delegate critics to evaluate the content of texts, but they would need detailed, constantly updated, guidelines. The critics would also face an increasing volume of work.

The arsenal of institutional economics includes tools for dealing with external effects (including various kinds of overlooked information costs). At least this branch of economics acknowledges that they exist, can point them out in particular instances, and occasionally, although this is rare, even manages to measure them. This makes institutional economics an important contributor to symbolic exchange economics. The greater part of the book's terminology has been adopted from institutional economics, and also from game theory, psychology, anthropology and art theory.¹⁶ The conceptual apparatus is, however, not the whole story. Our new branch of economics studies the rules by which markets operate, and it is primarily these which must be investigated if we are to understand what happens to culture in a commercial environment. Institutional economics, unlike traditional economics, takes account of the different ways market players apply information (using the concept of transactional costs). From an economist's point of view, culture, and specifically digital culture, *is* information plus the way in which it is reflected in the mind. Accordingly, as far as culture is concerned, the approach of institutional economics looks to be the most productive. Institutional economics cannot, however, move beyond the limitations imposed by the monetary system. This task must be taken on by symbolic exchange economics.

And so, to the structure of the present book:

Chapter 1 analyses the situation in the sound recording industry. This sector has embraced the latest advances in digital technology, and conveniently epitomises almost all the issues concerning culture. Music, presented in the form of an incorporeal file, is a perfect representation of culture in an age when technology is capable of mechanically reproducing a work of art (Walter Benjamin). For the analyst it is a stroke of great good fortune to encounter a compact, clearly delimited topic which contains the basic features of a broader area of research, in this case the whole of digital culture.

Sound recording is an ideal candidate for dissection, because it is a highly representative model of all the mass production segments of culture. There is a further very important advantage. After the appearance of the Napster online service in 1999, which made it possible to freely exchange music files over the Internet, the sound recording industry found ruin staring it in the face. Internet communication, free from middlemen, exposed to the world the vulnerability of copyright and, with it, of big business's production of culture. This brought about head-to-head confrontation of all the players in the market: music corporations, pirates, file exchange companies, and consumers. What at first appeared to be a local war brought issues affecting the entire cultural sector up to the surface. Who emerges victorious in this segment of culture will affect the climate of the entire territory, including book publishing, cinema and television. Issues of consumer choice, copyright, price formation for digital products and many other matters which had previously been discussed only in the innermost councils of business or in hushed academic settings

¹⁶I make use also of the scholarly apparatus of economic information theory, industrial organisation theory (based on game theory), and behavioural economics and economic psychology (the latter two, more implicitly than explicitly).

by a small number of theoreticians, suddenly became public knowledge. A huge amount of normally inaccessible information, the underwater currents and logic of different players, became available for analysis. What in other circumstances would have been a plethora of scattered fragments, acquired a wholeness which made it possible to bring together differing points of view, hypotheses and practical experience, and propose an integrated analytical approach to the situation. Chapter 1 of the book is devoted to the vagaries of this battle for music, its legal, moral, economic and institutional implications. Here too we propose a way out of the difficult (and possibly deadlocked) situation which has developed in this segment. It will involve setting up an institution for systematic evaluation by consumers themselves.¹⁷

In Chap. 2 we consider how far the issues identified from analysing the sound recording industry (and our proposed solution) can be applied to digitised culture as a whole. Digital culture comprises all those segments which can be encoded in digital form and transmitted to remote locations without in the process suffering any appreciable loss of quality. This includes films, television and video products, photography, computer games, music, literature, and so on. (From the point of view of economics, how 'digital' a product is can be calculated from the proportion of the price structure of a work of art which can be ascribed to the physical medium of the aesthetic product, and how much to the digitisation.) The simpler (cheaper) it is to reproduce the material shell, the more 'digital' the given segment of culture is.

It is hard to overlook the fact that culture as a whole is relentlessly being digitised. Even the markets of fashion, which at first sight have little in common with purely digital segments, are going the same way. Fiction too—which is a typically digital sector quite apart from whether we are talking about paper or Internet publications—is subject to the same influences as sound recording.

Following this economic logic, representative model situations in the cultural field were selected as benchmarks, and the operation of universal market mechanisms was observed on the basis of these examples. The rules extrapolated were then applied to more complex cases where products occupy an intermediate position between the tangible and incorporeal, the mass produced and the individually crafted. As boundary markers delimiting the research area we chose, on the one hand, the markets of digital files with artistic content (films, music) and, on the other, luxury markets, particularly upmarket watches and ties. A system of economic coordinates for culture has been constructed from detailed analysis of these segments. In the future, this will provide a basis for analysing creative practices outside the scope of the present volume.

The second part of the research is devoted to the tendency to adverse selection in culture and to ways of overcoming it. The causes of the process are analysed along with its characteristic features, the main one being paradoxical pricing. Although in the realm of culture adverse selection is difficult to diagnose (for which there are particular reasons), the present state of culture fits into this category very well. In respect of conventional markets, adverse selection has been investigated within the

¹⁷This would be based on a new approach to payment for cultural products, and collaborative filtration. See below, Chapter 1, Sect. 1.3.4.

framework of institutional economics. Sometimes markets fail and degrade. This results when some of those involved in transactions (usually the sellers) obtain a consistent information advantage and exploit it to the detriment of the other side in the transaction. The usual consequence is a falling off of responsibility on the part of manufacturers and a reduction of market share for higher quality producers. This dooms consumers to high selection costs and/or low-quality consumption. Usually markets find an antidote to adverse selection in the form of such special measures as guarantees, insurances, independent evaluation, etc. However, actual practice shows that none of these traditional means is working for culture as it should.

The only more or less effective countermeasures are mechanisms based on reputation. These are analysed in Chap. 3, which examines the economic logic of artistic reputation, the ‘star’ system, advertisement theory, and a number of other issues directly relating to adverse selection. A variety of segments of culture is analysed, including fashion and luxury goods, performance arts, and sport. We show how the maelstrom of adverse selection in the mass market sectors (which are most susceptible to this affliction) sucks in all the other sectors, including such physically mediated areas as art works and performance art. As technological innovation demolishes the economic constraint imposed by the need for minimum sales, the aesthetic markets lose their innate immunity to adverse selection. Chamber music, theatre, sport, the industries of haute couture, and so on at the first opportunity shamelessly adopt the methods of the (by definition, profitable) mega-mass sector of cultural business. In an attempt to grow their business, creators ruthlessly mine the same theme over and over again; actors, in order to escape that scourge of their profession, the need to learn lines, resort to the use of earpieces; composers redeploy their energies to the writing of ringtones, and so on.¹⁸ Those arts where no ways can be discovered to potentiate the artist’s work become marginalised and are squeezed out. This is, needless to say, only an overall tendency. There are exceptions, which stand out all the more because of their rarity.

The concluding Chap. 4 addresses the eternal question of what we mean by good and bad when referring to culture. The topic is considered on the level of social and cultural policy. Section 4.1 is devoted specifically to copyright, an institution as crucial in the present state of affairs as it is ambiguous. At one moment it is serving as a mediator which enables art and business to communicate with each other, and the next it is a bridgehead for business in its campaign to colonise culture.

The book has four Appendices. These give a thoroughgoing account of the current state of the sound recording industry, and present the evidence, the original data underpinning the chapters of analysis, for those readers who are interested. There is detailed description of documents which give insight into the current situation in this segment, which economists will find helpful when they approach music and other sections of culture.

¹⁸Television is showing the way for mobile technologies. Expert opinion holds that a mobile TV ‘programme’ should consist of clips running no longer than 90 seconds. At the International Broadcasting Convention in Amsterdam, Samsung and LG displayed new generation mobile telephones capable of receiving multi-channel TV.

A few words about the structure of this book. The structure is not pyramidal, with a linear argument and topics ranged in logical succession. It is spiral: a specific problem raised earlier is returned to for more extensive consideration. The conceptual apparatus is kept simple in the first chapters, and built up gradually. Particularly at the beginning, the precise meaning of terms is left to be understood from the context, with explicit definition left until later. These liberties are deliberately taken in order not to burden the text. Some departure from scholarly rigour has been seen as pragmatically justified by what the book sets out to do.

This is an investigation of culture in the digital age. Its main aim is to propose a practical action programme for the institutional transformation of culture. Like any other social project, the goal can be realised only if a critical number of like-thinking pioneering spirits sign up to it. That is why the book is addressed to a broad audience, all those directly involved in the production of art and culture: creative artists, performers, administrators; and those who are simply consumers of culture and interested in its arrangements. Students are particularly valued as the future managers of culture in the areas of cinema; television; newspaper, magazine and book publication; Internet projects; and performance. Economists who read the book may see culture in a new light and as a new field to work in. I hope they will not be put off by the non-canonical nature of the research.

The amazing opportunities for electronic communication and person-to-person cooperation opened up by the digital age can bring great benefits both for the digital and traditional sectors of culture generally. For this to happen, however, new tools need to be devised and pointed in the right direction. If the cultural community ignores these opportunities, we may be sure that business will press them into service, as is already rapidly taking place. This could block the most beneficial application of electronic innovations for many years to come, if not for ever. That would be a pity.

Chapter 1

A Promising Model for the Music Business

1.1 The Popular Liberation Movement in Music

1.1.1 Pros and Cons of Liberated Music

In 1999, when Shawn Fanning created Napster,¹ there was a whiff of revolution in the music sector. Exchanging music files over the Internet became much easier.² Purchasers found they could buy at one-fifth of the price of buying CDs in a shop. The Rio player, which accepted compressed music, had been invented and meant you could do without discs altogether. Young people were quick to take advantage. Seventy-five per cent of the price of a sound recording on disc may consist of distribution costs.³ When, with the coming of the Internet, Napster, and the MP3-format, popular to this day, that became avoidable, it seemed clear that the expensive discs would be uncompetitive, and that either sales would fall or their price would drop.

It seemed that the leading music companies, the ‘major labels’,⁴ which at that moment had almost totally taken over the music industry, were facing an inevitable price meltdown. Their business, which included expensive techniques of promotion and trade, would react negatively to a narrowing of the market and the appearance of alternative distribution channels. Legal manufacturers had already been suffering losses from clandestinely copied discs which sold at one-third to one-fifth of the

¹Eighteen-year old Shawn Fanning created the Napster programme after friends complained it was difficult to search for music and download it on the Internet. From July 1999, Napster offered a facility for exchanging music files in MP3-format user-to-user rather than via a central server. The server merely made it possible to search for music on the computers of other users connected to the Internet. For further details see Appendix 1, Sect. A1.9.2. Media Metrix reports that in July 1999, digital music had 4 million listeners in the USA; less than one year previously, there had been only a few hundred thousand. Some of the recordings circulating free of charge in the Napster network were protected by copyright. Napster ran into trouble 5 months later when, on 7 December 1999, the Recording Industry Association of America sued it for “direct and indirect infringement of copyright”.

²It was possible to exchange music files over the Internet prior to this, but peer-to-peer networks made it a good deal simpler.

³See Appendix 1, Sect. A1.6.

⁴At that time there were 5 major labels: Warner Music, EMI Group, Universal Music Group (UMG), Bertelsmann Music Group (BMG) and Sony. On 19 July 2004, the European Commission gave approval for the merging of Sony Music and BMG, which was part of the Bertelsmann AG group. One week later, the merger was sanctioned also by the US Federal Trade Commission for ensures compliance with antitrust legislation. Today there are 4 major labels: Warner Music, EMI Group, Universal Music Group (UMG) and Sony BMG.

price of branded discs. Despite the extensiveness of counterfeiting,⁵ it had proved possible to restrict it to less prosperous territories and contain it through ordinary methods of policing. A much greater threat was posed by music freely spread over the Internet by consumers themselves.

Although the Internet is not by any means accessible to all music lovers, you do not need to download digital music yourself. It only takes one person to copy music on to a CD, costing less than \$1, for it there and then to become available to the many. It was universally predicted that the leaking of music through the Net would bring down prices. Nobody doubted this. The only question was what was going to happen to the majors. It seemed they would either have to transform themselves, or face ruin. None of the experts imagined that not only would the main players not lose their dominant position, but they would manage to keep the price of music at almost its old level. Legal CDs cost \$13–20 retail back then, and so they do today.⁶ A single track costs just over \$1, which is close to the price of the same musical composition legally acquired over the Internet. The changeover took place smoothly, and was controlled by the hegemony of music themselves.

How did the major labels do it? Their opponents seemed to be holding all the trumps by offering a highly convenient service for the transfer of music files. On their side they had the ubiquitous availability of high-speed Internet, increasingly pro-active users, new technologies for digitising and compressing music, and the convenience of searching online. All these things together made it a good 10 times faster to find and acquire music as against buying discs in a shop. There was, in any case, a widespread belief on the part of the public that the \$15 price of a legal CD included a massive profit taken by the majors. If pirated discs could be sold at, say, \$3, and one-tenth of that was the cost of the blank, it seemed plain that legal media could not decently cost more than \$8–10, and anything over that was profiteering.⁷ Music lovers also did not take kindly to the padding out of albums, which seemed parsimoniously to include only one and a half hits, while the rest was ballast put in to justify the price.

This aroused a sense of rebelliousness against the dominance of the major labels, and the Internet community set about exchanging music with abandon, totally ignoring the rights of its creators and proprietors.⁸ This was very much in line with the ideology of the Internet community, which regarded copyright as a relic of the past. The Internet was a land where communication was free and unregulated from outside; it had been won from the tawdry world of business practice, and a majority of its adepts believed that it should in principle be protected from the baneful regulations of the private sector. In their view this was just something the offline world would have to come to terms with.

⁵On the scale of piracy, see Appendix 1, Sect. A1.8.1.

⁶From 2004 the price began to fall slightly. See Appendix 1, Paragraphs A1.5.2.1 and A1.5.2.2.

⁷This is not the case, but consumers may believe it is.

⁸In the course of a survey carried out by the Pew Research Center March–May 2003, 79 per cent of US users who downloaded music replied that they did not pay for it, and roughly two-thirds gave no thought to the matter of copyright.

The vulnerability of the sound industry to the technologies of Internet distribution could have seen this sector of the economy disappear. Why, after all, should the record labels manufacture and popularise a product for which consumers would not pay them? Faced with a massive leaking of their product through the breach made by Napster, the captains of the music industry needed to come up with something, fast. This was no simple matter. It was quite difficult to protect music content from unsanctioned copying, which was not something the MP3-format was designed to do. Neither did they immediately have legal distribution channels, for example, on-line services under their control, which were capable of competing with Napster. The same threat faced the video business and virtually all digital products.⁹ ‘Death by piracy’ did not immediately face video-cassettes and DVDs only because broadband Internet was so far insufficiently available. Films take more file space than songs, and for the time being it was less convenient to download them. This natural barrier was, however, already being undermined and might fall at any moment. The Motion Picture Association of America (MPAA) estimated that in 2004 the movie industry lost \$3.5 billion to piracy. If no formula for peaceful coexistence between the channels of distribution could be found, it would become unprofitable to promote music, and if that were to happen, even the adepts of free communications would find it difficult to know what to listen to. The function of selection was being carried out by music publishers and promoters, and, whether they did the job well or badly, whether they inflated prices or not, there was an alternative to them. For the time being, to ruin the labels would be tantamount to someone sawing off the bough on which he was sitting.

Of course, the unobstructed exchange of compositions which were already freely circulating could only gladden them. With new works, however, problems might arise for consumers. Until that happened, however, few consumers gave much thought to the mechanisms of production or the problems of those who make their living in this sector. Nevertheless, sooner or later, their predicament would need to be recognised, because outstanding creations and talents do not long survive in the marketplace if left to their own devices. Somebody has to sift out the untalented, organise high-quality sound recording, present new songs to the public and so on. It is the producers who, to the best of their ability, do this work. If it ceased to be profitable for them, the Internet would soon be inundated with hopelessly amateurish offerings. The crux of the problem was that, after a hit had been made public, the manufacturer and distributor were in practice no longer needed. They found themselves in the situation of a manufacturer of a public good who gets no recompense for his efforts. As economists know, this leads to underproduction of goods.

⁹The movie industry had faced a similar threat in the 1970s with the arrival of video cassette recorders.

1.1.2 Copyright in Defence of Whose Interests?

The appearance of Napster with its free electronic distribution appeared to signal the end of the sound recording industry as it was at the time. Nevertheless, the major labels managed to stay in the saddle, hanging on by their one and only asset—the law on copyright, which granted them exclusive property rights to music.¹⁰ This law, known in continental Europe as ‘Author’s Rights’, in this case was not so much protecting author’s rights in their work, but the rights of entrepreneurs who had bought them out.¹¹

Copyright was instituted in the early eighteenth-century to protect book publishers from treading on each other’s toes. Without it, it was difficult to embark on a publishing project with no certainty that competitors would not bring out the same work. It also helped to counteract literary pirates, who even then were enjoying the fruits of unlicensed borrowing.¹² Today, businessmen own the rights to most music that is published, and have the future output of songwriters and performers under contractual control. They have expanded into the airwaves and other channels through which music is delivered. For small and medium businesses (the ‘indie labels’) entry barriers to the market have become almost insuperable.¹³ A few very large companies have thus established a dominant position, nobody else, by and large, having the right to distribute music without first receiving a license from them. In effect, copyright allows the owners of content to legally dictate their own price¹⁴ and determine how the product is to be delivered.

The fact that the songwriter or performer of a song is by no means always the owner of the property rights to it was not self-evident to music lovers. They had no idea of the conditions on which these rights might have conceded to business. When they paid for music they wanted, primarily, to reward those who created it. The reality was somewhat different, and rumours circulating among music-lovers painted a very different picture. There were mutterings that slick operators were ripping off their idols. Usually the musicians’ take is one-seventh of the cover price, or even less. On average they receive €1–2 for every CD sold, but from this are deducted such expenses as the recording of the master disk, the production of the accompanying video, etc. It was also suspected that the companies played games

¹⁰Ruth Towse, “Copyright and Cultural Policy for the Creative Industries” (2002) in O. Granstrand (ed.), *Economics, Law and Intellectual Property*, Springer, 2004. Cited 18 November 2003. Available from URL: <http://www.serici.org/2002/towse.pdf>.

¹¹Copyright is the term used in Anglo-Saxon law, whereas continental Europe tends to talk of ‘author’s rights’. When discussing copyright, we shall normally be referring both to ownership of the work and subsidiary rights.

¹²See L. Aliab’eva, *Literaturnaia professiia v Anglii v XVI–XIX vekakh*, Moscow: Novoe literaturnoe obozrenie, 2004.

¹³On entry barriers see Chap. 3, Sect. 3.4.3.

¹⁴The UK Competition Commission determined that a secretly agreed price policy was operating in relation to CDs. Subsequently in the USA the majors were caught obtaining illegal advantage from their dominant position.

with the prices on the basis of which royalties were calculated. There were said to illegally write off 10 per cent of discs as ‘damaged during transportation’ and to exaggerate the number of discs distributed free for marketing purposes. Confirmation of such ungentlemanly conduct by the labels was believed to be seen in the fact that most musicians could barely make ends meet, and that even those who were relatively successful earned less than the average wage of the country in which they lived.¹⁵ Courtney Love estimated that musicians in the USA, an army almost 300,000 strong, on average earned \$35,000 a year.¹⁶

1.1.3 The Price Structure of Sound Recordings

Pirated discs threw a harsh spotlight on middlemen’s profits in the music industry. If the performers can expect \$2, roughly the same amount is taken as profit by pirate manufacturers on a blank disc costing less than \$1. This seemed to indicate that legal record companies were making a profit of \$10 or so on each disc. A public unversed in price formation came to the conclusion that a price three times the basic cost was extortionate. The music market, like all cultural markets, is extremely reflexive. George Soros’s attention was caught by the fact that what matters is not how matters really stand in a stock market, but what people think about it.¹⁷ Their subjective impressions determine demand and the financial health of a particular sector. If for any reason consumers decide that \$15 for a disc with only one song they think worth listening to is expensive, the music industry will not flourish. There is no law of nature which says that the price of an hour of music is \$10–20. This price might perfectly well be three times more or three times less. It can readily be calculated that one hour of reading popular literature costs consumers less than \$1,¹⁸ so why should listening to songs be so much more expensive? The price had evolved historically and, given the level of costs, was seen to be ‘fair’. Cheap counterfeit products began, however, to make it seem inexcusably inflated. Not knowing the cost structure of the legal manufacturers, consumers probably suspected a considerably greater profit margin than was actually present. Whether their suspicions were justified or not, they served to undermine the fragile consensus on price.

The actual mathematics is roughly as follows: the label sells its edition to a wholesale distributor at €7 per CD. From this must be deducted the cost of design, assembly, the cost of manufacturing the discs, sending out review copies to magazines, radio stations and Internet sites. On a good day the musicians and the label

¹⁵For economic analysis of the earnings of artists, see R. Towse, “The Earnings of Singers: An Economic Analysis”, in R. Towse (ed.), *Cultural Economics: The Arts, the Heritage and the Media Industries*, II, Chap. 11, Edward Elgar, 1997, 218–226.

¹⁶Courtney Love, “Courtney Love Does the Math” (transcript of an address to the Digital Hollywood On-line Entertainment Conference, New York, 16 May 2000. Cited 4 January 2005. Available from URL: <http://dir.salon.com/story/tech/feature/2000/06/14/love/index.html>).

¹⁷G. Soros, *Alkhimiia finansov*, Moscow: Infra-M, 2001.

¹⁸See the table of consumption costs of cultural/media goods in Chap. 2, Sect. 2.3.

itself will each get €2. The wholesaler distributes the discs to shops at approximately €10 per unit, collecting €3. The final price to the customer, somewhere between €15–18, is decided by the shop. This includes VAT (approximately €2), so that the return to the shop itself is €3–6. If a company is simultaneously acting as wholesaler, the resale stage is skipped. In addition, in the case of larger editions, the manufacture and marketing of the product is cheaper.

When, alongside discs which had been ‘burned’, a music distribution channel over the Internet appeared, the difference in price became embarrassing: it was the difference between \$20 and almost nothing. Internet delivery, moreover, not only freed customers from the need to pay anything at all, it even salved the pangs of conscience, which possibly troubled those buying pirated discs from a market stall. The public left it to the Internet gurus to worry about the ethics of free exchange of music files, and they energetically underpinned their emergent ideological platform. The teenagers on whom the sound industry had staked its money from the early 1990s repaid it with rank ingratitude, and defected in droves to pirate sources.¹⁹

Quite apart from the obvious motive of saving money, adolescents had just learnt how to use a computer and wanted a practical application for their skills. Interacting with providers of music content was just what they needed. It is germane that around two-thirds of the entire data flow on the Internet related to music files.²⁰

Although those who owned the rights still dominated the market, there seemed to be no stopping ‘weightless’ music whose advance was boosted by the spread of broadband, mass production of the technology needed for receiving digital music, the increasing capacity and diminishing cost of flash memory. The ratio of purchasers of discs to users of files shifted relentlessly in favour of the latter.²¹ Cost-free file exchange in tandem with the more familiar audio piracy seemed set to take over completely.²²

The labels realised that it was essential to explain the economics of music to their customers. In order to deflect the attacks raining down on them from all sides, they began regularly informing the public about the difficulties of their business, representing it as an extremely risky occupation largely motivated by altruism and a desire to serve to the muses.²³

¹⁹Universal makes a profit of only 14 per cent on music for teenagers, as against 53 per cent on pop music for adults aged 25–39.

²⁰OECD, “Peer-to-Peer Networks in OECD countries”, in *OECD Information Technology Outlook 2004* (online), Chap. 5, Paris, 2004. Cited 6 October 2004. Available from URL: <http://www.oecd.org/dataoecd/55/57/32927686.pdf>. This reflects the situation in 2002, since when the proportion of music content on the Internet has declined steeply.

²¹Forrester Research estimates that by 2008 online music will account for 39 per cent.

²²According to *PC Magazine*, in 2003, 60 million users in the USA considered file sharing convenient and agreeable. This was before the wave of lawsuits by the RIAA against private individuals actively exchanging music on the Internet, and before legal on-line services were widespread.

²³Chuck Phillips, “Record Label Chorus: High Risk, Low Margin”, *Los Angeles Times*, 31 May 2001.

They claimed that pop music was a segment with a low profit level.²⁴ More than 90 per cent of CDs issued were flops. This is confirmed by statistics compiled by Soundscan: in 2000, out of 6,188 albums only 50 sold more than one million copies, 65 managed 500,000, and 356 succeeded in selling 100,000 or more copies. On average, for an album released by a major label to be profitable it needs to sell 400,000 copies. When, in a paroxysm of openness, the top management of Vivendi Universal, AOL Time Warner, Sony, Bertelsmann and EMI Group allowed *The Times* newspaper access to the internal budgets of their music projects, it transpired that:

- only one in ten performers or groups would ever return a profit;
- production and distribution of a compact disc cost \$2, but marketing expenditure could be as high as \$10;
- successful performers broke their contracts, refusing to record the next album before they had been conceded better terms.

The labels admitted that in the past artists had not always received satisfactory compensation for their work,²⁵ but insisted that justice was now being done. A 30 billion dollar industry with an annual profit of \$3.5 billion was paying performers fair royalties, commensurate with the risk they were willing to take on themselves. The fact that few artists were inclined to share the risks of business was their personal choice.

The public did not believe the capitalists' crocodile tears, and regarded their PR as the machinations of wolves in sheep's clothing. Sympathies remained firmly on the side of the musicians. To be fair, music corporations or no worse and no better than any others. Business really is risky, and the contracts between representatives of commerce and art are invariably complicated.²⁶

1.1.4 The Economic Basis of Contracts in the Music Industry

A standard contract between a sound recording company and a pop musician will contain the following provisions²⁷:

the company pays the musician an advance for recording a first album and agrees the amount of the fee (royalty). On receipt of the studio recording, the company

²⁴The profit of one of the most successful sound recording companies, Universal Music Group, is approximately 15 per cent. (K. Law, "Music Industry Structure: Why Madonna Never Complains" (online), September 2003. Cited 4 January 2005). Available from URL: <http://www.pacificavc.com/blog/2003/09/a376>.

²⁵In particular, when in the early 1980s compact discs began to squeeze out vinyl gramophone records, music was re-sold in supposedly 'higher quality' editions. The entire income from this was taken by the sound industry, the musicians receiving nothing.

²⁶The contract for movie actors in the USA can run to 400 pages.

²⁷R.E. Caves, "Contracts Between Art and Commerce", *Journal of Economic Perspectives*, 17, 2, Spring 2003.

decides whether or not to market the album. From the moment it is issued, the clock is ticking in relation to the next album, which will bring the performer a higher advance and higher royalties. The company decides how to treat each album on an individual basis. If the income does not cover the advance, the deficit will be taken out of the profit on subsequent recordings. This is called cross-collateralisation. The company has the right to decide on this, and the musician cannot break his contract and record albums for a different company until the period of the agreement has elapsed. This can be as long as 10 years. The thinking behind taking the cost of recording the album out of the advance will encourage a group to make effective use of its time in the studio, and not to indulge in perfectionism. The long-term nature of the contract is needed in order gradually to recoup the costs of the early albums.²⁸ Explanation of this logic did not, however, stop the public from sympathising with the musicians whom they believed to be enslaved by monsters.

Why would a company not just exercise magnanimity and sign a short-term contract, allowing their idol to enjoy his success from the very outset? The answer lies in the fact that, as mentioned, 90 per cent of recordings make a loss.²⁹ In 2001 in the USA only 112 of 6,455 new groups promoted by major companies, fewer than 2 per cent were able to return the money invested in them. Why is the artist not allowed to make his own decisions? Well, because with his belief in art for art's sake³⁰ he is likely to blow the entire budget by dragging the recording out endlessly. In principle a performer could negotiate the right to have a greater say and a greater share of the profits in return for a reduction of guaranteed payments.³¹ At the beginning of their career, however, few have the courage to do so. Later on, if their career takes off, it is too late too alter the terms of the agreement. Is this not fair? The person taking the risk reaps the rewards? Quite understandably, artists tend to overlook the risks and focus on the rewards. Each side sees the other as causing the problem. The partners go on to hang out each other's dirty linen for the journalists to inspect, and they further inflame passions. Everybody is as guilty as everybody else:

- record labels are seen as committing larceny with their contracts and callousness towards artists;
- artists are seen as perfidiously seeking to make a pile and decamp;
- superstars want to get their teeth into one fifth of the takings, which is almost more than the company's share;

²⁸For more detail on contracts between performers and companies, see Appendix 1, Paragraph A1.4.4.2.

²⁹Chuck Phillips, "Record Label Chorus: High Risk, Low Margin".

³⁰The 'art for art's sake' argument is two-edged, sometimes referring to the satisfaction which artists receive from creating as grounds for paying them less. Alternatively, it can refer to artists' ideas about how works should be performed and when they can be considered completed. In the latter case, the principles of the artist or performer may complicate the drawing up of the contract. This is makes itself acutely felt when deciding who has the right to take decisions about when and how work should be released. R.E. Caves, "Contracts Between Art and Commerce".

³¹On payment for the work of musicians, see Appendix 1, Paragraph A1.4.4.3.

- pirates and file exchange services are knocking prices for six;
- music lovers want to help themselves to freebies.

The last villain in line is the retailer with his unbelievable markup and voracious appetite for hits.

1.1.5 Peripeteias of the Introduction of Internet Distribution

In fact, each of the players in the market was conducting affairs to the best of his ability. The economic scenario was that the major labels invested in production, and in return monopolised the authors' property rights and the right to set a price which would return a profit. The multiple by which the retail price exceeded production expenses did not indicate profiteering on the part of the record company, and was not excessive if the interest of the seller was taken into account.³² This is the normal markup for goods, for example, clothing, with complicated transport and warehousing logistics. Getting such products to the end user just does generate high costs. Distribution over the Internet does not, of course need shops or warehouses and music delivered in the form of files can be cheaper. The record companies' high markup was the only way to even out the risk of losses from unsuccessful music projects. Super-profits on particular hits negated losses on albums which flop. The real threat for the labels from uncontrolled and virtually cost-free Internet distribution was that it creamed off the profits from the most commercial songs. The industry would itself very much have liked to take advantage of low-cost Internet distribution, but it was a system ill-protected from freeloaders. Plainly, constructing a viable Internet business would take time, and although that day was not in the distant future, for the time being the corporations were obliged to exploit the morally outdated scheme of delivering music on physical media.

If recording music is not that expensive, why should not artists who are not bound by contracts turn to Internet promoters? They could launch their music on the Internet free of charge. But then what? Where would the royalties come from, if only at the niggardly levels paid by the parsimonious labels? To make matters worse, collecting money is only part of the story. No less important is how to promote the music. The Internet community would not hear about new products without a little help.³³ Somebody would need to give it pointers. That is what promoters do, and consumers manifestly underestimate their importance. Since individual musicians, especially those just setting out, could not afford to pay them, the notion of alternative distribution proved something of a non-starter. They were left with no option but to collaborate with the labels. It was all very well to criticise the labels, but if nobody

³²On the distribution of compact discs, see Appendix 1, Sect. A1.5.2.

³³Bloggers can partially resolve the problem, but even they are not always wholly reliable, and if money was involved the results would probably fall far short of what the community would consider acceptable.

could provide a better service, they could not be doing all that badly. Internet operators were capable of delivering the music, but not or providing a comprehensive service. The record labels were within their rights in not just handing over the most profitable part of their business activity. They consolidated their monopoly over the product by developing a monopoly on access to the airwaves and the retail trade.

What did that leave for the inventors of advanced technology for delivering music? They might not be able to take on the full range of production,³⁴ but the part they could do they were prepared to do for one tenth of the price. Overall, they could deliver music at half and possibly one third of the traditional price, which benefited everybody except the labels. The law, however, was on the side of the latter, and gave them the right to conduct their business as they saw fit, to appoint distributors of their choosing and dictate terms to them. On the other hand, whatever the law might say on the matter, the competitive advantage of the Internet channels was so substantial that there seemed to be no stopping it. Since the new players had no prospect of reaching an amicable agreement with the monopolists,³⁵ adopted a piratical stance. They based their strategy for market entry on blackmail, not attempting to make money from selling music directly, but instead stimulating free circulation of tunes on the Internet, introducing users to a new means of access, and popularising themselves as service providers. Their thinking was that, if the labels would not allow them into the market, they would spoil their game. They would dump free music until the labels accepted it was cheaper to buy them out than to destroy them.

That is precisely what the labels did. They either bought up independent online distributors, or bankrupted them through legal action while simultaneously themselves undertaking a crash course in the art of trading on the Internet. They have not proved too successful at this so far, since setting up a high-quality paid service is a good deal more difficult than giving out free music without having to worry too much about how convenient customers find the service.³⁶ We can already see, however, that legal music trade on the Internet is finding its feet.³⁷ The younger generation, who are the core of the Internet community, do admittedly continue to favour free downloads.

³⁴A typical budget for a Top Ten single in the United Kingdom would be: recording—£3,500; promotional video—£40,000–60,000; remixes—£5,000–10,000; merchandising—£9,000; video ‘plugging’—£2,000; radio plugging—£3,000–5,000; posters—£3,500; stickers—£1,500; PR (press)—£2,000; promo copies/postage—£3,000; creation of website—£10,000; manufacturing costs (50p per CD)—£20,000; royalties—£11,200. Total £113,700 (Brian Wheeler, “Counting the Cost of a Hit”, BBC News Online, 9 August 2001. Cited 28 November 2004). Available from URL: <http://news.bbc.co.uk/1/hi/business/1470667.stm>.

³⁵Napster offered the corporations 1 billion dollars for the copyright of the music, and later the company’s patrons offered several times more, but the labels naturally turned it down because their income is much higher.

³⁶On the difficulties of developing legal online distribution of music, see Appendix 1, Paragraph A1.5.3.2.

³⁷For data on legal online sales, see Appendix 1, Sect. A1.5.3.

1.1.6 The Elusive Avengers

In just a very few months from the moment of its birth, Napster became absurdly popular. Its user base grew almost exponentially day by day, and in parallel a number of siblings closely resembling it further developed file exchange services. The music industry was being robbed in broad daylight. Despite the fact that copyright was being infringed, as was clear from the fall in legal sales,³⁸ it proved very difficult to actually catch anybody red-handed. There were two aspects to the offence in law: illegal exchange of music, and facilitation of the process. These two operations were divided separately between the professionals (the pirates) and amateurs in such a way that it was difficult to prove the guilt of either. In itself, there is nothing illegal in providing a service which enables content to be distributed through file exchange. The free exchange of files between private individuals was a perfectly legitimate activity, and it was difficult to determine exactly where permitted individual use became abuse. People were exchanging recordings in the same way that they might exchange books, no money was changing hands, and nobody was making a profit.

In the activity of those developing software which provided an basis for searching for and exchanging information, it was also very difficult to differentiate between the provision of a valuable public service and violation of the law.³⁹ The parting of the record labels from their property was being conducted very elegantly. The file exchange service protested that it served the noble of publicising fledgling artists and acquainting listeners with examples of their work. It was being used illegally, then this was wholly the blame of music lovers, but they too, for the time being, appeared to be blameless. The end result was that some seemed to be offering the means by which others were achieving ends, and in the process nobody was paying anybody anything. The means could be used in an entirely legitimate manner, or could cause harm, and in just the same way the ends could be legitimate or not. There was no visible, documented evidence of criminal activity, and no witnesses in a conventional sense.⁴⁰ The file exchange services insisted they were doing nothing improper, and if their actions were devaluing somebody else's rights, that was a problem with copyright.

1.1.7 Socio-economic Counterbalances to Copyright

The copyright system proved ill-equipped to deal with this turn of events. The law had no precedents for the situation on the Internet, and music poured through the

³⁸During 2000–2003 the volume of the sound recording markets fell by \$6 billion. By the end of 2003 it stood at \$31 billion, the same level as in 1990.

³⁹The law distinguishes between direct and indirect complicity in infringement, as we shall see below.

⁴⁰Although records are kept of all Internet processes and communications, infringers find ways round this; for example, by registering false identities, which defeats the system.

gap. This was further facilitated by three features which distinguish music as what economics calls an information product. In the first place, music is an experienced good, or to put it another way, a good that needs to be valued. You need to hear it to know whether you like it and want to buy it. In the second place, it is far easier to replicate the content than to create it. And in the third place, it is not used up in the process of consumption; users are not competing with each other for a scarce resource, indeed they have an interest in expanding the circle of the initiated.⁴¹ To oblige the purchaser to conceal the content if he didn't feel so inclined was a separate matter.⁴² It is very difficult to sell such a good, because if you need to reveal it in order to show what you have for sale, but here demonstration is virtually tantamount to consumption. Having consumed an information product, you may not buy it (this does not apply to music),⁴³ and, more ominously, it can be copied by those intent on distributing it themselves. One could easily be left with no revenue. It does not take a lawyer to see that it is extremely difficult to halt the spread of information which has been revealed. The more so if:

1. Illegal use leaves virtually no traces which can be cited in a lawsuit;⁴⁴
2. The acts of those breaking the law are very similar to customary social practices. A recording could be legally acquired by one person and transferred to friends over the Internet. They had no reason to enquire into its provenance. Indeed, they had every reason to suppose that by listening to the music they were doing its authors a favour, and that it would be perverse to pay for this. It was to prove difficult to discriminate clearly between permissible and impermissible joint consumption of a work, and even more difficult to catch offenders red-handed, unless people's private life were to be totally monitored.
3. The 'abduction' of music was not directly linked to gain. The participants in file exchanges did not pay each other or engage in illegal entrepreneurial activity.

Accordingly, although the problem was very acute for them, it was no easy matter to organise a legal defence for the rights owners.

1.1.8 Blunting the Pirates' Competitive Edge

No matter how elusive and innocent the bootleggers might be, the loss of revenue was counted in billions of dollars, and nobody was going just to put up with that.⁴⁵ The labels might have been punched into a groggy state, but they fought back with

⁴¹On the value of knowledge shared within a community, see the notes in M. Adler, "Stardom and Talent", *American Economic Review*, 75, 1, March 1985, 208–212.

⁴²A Digital Rights Management (DRM) system has been created to combat copying. See Appendix 1, Sect. A1.10.1.

⁴³Music which people like is listened to repeatedly and it is convenient to have it to hand.

⁴⁴As wireless communications develop it becomes even more difficult to identify infringers.

⁴⁵See Appendix 1, Paragraph A1.8.1.1.

determination, arming themselves with the letter of the law. Since the end-users, who were the real lawbreakers, were dispersed and difficult to get at, the first target they attacked was Napster. The Recording Industry Association of America took it to court and, at the end of an extremely complex lawsuit, the service was ruled to be illegal.

There were found to have been three important breaches of the law:

1. As it had effective control of a service involved in infringement of the law, Napster was in a position block the misappropriation of music but failed to do so.
2. Napster obtained financial gain through facilitating illegal activity.
3. Napster failed to present a sufficient number of instances of its service being usefully employed for legal purposes.

The result was that Napster was closed down,⁴⁶ and with that the problem would seem to have been solved. This, however, was a pyrrhic victory. The Court unwittingly did the plaintiffs a very questionable favour. The controversy attracted media attention, and Napster gained unprecedented popularity. Through the efforts of its supporters a vast amount of digitised music was set free to roam the Internet. Fanatics assembled collections of millions of songs on their computers and willingly shared them with all and sundry. A chain reaction began which drew in hundreds of thousands of volunteers, file exchange systems helping them to find each other. Even as the court hearings were proceeding, illegal file-exchange services, clones of Napster, were sprouting like mushrooms after rain. Lawsuits were also brought against them, and some analogous cases were eventually won by the major labels, who managed to demoralise their most conspicuous competitors and put them out of business.⁴⁷ Even where it proved impossible to prove the guilt of providers, they were made to suffer through the imposition of legal costs. Would-be players, observing how the wind was blowing, were scared off and kept their heads down. A number of projects already begun were abandoned to avoid trouble. The labels drew their rivals into a war of attrition and used their financial muscle to crush them.⁴⁸

There were, however, some followers of Napster who learned lessons from the court case, and although their actions inflicted no less damage on copyright holders, they devised ingenious stratagems which enabled them to avoid legal liability.⁴⁹

⁴⁶Ruling of the US Circuit Court in the case of RIAA vs Napster of 26 July 2000. For more detail on the case, see Appendix 2, Sect. A2.1.1.

⁴⁷Examples will be found in Appendix 2, Sect. A2.1.2.

⁴⁸The concept of a war of attrition was introduced to population dynamics by John Maynard Smith to explain the battle between animals for prey. In games theory, firms are likened to animals which fight for control of a sector with increasing ferocity. The aim of the battle is to force one's rival out of the market. Jean Tirole, *Rynki i rynochnaia vlast': teoriia organizatsii promyshlennosti (Markets and Market Power: The Theory of Industrial Organization)*, 2nd revised edition, II, St Petersburg: Ekonomicheskaja shkola, 2000, 187.

⁴⁹The balance of power is constantly shifting between the two sides. For more detail, see Appendix 2.

1.1.8.1 Lessons of Napster. The Grokster Case

In this respect, the celebrated case of MGM Studios and others against Grokster and StreamCast Networks (2003, hereafter referred to as the Grokster case) is instructive.⁵⁰ The RIAA tried unsuccessfully for two years to obtain a ruling in its favour. Unlike Napster, the defendants in this case did not draw the information flows to themselves, but distributed software for the exchange of content through so-called peering networks, directly from user to user. As in the Napster case, the offence and the facilitating of it were separated, but so ingeniously that several courts at different levels were unable to establish the guilt of the defendant.⁵¹ As with Napster, there was no difficulty in demonstrating the obvious fact that end-users were infringing copyright, but how should the provision of auxiliary devices, software or equipment to be viewed? The provider of services cannot always be held responsible for his customers' actions. Indeed, in the Sony 'Betamax' case,⁵² which was referred to as a key precedent during the Grokster trial, it had been found there was no liability.

The law recognises liability for contributory infringement of the law and also for vicarious infringement. Contributory infringement is indicated in a case where the defendant knows about actual and not simply hypothetical infringements carried out at a time when he is physically involved in them. Vicarious infringement occurs if financial gain is present, and if the defendant could have controlled the process of infringement of the law but failed to do so. In the case of contributory infringement, the manufacturer is not liable for the fact that no mechanisms have been included in a product which would hinder illegal use. To put it more straightforwardly, the manufacturer is not responsible for how exactly a customer makes use of his product.

Ben Challis set out a number of considerations a court might take into account:⁵³

1. Are there [substantial] non-infringing uses? (*Sony Betamax*, *RIAA vs Grokster*, *Tariff 22*, *CBS vs Amstrad*) and can the defendant prove this (*RIAA vs Aimster*)? (For example, StreamCast persuaded the court that the Morpheus programme was used for searching for generally accessible materials, state documents, computer programs, and media content.)
2. Does the provider have clear knowledge of infringing uses? 'Wilful blindness' is no defence (*RIAA v Aimster*, *RIAA v Grokster*, *RIAA v Napster*):⁵⁴

⁵⁰See Appendix 2, Sect. A2.1.2.

⁵¹Only in summer 2005 did the court rule that certain aspects of the activity of the operators of peering networks were illegal. See Appendix 2, Sect. A2.4.

⁵²See Appendix 2, Sect. A2.1.2.

⁵³This shows how delicately balanced copyright issues can be. See Ben Challis, "Don't Shoot the Messenger: Copyright Infringement in the Digital Age", Mondaq (online), 24 November 2003. Cited 9 July 2004. Available from URL: <http://www.mondaq.com/article.asp?articleid=23411>.

⁵⁴During the hearing into Napster, two documents were cited in court in an attempt to prove that the defendant knew about infringements in its system. In the first, written by one of the founders of Napster, there was mention of the "need to continue to ignore real names and IP addresses of users, as they are exchanging pirated music". The second was evidence that the Recording Industry Association of America had informed Napster that it had more than 12,000 counterfeit

3. Is the provider able to supervise infringement if it so wanted? (*RIAA v Aimster*, *BPI v easyinternetcafe*)?
4. Has the provider materially contributed to infringements? (*Tariff 22*, *RIAA v Aimster*) e.g. could a provider remove an encryption system? Does the provider provide any assistance to those who do infringe?
5. Does the provider financially benefit from infringing uses even where the provider is not infringing itself? (*RIAA v Aimster*, *STEMRA/BUMA—v Kazaa*, *JASRAC v MMO*)?

Courts at various levels concluded on more than one occasion that Grokster/StreamCast were not conniving at exchange of files between users in the way that Napster had. Their clients themselves entered the network, themselves determined which files they wanted to share, themselves sent and received requests, and downloaded information, —they were doing all this without any kind of participation of the defendants. Even if the defendants went out of business, file exchange would continue. The software which Grokster was distributing was not their own. They could not change it. They did not own the network. There was no centralised file exchange server being supported as in the case of Napster. All this ensured their almost complete non-liability, despite the fact that their goals and tasks were the same as those of Napster. In total Grokster withstood the attacks of the major labels for two years, but on 27 June 2005 the US Supreme Court finally ruled that the service was illegal.

There is one other legislative precedent—the Kazaa case.⁵⁵ If the pioneer of file exchange could be stopped simply by pulling the plug, there was no plug to pull in the case of Kazaa. Users traded files by means of thousands of anonymous ‘supernodes’.

Moreover, soon after the serving of a writ on the Amsterdam company Kazaa.com, it dematerialised along with its owner Niklas Zennström. There no longer was a legal entity which could be closed. A few days later the firm was resurrected in a form just as decentralised as the peer-to-peer service it offered. Zennström, a Swedish citizen, transferred control of the software’s code to a company called Blastoise, registered on a remote island of the coast of the UK which was well-known as a tax haven. It was operating in Estonia, a haven for digital pirates.

The Kazaa interface was transferred to another company, Sharman Networks, registered in the state of Vanuatu and based in Sydney. The Kazaa.com domain was registered to the Australian firm LEF Interactive, whose name is derived from the French Revolution’s call for “Liberty, Equality, Fraternity”. It was virtually impossible to determine who should be sued. The Hollywood lawyers decided it would be

files in its system. In the case of Sony Corporation of America vs Universal City Studios, the sale of video cassette recorders was not regarded as cause for condemning Sony, despite the fact that the defendant was aware that the devices were being used illegally. The court ruled that the sale of copying equipment and other goods was not tantamount to complicity in infringement of the law if the goods would mainly be used for legitimate purposes.

⁵⁵For further details, see Appendix 2, Chap. 3.

best to squeeze Sharman, but it transpired that Sharman had no staff. All its workers were employed through LEF Interactive. The names of the investors and board members were locked away in Vanuatu, a bastion of confidentiality in matters of ownership. Kazaa was a corporate matryoshka doll which tormented the Hollywood lawyers for more than a year. During this time countless copies of the Kazaa software were downloaded, and by the beginning of 2003 it had more than 22 million users in the USA, and 60 million worldwide.⁵⁶

In December 2003, the Supreme Court of the Netherlands considered but rejected a writ from Buma/Stemra.⁵⁷ Against Kazaa, rejected it, ruling that Kazaa was not infringing authors' rights. The court found Kazaa not guilty because it could not prevent the exchange of counterfeit files.⁵⁸ A first precedent was thus established in Europe confirming the right to develop software for peer-to-peer networks.

The verdicts of a succession of courts in favour of file exchange services showed that the days of the traditional ways of selling sound recordings were numbered. Business itself came to recognise that it was a waste of time relying solely on the law of copyright. No artificial barriers could block this high-speed, low-cost distribution channel, and the monopoly was going to be destroyed sooner or later.⁵⁹ The rights owners prepared to seize the initiative and initiate reform of the sector. For this however, they needed time. With the benefit of hindsight, we can see that the process took around six years. Recognising that the pirates could not be litigated out of existence, and that in the meantime illegal exchange of music was spreading dangerously in spite of all their counter-measures, the corporations adopted a different tack. Technical measures to protect content were developed,⁶⁰ a campaign was begun to highlight the unethical aspects of piracy, and much else. These defensive actions were intended to raise the cost of the alternative distribution channels and make them less attractive to their users. They saw two options: to raise the costs of those offering a file exchange service; and to create problems for the users of unlicensed channels. The corporations brilliantly succeeded at both of these tasks.

In addition to copyright law, they now exploited a fifth column inside the camp of their enemy, for whose appearance the network players were themselves partly responsible.

⁵⁶Todd Woody, "The Race to Kill Kazaa", *Wired* (online), Issue 11.02.2003. Cited 19 June 2004. Available from URL: <http://www.wired.com/wired/archive/11.02/kazaa.html>.

⁵⁷Buma/Stemra is an agency representing local and foreign composers, songwriters and publishers of audio products in the Dutch market.

⁵⁸In September 2005, the Federal Court of Australia found Kazaa guilty of condoning infringement of property rights of the music labels. It added, however, that the service should have the right to continue to exist if it set up filters to make it possible to find only non-copyright files. For further details, see Appendix 2, Chap. 3.

⁵⁹On the how the various music distribution channels interrelate, see Appendix 1, Paragraphs A1.5.2.1, A1.5.3.1 and A1.5.3.2.

⁶⁰See Appendix 1, Sect. A1.10.1.

1.1.9 *The Piracy Business Model*

The information pirates could not go on representing themselves as Robin Hoods forever. Their presence on the Internet involved no great overhead costs, but did require some financial support. Digitally liberated music did not automatically convert into cash, and if they were to work on a professional level, while simultaneously fending off endless lawsuits, they needed some revenue. While the pirates were giving music away free, everybody loved them, but when their users began to notice how they were financing their activities, the enthusiasm waned. The pirates were unable to take payment directly from individual users. Like any other media business, the music industry must either rely on content that sells itself, or it must serve as a platform for advertisements or offering services to other businesses. The pirates began marketing their customers' attention to advertisers and marketing organisations, and also to trade in information about them.⁶¹ As Henry Wilson, the founder of Grokster, said, "All file-sharing clients must add these types of revenue generators at some point. . . We think this is a small price to pay for the ability to have free access to the files that are shared on Grokster."⁶² This was the opinion also of Niklas Zennström, one of Kazaa's co-founders: "Money has to come from somewhere. There are many people who think that everything on the Internet should be at no cost and free of advertisement—but that is, of course, not the way that companies can operate."⁶³ As the pirates became more commercialised, they became less of a moving target and more vulnerable to countermeasures. The labels took advantage of this, methodically seeking to discredit the illegal distribution channels. All manner of obstacles were slipped into pirate networks.⁶⁴ Pseudo-pirate websites distributed corrupt files (which, for example, could not be fully downloaded). Apparent music files coursed the Internet which, when downloaded, threatened court action. In some cases doctored files were interrupted by appeals to users from the artists themselves to desist from listening to bootlegged music. Other nasty surprises were in store.⁶⁵ In effect, the pirates had their own methods used against them with a fair degree of success. The growth of the practice of illegally exchanging music slowed. For all that, PricewaterhouseCoopers predicted that no real breakthrough

⁶¹The hidden software "captures activity and sends it home to the mothership". It is capable of "capturing every keystroke, reading every file. It could even modify your e-mail after you hit 'send', adding or deleting things without your knowledge." (Ray Everett-Church, well-known privacy consultant). Quoted in Damien Cave, "The Parasite Economy", *Salon* (online), August 2001. Cited 20 September 2004. Available from URL: http://archive.salon.com/tech/feature/2001/08/02/parasite_capital/print.html.

⁶²Damien Cave, "The Parasite Economy".

⁶³Quoted in Damien Cave, "The Parasite Economy".

⁶⁴Specifically, a group of hackers called Gobbles Security announced that it had created an effective weapon for destroying musical piracy on the Internet. This information could not be verified.

⁶⁵See Appendix 1, Sect. A1.9.5.

was imminent.⁶⁶ And of course, there was little anybody could do about the music which had already been ‘liberated’.

In peer-to-peer networks the problems multiplied: files names were deliberately falsified; there was meddling with the downloading queue, and the process itself could be slowed down, etc. Quite apart from this, glitches occurred with increasing frequency because of the phenomenal volume of traffic. The most important, and ever more obvious, drawback to the free channels was the obtrusive advertising and the spyware which accompanied the music.⁶⁷ Illegal downloading began to lose its attractiveness in comparison with the paid channels, which in 2003–2004 were joined by legal online services which the corporations had finally got up to speed.⁶⁸ By this time the record labels had virtually gained control of the situation. They evidently felt confident enough to embark on the trickiest part of the attack: they started taking private individuals to court. By this time, management had probably realised that the unity of the Internet community was not all it had been cracked up to be. There was no real danger of a broadly based popular front.

1.1.10 RIAA vs the People

The first to fall foul of the RIAA were the most shameless uploaders, those offering more than 1,000 songs for downloading. US law provides for fines of \$750–150,000 for each violation of copyright. On 3 April 2003, four students from different educational institutions were fined sums of \$12,000–17,000 for direct and indirect infringement of copyright. The public promptly started sending them money, and two months later one of the offenders, Jesse Jordan, put a request on his site for no more to be sent, since donations had already reached \$12,000.

The RIAA offered an amnesty: for those who voluntarily paid a fine before having a case brought against them the penalty would be limited to \$3,000. In September 2003, the RIAA sued 261 individuals. These included Brianna LaHara, a 12-year-old honours student living in a New York City Housing Authority apartment, Durwood Pickle, a 71 year-old Texan who had allowed his grandsons to use his computer during their visits, and also Sarah Ward, a 65-year old sculptress and teacher who had only Macintosh computers in her house, which cannot be used on peer-to-peer networks.⁶⁹ The RIAA’s intelligence was not always without flaws. In 2003 a total of 6,000 cases were brought against private individuals. Trials took

⁶⁶*Global Entertainment and Media Outlook: 2002–2006*, Price Waterhouse Coopers. (online). Cited 15 July, 2003. Available from URL: http://www.pwcglobal.com/e&m/outlook/Outlook2002_ExecSummary_Final.pdf.

⁶⁷See Appendix 1, Sect. A1.9.7.

⁶⁸See Appendix 1, Paragraph A1.5.3.3.

⁶⁹For Apple Macintosh computers to work in P2P a specially adapted programme is required. Those who set up peering networks were in no hurry to write this, and it was not suitable for all P2P files.

place throughout the country, and the risk of fines and protracted court procedures had many seriously worried. Nobody could be sure that the next step might not be for the RIAA to turn its attention to anyone downloading large amounts of pirate music.⁷⁰

While all these battles were being played out, it became evident that the advertising with which illegal providers were loading their music, when recalculated as consumer costs, was no less burdensome than the fees charged by legal suppliers.⁷¹ The legal and illegal channels began to reach a state of equilibrium of costs, rather like the level of fluid in communicating vessels. People began to recollect that the labels did actually produce and promote the music, whereas the pirates were parasites living off other people's work. Lauren Weinstein, creator of The Privacy Forum, summarised: "If the only way that file-sharing companies can survive is through inducing consent [to download spyware], then maybe they don't deserve to survive. Their actions are completely inappropriate."⁷²

1.1.11 How Much Does It Cost to Find a Song You Like?

Now, when the passions roused by the invention of Napster have settled, or nearly settled, and it is clear that the major labels are going to force the Internet to serve them, let us turn away from their problems and approach the music business from a different angle.

Obviously enough, the mission of the music industry is to offer various tunes and songs, but what is behind that huge variety? It is a fact that every year just under half a million songs are produced, of which only 100 or so become hits. The industry's annual receipts are just over \$30 billion, which works out at \$300 million per hit. Does that seem a bit on the expensive side? The question is not, of course, entirely sensible, and far more important than the price of a hit or a statistically average song is whether or not the labels are managing to provide the consumer with music he likes.

The creativity of the sector depends on how well large, bureaucratised companies with turnover in the billions interact with a business unit as tiny as a music group.⁷³ There are, of course, artists who have qualities which business needs but which are of secondary importance for the creation of music. The system singles these out as amenable business partners, stress resistant, down to earth, capable of completing the job on time, and so forth. In fact, however, where creative personality is concerned, the combination of inspiration and mental stability, emotional intensity and social competence, intensity and sociability, is rare. Those who commune with the

⁷⁰See Appendix 2, Sect. A2.3.2.

⁷¹See Appendix 1, Sects. A1.9.5 and A1.9.6.

⁷²Damien Cave, "The Parasite Economy".

⁷³A number of such aspects of creative work are considered in Appendix 1, Sect. A1.4.4.

muse are in general capricious and not good news for management. As they say in the fashion industry, the best model is the one who turns up on time.

How good are the record labels at stimulating creators and performers of music, and what kind of music do they put on the airwaves? The critics seem to feel that this creative dimension is unexciting. The labels cater for mass demand, which they themselves mould. They are into the business of musical mass production and the promotion of stars. Promoting a single successful song is not their thing. What they need is a string of songs and albums associated with a popular performer, otherwise they will be unable to cover the costs associated with promoting a name and turning it into a brand. Hence the relentless system into which a star is locked, like a squirrel in a wheel. Knowing that they have to run a marathon, performers flog to death any musical theme which they have found successful. Anybody unable to go the distance or to feign elation is rejected by the system. Peter Gabriel, the former lead singer of Genesis, claims, "The economic restraints of the traditional business model have for all these years dictated what music can be made and when and how it can be sold."⁷⁴ This has probably had a less than ideal effect on the product created.⁷⁵ The opinion of the representative of one of the sides cannot, of course, be taken as ultimate truth. We are still some distance away from that.

What matters to the consumer is not only the total number of works of high quality, but also how and whether they can be rescued from the flood of offerings. Of those half a million compositions produced annually, almost 1,500 a day, the amount reaching the ears of the consumer that is worth listening to is not that great. Any human being would be content with one thousandth of what is on offer, and by no means everybody finds his way through to tunes he wants to listen to.⁷⁶ The sheer quantity of music increases year after year, and in the end even the most dedicated music lover begins to feel glutted.

Nobody can predict at the beginning of a project how commercially successful it will be. There is a wry saying in Hollywood that, "Nobody knows anything", for sure at least. All that is known is that one in ten of the albums brought out will be profitable. Unfortunately, there is no telling in advance which that will be. To be on the safe side, the labels submit all their products to the judgment of listeners. There is also the consideration that, having created a product, no matter what its quality, they would like to get back at least some of their money. Fortunately, demand can be stimulated.⁷⁷ The upshot is that the market stall of music stall is piled unreason-

⁷⁴A. Shirikov, "Soiuz nerushimyi artistov svobodnykh", *Komp'uterra* (online), No. 28, 10 August, 2004. Cited 18 January, 2005. Available from URL: <http://offline.computerra.ru/offline/2004/552/35147/>.

⁷⁵This has been true of every aspect of the segment. If cooking recipes could be copyrighted, then instead of small, medium and large pubs, trattorias, and ethnic restaurants we would have universal McDonald's.

⁷⁶Only people exceptionally interested in music, about 5 per cent of music consumers, have no problem with selection. These are people who listen to the radio ceaselessly and buy more than 9 CDs a year.

⁷⁷Distributors in fact assess quality very carefully. The cost of promoting a hit is roughly \$3 per disc, while a 'miss' can cost them three times as much.

ably high. Perhaps business is right in to offer the consumer the opportunity to make his own choice, to decide what to buy or not to buy. Unfortunately, so much variety leads to high selection costs, the invariable downside of an insufficiently sorted abundance.

The consumer cannot discriminate between music he considers good or bad without hearing it at least once, and possibly several times. He either buys discs with his fingers crossed, or spends his days listening to radio and television. The true cost of a 'good' song needs to have added to the money paid in the shop also the costs associated with finding it: money spent on buying songs which are not liked, time spent on listening to them, including listening to them on radio or television, time spent on reading advertisements, and emotional costs. No measurements have been made in his area, but everyday observation suggests that the cost of acquiring a really pleasurable song (not a hit) may exceed \$30, along with two or three hours of less than enjoyable trying out.⁷⁸

1.1.12 The Economics of Sampling

In the current business model, those delivering music have little interest in lightening this burden of trying out. Precise selection by the consumer is not in the interest of sales. The issue of trying out, or sampling, music was analysed in economic terms in considerable detail during the lawsuit against Napster, but whether sampling was bad for sales remained unclear.⁷⁹ On the one hand, if you reveal too much before payment, consumers may simply not buy the product because they don't like it. On the other hand, while listening to a tune the consumer becomes emotionally involved in a way which stimulates him to want more. Different kinds of cultural production permit different degrees and procedures of sampling. Books can only be leafed through before purchase; movies can be viewed in the form of a 30-second trailer.⁸⁰ By and large books and films are both products which are used once only, so the only commercially viable approach to selling them is 'pay and take it'. Songs, on the other hand, are consumed many times over. Hits may be listened to as many as 200 times. Allowing one-off access a single time, or even several listenings, does not reduce their attractiveness as purchases. The entire sales model is based on this. Manufacturers are not afraid of people listening in a shop, or hearing a song broadcast on radio and television. They are uneasy about less straightforward music which doesn't fit the format of presentation over the airwaves and which cannot be

⁷⁸As we shall see, the spread and development of music recommendation services will change this situation for the better. See Appendix 1, Sect. A1.11.

⁷⁹On sampling in the Napster case, see Appendix 2, Sect. A2.1.1.

⁸⁰Usually all the best scenes in a movie are crammed into the trailer. This ploy becomes impossible if a complete scene is shown. The movie's quality would rapidly become apparent. If this became common practice, attempting to advertise a movie using a trailer would immediately give the game away.

instantly appreciated.⁸¹ This feature of distribution leaves its mark on music output and subsequently on consumption: music should be memorable after only one or two listenings. Consumers promptly react to this simplified offering and music becomes a mere background for numerous occupations,⁸² and primarily clubbing. They make up for the inadequate pleasure and stimulation they are getting from the tunes by dancing, and ingesting spiritous and consciousness-altering chemical substances.⁸³ Banished to the background, music is downgraded as an art form in the eyes of its consumers.⁸⁴

1.2 The Paradox of Uniform Prices

The situation in music is in to a large extent a result of an unusual practice in the segment known as the principle of ‘uniform price. This entails offering for sale products of differing quality at the same price. This is not what normally happens in markets, and it is important to understand what is going on, since within the practice is to be found the genetic code of the entire music industry.⁸⁵

Strangely, quite different songs and albums are sold at virtually one and the same price. Even reissues, where there is no copyright cost, are no exception. Reissues of albums from the 1970s and 1980s which record the noise of rain falling in a tropical forest cost just the same as The Beatles or present-day hits. A compact disc containing 40 minutes of music is equal in price to another where the recording lasts twice as long. Uniform pricing is found not only in the music industry, but also in movies, television, video and book publishing.

⁸¹In the 1990s, the labels put their money on promoting ‘stars for a day’. They were ‘available’ idols, but their singing was indifferent. In that environment, original, complex songs were seen as risky, as they demanded more than superficial appreciation.

⁸²The results of a survey by MTV Networks show that the average American teenager surfs the Internet, views DVDs, listens to music in MP3-format, exchanges messages, downloads films and even watches TV to a large extent in parallel, with the result that their media use totals 30 hours per day. See N. Parker, C.L. Gerlach, and S.J. Bowman, “What I Want When I Want It: an On-demand Vision for Media and Entertainment Businesses”, *Executive Brief*, IBM Institute for Business Value, 2003.

⁸³Some music is written specifically to be heard to full advantage only with an altered state of consciousness on the part of the listener.

⁸⁴T. Cohen asks the question of why music lovers mainly purchase relatively new releases rather than recordings of the 1950s and earlier, despite the critics’ respect for their outstanding quality. Every year the chart toppers are releases of the last couple of years, almost the only exception being the Beatles’ ‘No. 1’ EP. It would seem that the music market is driven by something more than simply good tunes and songs. The music is being used like fashionable clothing, as a means of communication, and the market is providing essential novelty. This does not mean that the music is terrible, but only that its quality is not the main factor. See T. Cohen, “Copyright and the Symbolic Nature of Art” (2002), *Symbolic Goods: the Liberal State in Pursuit of Art and Beauty*. Unpublished manuscript, Chap. 5 (online). Cited 15 September 2003. Available from URL: <http://www.serci.org/2002/cowen.pdf>.

⁸⁵This is discussed in detail in Chap. 2.

1.2.1 *Is It a Good Thing If Prices Are the Same?*

Prices normally reflect quality and, as a rule, more expensive means better.⁸⁶ People who repeatedly buy goods and services, including those of a cultural nature, are guided by their understanding of their quality. The amount on the price tag helpfully indicates the value of the product.

In digitised culture everything is quite different, the main reason being the absence of repeat business. Each time the customer is being offered something that is substantially new, and if the item being assessed is always different, then previous experience is no guide. Consumption of the cultural good provides no feedback relevant to the next choice.⁸⁷ A second reason for the failure of the price mechanism is that tastes differ. There is also the absence of recognised criteria of artistic quality, which makes it difficult to quantify. You cannot label a song to indicate how many cultural calories it contains, and accordingly you cannot vary the price to reflect that.

As a general rule, if content and quality differ while prices remain the same, this tells an economist that something is seriously wrong with the market which requires investigation and possibly regulation.⁸⁸ Uniformity of prices here is an indication that money's most crucial function, as a measure of value, has been abandoned. In the absence of price signals, suppliers and consumers are both in the dark. It is as if money did not exist. There is general agreement about the positive role of money in ordering conventional markets. Perhaps, however, cultural markets are an exception, and the non-involvement of money is here benefiting the public in some way?⁸⁹ Since nobody is sounding the alarm, perhaps the situation is to everybody's satisfaction. Or is there a problem which is merely being overlooked? Uniformity of prices does make one uneasy because, within a market economy, if people are not paying a premium for quality, less care will be taken to provide it.

Scholars rarely ponder the riddle of uniform prices. Professional operators in the entertainment market maintain a prudent silence on the matter. Consumers are so used to paying the same price for products which are similar in type but different in quality that they never give it a second thought. We might suppose that, if in some cases identical pricing means that some good are being sold cheap while others are being sold dear, then on average everything will work out fairly. In fact this is a complete misapprehension. Even though consumers on average neither gain nor lose money (it is a so-called 'zero-sum game'), everybody is in fact losing out. The

⁸⁶In fact, over time the number of exceptions increases to the point where they can hardly be classified as exceptions any longer. This tendency is discussed in Chap. 3.

⁸⁷Other than where choice is deliberately simplified This partly accounts for the competitive advantage of serials and sequels.

⁸⁸In such cases neo-classical economics speaks of a market failure, a situation where optimal deployment of resources is not achieved. *Collins Dictionary of Economics*, eds. Christopher Pass et al., 3rd edition, 2000.

⁸⁹This will be the view of those who consider that money is the root of all evil and something which divides people. In fact, viewed as a universal language, money tends more to unite them. It is different cultural traditions which are divisive.

loss is not clearcut and goes recognised, but it is associated with the non-material costs of the game itself. Because money is not doing its job, purchasers have to work harder. The absence of prices signalling the quality of the goods burdens them with navigation costs. When acquiring conventional items, the link between price and quality is considered self-evident and people are unaware just how important an informational stimulus it is. Clearly, if all the goods in a shopping centre were on sale at the same price, selection would become far less convenient and efficient.⁹⁰ If the price tags were removed from washing machines and consumers had only the recommendation of shop assistants to go by, they would probably find it easier and quicker to buy new clothes than to decide which washing machine to buy. If we imagine people having to buy a new washing machine every day, we replicate the situation in culture.

We might think things couldn't be better than having identical prices for music recordings. Music lovers who knew what they were after could get top quality on the cheap. This however is now how it works. In a 'proper' market you never get anything cheaply. If you think you are, it is simply because the losses are not visible. We can root out the best without spending extra money, but we will have paid in a different currency: a sense of exasperation, perhaps, or time needlessly wasted, or even both at the same time. In general, the same price paid for goods of differing quality is a warning of hidden consumer risks. Ideally, prices should reflect quality 100 per cent and, since quality does differ, so should prices. In reality, we come up against practical limitations. Too much price differentiation causes confusion. The sound industry, however, is practising a complete renunciation of gradations, with the result that the basic function of prices, registering equivalents in the exchange of values, is not being allowed to operate. The process of selection has to start from scratch, blind, every time.⁹¹ As a result choice is either limited to the most popular compositions, or becomes random. Non-transparent prices also hit the producers of high quality products because, if their goods are not deservedly singled out, they attract no premium for quality.

Since nobody other than totally dedicated fanatics is in any position to rank the music on offer, many worthwhile works sell fewer copies than they might because they are not recommended as they should be. Customers are faced with rummaging through mounds of audio-rubbish, and are at risk of paying the same amount for it as they would for good songs. The situation is similar in publishing, where books deserving of attention are buried beneath heaps of garbage. Uniform prices have not, however, been handed down with the Ten Commandments. They reflect a decision

⁹⁰A single price is no better than an undisclosed price. Before the invention of department stores, shopkeepers would personally agree prices with the customer. This required him to be present, rather than working to expand his business; it also wasted the time of masters who could not leave such negotiation to their servants. Naming prices liberated both sides.

⁹¹The new theory of institutional economics, money appeared in order to overcome this problem and to lower trading costs. See, for example, R. Klauer's model in the textbook *Institutsional'naya ekonomika*, ed. A.A. Auzan, Moscow: Infra-M, 2005, 335–338.

of the market. Accordingly, we must assume that price insensitivity to quality is there for a reason.⁹²

1.2.2 Why Are Prices Not Differentiated?

The usual explanation for the lack of price differentiation is that nobody knows in advance what the public is going to like so goods are promoted on a broad basis. This explanation however is only half sound. It is also half disingenuous. If the provider does not know at the production stage what his product will be worth, he has a pretty shrewd idea after the product is finished. He certainly knows immediately when he has a weak product. It is, however, hardly in his interests to let the purchaser identify it as such before he has paid for it, and accordingly the manufacturer prefers to emit no signals which might discredit the goods. Supposing the tickets for one movie were ten times the price of those for another. The customer would almost certainly perceive this as an indication of quality, and steer clear of the cut-price movie.

There are obvious risks here for sellers. If the industry took a step in this direction, there is no telling where it might lead. If, choosing between price and quality, the customer gave his preference to quality, a majority of manufacturers would feel the draught. By not taking the risk of identifying works as weak by low pricing, sellers simultaneously deprive good works of the hallmark of distinction. Price differentiation is avoided intentionally. The Harvard analysts Liran Einav and Barak Orbach come to a similar conclusion: “There are several indications that raise the industry practitioners’ concerns that moviegoers perceive the price as a signal for quality, and therefore a price differentiation would deter them from watching low-priced movies.”⁹³ This may have been what the President of the National Association of Theatre Owners of the USA had in mind when he said, “We want people to get in the habit [of visiting the theatre] on a regular basis and to see as many movies a year as possible. To build that kind of loyal clientele, you can’t bounce admission prices around on them.”⁹⁴

There are other considerations which discourage attempts to vary prices. Specifically, businessmen are afraid of price changes which customers may perceive as unfair. This has caused problems in the past. For example, the public objected when Coca-Cola introduced a vending machine which adjusted prices to weather conditions. If a manufacturer’s costs genuinely increase, prices increases are perceived as fair, but raising prices purely on the basis of an increase in demand may be considered unfair. In practice, customers react in different ways to price rises: hotels have

⁹²An economic rationale is often claimed for uniform price formation, citing operational expenses like information costs and menu costs, expense incurred by the seller when prices change, and regulatory rules. The practice of uniform pricing for cultural products is, however, different in nature. See L. Einav and B. Orbach, “Uniform Prices for Differentiated Goods: the Case of the Movie-Theater Industry”, Discussion paper No. 337, Cambridge: Harvard Law School, 2001.

⁹³Ibid.

⁹⁴Ibid.

no qualms about raising their tariffs on days when there is a football match. On the other hand, tickets to sports events are often sold at standard prices, even when it is known they will sell out.⁹⁵ We can name one further reason for the uniformity of prices: cultural services are often provided in a package together with other accompanying goods which generate the main revenue. In cinemas the box office may prove less profitable than the buffet and gaming machines. In that case, it would be unwise to risk scaring away visitors to the cafe by juggling with the price of tickets.

The same logic can be found in online music sales. If, out of the 99 cents for which a song is sold, 65 cents goes to the rights holders and a further 20 cents to the payment operators, the online music business hardly seems worth the candle.⁹⁶ If, however, we take account of revenue from the sale of players, everything falls back into place. The music itself does not need to generate a profit if its role is to serve as a catalyst for much more substantial earnings. To follow this to its logical conclusion, the price of the catalyst is neither here nor there.

1.2.3 Is a Different Price Policy Possible?

These arguments should not, however, be overstated. We maintain that the main reason for uniform pricing of music recordings is, as already mentioned, to prevent the customer from being able to judge quality on that basis. The inertness of money makes it possible for the labels to maximise their revenues at the expense of their customers.

Is a different strategy possible, or is uniform pricing the sole feasible manner of managing the risks of production, and any other approach would be commercially unsustainable?

Having to carry the cost of their numerous projects, the last thing the labels want to is for their customers to focus their interest exclusively on a small number of carefully evaluated purchases. Their business is viable only if absolutely everything can be sold, or if the high price of potential hits can carry the weight of the whole range of offerings. There is no other alternative. If the second approach is adopted, what is to be done about pirates? At today's prices, the attractiveness of the legal and illegal channels is relatively equal, but if the price of a particularly successful composition were to be raised fivefold or tenfold times, it would be almost impossible to neutralise the magpies. Copyright, like any other means of defence, has its limitations, and these are bound up with the product's value. Profitability of the legal business hovers around 10 per cent, but if the pirates were making off with the choicest pieces their profits could run into thousands of percentage points. It is much easier to control conventional customers than pirates, and the present price formation model solves the problem of competition at the expense of the weakest. Were it

⁹⁵Ibid.

⁹⁶On the economics of online sales, see Appendix 1, Paragraph A1.6.2.1.

not for the pirates, it would at least be possible to look at practical ways of differentiating prices.⁹⁷ As it is, however, because of the failings of copyright, no alternative has yet been found to the equalising price formation model. Anything else would leave the sellers facing unacceptable risks of financial loss. They would respond by scaling down their activities and leaving consumers with no music recordings at all.

1.2.4 The Vulnerability of Unwrapped Cultural Products

The defence capability of the manufacturers of culture is directly linked to the cost of the material wrapping of their works. How high or low it is produces two clearly defined sectors. In the industries of luxury and taste, and in the performing arts like theatre, classical music, and stage entertainment, aesthetics is inextricably associated with relatively expensive medium of delivery. This means, firstly, that prices are differentiated in accordance with the quality of goods; and, secondly, that the quality can be established before purchase, since it is, at least to some degree, related to material attributes.⁹⁸ The more difficult it is to mass-produce such goods, the better protected the rights owner is against pirates, and the market from pricing chaos. If, on the other hand, a product is easily copied, plagiarists will be attracted. They are spared a whole range of production costs and can sell their output for next to nothing and generally manipulate the market. They are competing on the basis of the cost of the material wrapper, and can forget about the markup related to content.

The so-called digital industries fall into this second category. The material medium here is cheap or non-existent, and the costs of duplication are correspondingly low. From the economist's viewpoint, the basic difference between the two sectors is the ratio between the cost of producing the prototype and copies of it. In the sector of 'weightless' audio-visual products, the greater part of the cost is in creating the prototype and the sales infrastructure, after which the publication costs tend to zero. Accordingly, what is most profitable is to sell as many copies as possible. Unfortunately, it is just this that makes it difficult to protect this kind of business from illegal raiding, because all the pirates have to do is get their hands on an original as quickly as possible.

1.2.5 The Flea-Market of Sound Recording

The scheme of trading which predominates in the digital sector of culture has a lot in common with a flea-market: goods of the very variable quality are piled up in a heap.

⁹⁷Although piracy is not by any means the sole reason for the levelling out of prices. This question is comprehensively examined in Chap. 2.

⁹⁸In economics such goods are categorised as search goods. Goods whose quality cannot be determined in advance, or where this would be too expensive, are called experience goods. Their quality is discovered in the process of consumption.

An ordinary flea-market is, however, only one trade outlet, apart from which there are other places offering a different assortment of goods, displaying them in accordance with different rules, and with a different system of price formation; the sound recording market is restricted almost entirely to this flea-market environment.⁹⁹

In music kiosks, much like in a bazaar, the goods on offer vary all the way from mass-market items to the creations of great masters, from unsaleable collections from the past to counterfeit items and amateur recordings. Precious items are also to be found, deployed to snare the customer, costing the same as the goods next to them but with their price five or ten times lower than it might be. The sellers have an interest in making sure that the buyer's drag-net brings in a lot that is substandard along with the valuable haul. In the fashion industry, information about quality converts directly into a monetary premium, but the sound industry works on a different principle. Here quality is not bought for money, but has to be discovered after much searching and listening, that is, after spending time. From the economist's viewpoint, selecting means incurring information costs. In the fashion market with its boutiques, ateliers offering individual tailoring, shops selling off the peg, department stores, discount outlets and flea-markets the risk of getting the price and saleability of goods wrong is shared between the seller and the purchaser. The important point is that it is shared in different proportions. Items of a particular quality may be found anywhere, but with varying degrees of probability because there are varying degrees of preliminary sorting, and it is carried out by experts with different levels of qualification (couturiers, buyers, goods managers, secondhand dealers). The price varies accordingly.

In a flea-market, the risks of getting it wrong are highest. Nobody cares about the manufacturer's reputation or other clues, and the whole burden of informational sorting out, that is, of discerning quality, is borne directly by the consumer. In other words, the purchase price is at its lowest, and search and selection costs are at their highest. It is rather like a lottery where tickets have different prices reflecting different probabilities and sizes of winnings. This brilliantly simple way of getting the customer to sort products is one of the ideas behind cut-price sales.¹⁰⁰ The clothing market, unlike the audio market, allows a person to choose between trading outlets of differing status. A shop targeting a particular class of purchaser is designed accordingly and acts as a filter for goods of a particular quality. It is not in its interests to play tricks with its goods, for example, by mixing in a number of lower quality items, because its customers will soon detect this and leave.¹⁰¹ The customers buying clothing can rely on the reputation both of brands and of the sales outlet. For this they pay extra, but in return run less risk of disappointment. They can, of course, rely more on their own resources by purchasing from less reputable counters, and obtain a cheaper price in return for the labour of sorting goods themselves. This is

⁹⁹Only a relatively small number of works heard on radio and television are promoted differently.

¹⁰⁰Discounts also enable sellers to determine the optimal point for goods on the 'price-demand' scale and also, of course, to sell off their remainders.

¹⁰¹Although there have been scandals where traders have been caught trying to sell good quality counterfeit goods as genuine.

a fairly honest lottery: the more you pay, the more likely you are to win. The sound recording market, however, is a completely absurd lottery, in which there is always some cost in addition to the price. Some guidance is offered by performers' star status, although this is not always reliable.¹⁰² The labels guarantee a basic level of quality, and specialist and independent labels in particular may indicate genre and stylistic attributes.¹⁰³ All of this, however, still leaves the consumer with plenty of problems for getting access to the music he wants. The signalling function of money is not readily replaceable.

1.2.6 Adverse Selection in the Sound Recording Industry

The uniform price policy is responsible for a lot more than just selection problems in the music market, and more generally in all the mass segments of culture. Under cover of fixed prices, ill-qualified and disreputable participants flood the shops with second-rate goods. As these begin to dominate the market, the proportion of high quality products falls and, as good and bad products are outwardly indistinguishable, the prospect of selling both is equal. Since the costs of conscientious manufacturers are invariably higher, they lose their ability to compete. It is a general rule that if in any sector the consumer is unable to make a rational choice on the basis of market signals, and if the situation is not put right through the agency of guarantees and impartial advice, that sector will degrade. The phenomenon is known to economics as adverse selection, and it was identified by George Akerlof who was awarded the Nobel Prize for Economics for having done so.

Akerlof demonstrated that if in any market a situation one side (usually the seller) is consistently better informed about the quality of goods or services than the other, if, in other words, information asymmetry regarding quality is not dealt with, then those markets have a tendency to adverse selection.¹⁰⁴ The main cause of the phenomenon is to be found in the participants' motives. Well-informed players can cheat on quality, knowing that their less informed vis-a-vis will not notice anything. Sooner or later, however, the latter does realise he has been deceived and that the other party is benefiting at his expense. He will attempt to restore the status quo, failing which, he will abandon the area in which he is failing. Akerlof examined the problem of information asymmetry on the example of 'lemons' as hopelessly beat-up motor vehicles are known in the USA. Merely from looking at them, it was difficult to tell them apart from vehicles with moderate depreciation, and they were all much the same price. If a customer could not tell a bad car from a good one, and

¹⁰²Chapter 3 of the book analyses the efficiency of branding and, in particular, of 'stars' in the culture industries.

¹⁰³Thus, for example, enthusiasts of Gothic music home in on releases from the Trisol label, while admirers of progressive rock look for albums issued by Inside Out.

¹⁰⁴G.A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism", *Quarterly Journal of Economics*, 84, August 1970, 488–500.

the seller was recommending them all in similar terms, then adverse selection was inevitable. Good cars would remain in the possession of the purchasers, while duds would be returned to the market for resale. Moreover, it was disadvantageous to sell cars in reasonable condition at the same price as lemons, so they were squeezed out of the market. The likelihood of ending up with shoddy goods increased. Ultimately, if no corrective measures were taken, the market would be undermined and have only bad cars left in it. In a word, adverse selection leads to good quality items being offered with increasing rarity, and being squeezed out by surrogates.

In the case of the sound recording market, the information asymmetry is only too evident. The music labels, although they do not know everything, undoubtedly are much better informed than consumers, and unvarying prices only facilitate information asymmetry. As a result, the key prerequisite of adverse selection is present: unequal knowledgeability of the sides. The better informed side finds itself in a situation where economic motives are likely to prevail over professional honesty. Manufacturers have a vested interest in exploiting the effect of growing returns from economies of scale. The crucial point is that, as sales increase, such relatively fixed costs as retaining staff, paying for offices, acquiring rights, etc.¹⁰⁵ comprise an ever decreasing proportion of the unit cost of a product. This part of the expenditure tends to zero, and the unit cost approaches the cost of the audio medium. Large-scale production is, then, highly profitable, and the recording companies go to great lengths to force up the volumes of production (and hence of sales). This pursuit of quantity, however, is based on a dearth of creativity, which leads to an excess of choice coupled with a decline of quality. Real masters of their trade find themselves in an unprofitable situation, since apprentices can flood the labour market.

Companies had one further specific reason for ratcheting up output. All the time the lawsuits against the file exchange companies were being pursued, music was leaking on to the black market and being dispersed to millions of private collections. There were problems collecting the revenue from them, the producers found themselves having to increase the rate at which they renewed their offerings in an attempt to consign to oblivion everything that had previously been sung, sold, or listened to. Fashion houses operate in a similar manner, releasing collections at such a rate that the styles date faster than the pirates can flood the market with them. The pace of innovation is not infrequently dictated by the need to render your competitors' achievements obsolete.

It is not only the major manufacturers, with their vested interest in increasing the volume of music, who are to blame for over-production. Illegal manufacturers and graphomaniacs also make their contribution. The real problem is not, however, over-production in itself. If there were ten or 100 times more music, this would do no harm providing that bad works did not obscure good compositions. However, in the absence of effective methods of impartial assessment, the unbridled increase of the range of music on offer results in the problem of mere noise, and no amount of ratings and billboard advertising can save the situation.¹⁰⁶ Many would-be artists

¹⁰⁵These include fixed and absorbed costs.

¹⁰⁶For more detail on ratings, see Chap. 2, Paragraph 2.6.4.4.

with a genuine love of music find the entry barriers prohibitively high. The effort involved in finding the tunes they need involves listening to an enormous quantity of material of little interest. This takes up a lot of time and doesn't improve their mood. After several unsuccessful attempts to make sense of the situation, they conclude that the music industry is not for people like them.

1.3 Navigation: A New Kind of Service in the World of Music

The current model of the music business used by manufacturers is not particularly progressive, with excessive expenditure on advertising and distribution. This undoubted shortcoming is, however, as nothing compared with the hidden drawback of a lack of user-friendly navigation. An ordinary person does not have so much free time that he can spend hours looking for the music he wants. As it happens, the technologies already in use for Internet distribution and information processing are so highly developed that the segment could be reformed by using them. The latest applications bring us close to solving the problem of how to lower retail prices and, more importantly, how to ameliorate consumer navigation. The future of the music segment lies in rescuing people from unproductive searching. A high-tech navigational service is needed which would make it possible to buy what you want without first having to rummage through everything you don't.¹⁰⁷ If this comes about, music will again become attractive to those who are being put off it because of a feeling that, under the current rules, they can only lose.

1.3.1 The Solution of the Problem of Consumer Navigation: Public Assessment of Perceived Quality

How can we reduce consumers' costs on the way to finding the music they want and raise the effectiveness of choosing?

The idea is to evaluate music through the efforts of consumers themselves. After all, quality is established not by conformity to extraneous rules but through a consensus of listeners. If consumers' own assessments can be suitably ordered and annotated, it should be possible to devise an effective recommender system.

Let us suppose that somewhere among the vast quantity of music available there is something that a particular individual would very much enjoy listening to. The question is, how can this tune be identified and brought to the attention of its potential listener without his having any prior knowledge of it? What criteria should lead to the rejection of music as bad? Tastes differ. What mechanism could predict

¹⁰⁷Very intensive development of a number of recommender systems is progressing (see Chap. 2, Sect. 2.7). There are almost daily press reports that such a service is just around the corner. For more detail on navigation on the Internet, see Appendix 1, Sect. A1.11.

the preferences of previously unknown individuals? To this apparently impossible task an elegant solution has been found. Its secret is that it is based on the appreciation of music by consumers themselves. It is only listeners who can perform the filtering. As they listen to music, they are assessing it in a perfectly competent manner. Once they have done the work, a way must exist of using their conclusions. The usual way of processing individual judgements to produce a rating is not noted for generating accurately targeted recommendations, if only because no account is taken of who has come to a particular assessment.

In order to obtain effective, targeted recommendations, more sophisticated interaction with consumers is needed, which takes account of differences of taste, which is key to resolving the problem of navigation. Traditionally, appreciation of music has been performed by specially chosen critics. This raises at least three problems: how are they to be chosen; what criteria should be used for assessing quality; and how can individual judgements be combined into an overall evaluation? In theory a critic-based system could be devised, but as it would have to be modified for each specific task, it would prove extremely expensive. In the appreciation of music, moreover, the impression made depends not only on the tune itself, but also on the environment in which it is heard, mood at the time, and much else besides. How can all this be taken into account and an appropriate assessment delivered to a particular consumer?

1.3.1.1 How Are Differences of Taste to Be Taken into Account?

The underlying idea is that participants should be 'authorised' on the basis of their assessment of works they know. Let us suppose that these opinions have been received. In order for recommendations to be derived from them for a specific consumer, his own assessment of songs he knows needs to be received. This provides the criterion for automatically selecting assessors from the subscribers to the system. They will be those whose assessment of songs mentioned by the customer coincides with or is close to his own. A particular request will be answered on the basis of a combination of assessments derived from the responses of only those participants. The individual thus receives recommendations from those whose tastes are close to his. No other statistics are of no interest to him. Let us suppose, for example, that a certain subscriber has indicated high (or, for that matter, low) appreciation of the songs of, say, the Beatles, Queen, Madonna, Peter Gabriel, Tarkan, and Martin. He will receive recommendations from others whose appreciation of these songs is similar to his own. Suppose his opinion of ten works which he himself named coincides with that of a particular subset of assessors. In reply to his query he receives an assessment which these subscribers have given to a work which they know but which, so far, he does not. There is a high probability that the user will make a pleasant discovery if he follows these recommendations. Of course lapses are possible, caused perhaps by differences in the situation when the music is listened to (mood, company, and so on). Another possible source of disagreement is differences in interpretation. One person may find interpret a work in a way which another has

missed. Differences of interpretations could, of course, be of value in themselves, with the customer in effect being given a hint to listen out carefully for something he has missed.

Any set of criteria (not necessarily musical) is possible for making the selection of assessors. One could require an acquaintance with the works of Marcel Proust, or a negative assessment of Terminator 3. It is feasible to independently set personal criteria which will give a high probability of coinciding taste and quality of recommendations. The main thing is for the subset of advisers to be limited to those whose priorities correspond to those of the customer. That is the whole beauty of the system, resulting in, not impersonal, statistically average assessments, but personal recommendations which the computer automatically issues on the basis of similarity of the judgments of the specific customer and other participants. This replicates a situation everyone is familiar with, where someone listens to the opinion of people whose tastes he knows, has a fair idea why those in around him liked or did not like a particular piece, and easily decides whether or not to follow their recommendations. The technology described effectively forms artificial circles of friends. Given that the hypothetical similarity of tastes is based on an actual similarity of earlier appreciations, the recommendations will be highly reliable. This concept is an automated analogue of 'word of mouth'. There is no need for person-to-person communication, so costs are minimal.

1.3.1.2 What Should Reviewers Evaluate in Music?

In order to generate recommendations of this kind, a database of users' assessments is needed. The obvious input is a numerical/points system for coding assessments. How, though, can appreciation of music be expressed in points? Curiously enough, there is no need for objectivity. Consumers should be asked to give a purely subjective impression. This is a far cry from the expert assessment of a professional art critic, which is more than one could ask for from amateur music lovers. Fortunately, the present task has no need of judgments about the 'true' quality of a production. What is needed is purely an expression of personal feelings. These will depend on many things: the participant's taste, artistic competence, general cultural level, outlook, his company at the time, social environment, the influence of friends and, naturally, the music. It would be practically impossible to categorise all this, but anybody can say whether he enjoyed listening to a particular tune or not, and how far the impression related directly to the music rather than extraneous circumstances does not matter in the least. The tune either does or does not induce certain desirable states, and it is precisely this that needs to be assessed within the framework of the recommender system. The only essential is that the listener should know for sure whether he liked the music or not and, perhaps more precisely, whether he liked himself in the presence of this music. Only he can communicate the value it had for him. It is not a work of art as such which is being assessed (something which can be left to the art critics), but the subjective effects it engendered. That is what the consumer of culture is unquestionably competent to judge. The assessment is subjective and, for the whole system to work, that is precisely as it should be.

Whose assessments should be gathered? Those of all the volunteers without exception. There is no need for artificially contrived referent groups.

1.3.2 The Invention That Never Was

1.3.2.1 Collaborative Filtration: A Fundamental Solution to the Problem of Navigation

This approach to the problem of selection may appear fantastic, but not only is it not new, it has been implemented in practice for over ten years. The prototype of the mechanism of consumer selection dates from 1992. The idea of automatically identifying taste communities and enabling their members to exchange their judgments was proposed by Dave Goldberg and his colleagues at the Xerox PARC research centre in Palo Arto, California, and it was they who introduced the term ‘collaborative filtration’.¹⁰⁸

In the years which followed, the initially raw idea of collaborative filtration was brought up to speed, and recommendations are today being made on the basis of the similarity of a person’s preferences to those of other users. For this the subject needs to rate several items, and on that basis his personal profile is plotted. Suitable advisers are then selected, and their opinions on works with which the client is unfamiliar are brought to his attention. This elegant scheme began to be actively developed in 1994,¹⁰⁹ but its path proved thorny. Initially the method had one defect which was to lead to problems. The nature of the shortcoming and how it was overcome is explained below, after consideration of the first attempt to implement collaborative filtration.

1.3.2.2 The Mechanism of Collaborative Filtration

Because personal recommendations are generated after analysis and comparison of the assessments of a particular user and other people, the method by which these other people are found is crucial to the success of collaborative filtration. In general terms, the procedure is:¹¹⁰

- the preferences of a large group of people are registered, and on this basis a profile is created for each user;

¹⁰⁸“United We Find”, *The Economist*, 10th March, 2005.

¹⁰⁹F. Heylighen, “Collaborative Filtering”, *Principia Cybernetica Project* (online), 2001. Cited 28 February 2005. Available from URL: <http://pespmc1.vub.ac.be/COLLFILT.html>.

¹¹⁰F. Heylighen, *ibid*.

- a subset is identified whose judgements are similar to the judgements of the person wishing to receive a recommendation.¹¹¹

On the basis of comments received from this subset, an assessment is generated and is issued to the client as a prediction.

The method has been used for evaluating books, music CDs, and movies. In principle, it can be used to assist the choice of products and services of any description. Sites based around collaborative filtration began to appear on the Internet from the late 1990s. The first, or one of the first, was Ringo.

1.3.2.3 Ringo—The World’s First Music Suggestion System: Its History and Its Experience¹¹²

The system’s developers were looking for a solution to the problem of the information explosion. Massive quantities of books, movies, CDs, news and online information were far beyond what any individual could realistically hope to assimilate. The creators of Ringo applied collaborative filtration specifically to music, applying the following scale of assessment:

- 7: BOOM! One of my FAVOURITE few! Can’t live without it.
- 6: Solid. They are up there.
- 5: Good Stu.
- 4: Doesn’t turn me on, doesn’t bother me.
- 3: Eh. Not really my thing.
- 2: Barely tolerable.
- 1: Pass the earplugs.

As the number of a subscriber’s assessments increases his profile becomes more accurate. The system compares profiles of users, identifies people with similar tastes, and predicts how much a person will like an unknown album or artist.

Ringo was created by Professor Pattie Maes and three of her students and appeared on the Internet on 1 July 1994. After an incubation period, word spread about the service and in less than a month the number of users had reached the 1,000 mark. By the end of the second month it was approaching 2,000. The database was, of course, growing in parallel. Initially the system covered 575 artists, but it soon had 3,000 performers (and 9,000 albums). Almost 500 messages were being processed every day.¹¹³ When users first logged into Ringo, they were given a list

¹¹¹The usual measure of similarity between consumers is the Pearson correlation coefficients between their preferences, expressed in points, or the angles between vectors reflecting consumer preferences. For more detail on recommender systems, see Chap. 2, Sect. 2.7.

¹¹²Based on Upendra Shardanand and Pattie Maes, “Social Information Filtering: Algorithms for Automating ‘Word of Mouth’”, *Proceedings of CHI ’95 Conference on Human Factors in Computing Systems*, ACM Press, 1995. Available from: <http://citeseer.ist.psu.edu/correct/323706>.

¹¹³A user could send dozens of requests in a single day. Messages were sent to the main server which processed and responded to the accumulated correspondence on a daily basis. For more details see F. Heylighen, “Collaborative Filtering”.

of 125 performers and asked to award them a rating in accordance with instructions. Users were asked to rate performers without going into detail, avoiding judgments of originality, musical skill, and so on, and merely basing the rating on how much they liked to listen to them.

Having generated his personal profile, a user could log into Ringo to request:

1. A suggestion of new performers/albums.
2. A list of artists/albums that the user would hate.
3. A prediction about a particular artist/album.

Recommendations were accompanied by an indication of their probable accuracy which was based in part on the number of like-minded users drawn upon in order to arrive at the prediction. Information about other subscribers was not provided, but he also had access to all the reviews of his user group, and also to a dossier on any artist with a list of his albums and average assessment given to him by users. Each Ringo subscriber rated on average 100 artists; the average point score was 3.7 (that is, between “Doesn’t turn me on, doesn’t bother me” and “Eh. Not really my thing”). At first Ringo’s recommendations were not accurate, because the service had not yet acquired a critical mass of data. As the number of users grew and the number of requests, the competence of the predictions increased. In order to get up to speed, it was necessary to perform the operation of ranking artists a couple of times, as a result of which the list of ‘similar users’, his so-called “neighbours”, became significantly more accurate.

In 1995 a programme based on Ringo and called ‘Helpful Online Music Recommendations’ (HOMR) was created. In 1995 Agents Inc. was founded, shortly to be renamed Firefly Network. By mid-1997, together with Microsoft and Netscape, it had reorientated itself towards regulating the protection of privacy on the Internet. In 1998 Microsoft bought the company, which was experiencing chronic financial difficulties, but the new owner proved more interested in Firefly’s experience in the realm of processing personal information about users than in collaborative filtration. On 4 August 1999 Microsoft closed Firefly.com down, and one of the most important experiments in the history of the Internet community came to an end.¹¹⁴

The experience of Ringo shook up conventional ideas to the effect that cultural content had first to be filtered by experts, and that only after that could it be published. A successful experiment had been conducted which reversed this order by offering content to public view and transferring the task of filtration to a non-professional community.

Another pioneer of the technology, John Riedl of the University of Minnesota, launched a service based on collaborative filtration, which generated movie recommendations.¹¹⁵ On the MovieLens website each user was asked to award a number

¹¹⁴Chris Oakes, “Firefly’s Dim Light Snuffed Out”, *Wired* (online), 8 December 1999. Cited 20 February 2003. Available from URL: <http://www.wired.com/news/culture/0,1284,21243,00.html>.

¹¹⁵Riedl set up Net Perceptions jointly with Steven Snyder, formerly a top manager at Microsoft. The first vice-president of this company, Steve Larsen, predicted that very soon there would be electronic booths in every video shop where, after rating a couple of dozen videos, you would

of films points from one “terrible” to five “worth seeing”. A high degree of accuracy kicked in after fifteen or so assessments.

1.3.2.4 Stopping Filtration

For all its attractiveness, collaborative filtration, at least in its original form rather than as subsequently modified by business, is not well known outside a circle of specialists even today.¹¹⁶ Despite its obvious utility, it has been waiting for its hour to come for a full twelve years. What is going on?

In the first place, in order to work properly it needed a clock speed which has only recently become widely available. In the second place, in order to demonstrate its full potential, collaborative filtration needed to survive until Internet shopping became common. Many people see the technology as a natural adjunct to this. Today trading on the Internet is a fact of life, but collaborative filtration is not being extensively used, even for music, an area to which it is ideally suited. This is despite the fact that from 1999 until 2002 a whole succession of companies with an extensive range of applications for content management attempted to modernise the music industry. They included eTantrum, GigaBeat, HiFind, Music Buddha, Sonic Print and Uplister (none of them any longer in existence), as well as Cantamatrix (acquired by Gracenote), Mongo Music (acquired by Microsoft), AgentArts, Audible Magic, BayTSP, Friskit, Media Unbound, MoodLogic, Relatable, Savage Beast, Sonicprint and Tune Print.¹¹⁷ Most of these have ceased trading, disappearing without trace and without sharing their know-how.

The rather dismal fate of an invention which seemed set to revolutionise consumer navigation can be explained by an important flaw from which it suffered from the outset, and which derailed a potentially very valuable and highly relevant venture: the technique of collaborative filtration was not underpinned by a well thought out business model. This doomed the service to drift under the control of business. Increasingly, the aspirations of the developers were left behind as the needs of the new owners took centre stage and they started exploiting the concept for purely commercial purposes.

Economic dependence makes such changes unavoidable, often leading to a loss of the autonomy and integrity which are vital for an advisory service. The only way to implement this kind of altruistic service is by remaining completely independent of the distributors, which means the service absolutely must make money itself. The pioneers of collaborative filtration needed to work out how to sell their product,

be able to obtain recommendations of movies to watch. They are already to be found in music shops, operated by Media Unbound, where they are known as Mix&Burn. They allow customers to receive personalised recommendations, listen to music, mix a disc with the compositions they want, and record it.

¹¹⁶As of the end of 2005, not a single article on the subject had appeared in Russian. Almost nobody in Russia knows what collaborative filtration is.

¹¹⁷See Appendix 1, Sect. A1.11.

namely recommendation and related services, but failed to do so. It seems never to have occurred to them to take payment from their individual clients for information which the clients themselves were providing. Instead, the creators of Ringo tried to make money by selling their applications to other companies. Things seemed, at first, to be going their way. By the end of 1995 they had made \$2.6 million, but this approach led to disappointment and they were unable to find other sources of income. This forced them into a merger with the much larger Microsoft, which promptly made its influence felt. The Microsoft managers evidently decided that the best business use of collaborative filtration was to integrate it directly into an online shop. The shop had a logic of its own laws, and the fine line between impartial recommendation and marketing was easy to transgress. The system's advisory function, which had initially empowered users, began to contradict the interests of sellers. The system was soon producing modified suggestions. If the initial, altruistic version had responded sensitively to questions and guilelessly also pointed out what the customer should not buy, the commercialised scheme pursued the goal of encouraging purchases as much as possible.

Another aspect of the experience of the pioneers of collaborative filtration deserves mention. In the earlier versions it had been seen as essential for the client the first to complete a questionnaire in order to inform the system of his preferences. In business applications it was evidently felt that this was too burdensome. The minutes spent constructing a personal profile were seen as an insuperable barrier to mass usage, as if in return they were not being offered a saving of hours and months of leisure time. This bizarre conclusion was evidently arrived at because business had no need of a sophisticated and discerning client. It was more interested in manipulating the customer. Why did the customer not prick up his ears when the priorities were reversed in the original equation which stated that "the expenditure of time on obtaining impartial recommendations is less than the costs of unsatisfactory consumption"? Why did he not complain when a valuable technique (admittedly still newborn and puny, but plainly with the potential to grow into something very robust) was digested in the bowels of a computer giant?

Evidently the invention and its users got their timing wrong. The collaborative service appeared before consumers had found their bearings in the commercial environment where the technology would really have come into its own. When, with the development of the Internet, the mass market customer was ready for the technological environment in which effective searching would have been possible, he found an emasculated recommender system waiting for him. This is what business had decided to use, having recognised the threat posed by the method and determined to keep one step ahead of the game. We can interpret this now as a brilliant counter-coup. Business had lured this new agent of the consumer into its camp, and turned him into a double-agent. The agent was allowed to carry on acting as if nothing had happened, but the messages he transmitted were doctored. Consumers for their part, failing to realise that their agent had been 'turned', took his information on trust, but noticed it had become less useful. The fact that its true value might have been a hundred times greater was something few were far-sighted enough to see, and business did nothing to improve their vision. As one of those who had enjoy

the Ringo service in its heyday said, “Not one of the navigation systems operating today can compare with the quality of Ringo”. If this was clearly seen by an ordinary user, it is difficult to believe that Microsoft did not know it, having worked with Firefly Network for several years before buying it. A seller needs a technology which helps him to sell, not a technology which enables consumers to select unerringly, thereby leaving the manufacturer with piles of unsaleable goods. Collaborative filtration did not directly threaten Microsoft’s business, but it was enough that the technology posed a threat to many other businesses, and Microsoft could have no illusions regarding the commercial prospects of recommender systems. In August 1999 a statement appeared on the Firefly.com site: “In preparation for the launch of Microsoft Passport, we will be shutting down this Firefly Web site and its associated services on August 18.” When nothing similar to Firefly was discovered, the Net community failed to display its renowned solidarity, although possibly at the time it simply did not recognise the significance of what was happening. Napster was just getting up to speed. The recommender systems were reorientated to serve a new master without any protest. The pioneers of the new technology surrendered one after another to the blandishments of business, or peacefully expired within the framework of university projects. They had seen their mission as purely a means to an end, as a service to a segment dear to their hearts, and proudly believed that now big business had taken over the baton. They expected the relay to continue to continue in the same direction, but it changed markedly. Nobody recognised at the time just how radically unfettered consumer assessment of quality changed the correlation of forces in the marketplace. If the consumer does not show his strength by drawing on sources of impartial information, he panders to the worst instincts of the market professionals.

1.3.2.5 The Technology Substitution Trick

An innocent-seeming pretext for terminating the virginally pure navigational service was to hand. It was that same necessity of gathering clients’ preferences. To work effectively, collaborative filtration needed a large database of clients’ assessments, 100,000 as a minimum. Before this critical mass is reached, users have little motivation to provide their judgements, since the system is not yet capable of rewarding their efforts with accurate predictions. This is known as the cold start problem. Somebody has to be first to do work for the benefit of everyone else. It is a classic predicament in the production of a social good. To try to make the start a bit warmer, one needed to avoid asking the clients for any input, and to try to deduce the preferences implicit in their actions (which need not necessarily have been performed within the context of the advisory system).¹¹⁸ Business followed this route, and soon discovered that it was possible to proceed without gathering any direct, explicit client preferences.¹¹⁹ These indirect sources could be, for example, a record

¹¹⁸For more detail on this, see Chap. 2, Paragraph 2.7.3.1.

¹¹⁹Preferences may be explicit (if the user himself rates a book, compact disc or restaurant) or implicit (where conclusions are inferred from his actions).

of purchases they had made in the past, how long they spent looking at a particular Web page, or the sequence of clicks on Web addresses or pages. W.W. Cohen and W. Fan showed how music preferences can be deduced by analysing user logs (chronological records of Web events), downloading statistics, and other technical information.¹²⁰ Performers or composers could be identified from the name of a file, and consumers from IP addresses.

The same principle is applied by the Internet shop Amazon: every book found is accompanied by a list of titles bought by other purchasers of that particular book.¹²¹ The idea is that those earlier purchasers provided an assessment by making a purchase. Although what is bought and what is liked are clearly not the same thing, Amazon believes the distinction can safely be ignored. Despite the fact that the accuracy of predictions deduced from indirect data is lower than that from direct consumer assessments, business has put its money on the former, which might make one wonder whether this reflects a desire to save purchasers needless trouble, or to limit their competence, the motive which we believe introduced uniform pricing to the digital segments of culture. Options which facilitate choice attract customers and hence tend to increase sales, but they also make choice more focused, which tends to decrease sales. In offering a navigation service, business wants something which will not hinder the marketing of products of differing merit. It chooses the option which is most favourable to itself, which is not necessarily the best option for the purchaser. If Amazon's navigation service was a paid service providing revenue comparable to that received from the sale of books, a higher quality service could be expected, but you do not look a gift horse in the mouth. The purchaser has been provided with navigation of a sort, and should be grateful for that. Unfortunately, combining an advisory service with a focus on sales contains a potential for double-dealing. If it can be relied on at all, then only with many reservations.

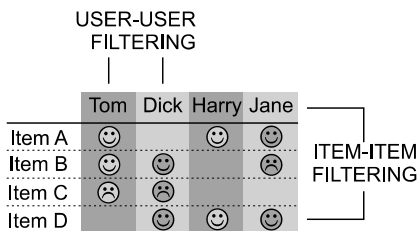
1.3.2.6 Who Is Filtering Whom?

As the number of participants in collaborative filtration grows, the problem of processing their data grow proportionately. Given several million users, limitations of processing speed become perceptible. Accordingly, when an advisory service is used as an adjunct to commercial systems, filtering of the user-user type is replaced by an item-item chain (see Fig. 1.1). This approach is more economical, particularly because it does away with the need to frequently calculate the similarities between

¹²⁰William W. Cohen and Wei Fan, "Web-Collaborative Filtering: Recommending Music by Crawling the Web", *Proceedings of the 9th International World Wide Web Conference on Computer Networks: the International Journal of Computer and Telecommunications Networking*, 2000, 685–698. Available from: <http://portal.acm.org/citation.cfm?id=346241.346394&coll=&dl=ACM&CFID=15151515&CFTOKEN=6184618>.

¹²¹For further details, see Appendix 1, Paragraph A1.11.6.1.

Fig. 1.1



users.¹²² Here we see the beginning of an imperceptible reorientation of the method away from the needs of customers and towards the interests of sellers.

At the basis of item-based filtration is the registering of all ratings revealed by users of the system for various items (which might be goods, services, institutions, etc.), and analysis of the similarity between the items, which is not quite the same as the similarity between people. For example, a specific product is taken, a book, say, and all the other books are found which have obtained a similar rating from other customers. Although from a mathematical viewpoint the item-item calculations would seem to be identical to the data obtained from consumers’s ratings, in the latter case products are being selected which people need, and in the former the people ‘needed’ for selling of products are being selected. In item filtration the similarity between goods is established from the profile of a consumers’s ratings, while in the ‘human’ version this is done from a series of personally expressed and meaningful parameters. The difference is that, in collaborative filtration where consumers participate directly, they themselves place the emphases, while the item-based scheme does without this. The methods would be identical if the client-based version took account of all the ratings of all the purchases made by all the consumers.

Disregarding explicitly expressed ratings is no different from judging the coincidence of people’s tastes on the basis of their acquaintance with blockbusters. Obviously too, the fact of consumption of an item does not always mean that satisfaction was obtained. There is a gap between interest in the product and its final rating. The moderators of Ringo quite deliberately did not confine themselves to frequently ranked artists, but left room for individual preferences. The divergence between payment and satisfaction is particularly important when there is no repeat consumption, and accumulation of information from previous purchases, whether positive or negative, does not occur. It is for precisely this reason that cultural production, consumed only once, proves to me among the most difficult areas for item-based collaborative filtering. There can be a great gulf here between interest, expectations, and final impressions. In the material sphere, the situation is less acute.

¹²²This type of navigation was proposed in 2001 by Badrul Sarwar and his colleagues at the University of Minneapolis. See B. Sarwar et al., *Item-Based Collaborative Filtering Recommendation Algorithms* (online). Department of Computer Science and Engineering, University of Minnesota, Minneapolis, 2001. Cited 15 February 2006. Available from URL: <http://www10.org/cdrom/papers/519/index.html>. Other groups, including Amazon, were working in the same direction.

In the user-based version, people signal their total emotions and impressions, but in the item-based version goods indicate their ability to attract the attention of people which is clearly a function not only of their intrinsic quality but also of advertising and price.¹²³ Accordingly, people give their rating of goods with great benefit for themselves, especially if we bear in mind the fact that their very involvement in the process is positive in itself. In areas where people consume much the same range of goods, for example, cars or detergents, the similarities in their list of purchases will not reveal differences of taste, although it may well indicate similarity of status, and to this extent item-based filtering will prove informative. It clearly also tends to encourage a tendency to imitate, rather than to differentiate one's likes, and this is all to the good for business.

As we have noted, analysis of similarity within the framework of item-based filtering does not need to be carried out every time, which ensures a rapid response to a query. This is exactly what Amazon and other traders need in order to bombard customers with recommendations while they are in purchasing mode. People search and make purchases on the Internet, and in the process leave tracks on various sites. In the process information rains down upon them, either in the form of recommendations or of advertising. Any click on a Web page is counted by the system as an act of consumer rating, but pausing to look at a particular offering, or possibly for some unrelated reason, is not a particularly accurate indicator of interest in a specific item. Moreover, not all purchases are made over the Internet by any means, and accordingly deducing a purchaser's preferences exclusively on that basis is not fully representative. Collaborative filtration in which the user participates directly may be slower, but it more truly serves his interests.

1.3.2.7 The Business Version of Collaborative Filtration, or Why You Should Compromise Your Principles

A recommender system integrated into the sales process in order to suggest other goods while something is being purchased or searched for addresses the interests of business. It requires no action on the part of the user other than his entry into the trading area. Here he is seized upon. Striking while the iron is hot became the main driver of the evolution of collaborative filtration. To have your ratings at the ready and be able to deliver them instantly as required by the interests of business, without asking anybody about anything, led to an unseen moral compromise. As soon as the decision was taken not to disturb the customer over such trifles as his opinion of what constituted quality, the whole affair increasingly came to resemble behavioural programming.

If, for conventional goods, item-based filtration can in certain circumstances produce the desired result, things are less straightforward for navigating through cultural offerings. To be fair, we should say immediately that music occupies a special niche among cultural goods. Since people often return more than once to a good

¹²³For more on the relationship between advertising and price, see Chap. 3, Sects. 3.4.1 and 3.4.2.

tune, consumer ranking can be successfully replaced by counting the number of times a particular song is listened to. This is that rare instance where implicit preferences closely reflect explicit, and this is exploited by Audioscrobbler Music Services (now Last.FM), Launchcast Radio, and others.¹²⁴ A special plugin is loaded on to the computer on which the music will be listened to. No more is asked of the user.¹²⁵ He is not burdened with requests to rate musical compositions, is asked no questions about his mood, and so on. The plugin tracks the music a person plays and passes the information to the server. It also creates personal Web pages for users of the service, displaying lists of what has been played. If more than half a song has been played, it is assumed to have been liked and included in the profile. Even so, there are hidden limitations to this method. The server receives information only about music played on the computer, which indicates a particular environment, probably an office. This is going to favour particular kinds of music: for example, background music. A quite different playlist may be listened to in the car or on high-end equipment. This suggests that the automatically generated consumer profile is bound to be distorted.

If we are looking at works which are used once only, books, plays, movies, and so on, accurate results will only be obtained using a filtration method based on considered reflection on the part of consumers. In order to improve the accuracy of recommendations in an item-based scheme, the database is augmented by extraneous information about clients. In the glorious traditions of marketing they are slotted into such socio-demographic categories as: middle-class suburban; young urban professional; rural religious with bicycle; and an attempt is made to break the population down into clusters. There is no information business will not try to press into service: academic records, work experience, marital status, age, sex, race, postcode, credit records, focus-group sessions, and so forth and so on. In order to determine what consumers are going to want, the attempt is first made to establish who they are. This is fairly labour-intensive, pointless, and in some respects downright distasteful because there is a high probability that other customers may be found for such information, and this will be no consumer of culture but somebody quite different whose intentions can only be guessed at.

The great advantage of user-based collaborative filtration is precisely that the process is focused. The system has no particular wish to know who is who, it needs only to collect voluntarily expressed preferences. It is only from these that it deduces who belongs to which cultural 'neighbourhood'. The communities are not fixed, but change as people change. For example, one consumer may never have seen a film by Buñuel, but if tomorrow he goes to see "Cet Obscur Object du désir" and gives it a high rating in the MovieLens system, the group of people previously classified as closely similar to him will immediately change.

¹²⁴Audioscrobbler has moved to www.Last.FM; Launchcast Radio can be found at an old address—www.launchcast.com—and a new one <http://launch.yahoo.com/launchcast/>. For further information, see Appendix 1, Sects. A1.11.4 and A1.11.8.

¹²⁵It remains preferable to rate the first few compositions.

The approach to approach to filtration based on implicit preferences lends itself suspiciously well to commercial uses. The element it most spectacularly lacks, an emphasis on perceived quality, dooms it to be of less utility to the consumer, although today, while recommender systems are still in their infancy, we should not suspect any party of manipulation. Amazon, for example, very properly offers its customers the opportunity of training the system by commenting on the appropriateness of its recommendations. There is nothing inherently wrong in using information filtration systems in a commercial context, but as the popularity of these services grows, the temptation to manipulate them will not be far behind. Publishers may be tempted to intervene in the rating process by recommending their own books; authors and their friends will find it difficult to resist the temptation to ratchet up the ratings. Michael O'Mahony has shown that the most robust systems of filtration are vulnerable to the wiles of malicious agents.¹²⁶ They are not designed to keep them out. Countermeasures are being developed against 'recommendation spam', but it is early days to talk about applying them in practice.¹²⁷ In one of these pilot versions of protection, honest ratings are separated out from malicious ones by mathematical means. There are plans to reward responsible users with discounts and bonuses, and to punish tricksters. However, when collaborative filtration becomes universal, it will be much more difficult to protect systems against premeditated attacks.¹²⁸ There is a risk that the recommender system, like a doctored roulette wheel, will be skewed to issue only particular suggestions. Will the system be recommending, or frogmarching customers to a particular product. Can we really see businessmen selflessly laying out navigation lanes for consumers? Can we trust the recommendations of merchants?

1.3.2.8 Collaborative Filtration and the Price System

If we were of a suspicious nature, we might feel by now that we were on the threshold of uncovering a conspiracy. There was nothing too blatant, of course, but if we stand back and take a longer view of the way recommender systems have evolved it is difficult not to wonder whether there was a plot of some description. It is very tempting to declare that dark forces are operating in the cultural realm to conceal a miraculous way of saving time and money.

They conceal it using the classic method of putting it in a prominent position. The high-minded original idea has been taken over, re-programmed to their needs, and launched once more under its old name. What better way could be found of

¹²⁶M. O'Mahony et al., "Collaborative Recommendation: a Robustness Analysis", *ACM Transactions on Internet Technology*, 4, 4 (November 2004), 344–377. Available from: <http://portal.acm.org/citation.cfm?coll=GUIDE&dl=GUIDE&id=1031116>.

¹²⁷Nolan Miller et al., "Eliciting Honest Feedback: the Peer Prediction Method", Harvard Kennedy School Research (online), June 2004. Cited 20th February, 2006. Available from URL: <http://ksghome.harvard.edu/~RZeckhauser/elicite.pdf>.

¹²⁸The technical term for this is 'semantic hacking'.

discrediting the original? In a genetically modified version, recommender systems have begun appearing all over the place. Customers in Internet shops are constantly having something pressed upon them. Now everybody knows what navigation is, and they also know it is not that useful, and sometimes downright brazen. People imagine that the service they have tried, for example on Amazon, is navigation true and proper. In reality, a good method which could save endless futile testing and be operated strictly in the interests of consumers simply cannot make headway.¹²⁹ At the outset, the problem to be resolved was the consumer dearth of information about the real quality of products. Now it has been replaced by dearth of information about the real intentions of the operator of the recommender system. The one is no better than the other, and in addition one begins to sense that one's independent ability to choose is being undermined.

Manipulating collaborative filtration under the pretext of improving it perverts the original idea. We cannot blame anybody for this. Business could not see a way of making money from user-based filtration, and neither could those for whom the good of the community was genuinely their main priority. Undoubtedly, however, business also saw a threat to its interests. An open warning was issued on the pages of the *New Yorker* in the year when Napster was born.¹³⁰ It stated that collaborative filtering was, in effect, anti-blockbuster. Suppose that somebody entered his rating in MovieLens of 15 popular American films. This person rarely viewed anything other than commercial Hollywood releases, and had little knowledge of the world of cinema. In reply, the system, which possesses data about the preferences of people similar to himself, informs him that he might enjoy “C'est Arrivé Près de Chez Vous”, an obscure 1992 Belgian comedy and “Let's Dance” (1950) with Fred Astaire and Ginger Rogers. He discovers this really is the case. The method “favours the smaller, the more talented, more quality products that may have a hard time getting visibility because they are not particularly good at marketing.”¹³¹

Competent recommendations will lead to a rise in sales of works and authors who have not been pushed but which are none the less interesting for that, and sales of blockbusters will fall. When everything is unclear, when there are no reliable recommendations, people buy something predictable, that is, a blockbuster. With the appearance of reliable recommendations, the blockbuster will lose part of its audience, because people will find they have new ways of making their choice.

If people start making fewer unnecessary purchases, then the business of churning out products, and with it the policy of uniform prices, will become pointless.

¹²⁹It is widely believed that a similar fate may befall the free browser Firefox, a competitor to Microsoft's Internet Explorer which comes embedded in Windows. Firefox appeared in November 2004, blocks pop up advertising, is practically impenetrable by viruses, and takes up little space. For all that, it is having great difficulty in getting through to users, because Internet Explorer is already present in billions of computers and in the habits of users.

¹³⁰M. Gladwell, “The Science of the Sleeper: How the Information Age Could Blow Away the Blockbuster”, *The New Yorker*, 4 October 1999.

¹³¹John Hagel, global leader of McKinsey & Co's Electronic Commerce Practice, quoted in M. Gladwell, “The Science of the Sleeper”. He is the co-author of *Net Worth* (J. Hagel and M. Singer, *Net Worth*, Harvard Business School Press, January 1999).

As soon as recommender systems become widespread, the era of uniform prices will come to an end. It is entirely possible that when automated recommendation services really start helping consumers to select works, they will find higher, more differentiated prices fair. It is also possible that by that time ways will have been found to root out piracy. If neither of these things occur, the prospects for the culture industries are bleak.

1.3.2.9 Recommendation as a Self-sufficient Business

Having developed a method for selecting books, music and movies, collaborative filtration may expand into other spheres. It might, for example, help in the choice of television programmes, restaurants, holiday trips, educational institutions, a personal trainer, an architect, and so on. For the time being, the vast majority of such decisions are taken in the old way. The term ‘collaborative filtration’ is to this day little known. The obstacles in the path of this progressive technology are not only people’s conservatism, but more importantly a number of factors in the invention itself. There are three bottlenecks in the system which stand in the way of its becoming widely implemented. Two of these can probably be overcome by further development work: the cold start (acquiring a critical mass of users); and clogging of the filters as a result of garbled data. The third problem, however, is existential: how is the deviser of a recommendation service to survive if he doesn’t go into service with a seller? This is not merely a local problem of recommender systems but part of the wider issue of how culture can be integrated into the business environment. The only way to find a solution is to undertake a radical re-think.

The problem of the cold start was already being successfully addressed by the pioneers of the technology. Clogging of the system with ‘noise’ is one they hadn’t, in that age of innocence, yet encountered. The most fundamental issue, that of retaining the system’s independence, is the one they had no answer to and, as we have seen, they paid a high price for that. The independence and integrity of any advisory service is a basic requirement. You cannot bite the hand that feeds you. You cannot, if you are being kept by a merchant, publicly criticise his goods and spoil his business. As soon as the inventors had developed their models to a relatively effective level, they were overwhelmed by a desire to turn themselves into entrepreneurs, at which point they were, as a rule, swallowed whole by bigger players. Why did it have to end that way?

In the first place, as we have said, the method’s proselytisers overlooked the only possible strategy for entering the business world: selling their product to its end-user, the consumer of culture, and only after that to add on extra income streams by, for example, acting as portals for other businesses. Any other solution laid them open to losing their integrity.

In the second place, they saw their mission as being no more than to provide a good service with a little cultural flair. The inventors had no lack of innovative ambition, but lacked the breadth of vision needed to instigate social reform. None of them seem to have recognised that the solution they had stumbled upon was applicable far beyond the segments of music or the cinema. The problem of consumer

navigation is a major problem of digital culture, and how it is solved will be of crucial importance to the direction of the entire cultural process. The remaining parts of the present study are devoted to this wider area of concern.

And finally, consumers' points ratings simply cannot be fitted into a commercial framework.

1.3.3 An Invention Whose Time Is Yet to Come

The above considerations suggest that collaborative filtration needs major further development if it is not to be introduced with its wings clipped. We can attempt to deduce from first principles the elements it lacks before it can truly take flight. Culture, as social property, and money, as an instrument of private property, are strange bedfellows.¹³² At the same time, like it or not, culture cannot get by without money. How can money be harnessed in a way that stimulates business activity while giving culture a bigger say? It seems reasonable to suppose that the consumer, as the representative of non-commercial interests, needs to become integrated as a player in his own right in the cultural sphere.

There may be one answer to all three of the problems mentioned above: the cold start, the clogging of filters, and genuine independence of the advisory system from business pressures. It should be possible to breathe new life into the system of collaborative filtration by freeing it from its present subservience to business. This requires injecting money into it from a different source. Money can be put at the service of culture by being put at the heart of recommender systems. Rating of work of art should be expressed in monetary terms; we suggest that this is a prerequisite to releasing recommender systems from their current status as the stepdaughter of commercial interests. Those who wish to contribute their ratings and discover the ratings of others need to pay an amount proportionate to the benefit they obtain. The suggestion might seem nonsensical at first sight. Not only will the consumer, that sacred cow of commerce, be asked to provide information about himself, not only will he have to communicate directly with the service (business has already written off as an absurd imposition), but for his pains he will also be asked to pay good money. Even a sacred cow, however, if short of sustenance, will go off to where it can be found.

Three conditions need to be met before a feasible system can provide worthwhile recommendations:

- standard numerical rankings need to express impressions sensitively and consistently;
- ratings have to be honest;
- judgments have to be logged in an efficient and trustworthy manner.

¹³²See A.B. Dolgin, "Vtoroi universum", *Logos*, 2002, 5–6, 243–291.

All these requirements can be met by the simple expedient of using money as the vehicle for rating quality. This is not payment for the right to access to the work, but a supplementary payment made on a voluntary basis after consumption and in recognition of the positive impression made by the work. It will then reflect the genuine opinion of the consumer. Under the current dispensation, the quality of music has no impact on price. Prices are uniform and hence, by definition, cannot register quality. A voluntary payment after enjoying the work will give money back its signalling function. Only in this way can an autonomous system of consumer evaluation, safeguarded against outside interference, un beholden to business, hope to survive. The consumer should be able to reward above-average quality, and possibly be compensated for substandard quality. The simplest way of doing this is to divide payment into stages: a first payment for the right of access to the content,¹³³ a second payment for recognised high quality (or a no-quibbles refund should it be absent).¹³⁴ This gratuity payment by the consumer can, we anticipate, provide the solution to the problem of rating music and other information products. But, the reader may ask, is this feasible? Will consumers be prepared to follow the rules? Who will collect the contributions? What is the economic significance of voluntary payments?

1.3.3.1 *The Cinema and Theatron Projects: A Field Trial of a Two-Stage Payment System*

The hypothesis that changing the rules of payment in culture might have a beneficial effect was put to the test in an experimental project in a number of theatres and cinemas¹³⁵ where those taking part were invited to give monetary expression to the impression particular works had made on them. Several thousand audience members took part in the experiments, ordinary members of the public who had come to a cinema or theatre performance after buying a ticket. Before it began, they were handed an envelope containing six 10-rouble notes. The purpose of the experiment was explained to them, and they were invited to rate the impression made by the film or play in monetary terms: to pay more for a positive impression, or to retain a sum of money if their impression was negative. A ranking scale was provided, running from minus 50 roubles (at the time the experiment equivalent to US\$1.75) to plus 50 roubles. Participants were asked given an assessment at the end of the performance of how enjoyable it had been either by removing from the envelope a sum of 0–50 roubles (but not 60!),¹³⁶ or by adding to it from their own money within

¹³³In certain cases, e.g., for products distributed over the Internet, this could be zero.

¹³⁴How this might be funded is considered later.

¹³⁵The ‘Theatron’ and ‘Cinema’ experiments were conducted by the Pragmatics of Culture Foundation at the instigation of the present author. Further details of the projects are given in Appendix 4.

¹³⁶If all the money was removed, the response was deemed invalid since the individual’s actions lacked integrity.

the same limits. The envelopes were then returned to the organisers. If members of the audience had enjoyed the performance, they gave a tip; if not, they helped themselves to a refund from the organisers of the experiment. Central to the research was that consumers were being asked to give a monetary assessment, not of the quality of a play or film, but of their personal enjoyment of it, its value to themselves. Five cinemas were involved in the experiment, with 9 films being viewed, and more than 13 theatres presenting 24 plays. The result obtained was a positive response to the key question. More than 75 per cent of those invited to take part agreed to do so and successfully expressed their rating through a voluntary payment after the performance. Only 10 per cent failed to respond to the invitation to take part. Eight per cent of spectators in the theatre and 16 per cent in the cinema helped themselves to all the money in the envelopes. A parallel survey indicated that roughly one-third of the spectators would welcome the innovation, one-quarter would not, and the remainder made no comment.

However utopian this proposal for consumer rating may appear at first sight, its viability will depend mainly on its actual effectiveness. If widely implemented in real life, the scheme would differ from the research project described above in that no irrevocable sacrifice would have to be made by the subscribers to a collaborative system. We shall see below how their efforts can be used to create an information product which could be sold and which would provide an appropriate return to its creators.

1.3.3.2 Why Money Rather than Points?

Collaborative filtration with the use of money gets round the crucial question of how to express personal ratings in terms meaningful to other people. Let us see how this works by taking the example of music, a typical information product.¹³⁷

It is typical firstly because the consumer can evaluate music only after having heard it; secondly, since the rating is subjective, there cannot be any external institution validating it (which does not preclude filtering out malicious agents); thirdly, consumers should be given additional incentives to evaluate thoughtfully, honestly and responsibly; fourthly, the processing of their comments should be simple and reasonably rapid. It also makes sense to have a single scale of assessment.

Money paid out after consumption of the product meets all these requirements: it is quick acting, relevant, voluntary, graphic and economical. Briefly, the theoretical considerations in its favour are:

- money brings a sense of responsibility and discipline when commenting;
- if there is no charge for posting ratings, market agents and others can flood the system and distort the picture to their own advantage. It needs to be made un-

¹³⁷Music products are distinguished by the fact that they: 1) cannot be assessed by their external appearance, and the formal description offered tells the consumer almost nothing about their quality for him; 2) they are a one-off purchase.

profitable to attempt to manipulate ratings. If money mediates of the posting of ratings this in itself will be a barrier to fraudulence.¹³⁸

- if the logging of ratings is not meticulously audited, it will be difficult to avoid distortions. The best available system at present is based on monetary transactions;
- people are perfectly willing to pay for the right to express their opinion, as can be seen from the success of interactive radio and television programmes. When users feel involved, they have no objection to paying up to \$1 for national-rate telephone calls or SMS messages. The quality of leisure time is a matter of considerable topical interest;
- money has a value familiar to all, whereas points are open to interpretation.¹³⁹ The value of money can admittedly be different for people with different amounts of wealth, but in theory this can be allowed for.

The major reasons for using money as the medium of assessment are, however, to protect the recommender system against malicious attempts to falsify its results and from spam and, no less importantly, to enable it to be financially independent. If we were concerned only to prevent malicious attacks it would by and large be possible not to involve money.

There are sources of authentic assessments of quality to be found on the Internet, for example, blogs, personal diaries. Existing technologies of automated semantic analysis make it possible to extract such assessments from blogs. Such messages, if not intended for this purpose but nevertheless honest, can be included in the database of a recommender system, and solve the problem of the cold start. This approach does not, however, help with the problem of achieving independent financial viability.

1.3.4 How to Constitute a Stock Exchange for Culture

A new institution for attestation of quality is currently in the pipeline.¹⁴⁰ This will be a payment centre able to collect and process voluntary payments made by consumers appreciative of the quality of a wide variety of cultural products. This recommendation service is not intended to be restricted only to literature, music or movies. Initially, the mechanism for post-consumption rating will be tried out on books, but the intention in the near future is extend the resource to the whole spectrum of cultural

¹³⁸Some defence against manipulation of ratings is afforded by non-monetary costs, like the effort involved in writing ratings.

¹³⁹Although money is better than points, this would not be enough to make its use essential. The problem of evaluating points can be resolved using methods discussed in Chap. 2, Sect. 2.7.

¹⁴⁰The Russian-language version was launched in autumn 2006 as IMHOclub, a recommender service for literature. URL: <http://imhoclub.ru/>. The principle on which it works is described below in general terms, but trade secrets are not revealed.

products. All those wishing to take part will be able to open personal current accounts. After appreciating the work, they will be able to instruct the system operator to deduct or credit a sum of money to the account through all the usual method: over the Internet (preferred), through call centres, by SMS message, oral instructions to the operator, and other personal channels of communication. Account transactions will accumulate to become the most precise available documentation of consumers' personal assessments of particular works. The accumulated database will be able to be processed using the method of cash-based collaborative filtration, and the results sold to customers as recommendations. Users will be able simultaneously to act as recommenders, or not.

This will make it possible to respond to all manner of enquiries to the system, providing recommendations on the current stage repertoire, a new author or album, book, film, photos, play, exhibition and so on, and also to indicate items which are deemed unsuccessful. It will be possible to request a listing of one's own assessments, a kind of cultural aide-memoire. For each enquiry a group of recommenders will be formed automatically in compliance with the criteria laid down. The cultural stock exchange will also facilitate the formation of offline taste communities. If both sides are agreeable, recommenders can be given mutual access to their neighbours' data.

A wide range of options will be possible within the framework of the recommendation service, each an information product in the fullest sense of the word. The main utility of this service is saving time on the studying of menus, selection costs, and the experiencing of unsatisfactory consumption. Reducing such costs has a value, and accordingly the service will come at a price. The process of producing and providing recommendations accords entirely naturally with business logic. Customers will obtain recommendations in return for payment. Those who have taken part in the monetary signalling of quality can be regarded as sub-contractors of the firm helping to produce the information. Part of the proceeds from the sale of information can reasonably be shared with them as providers of raw material. They will be recompensed fairly in accordance with the demand for the information provided. A particular assessor's recompense should be based on receipts from those customers who made use of that individual's recommendations. Those who are in demand, possibly including professional critics, will receive more money. Those whose recommendations evoke no interest may nevertheless be granted discounts proportionate to their efforts.¹⁴¹ In accordance with normal market practice, supply and demand will determine the price of the information provided. Its value will lie in predicting consumer enjoyment and saving people from the risks of uncertainty.

If we accept that successful selection of products will increase from, say, 25 to 50–70 per cent (the consumer will be satisfied not with every fourth but with every second purchase), the gain will be the total cost of the products avoided. Taking this as a basis, it is possible to derive a structure for price formation for recommendations. The price will be commensurate with the value of the good. It would seem

¹⁴¹It is intended to reward participants who, for example, are the first to rate a work which, through their identifying it, subsequently becomes popular.

worth while to pay 150–200 per cent of the price of a disc in order not to waste money on 2 or 3 unsatisfactory purchases. The suggestion of a worthwhile film also seems worth US\$1–3 if it enables you to avoid 3 wasted visits to the cinema.¹⁴² It seems only fair that a proportion of the proceeds generated by the business should go to the creators of works and rights holders, and what this proportion should be could be decided by the users themselves, who could include it when making their post-consumption payment. The public likes to show its appreciation to performers, especially if it knows that the cash will go directly to the artist. I don't imagine creators will object to this additional source of income, and that their lyre will gladden the soul all the more.

1.3.4.1 Difficulties and Worries

Needless to say, there is many a slip 'twixt the cup and the lip. In addition to the usual teething problems, answers have yet to be found to a whole range of basic questions.¹⁴³ As of now nobody can say whether monetary ratings after cultural consumption will become an accepted part of everyday life, or whether, having experimented out of curiosity, people will abandon the practice. No doubt this will depend on a whole range of factors which are difficult to predict, but primarily, on the quality of the recommendations given and how much support the project generates. This is a worry which can be allayed only by the experience of success.

Immediately after its launch, it is unlikely that the system most probably will be able to produce high-quality recommendations, or to generate revenues. This means that, as the service develops, the issue will have to be faced of how to develop from a free to a commercially based system. It is early days to say which will be the best alternative, and indeed at different stages the service may need to be offered to different kinds of community with different options for participation. The only prerequisite is that ultimately a proportion of the ratings received should arrive in the form of money. These will serve also as an internal check for identifying and eliminating assessment spam, inflated ratings posted by self-interested parties.

Another sensitive issue is the appropriate level of payments. If the rate is set so as not to be burdensome for the majority of users, will the service attract enough revenue to cover its expenses and remain financially independent? There are, in fact, proposals to generate additional sources of income as it becomes established. Setting a low upper limit on the supplementary payment, at, for example, \$1, might not effectively deter fraud. The intention is to resolve this kind of issue with the aid of mathematical modelling.

¹⁴²If the costs of going to see a movie are taken to include the cost of transport, parking, and hiring a baby sitter, the total will be well over \$5. If we multiply this by the number of viewings regularly regarded as unsuccessful, paying a few dollars will seem entirely prudent. Working out the detail of tariff plans is clearly a practical matter. Individual transactions seem likely to be in the region of \$1.

¹⁴³A number of issues not mentioned here are discussed in Chap. 2, Sect. 2.7.

A no less delicate matter concerns negative ratings. Should a refund be paid to subscriber who has been disappointed by a particular work, thereby risking incentivising people to behave dishonestly? For the present, the answer seems to be to limit the right to a refund to those who deliver their ratings in cash terms.

A relatively simple problem is how to deal with anyone attempting to use the service without themselves providing any information input.¹⁴⁴ The short answer is that such parasitism is simply not possible. Subscribers will be unable to obtain high quality recommendations without taking the trouble to provide a full and accurate profile, which automatically augments the ratings database. It will be impossible to use the service without incurring costs of some description, and users will have a motivation to provide ratings as accurate as they can make them.

The cold start problem affects all recommender systems: how to mobilise the pioneers who cannot yet be offered good quality recommendations.¹⁴⁵ Other than relying on their enthusiasm and networking effects (which suddenly cause co-ordinated activity to arise among users), a number of auxiliary stimuli can be deployed. These can include the establishing of ranks within the community; direct subsidy; lotteries; prizes for quality of recommendations; share participation schemes; and providing access to original content. As already mentioned, the cold start problem can be minimised by topping up the database itself with assessments obtained from existing recommender systems and other sources. Needless to say, incorporating outside assessments into the system will require special arrangements, but this approach is perfectly feasible and acceptable.

Next, will customers be able to use the service by awarding points rather than providing monetary ratings? Given safeguards against parasitism, it should be possible to offer users a choice of tariff plans. These could range from entirely free of charge, but with payment in some other form such as loading with advertising, to 100 per cent paid but offering a premium selection of services. Subscribers are likely to self-select depending on the relative priorities they give to time and money. Fine-tuning the tariff plans is a matter of trial and error.

Theorising could go on forever, but there comes a time when one has to get stuck in to practical implementation, reacting as appropriate to opportunities and threats rather than trying to anticipate everything without casting off from the shore. The structure of the new service will, we hope, enable it to cope with unforeseen challenges. Success will depend primarily on whether the cultural community values the form of collaboration proposed, and also how rapidly people come to regard the selection of culture as a process involving costs which can and should be minimised.

1.3.5 Advantages of the New Model

The institution we are proposed, based on a monetary rating of perceived quality, will shift the balance of power in the music business and in other segments of cul-

¹⁴⁴For further detail on this problem, see Chap. 4, Paragraph 4.1.2.

¹⁴⁵The so-called problem of the 'cold start'; for further detail, see Chap. 2, Sect. 2.7.3.1.

ture. The introduction of highly efficient consumer navigation will call the bluff of deceptive marketing. It will become quite pointless to promote works which the manufacturer already knows to be weak because they will simply fail to sell. Every player in the cultural field and its associated markets will be obliged to radically alter their game.

The current model of the music business is wasteful both of consumers' time and money. The proposed model aimed to rectify this. Here are a few of the changes we anticipate:

- producers of cultural products will have direct access to their public, without the involvement of middlemen;
- distribution and consumption costs of music will fall;
- exciting original works will find their public;
- the pirates' share of the market will be reduced because, by saving on promotion costs, legitimate manufacturers will be better able to compete with them on price;
- creative artists will have an economic motivation to produce their best work rather than to churn out potboilers.

1.3.5.1 The Economic Logic of the Solution Proposed

Until now consumers of culture lacked the technology to enable them to share their experiences, thus reducing individual navigation costs through a division of labour within the community. The economic logic of the proposed solution is that selection costs will be redistributed between members of taste communities in general, so reducing them for each individual in particular. The consumer of culture receives signals from forerunners which lower the risk of failure, and effectively pays for this useful information from cost savings. Only the very first consumers are unable to avoid that risk; those, for example, who see a movie on the Saturday of the first weekend after its release. These will be approximately 10 per cent of the total of moviegoers viewing the film. On a different occasion it will likely be other people in this predicament.

Manufacturers are interested in the volume of goods sold. The sale of each additional product is disproportionately profitable, with the result that shifting shoddy work is commercially attractive. By sharing out the drudgery of sampling, consumers will be able to strike back at the consequences of excessive throughput. Consumer rating can act as an antidote to adverse selection. The new cooperative scheme will make it impossible to pull the wool over the eyes of each individual purchaser. If in the past each consumer has had to sift the cultural ore on his own, repeatedly duplicating tests and unsatisfactory experiences already suffered by others, now there will be channel through which this work can be shared between participants, significantly reducing duplication of effort. The successes, and indeed the failures, registered by each will become the property of all. How unproductive the work of geologists would be if they did not break down a territory into tracts and share information about the results of their explorations. They would repeatedly

comb the same areas of territory, and miss some out altogether. Today this absurd method is applied to the territories of culture.

Movies, video and other digital sections of culture need such a recommender system almost more than music does, but the need is felt not only the digital sections. The most diverse areas of culture suffer from problems with one and the same cause: the speed of assembly line techniques of production and the instant delivery of products results in output which far exceeds what can be satisfactorily evaluated. The result is release on a massive scale of products of questionable merit, and a reduction of the proportion of high quality goods. This leads to unproductive, predatory exploitation of culture's most valuable resources: the free time and attention of consumers. Given that nowadays the communication of information is unbounded and cheap, and that human attention is valuable, the centre of gravity simply must be moved; attestation of the value of goods and services is essential. The cheapest way to do this is to use a method already implanted at the very heart of the market system—monetary signaling of consumer value.

1.3.6 Forerunners of a Cultural Stock Exchange

In recent years a number of components of a solution of the problem of consumer navigation have been literally waiting to be brought together. The invention of collaborative filtration and of Napster are the most important precursors of a cultural stock exchange. The reason why they both appeared in the area of music recording is because this is where some of the problems of contemporary culture come together most painfully: equalising price formation, copyright, piracy, navigation difficulties, and corporate dominance.

It was here that they took the form of an open confrontation between consumers and big business. Whatever one's attitude towards Napster, this was the battleground where consumers discovered they were not defenceless, and the problems immediately ceased to be only on their side. No matter how skilfully business defended itself, the genie had been let out of the bottle and there was no putting it back.

1.3.6.1 The Real Significance of the New Artist Programme

The actions of Napster and its supporters played an extremely positive role, and one, moreover, which extended to the whole cultural realm. They may not have made music better or much cheaper, but they should not be written off as pirates who subsequently defected to the camp of the enemy. The jolt they gave to the whole of contemporary culture is deserving of admiration. From the records of the lawsuit brought against it, we can see that Napster's declared intention, through its New Artist Programme, was to promote independent artists without the services of middlemen. The court was unimpressed, noting that this programme was not fully developed and dismissing it as a pretext. The desire to foster emergent talent may

indeed have occurred to the defendant belatedly, but this does not diminish the validity of the concept. Napster from the outset positioned itself as a search tool for new music. There really was a need to be able to find the name of a completely unknown song or performer, and at the time the only way was by relying on obsessives who listened to everything without exception. Neither Napster nor its contemporary peering networks achieved much in this direction, but just having made the effort is enough to vindicate any supposed or actual misdemeanours on the part of Napster. It demonstrated the fundamentals for a very different marketing system which dispensed with the hyping of celebrities and inflating of costs. Even if the idea was not fully thought through, we can see it as a step towards a new model of the music business.

Voluntary cash-based rating of perceived quality is the component Napster lacked in order to become financially viable. This is the mechanism which makes it possible to turn the rating of quality into a free-standing market product and to generate revenue for those who deliver it. The payment of gratuities on top of an initial sum is not as exotic as it might seem. There have been many near precedents. A Czech restaurant owner did not specify a fixed price for the dishes he served but relied on the generous appreciation of gourmets. He flourished. German restaurateurs followed suite, also successfully. Stephen King tried to introduce something along the lines of payment on trust. In summer 2000, he turned his back on traditional publishing practice for his 'serial novel', *The Plant*. He began publishing it in parts on his website, where it could be downloaded free of charge. King stipulated that the next part would be made available only if at least three-quarters of those downloading it paid \$1 for the preceding episode. For five episodes he took around \$500,000, having spent \$125,000 on advertising, and a little more on as commission to Amazon. As new chapters were published, the income from them fell off, and after the sixth instalment King, disappointed by his readers, discontinued the experiment. Only 49 per cent paid for the fourth instalment, and, for the fifth and sixth parts, even fewer. King judged the experiment a failure and his faith in human nature was dented. Perhaps, however, the new approach was simply too unfamiliar to his readers, or there were other reasons.¹⁴⁶

Let us, however, return to Napster. For all its deficiencies, we can see in the New Artist Programme the germ of an alternative business model. Essentially, Napster showed that part of the work undertaken by the major labels could be done in a fundamentally different, and more economical, way. Today the greater part of the expenditure of the recording companies goes, not on creating and manufacturing the product, but on marketing it. The most expensive item is getting the artist noticed. What would happen if the labels ceased to put new names and titles in the spotlight? What would happen if every would-be songster rushed to self-publication on the Internet? What barrier would there be to keep out the totally untalented? This is where automated recommender systems based on consumer rating expressed in monetary terms come into their own.

¹⁴⁶This issue is considered in greater detail in Chap. 4, Sect. 4.8.2.

The pieces of the jigsaw are all there. Stephen King tried to change to a scheme of payment by subscription. The Czech restaurateur bet his money on a post-consumption gratuitous payment. Both shift the balance of power in favour of the consumer. Napster introduced the criticism of music by users themselves. These diverse ideas did not work without a crucial element which our model introduces. This consists of, in the first place, a voluntary post-consumption payment signaling perceived quality; and in the second place, a means of processing monetary signals from consumers in a manner capable of producing an information product of value to the individual. All that remains now is to see for ourselves whether the idea is viable and capable of producing the hoped for results.

Chapter 2

Adverse Selection in the Culture Industries

2.1 Consumer Navigation in Culture

Until consumer collaborative filtering arrives, navigation will continue to be the burning issue for present-day culture. There are no books or articles giving clear, systematic consideration of the problem. This is odd, because how well people are able to find their way around in the available offerings of culture directly affects both their aesthetic experience and their outlook on life. Those working commercially in the cultural sphere target as large a proportion of the public as they can, and today the technological tools at their disposal are more powerful than ever before: anything that can be digitised can be delivered almost instantaneously to any place at minimal cost.¹ Cultural goods are universally accessible, but the downside of such profusion is the problem of what to choose.

The manufacturer wants to direct attention to his product and has no inclination to reduce the circle of his potential customers by targeting publicity too accurately. Junk mail deluges the consumer, who cannot tell from the outside of an envelope whether the contents are important or not. He is forced to sift through mountains of information that is of no conceivable interest. Advertising of the most diverse character, quality, and purpose circulates through an informational irrigation system which gushes from radio, television, the Internet, and the press. These may be coordinated or not, may or may not back each other up, but all of them ultimately come up against the limit of what a human brain can assimilate. On the surface there appears to be a great abundance of leisure offerings; the consumer's choice appears to be unfettered; but what is really being held out is freedom to choose the wrong product. The consumer is faced with a smorgasbord of dishes he cannot discriminate between.

At first sight there seems to be no shortage of helpful recommendations: the genre of the entertainment—comedies, thrillers, farce—is clearly documented. Within each genre you can be guided by the reputation of the actors and directors, by the competitions and prizes they have won or failed to win. Yet still people are perplexed, not least by the dilemma of which television programme to watch. The ones they would like to see are broadcast at thoroughly inconvenient times, while peak viewing time is a desert of films with 'universal appeal' or ageing classics which are

¹There are many indications that the 1970s and 1980s ushered in the previous period in culture: fashions began to change more rapidly, blockbusters appeared... The next twist of the spiral came towards the start of the millennium with the new Internet technologies, including peer-to-peer networks.

only too familiar. Ploughing through the television guide is an unproductive chore and, faced with five reasonably hopeful films, none of which is a clear winner and all of which are being broadcast virtually simultaneously, half an hour or an hour of channel-hopping is enough to ruin anyone's evening.²

Choosing which film to watch on television is not the worst of the consumer's predicaments. Every year there are perhaps a dozen or two films which everyone talks about. You get to hear about another fifty or so by word of mouth, by which time you have probably been alerted to nearly everything that is reasonably worthwhile, if in a fairly haphazard manner. It is a bit of a struggle, but there is a fair chance you will find the films which interest you. When we turn to books the situation is far more dire.

How do you choose the one book out of the hundreds of thousands on offer which you will really enjoy reading without first reading it or at least browsing through it? How helpful are bookshop catalogues, advertisements, the literary prizes? Perhaps readers should just go by the results of the Booker or Whitbread Prizes? Alas, in Russia at least, few readers know what made the shortlist or even who won.³ Advertising is far more powerful than informed opinion: a thought-through promotional campaign—and Coelho is a classic, Murakami a gripping read, Houellebecq the greatest intellectual in Europe. In 2006 we saw Dan Brown propelled to eminence.⁴ Even book publishing, though, is not the most impenetrable jungle—information about good authors and titles does get around and improves your chances of stumbling across a personal favourite. With the theatre the situation is downright disheartening.

If you are not an insider, the chances of missing an outstanding production are high since the critics alert you to major events only after the event. The culture sections of the press provide rear mirror navigation by reviewing performances which have already taken place: 'Yesterday this exceptionally talented German performer delighted his audience. His next visit is three years from now.' If you just take pot luck, you find most performances provide less to delight their audience than the average movie.

The public are, if anything, even more at sea with the contemporary music scene, but this is perhaps unsurprising since the music industry targets primarily a particular sub-species of adolescent.

Am I exaggerating the difficulties of navigation? Are people not managing their cultural leisure time well enough, enjoying music, visits to the theatre, art galleries

²A programme glanced at in passing picks up a point in the viewer figures without advertisers actually being deceived. In reality it would be better for them if commercials did not intrude at some exciting moment and get up the nose of their target audience.

³I once asked students at the Moscow Institute of Economics to name one international and three Russian literary prizes. No response. I asked them to name just one. Still no response. I asked who had won a prestigious prize a few days previously, which had been well covered in the press. More silence.

⁴Dan Brown, author of *The Da Vinci Code*, was instantly added to the ranks of the world's foremost intellectuals.

or whatever? Why, if things are so bad, is there no widespread public voicing of dissatisfaction? I fear the absence of debate about the difficulties of making the right choice in culture is itself a part of the problem. People muddle through, or have given up believing there might be anything exciting out there to choose from, or assume it is their own fault for not knowing more about a particular segment of culture.

Some art professionals see no problem of navigation, and argue that the process of choosing is an end in itself. Who is going to deny that finding your way without a guide can be fun: browsing through books, reading advertising matter, surfing the Net, strolling through a new town with no particular end in view other than soaking up the ambience? It can be fun not to rely on other people's recommendations and then to happen upon something unexpected rather than the next sight identified for you by the guidebook. And if you risk missing something important, who cares? But is this grounds for denying the need for maps? Mooching around palls in the end, and then the mapless are doomed to a taxing and inefficient search for the way home.

Writers, musicians and film critics do not need a navigation service. They know their way around their professional habitat, much as native peoples get by without maps of the jungle. And yet, if you ask such a specialist for recommendations in another area of culture, he will be stumped. It seems that those who deny there is such a thing as a navigation problem belong to two extremes: there are those who are amazingly well-informed about a narrow area, and there are those who are just pig-ignorant. The multitude in the middle take what they are given and have no sense of having been cheated. Apart from these contented sections of the populace, however, there are very many consumers of cultural products who are only too aware of the problems of navigation.

Products for the masses—blockbusters, soap-operas and the like—are part of the modern lifestyle. They have no difficulty finding their way to the mass consumer, or he to them. The end result is that this type of product becomes the 'only alternative' which is profitable, and other cultural lines are gradually discontinued as less financially attractive.

At the root of this situation is a failure of navigation which prevents demand meshing with supply. The less widely popular product, which is often more subtle, is failing to reach its territorially dispersed and, as a rule, pickier target customers. In the end these consumers are likely just to give up on the culture markets and find a different way of spending their leisure time. The cultural product which would have met their preferences ceases to be offered on the screen, the stage or the shop counter.

The belief that the problem of navigation in culture is artificial would seem to stem from a belief that these ills are incurable, or from a sense of disappointment with cultural goods in general. That disappointment is, however, itself a product of unsuccessful navigation.

You can spend your time and money and get nothing in return. Your money you can save by giving up on all cultural leisure provision, but time you cannot save. Time cannot be stored, so even just going with the flow entails a cost. Economics

considers how limited resources can best be allocated. It is for the science of cultural economics to provide an answer as to how the consumer's limited resources of leisure time can best be allocated. The issue of cultural navigation is basically a problem of enabling effective choice.

2.2 Economics on Culture

The emergence of cultural economics as a separate discipline is usually dated from the publication in 1966 of a book by William Baumol and William Bowen titled *Performing Arts: The Economic Dilemma*.⁵ The views of these economists deserve a separate study to themselves,⁶ but in the present book we shall focus only on those of their discoveries, and the discoveries of their followers, which bear directly on our topic, which is consumer navigation and adverse selection. They are aspects of a single problem: effective choice.

Economic logic is most at home when there is a clearly defined economic agent with clearly defined resources and aims, and where there is a desire to distribute those resources optimally in order to meet the aims. Business activity in the sphere of culture fits these requirements admirably: the resources are measured in financial terms, and the ends are commercial. No surprise, then, that economists generally view culture from the standpoint of the businessman.

The economist is less at home when resources are calculable but aims are ill-defined. This is the predicament of the state when it tries to formulate its cultural policy. It has a duty to preserve the cultural heritage (a clearly defined aim), but additionally it is expected to enrich the cultural environment and facilitate development of the arts.

These are commendable aims, but which criteria are to be used to assess needs and set forth optimal outcomes? To date nobody has come up with a coherent definition of what the desired outcome in culture is. This means trouble: how is the state to decide which artistic initiatives to support? How should it allocate the culture budget? As things stand, any result could be declared a desirable outcome and hence any expenditure justified in retrospect. The criteria for judging creative products and services have yet to be defined; there is not even general agreement about what is and what is not art.⁷ The numerical and financial indicators currently used for quantifying culture are far from satisfactory, so how can we judge the effectiveness of cultural policy?

⁵William J. Baumol and William G. Bowen, *Performing Arts: The Economic Dilemma*, NY: Twentieth Century Fund, 1966.

⁶Cultural economics now boasts an Association (1979, reorganised 1992), a journal (founded 1973), and a regular international conference (first held in 1979).

⁷See, for example, Boris Groys, "'Bolshoi proekt' kak individual'naia otvetstvennost'" ["'The Grand Project' as Individual Responsibility"], *Khudozhestvennyi zhurnal*, No. 53, 2003, pp. 40–43.

Selecting and coordinating the cultural aims of a society may be difficult but, given sufficient effort, it is not impossible. Once that has been done, the question can be addressed of how to optimise expenditure and what rules of financing to apply. This is legitimately the province of economics, as Baumol's own articles on the economics of art show convincingly. Among the salient points he makes is the simple but important truth that very little has been invested in improving labour productivity in the arts, which has resulted in a loss of competitiveness. Over the past two centuries industrial productivity has increased many times over, but the cost of putting on a music concert remains much the same. Concerts used to last several hours, and still do, and there is no reason to expect any great speeding up in the near future. The costs of live performance in the arts outstrip general inflation. Artists' remuneration needs to rise in line with the overall rise in wages if their profession is to continue, but the revenue from concerts is too little to cover this.⁸ There is a gap between revenue and expenditure and cultural institutions are unable to be self-sufficient.

Baumol described this as the 'cost disease', explaining in comprehensible terms to government and the rest of us that culture is not malingering but genuinely ailing and in need of help.⁹ The arts have, of course, been receiving subsidies in the past, but thanks to the calculations of economists it is now easier in the United States to do this effectively. There a law encourages sponsorship by freeing money contributed to cultural enterprises of tax. The state forfeits part of its revenues, but in so doing stimulates private involvement in the financing of culture.¹⁰

Economics, then, has found a constructive role in advising on and managing the actions of business and government in the cultural sphere, but it has really had very little to offer consumers. The public have no questions to ask economists, and if they had would be unlikely to receive any helpful answers. Neither the resources nor the aims of spectators, listeners, or readers have yet been described in a language which economics can understand, unless, perhaps in the matter of how consumers can best allocate the resource of their free time. This, indeed, is the take of economics on the problem of consumer navigation in culture. Effective use of any resource is facilitated by describing and objectivising the desired outcome. This raises some basic questions for the economist, not least, how we are going to identify and quantify cultural value. These we shall address in the final Chapter, but for now let us agree to make two important assumptions.

First, let us agree that anyone who wants to can learn to give an overall rating of the value he receives from an act of cultural consumption. At the very least, even when he is just beginning, he should be able to say in general terms whether he is more or less satisfied after a cultural experience than usual. We can see from the

⁸This occurs because of a belief that the ticket price of the performance arts should be relatively low in accordance with popular ideas about a 'fair price' keeping art accessible to all. Insistence on this principle can make artists reluctant to continue working in their profession for a pittance.

⁹Analysis of 'Baumol's diagnosis' will be found in Tyler Cowen, "Why I Do Not Believe in the Cost-Disease", *Journal of Cultural Economics*, vol. 20, No. 3, 1996, pp. 207–214.

¹⁰A similar law has been under discussion in Russia for a very long time.

experience of recommender services, which are based on such assessments, that the vast majority of their customers successfully acquire this knack of rating.

Secondly, the higher the numerical points awarded within the context of a recommender system, reflecting the customer's overall perception of cultural value, the more effectively a person has spent his leisure.

If we accept both these premises, the consumer of culture stands before us as very nearly a valid *homo economicus* conscious of his aims, capable of assessing the degree to which they are realised, and having at his disposal all the resources needed to realise them: free time, money and cultural capital. That qualification 'very nearly' is necessary because his actual aims are known only to himself. No outside observer can tell for sure whether a cultural consumer is realising his aims successfully; certainly not the economist who has only incomplete information about how the consumer is spending his resource of leisure, although this lack of data is not insurmountable. Additionally, however, he has no criteria by which to judge whether the consumer has achieved the aims on which he spent his resource. Money, we have already seen, is a poor indicator where cultural consumption is concerned. Accordingly, as we tentatively make our incursion into alien territory it is unclear how best to deploy the instruments of economics to the advantage of the consumer. Perhaps the best way forward will be to try to analyse how far the markets of culture are working in the consumer's favour. Are they currently facilitating or obstructing the achievement of his aims? We are back to the question of navigation in culture: do the markets enable him to choose correctly, to his satisfaction? If not, and everything seems to indicate that they do not, may it not be time to seek a new institutional solution?

2.3 Business Interests vs the Interests of the Consumer

If we define culture as the sphere in which symbols¹¹ and signs are produced and circulated, we can confidently ascribe a good nine-tenths of it to commercially motivated activity.¹² This sphere will include the entertainment and media (E&M) industry, the industries of luxury and taste, and the greater part of the performance and visual arts. If we assess the ratio financially, the figure will be around 9:1 even without including the aesthetic or design component of utilitarian products. If we make the calculation in terms of time spent on consumption, the proportion of culture wedded to business will be even higher. The remaining, supposedly non-commercial sector of culture is also closely tied in to the market, like a satellite orbiting a planet.

¹¹ A symbol is any sign which produces a common reaction in a community. The symbol's meaning is random in the sense that it is not inherent in the sound, object, phenomenon, etc. as such, but is formed in the process of communication and by mutual agreement. Examples of symbols are a word, a flag, an engagement ring. See G.A. and A.G. Theodorson, *A Modern Dictionary of Sociology*, NY: Harper & Row, 1969.

¹² It is only this commercial component of culture which is the object of our study.

The average consumer has no direct contact with the creative artist. He encounters only what the representatives of business, guided by economic expediency and market rules, decide to give him access to: big-time cultural projects. Blockbusters, biennales and bestsellers need commercial nous, and this is provided by managers who stand at the helm of culture. Their aims are profit and capitalisation growth, and these demand large-scale output of production. This is particularly true of the mass sectors of intangible culture because the costs of copying and transmitting data are a relatively minor part of production costs. In the cost structure there are variable costs, which are those directly associated with manufacturing each unit (in publishing this would include the cost of paper, printing, designing the cover, paying the author's advance, etc.). There are also fixed costs associated with the commercial infrastructure—the office, lawyers, editors, logistics, managers, etc. and also with the financial investment. The engine which really drives business is economies of scale which are achieved by sharing out the fixed costs over a larger volume of goods. The greater part of the cost is in creating the prototype (the master copy, the original model) and in putting the marketing infrastructure in place. Accordingly, unit cost falls as the number of items produced increases, which means that business has a powerful incentive to increase unit output and product range. For culture this is both a good and a bad thing. As far as distribution of works is concerned—making them physically available and providing the framework for culture—the interests of business and culture coincide. The downside is the difficulties this creates for consumer navigation. The problem was exacerbated twenty years ago or so when considerable human resources were freed from the material sector of the economy and redeployed to non-utilitarian segments.¹³ Navigation became even more difficult with the subsequent further advances in information technology.

Digitisation provides not only the technological basis for manufacturing and communication, it also provides a means to obtain the feedback to make accurate targeting of consumer demand possible. The capacity to mathematically predict demand has changed the nature of creativity and subordinated it to marketing.¹⁴ The mass production techniques and cultural products which optimise box-office takings can be identified, but what is best for business is not necessarily what is best for the consumer of culture. In order to revise and replicate a successful formula devised to maximise mass appeal you do not need great geniuses with their unpredictable bursts of inspiration. Indeed, major talent does not lend itself to plodding away under someone else's direction. Different people are needed, people whose talent is for keeping productive capacity fully loaded whether or not the creative component is currently available.

¹³The average annual growth of world consumer spending in the entertainment and media industry is just over 7 percent. In Latin America it is over 12 percent (from *Global Entertainment and Media Outlook: 2002–006*, PriceWaterhouseCoopers, online. Cited 15 July 2003, available from URL: http://www.pwcglobal.com/e&m/outlook/Outlook2002_ExecSummary_Final.pdf).

¹⁴Arthur De Vany and W. David Walls, "Movie Stars, Big Budgets, and Wide Releases: Empirical Analysis of the Blockbuster Strategy", in De Vany, ed. "Hollywood Economics: How Extreme Uncertainty Shapes the Film Industry", *Journal of Business*, vol. 72, No. 4, October 1999, pp. 463–492.

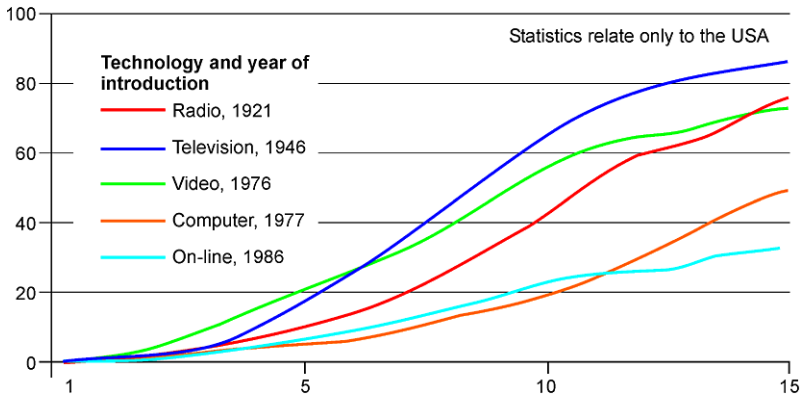


Fig. 2.1 Household penetration by technology (%) (*Global Entertainment and Media Outlook: 2002–2006*)

Three factors have led to the supply of cultural output being many times more than human beings can assimilate. These factors are: an increased supply of creative professionals; replacement of talent by technology; and advances in distribution. At any hour of the day or night the consumer can access a menu of thousands of items totalling millions of hours of entertainment per year. Of this, the average US citizen will consume more than 1,500 hours (see Table 2.1).

As can be seen from Table 2.1, media usage already takes up so much time that if the industry has anywhere to grow, it is mainly among the unemployed. According to data from another source, the average American spends almost half the twenty-four hours on media usage: less active consumers use approximately five hours while aficionados manage seventeen hours.¹⁵

It has been discovered that in reality people spend twice as much time using the media as they realise. On average three hours person per day is spent listening to music, including people who do not listen to it at all. This is enough time to listen to sixty three-minute songs or forty-five four-minute songs. Even if you sleep only five hours a day and listen to music uninterruptedly for the rest of the time, you will manage to listen to only 285 four-minute songs per day or approximately 100,000 per year. Despite your heroic effort, you will be unable to check out even one-fifth of the recording industry's annual output of over half a million tracks.¹⁶ The fact that free time is limited and the process of selection so unreliable makes navigation an acute problem for the cultural community. The rest of this book will be devoted to examining it.

¹⁵Information from Ball State University's Center for Media Design.

¹⁶For further detail about demand for and consumption of music recordings, see Appendix 1, Sect. A1.7.

Table 2.1 Media usage in the USA (hours per person per year)

Percentage change in consumption							
Film Entertainment	1999	2000	2001	2002	2003 ^a	2002–2003	1999–2003
Cable and Satellite TV	720	774	844	914	949	3.8	31.8
Terrestrial Television	867	865	828	786	778	(0.6) ^b	(8.4)
Internet	80	107	136	154	169	9.7	111.3
Domestic Video (viewing of pre-recorded video-cassettes or DVDs)	55	57	60	58	67	15.5	21.8
Film rental	13	12	13	14	13	(7.1)	0.0
Interactive TV (video on demand)	1	2	2	2	2	0.00	100.0
Total of Film Entertainment	1,736	1,817	1,883	1,928	1,978	2.6	13.9
Other Entertainment	1999	2000	2001	2002	2003 ^a	2002–2003	1999–2003
Radio	939	945	953	994	1,013	1.9	7.9
Music (pre-recorded)	281	258	229	201	188	(4.2)	(19.4)
Newspapers	183	180	177	176	173	(1.1)	(5.4)
Popular magazines	134	135	128	125	123	(1.7)	(6.4)
Fiction	119	109	106	109	110	(1.8)	(10.8)
Video Games	53	59	60	67	75	11.9	41.5
Total Spent on Other Entertainment	1,709	1,686	1,653	1,672	1,682	0.6	(1.6)
TOTAL	3,445	3,503	3,536	3,600	3,660	1.7	6.2

Source: Veronis Suhler Stevenson, 2003

^aData for 2003 is based on preliminary calculations by Veronis Suhler Stevenson

^bBrackets indicate negative change. Thus, people are spending 0.6% less time watching television (786 hours in 2002 against 778 in 2003)

2.4 Adverse Selection in Culture: Formulating the Question

As already mentioned, repetition has an important role to play in the process of consumption,¹⁷ but repeat purchases are not the norm in culture.¹⁸ The result is that

¹⁷Vilfredo Pareto wrote on this subject: “As regards the replacement of a feeling of possible consumption by a feeling of actual consumption, then, if we examine repeating phenomena, as political economy does, these two feelings ultimately are so permanently interrelated that it would not be a serious mistake to substitute the latter for the former.” V. Pareto, *Manuel d’Economie Politique*, Paris, 1909. Cited in J. Weiner, “The Concept of Utility in Value Theory and Its Critics”, in *Vekhi ekonomicheskoi mysli [Landmarks of Thought in Economics]*, vol. 1, SPb: Vysshiaia shkola, 2000, p. 106.

¹⁸And even when they occur the act of consumption is not identical since a person, after the first experience, will have changed.

the link is broken between consumer rating of a product and improvement of its quality, because the manufacturer has no incentive to upgrade his product. There is no return flow of information to ensure signalling, predicted prices. If the consumer were buying the same item repeatedly, the situation would be as it is in conventional markets, where prices are informative.

If the price does not indicate an item's value, would-be purchasers have to try to obtain the information they need in some other way. Costs associated with decoding prices are present in conventional markets also, and indeed the concept is central to the theories for which Ronald Coase, who founded Institutional Economics, won the Nobel Prize in 1991.¹⁹

Coase introduced the notion of 'transaction costs' associated with establishing price, conducting negotiations, drawing up contracts, exercising oversight, settling disputes, etc., and showed they were not the same as management costs.²⁰

Coase emphasised that transaction costs are omnipresent in economics, and culture is no exception. A whole range of easily overlooked consumer costs in culture would appear to come under this heading. There is the cost of wasted time, emotional expenditure, mental stress, etc. These are difficult to measure and may as a result be overlooked when decisions are being reached, but this does not mean they are negligible or unimportant. Rather, they should be included as external effects, important aspects of a deal which the participants cannot, or choose not to, take into account in the contract, with the result that they are omitted from the financial calculations. Undervaluing the resource of consumers' mental energy is analogous to Coase's transaction costs, when something significant was left out of the equation solely because it could not be measured. If important factors are ignored by the participants in a deal, their behaviour is unlikely to be optimal.

¹⁹Coase asked why firms exist. He concluded that if there were no costs involved in using the price mechanism, an entrepreneur would be an independent, self-employed individual who contracted with other similarly independent individuals. The processes of searching and purchasing do, however, involve costs, transaction costs, and these make it disadvantageous to start afresh each time you need to obtain, say, professional services. A worker in a firm is employed for an extended period of time, not by the day or the minute. The firm also exists because it can coordinate operations more cheaply than through discrete market transactions. Put simply, certain solutions and resources can be provided more cheaply within a firm than if they were outsourced. This provides the incentive to create a team.

²⁰Coase expounded his views in an article "The Nature of the Firm", published in 1937. This was one of two works for which, fifty-four years later, he was awarded the Nobel Prize for Economics. In the words of Coase, his main contribution to economic science was that he insisted on including in the analysis features of the economic system so obvious that they had escaped attention, namely, transaction costs. If these features are included they lead to a complete change in the structure of economic theory. The sum of managerial and transaction costs borne during production within the firm should be less than the sum of the same costs borne through market purchase. This is a crucial element of Coase's theorem. Ronald Coase, "The Nature of the Firm", *Economica* (n.s.), vol. 4, No. 16, 1937, pp. 386–405.

2.4.1 Information Inequality as a Reason for Rewriting the Market Rules

From the viewpoint of institutional economics the difficulties placed in the way of consumer navigation are a problem of information asymmetry.

People's behaviour in the culture markets (or any other) is dependent on availability of information about the quality of the goods on offer. Where both sides are not equally well informed, this affects both the terms of the deal, and even whether it takes place at all. Sometimes potentially beneficial deals fall through solely because one side realises it is insufficiently briefed in the matter and fears the other side's informational superiority will disadvantage it.²¹ Where one side derives an advantage over the other contracting party through being better informed, its conduct is classified as opportunism. In a one-off deal or where the relationship is of brief duration, the victim can do nothing about it; if, however, the relationship is protracted and/or repeat deals are involved, the subterfuge usually comes to light and the offended party attempts to retaliate by looking for other factors left out of the contract which it can exploit in order to restore the balance. If this is not possible, contracts simply do not get renewed.

2.4.2 What is a Tendency to Adverse Selection?

In Chap. 1 we noted that the problem of information asymmetry had been researched in detail by George Akerlof, the Nobel Prize winner for Economics in 2001. Akerlof showed that if markets are to progress in which the quality of goods and services is not immediately apparent, special institutions or guarantees are needed to remove information anomalies. Without this no market may emerge, or it will degrade because of an outflow of disgruntled participants. It is difficult to think of a sphere where the information asymmetry between sellers and buyers is more pronounced than it is in culture. The sellers know all almost everything about their goods, while the buyers know remarkably little.

2.4.2.1 In Praise of 'Lemons'

Akerlof propounded his theory in a ground-breaking article we have already mentioned, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism".²² The main postulate of this work is that if buyers cannot accurately assess

²¹As Paul Milgrom and John Roberts point out, potential participants in a deal are inclined not to attempt to reach agreement if they foresee additional costs arising. Milgrom and Roberts, *Economics, Organization and Management*, Englewood Cliffs: Prentice-Hall, 1992.

²²George A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism", *Quarterly Journal of Economics*, vol. 84, August 1970, pp. 488–500. Akerlof's article was

the value of a product through examination before a sale is made, and if the problem is not resolved by effective public quality assurances, through reputation or regulation, guarantees or warranties, then the market is subject to a tendency to adverse selection where better quality goods are squeezed out by goods of inferior quality.

As an illustration Akerlof used the 'lemon' market. (In the United States beat-up used cars are referred to as lemons.) Akerlof asks why a car depreciates so sharply as soon as it leaves the showroom. Various explanations had been offered, including the view that possessing a car with no miles on the clock was a source of immense personal satisfaction. Akerlof explained the phenomenon as resulting from information asymmetry. The owner of a used car knows its true condition better than other people. If it is sold, the information advantage is on the side of the seller. A buyer in possession of very incomplete information runs a high risk of not buying what he wants. Good and bad cars, which the buyer cannot distinguish between, fetch the same price.

The sellers of good used cars are at a disadvantage. Those buying a used car are suspicious as to why it has been put up for sale, and those selling it know they are not going to get a fair price for it.²³ As result, the 'lemon' market is subject to adverse selection, with good cars left on the hands of their owners, and bad cars returned for re-sale. Ultimately, if no countermeasures are taken, bad cars squeeze out good cars and the market is destroyed.

2.4.2.2 Other Examples of Information Asymmetry: Pre-Contractual Opportunism

Used cars are not the only or the most serious example of the effects of asymmetrical information. In the same article, Akerlof gave other illustrations of his hypothesis, including the medical insurance market. He pointed out that an individual is far more capable than an insurance company of accurately assessing the risk of his

not immediately understood or appreciated. The problems it raised were considered trivial and unworthy of publication in a scholarly journal. When the article finally did get published, it caused a sensation among economists. It contains the insight, among others, that there are many markets where buyers are forced to fall back on market statistics to form judgments about the quality of goods they plan to purchase. In such markets sellers have an incentive to pass off low quality goods, since high quality creates a reputation not for a particular seller but for all sellers in that market. As a result there is a tendency both for the average quality of goods and the size of the market to fall.

²³Akerlof draws a parallel with Gresham's law. 'Bad' cars have much the same tendency to squeeze 'good' used cars out of the market as, according to Gresham's Law, 'bad' money drives 'good' money out of circulation. The analogy is not complete however, as Akerlof points out. Bad cars squeeze out good ones because both are being sold at the same price, and in exactly the same way inferior money squeezes out superior money because the exchange rate is the same for both. The fact that cars of differing quality can be sold at the same price is because the purchaser is unable to tell one from the other. The real quality is known only to the seller. Gresham's Law, however, assumes that both buyer and seller can tell the difference between 'good' money and 'bad'. Thus the analogy, although instructive, is not perfect. Akerlof, "The Market for 'Lemons'".

falling ill. As result, the premium for an insurance policy is determined by the poor state of health of those wishing to insure themselves, with the ultimate possibility that it might become impossible to obtain insurance at any price.²⁴ Akerlof had good reason to consider the insurance industry, since that is where the term ‘adverse selection’ originally comes from.²⁵ Those who know they have health problems are more inclined to buy health insurance policies. A policy reimbursing the medical costs of childbirth is clearly more likely to be taken out by women planning to start a family in the near future. The insurers, aware of this, have to set the premium accordingly. Customers whose family planning is at less advanced stage will find the insurance too expensive and not buy it. In the United States this kind of insurance is not widely available precisely because of adverse selection.²⁶ The example demonstrates that in economics agents tend to enter into deals in which they can turn better information to advantage. If car dealers offer extended warranties on higher mileage cars, these are likely to be acquired by people intending to do a lot of driving on country roads.

Akerlof argues that information asymmetry throws light on the plight of those belonging to national minorities who are seeking employment. They are frequently rejected not so much because employers are racist as because they calculate prudently. Ethnicity can signal the candidate’s likely social status, abilities, and the quality of his training. A college with a good reputation is seen as attesting that its alumni are trained to a good level, which means that those hiring them can expect to make fewer mistakes in their choice of staff. The lower reliability of schools in poorer areas restricts the economic prospects of their graduates, particularly for those from ethnic minorities. An employer may quite rightly decide that hiring such people for skilled work is unwise because it is difficult to differentiate well-trained workers from those who are likely to prove incompetent.²⁷ Some educational institutions react to the situation by resorting to guile: in order to attract pupils by offering them the prospect of greater employability, they adopt names similar to those of successful brands.

Akerlof found striking examples of adverse selection in the developing world. In the recent past Indian housewives had every time to sift meticulously through rice bought at the bazaar because the sellers regularly adulterated it with tiny stones similar in colour and shape to grains of rice. At the moment of purchase it was difficult to tell good quality grain from bad. Still in 1960s India, rural money-lenders were able to charge interest double the going rate in large cities. This was ruinous for peasants. The money-lenders did not have to fear being undercut by middlemen taking loans in the city to give credit to country people because the middlemen

²⁴Akerlof, “The Market for ‘Lemons’”.

²⁵Insurance textbooks warn that for the 65+ age group regressive selection is a particular problem. Insurance premiums are so high that only the most profound pessimists will consider taking out a policy.

²⁶The example is taken from Milgrom and Roberts, *Economics, Organization and Management*.

²⁷Akerlof, “The Market for ‘Lemons’”.

did not know the local population and would risk taking on borrowers incapable of repaying their loans.

Another sphere where lemons are likely to appear is in the securities market. Those issuing new shares are better informed about their value and prospects than investors obliged to put their trust in analysts. Akerlof sees this as accounting for the price volatility of technology shares.

An information inequality which favours one side in a deal is, then, a trigger for adverse selection. One party is misled by the other's concealment of salient information. This behaviour is called pre-contractual opportunism, but in fact the invariable imperfections in the description of a deal mean that preconditions for opportunism are present to a greater or lesser degree in any contract. The more experienced side often draws up the contract to suit its needs, oversimplifying or sidestepping certain issues in order to open the way for subsequent opportunism. Adverse selection is effectively a form of pre-contractual opportunism, of rigging the terms of a deal.

Markets react to information asymmetry by creating institutions to iron out the inequalities. These can be guarantees, insurance, or a general concern to maintain a good reputation, perhaps through the use of brands, branded shops, or franchising. Such measures are usually effective in counteracting adverse selection: the used car market in the United States continues to function,²⁸ insurers prosper, and Indian dentists have their earnings reduced by the disappearance of disreputable retailers of rice.

Such institutions can, however, fail to appear, either because of a failure to keep up with the advance of technology or for other reasons. Culture, alas, is one sphere where all the prerequisites of unfavourable selection are present. To date nobody has clearly indicated the parallel between the ills which can strike conventional markets and those affecting the markets of culture.²⁹ Moreover, unlike the industrial sphere where the malady has proved treatable, in culture it gives rise to more serious complications. In utilitarian sectors it is far easier to diagnose adverse selection than in the aesthetic realm, where its action is much less visible.

2.5 The Susceptibility of Culture to Adverse Selection

2.5.1 *Preconditions for the Appearance of Adverse Selection*

The problem of imperfect information affects any sector where assessing quality before concluding a deal is either impossible or unreasonably costly. In culture we

²⁸In Akerlof's example of used cars, buyers can, of course, insist on seeing a car's maintenance record, have it inspected by an experienced mechanic, or buy through dealers with a good reputation who provide a guarantee.

²⁹Only one, Internet, publication has been found: Lisa N. Takeyama, "Piracy, Asymmetric Information, and Product Quality Revelation", Department of Economics, online, Amherst College, 2002. Cited 25 May 2004, available from URL: <http://www.serici.org/2002/takeyama.pdf>. The article makes direct mention of adverse selection in respect of cultural markets.

should expect it to be particularly acute since information inequality between the professionals and the public is very much in evidence. Critics like to posture and say it is not for them to pronounce on the actual quality of works. The Hollywood saying ‘Nobody knows’ implies that providers and consumers are equally in the dark, but it should not be taken too literally.³⁰ Providers may be unable to predict the commercial success of a work with total certainty, but they know almost everything there is to know about it. They themselves have already consumed it, unlike its potential viewers and listeners. Consumption of a work of art presupposes an encounter with something new, of which the public is necessarily going to be ignorant. This means that a different way has to be found of getting round the problem of information asymmetry than can be used with utilitarian goods. Guarantees, insurance, and franchising have found no place in the cultural sphere because, as we shall see, they are not applicable there. The only institutions brought in to counteract quality uncertainty are brands, reputations, and critics—and they cannot be said to have been much help.

Given that information asymmetry regarding the quality of cultural products is so evident and that institutions to counteract it are weak or non-existent, there is only one answer to the problem of adverse selection in this market. The nature of creative products themselves, difficult to categorise and constantly changing, makes the task of dealing with asymmetry more difficult. Providers of cultural goods and services have every opportunity to engage in pre-contractual opportunism. At little risk to themselves they can promise high quality and deliver low quality. Players trying to avoid a bad reputation and seeking to deliver consistent quality find themselves obliged to standardise the production process, which has an ill effect on culture.

Altogether, Akerlof’s concept of adverse selection appears a perfect fit for the state of the artistic markets. He warns that the presence of sellers wishing to sell substandard goods undermines the functioning of the market.³¹ The culture markets are wide open for providers of substandard products. The market rules work in favour of the untalented and to the disadvantage of the gifted. It is estimated that the makers of only one in thirty films set out with the intention of creating a work of art; the remainder do not even aspire to that.³² As in the situation which Akerlof models, there may be potential buyers of high quality goods in the market, and potential sellers of such goods at an appropriate price, but the presence of sellers seeking to present their substandard goods as high quality crowds out the honest business. The costs resulting from such unconscientious behaviour include not just the money which the purchaser is tricked into paying, but also losses associated with the diminishing of the realm of honest business.³³ Akerlof’s concept closely models the present situation in culture.

³⁰Ruth Towse suggests this should be revised to, ‘Some people know more than others’. Ruth Towse, “Copyright and Cultural Policy for the Creative Industries” (2002), in Ove Granstrand, ed., *Economics, Law and Intellectual Property*, Kluwer Academic Publishers, forthcoming.

³¹Akerlof, “The Market for ‘Lemons’”.

³²This opinion of the classic Hungarian film director, Istvan Szabo, was expressed in an interview given to Polit.ru, 2005.

³³Akerlof, “The Market for ‘Lemons’”.

2.5.2 How Adverse Selection Operates in Culture

Adverse selection in the cultural sphere is facilitated by the fact that it has little protection against invasion by enthusiasts with insufficient professional expertise, and by opportunistic agents. Playing on the undoubted fact that tastes vary, and sometimes on the critical incompetence of consumers, they masquerade as genuine artists and flood the market with shoddy products. These pseudo-goods are presented and packaged exactly like genuine goods, the consumer fails to notice the difference and pays for them as if they were top quality. Surrounded on all sides by low-grade offerings, buyers may ultimately cease to recognise quality, or even find that they can do without it.

Dishonest players build their business on this, profiting from the fact that it is easier and cheaper to exploit other people's templates than to create top-notch products of your own. In the various markets in which adverse selection is operating, participants exploit their information advantage in different ways. In culture the driving force is manufacturers' desire to increase the number of units sold, and with it their profit. In the digital sector where the cost of copying is negligible, this is particularly noticeable. In tangible sectors it develops in proportion to the falling cost of the material medium.

Quality, because no standards are defined and because it cannot be ascertained before consumption, is sacrificed to quantity. This is the point where the interests of the realms of business and culture diverge fatally. To pre-contractual opportunism is added post-contractual opportunism—a moral hazard arising from the divergent interests of contracting parties when outcomes are finally considered. We find the businessman adhering strictly to the letter of the contract and not troubling himself about any kind of moral obligations implied by the spirit and essence of his interaction with the other party. The buyer is guided by generally accepted parameters, and the seller attempts to limit himself only to these, disregards everything else, and is confident he will get away with it. *De jure* the contract is fulfilled, but *de facto* the game is very one-sided. The fact that the quality of works of art is so ill-defined powerfully attracts businessmen who feel at home in a morally questionable situation.

Business's urge to increase throughput leads to two things: the manufacture of averaged-down products for the mass market, blockbusters, and the release of an excessive variety of offerings. As a result, tons of aesthetically low-grade ore gets mined. Potential consumers have to put in a lot of hard work if they want to form an independent opinion of the quality of a cultural product before they buy it. Either that, or they will have to take the risk of finding their purchase not to their taste. Buyers are almost certainly unaware of just how rigged this lottery is against them. As they do not know what would be regarded as a fair percentage of losing tickets, they cannot establish what is unfair. This allows those on the inside to toss in as many losing tickets as they choose.

Business not only exploits its information advantage, certain players cynically exacerbate the inequality as a prelude to opportunism. Certifying institutions fail to ensure effective sifting and enrichment of the artistic ore, the critics' filters are

soon clogged, and items of real interest simply get lost among all the dross. This is the source of the problem of consumer navigation in culture: the technologies for providing consumers with critical guidance are no longer keeping up with the sheer volume of mass produced culture.

Analysing the motives and logic of business suggests that the current state of affairs is the result of a process of adverse selection which has been worsening for some time. We could of course keep our fingers crossed and hope that culture has an innate immune system which will protect it from this kind of process. It is still too early to make the diagnosis with any certainty, but it has to be said that all the preconditions are there for this dangerous tendency to develop. Adverse selection is not, of course, the twilight of the gods, the triumph of an era of journalistic values, or the crisis of art which cultural studies academics so often invoke. If it is occurring, that would not shame the cultural community or disavow its achievements. Adverse selection is merely a market mechanism, and analysing it might explain why the culture markets are failing. The metaphors of cultural studies are of no help here. What is needed is scrutiny of the mechanisms of the culture business, which may then reveal points at which our leverage can best be applied. The first necessity is, of course, to make sure that the diagnosis of adverse selection is correct.

2.5.3 Symptoms of Adverse Selection in Culture

If adverse selection is operating in the culture markets, we would anticipate a number of tell-tale signs. On the basis of how other markets have behaved, we would expect to find:

- large-scale output of products of questionable quality;
- a fall in the proportion of high-quality products (successful works) in the market;
- high consumer search and sampling costs, dissatisfaction among consumers, and defection of the most competent;
- under-realisation of certain types of products because of distribution and marketing problems, leading to underproduction;
- gravitation of consumer preferences to particular segments of culture; narrow specialisation and differentiation of the cultural community;
- deterioration of taste;
- defection of gifted, creative people out of the arts.

2.5.4 Why Is It Difficult to Prove Adverse Selection in Culture?

The symptoms we have listed are not visible on the surface. Other data might suggest that adverse selection is not occurring. It is probably not possible to confirm or refute every hypothesis empirically. To assess the state of a particular segment

of culture objectively, let alone the state of culture as a whole, is also impossible. There is no way, for instance, of quantifying the loss caused by the disappearance of certain cultural practices, or by the fact that certain works were never created, and measuring it against the gain from practices which came in their place. There is no way of measuring a general decline in good taste. Despite all this, we see from numerous public statements made by people in the arts, the artists themselves, critics, academics and some groups of consumers that they have a persistent sense that things are moving in the wrong direction. Why is it so difficult to translate these opinions and moods into irrefutable evidence?

Suppose that our research was into the effects of industrial waste on the state of the fisheries. We discover that the harmful effects of effluent have caused several species of fish to die out, others are in the process of dying out, and others again are mutating and adapting to the new environment. If we conducted an opinion poll to see how the fish feel about what is happening, we would register no opinions from the first group, whose representatives' voices have been stilled. From the second group we shall obtain a certain amount of barely audible sighing and a mood of decadence. The third group might well be optimistic, since it would owe its very existence to the changes, but how valuable is the opinion of a group unable to make comparisons? If they were to encounter a fish previously regarded as an outstanding specimen, could they appreciate it with no knowledge of the old context? A ballot would show the opinions of group three to be in the majority, but is the future as rosy as they imagine, with the balance of the ecosystem disrupted? Only the second group, almost unable to express their views, are still capable of seeing the direction of the changes.

Our analogy is not invalidated because fish cannot talk: consumers of culture also have no voice in the markets which would enable them to express their views on what is happening. The individual consumer cannot analyse a situation of which he is himself a product. Like a patient undergoing anaesthesia, he hears no confirmation that he is losing consciousness. V.S. Naipaul once complained that literature had died and the world did not seem much troubled by the fact. People simply no longer felt the need for it.³⁴

Adverse selection is like a virus during its incubation period. By the time the damage it is causing becomes apparent, it may be too late to do anything about it. There are no written standards for consumers of culture, so it is difficult to say when they are not being met. The protests of the discontented are swept away by the actions of the professional players pouring water on the mill of adverse selection. The cultural community lacks the vigour to rise up against them. Mass produced culture is profitable: pandering to minority groups is not. Indeed, these groups have themselves a penchant for bargain-basement prices and may no longer be willing to pay a higher price for better quality.

It is no good railing at business, which is only acting within the current rules and standards. No amount of exhortation will change its behaviour to some-

³⁴Cited by A. Konchalovskii "Victory of the Market over Art" ["Pobeda rynka nad iskusstvom"], *Rossiiskaia gazeta*, 9 February 2005.

thing less profitable. We face an institutional equilibrium from which it is increasingly difficult to escape, if only because a decreasing number of people wish to do so. The solution is a new business model for culture, but this first requires a clear demand for change and a vision of what the future could hold.

Meanwhile, things are getting worse. Business is itself bringing forward the moment of collapse by obstructing the flow of information. When that quartet ‘everything, all the time, for everyone, everywhere’—every genre day and night, available to everybody no matter where they may be—becomes a reality, the question of ‘what’ will become crucial. What should be chosen from the hundreds of television channels and thousands of digital and non-digital products on offer?

Obviously, one cannot simply dismiss the preferences and likings of the mass consumer, even if they are orchestrated. The predominating tastes are immensely important to the markets and they can be influenced only by surreptitiously grafting on cultural practices which call for a higher degree of intellectual effort. With the advent of collaborative filtering a glimmer of light has appeared at the end of the tunnel. If some rather small but very active taste communities can be just slightly redirected and turned into users of collaborative services, this whole process will begin to take off. Few though these groups are in number, they already operate an automated bush telegraph. For the time being it is low-powered in comparison with the radio stations subsidised by the promoters of culture.³⁵ It frequently breaks down, but if consumers tune in to a common monetary wavelength, the informational ‘interference’ from outside will be silenced. This is the antidote we see to adverse selection, providing, of course, that the very fact of its existence in the realm of culture is not denied. That it is operating is proved by one piece of evidence it is impossible to ignore.

³⁵The Attorney General of New York State and Sony BMG Music Entertainment came to a settlement under which the firm agreed to stop making payments and providing expensive gifts to radio stations and their employees in return for airplay for the company’s songs. The main points in respect of Sony BMG were:

- To cease interference in the compiling of radio stations’ programmes (payments to responsible individuals to play new songs released by the label);
- To cease making payments to radio stations to obtain or increase airplay in order to raise ranking of their songs in the music charts;
- To pay 10 million dollars to New York State charities to fund programmes aimed at music education and appreciation.

The agreement was extended to include such other major labels as Universal Music Group, Vivendi Universal, EMI Group and Warner Music. Numerous complaints from listeners had forced the adoption of these measures. (Information from the *New York Times*, published in Russian translation on Polit.ru, 25 July 2005).

2.5.5 Unification of Prices and Adverse Selection

In Chap. 1 we touched on the paradox of uniform prices. We noted that the situation in music is typical of the digital industries. Not only CDs and online music tracks, but even cinema tickets are sold at the same price, varying only slightly in accordance with the furnishing of the auditorium, the time of showing, location of the cinema and similar factors.³⁶ The quality of the films has no impact at all. The situation is roughly the same in respect of DVDs, video-cassettes and books (apart from business literature, for which there are particular reasons). Although the price of books seems at first sight to vary, if we strip out the cost of printing and paper and take account of the location of the shop, we shall see that the basic price bears no relation to content. Uniform prices for products of the same type but differing quality have become so familiar that it is difficult to imagine anything else.

But precisely because price is no indicator of quality, consumers are bound to make mistaken choices, and sellers are given an opportunity to exacerbate the situation to their own advantage. There are two questions in this connection which are crucial to understanding the culture markets. The first, why prices are not differentiated, has been fairly fully analysed in economic literature.³⁷ The second, what consequences uniform prices have, has so far been neglected. Economists have taken a greater interest in the gap between price and demand and a failure on the part of producers to fully realise potential profits, whereas we are more concerned about the losses and inconvenience suffered by consumers. Let us, however, first examine the theories which illuminate the practice of unifying prices.

³⁶Exceptions are day-time screenings and concessionary tickets for children, students, ex-servicemen, and pensioners. Some degree of price differentiation is found, linked indirectly to comfort. Auditoria with large screens, better acoustics and newer seating are reserved for popular films. Prices actually vary little as a result of competition between cinemas. Peter Davis, "The Effect of Local Competition on Retail Prices: the United States Motion Picture Exhibition Market", Working Papers, London School of Economics, October 2002.

³⁷See, for example, J. Tirole, *Markets and Market Power: the Theory of Industrial Organization* [*Rynki i rynochnaia vlast': teoriia organizatsii promyshlennosti*], vols 1, 2, 2nd, revised, ed., SPb: Ekonomicheskaya shkola, 2000. The following articles are devoted directly to ticket prices: Pascal Courty, "Ticket Pricing Under Demand Uncertainty", *Journal of Law and Economics*, vol. 46 (2), October 2003, pp. 627–652; Allan C. DeSerpa, "To Err Is Rational: A Theory of Excess Demand for Tickets", *Managerial and Decision Economics*, vol. 1 (5), 1994, pp. 511–518; Stephen K. Happel and Marianne M. Jennings, "Assessing the Economic Rational and Legal Remedies for Ticket Scalping", *Journal of Legislation*, vol. 16 (1), 1989, pp. 1–14; Philip J. Leslie, "Price Discrimination in Broadway Theatre", *Rand Journal of Economics*, vol. 35, No. 3, pp. 520–541; Daniel R. Marburger, "Optimal Ticket Pricing for Performance Goods", *Managerial and Decision Economics*, vol. 18 (5), 1997, pp. 375–382; Serwin Rosen and Andrew M. Rosenfield, "Ticket Pricing", *Journal of Law and Economics*, vol. 40 (2), 1997, pp. 351–375 (In this important article price discrimination of the second and third categories is examined in connection with questions of price formation in the ticket market); Andrew T. Williams, "Do Anti-Scalping Laws Make a Difference?", *Managerial and Decision Economics*, vol. 15 No. 5, 1994, pp. 503–509.

2.5.6 Why Do Suppliers Leave Prices Alone?

Einav and Orbach analyse the problem of uniform prices with reference to the film exhibition industry.³⁸ Believing the system of levelling prices in cinemas to be inefficient,³⁹ they ask why it is clung to so persistently. Non-variable pricing is found in respect of many goods and services, despite their differing quality or a different make-up of the services provided. For example, in the USA the postal service levies a uniform charge whether a letter has to be delivered to a remote destination or within the limits of a single city.⁴⁰ There are usually particular economic reasons for failure to differentiate prices. There will often be additional operational costs for the seller if rules and prices are to vary, such as the expense of distributing up-to-date information, and menu costs.⁴¹ There appears, however, in the opinion of Einav and Orbach, to be no compelling reason for the practice of uniform pricing in cinemas.

Cinematographs appeared in 1905–1917 and were called nickelodeons because the ticket cost five cents.⁴² The name was retained even when the price rose to ten cents. In those days movies were all of much the same quality and were sold to those screening them at a fixed price per foot. With the coming of full-length features and sound, purpose-built premisses for showing films began to appear and the price of tickets rose. Despite that, no attempt was made to price films in accordance with demand, although in the first half of the twentieth century prices varied considerably more than they do today; for example, cinema-goers paid more for the first-night showing. From the end of the 1960s, however, such variations in the price of a cinema ticket ceased. Today, even in cinemas which show new and older films, the policy of equalised prices prevails. Attempts to react to demand for tickets are rare. Thus, in 2000 when the owner of a cinema in China slashed ticket prices by two-thirds, he merited a piece in *Time Magazine*. In 1978 several cinemas in Washington, DC cut prices from Mondays to Thursdays by two-thirds, with a resultant increase in their box-office takings. Analysts noted that a side-effect of this experiment was a doubling of popcorn sales.

The mechanism of uniform price formation was considered briefly in the Chapter on music. Here it will be analysed in greater detail. Einav and Orbach reject the

³⁸Liran Einav and Barak Y. Orbach, “Uniform Prices for Differentiated Goods: the Case of the Movie-Theater Industry”, Discussion Paper No. 337, Harvard Law School, Cambridge, MA, 2001. Einav and Orbach base themselves on numerous interviews with practitioners and experts in the industry who have an inside understanding of the logic of price formation.

³⁹In the epigraph to the article they adduce the words of Edgar Bronfman who at that time was director of Seagrams which owned Universal Pictures: ‘This is a pricing model which makes no sense, and I believe the entire industry should revisit it’.

⁴⁰This form of price discrimination is examined in the next Chapter.

⁴¹If price tags are changed frequently and menus corrected, additional costs arise for paper, printing, making calculations and auditing sales. This is described as ‘menu costs’.

⁴²A five-cent coin was known as a ‘nickel’. The term Nickelodeon also came to be applied to jukeboxes set up in cinematographs which could be made to play for five cents.

generally accepted explanations for uniform prices (cinema owners are in a cartel; they are against assessing art on principle; the expense of publicising differential charges would exceed any potential gains). They identify what they regard as four real reasons.

The first is perceived fairness, where consumers feel no cause to accuse exhibitors of being greedy. Businessmen seem to fear that variations in price might produce a backlash if consumers consider them unfair. Artists like U-2, Pearl Jam, Billy Joel, Garth Brooks and others also take the view that fixing a ‘fair’ price for their concerts, i.e. charging less than they could, is appreciated by their fans.⁴³ Low prices can be good for a star’s image, where raising them might harm his reputation and future sales.

The concept of ‘fairness’ is often used by economists. Thus, it is considered fair to raise prices where a manufacturer is facing increased costs. Undisguised attempts to increase profit by exploiting heightened demand or other problems confronting the consumer are judged to be unfair. Coca-Cola, for example, faced mass protests from consumers when they installed vending machines which adjusted prices to weather conditions. Raising admission prices at weekends and on holidays might be found objectionable by cinema-goers, although the practice is not unknown. Charging a premium for a hit is regarded as fair, with the result that the budgets of movies and fees paid to stars are meticulously publicised so that the public should be aware of the connection between higher prices and high production costs.⁴⁴

The fact that uniform prices for cinema tickets has become standard practice over the years led to its being regarded as the sole fair system. The film industry cannot ignore this, because its goods are readily replaceable by other films or by other leisure activities, including viewing films at home.

The second reason, according to Einav and Orbach, is the so-called agency problem, the difference between the interests of the principal, who commissions, and the agent, who fulfils. In the present instance this relates to contingent sales. The interests of distributors and exhibitors of films as regards box-office takings diverge. Although they sup from the same bowl, the exhibitor has additional sources of income. For him a dollar made from selling refreshments is worth more than an extra dollar on ticket sales because he does not have to share his profit on popcorn with the distributor. Cinemas thus have an incentive not to risk reducing their snack bar revenue by raising admission charges. Against this, selling tickets too cheaply may attract ‘non-snackers’, spectators who come to the cinema solely in order to watch the film. This factor has to be taken into account not only by cinema managements but by the entire entertainment industry and its agents—owners of sports teams, performers, promoters etc.

⁴³Stephen K. Happel and Marianne M. Jennings, “Creating a Futures Market for Major Event Tickets: Problems and Prospects”, *Cato Journal*, vol. 23, No. 3, Winter 2002, pp. 443–461.

⁴⁴This also provides a motive for exaggerating costs in order both to reduce royalties and minimise tax.

The popcorn issue is meticulously studied in Stephen Landsburg's article, "Why Popcorn Costs More at the Movies and Why the Obvious Answer Is Wrong".⁴⁵ The right answer, according to Landsburg, is that owners and promoters sell a package consisting of both the entrance ticket and contingent goods. It is surmised that cinema-goers are willing to spend a certain amount of money on their experience, and that they are not bothered whether they pay seven dollars to get in and one dollar for popcorn, or five dollars to get in and three for popcorn. Sellers therefore need to attract consumers prepared to pay as much as possible for the overall package. Although the buyer may not care how exactly his expenditure is divided, this is not true of the cinema- or theatre-owner, whose total profit is made up from services which vary in profitability. Particularly good seats are sold at a price less than what purchasers could afford, but the profit forgone is more than made up for by revenue from the sale of contingent goods. Less attractive seats are not markedly cheaper, because then they would be taken by non-snackers who merely wished to see the film. Nevertheless, some of the worst seats are virtually given away by exhibitors in the hope that some at least of the consumers will spend money on food.

Marburger reaches the same conclusion as Landsburg, demonstrating theoretically that ticket prices are designed to maximise the sales of accompanying goods.⁴⁶ Rosen and Rosenfield draw attention to the fact that serving one group of customers can limit income from the sale of accompanying goods to other groups.⁴⁷ Leslie, taking the example of the Broadway play *Seven Guitars*, demonstrates that introducing variable pricing can enhance the profit margin by approximately five percent.⁴⁸ DeSerpa describes concerts as 'crowd goods', meaning that what is consumed is not only the action on the stage, but also the reaction of the audience, perceived as a kind of 'club good'.⁴⁹ For members of the community the atmosphere they jointly create is the most attractive element of the experience, and it naturally falls into the category of external effects. Sellers cannot attach a price tag to this component of the good, but they do recognise that the buyers prepared to pay the highest price for a ticket are not usually the 'best punters' because they do not provide revenue from contingent goods. Price filters are accordingly adjusted to ensure an optimal mix of different types of consumers. Quite understandably, owners and promoters, having found a precarious balance between ticket prices and supplementary goods, strongly oppose any changes which might damage sales strategems they have devised in the light of long experience and which have proved profitable.

⁴⁵Steven E. Landsburg, "Why Popcorn Costs More at the Movies and Why the Obvious Answer Is Wrong" (1993), in Landsburg, *The Armchair Economist: Economics and Everyday Life*, NY: Simon and Schuster, 1995.

⁴⁶Daniel R. Marburger, "Optimal Ticket Pricing for Performance Goods", pp. 375–382.

⁴⁷Sherwin Rosen and Andrew Rosenfield, "Ticket Pricing", *Journal of Law and Economics*, vol. 40(2), 1997, pp. 351–375.

⁴⁸Philip Leslie, "Price Discrimination in Broadway Theatre", cited in Stephen K. Hoppel and Marianne M. Jennings, "Creating a Futures Market for Major Event Tickets".

⁴⁹DeSerpa, "To Err is Rational".

It is generally true that, within horizontally or vertically integrated businesses, content is often no more than a catalyst for much more substantial earnings. Content can be compared to an ‘anchor tenant’ in a shopping centre: the food shop which draws in buyers who in turn become customers for other shopping outlets which are then able to pay higher rents. Accordingly, it may be prudent to grant the food shop a lower rent. In just the same way music may be sold quite cheaply, a monthly subscription of \$4–5 providing unlimited access to hundreds of thousands of songs, because the main revenue stream is from sales of audio-players.

The mere thought that inexpert ticket price formation might damage contingent sales is enough to scare business people off experimenting with them. No less important is the fact that the exhibitor of films is a servant of many masters. He is screening films from different distributors, and differentiating prices will further complicate already difficult negotiations over the right to exhibit them. Imagine trying to justify a steep discount for a particular film! The calculations are no simpler for the distributor, who has to take account of income from secondary markets, for which the screening of his film provides advertising.

The third reason for the uniformity of cinema admission charges is the unpredictability of box-office success.⁵⁰ Films have a short screen life, which leaves little time to adjust prices after the first weekend’s showings. Einav and Orbach, like myself, are unconvinced by this, the most popular of the explanations. The uncertainty is less than claimed, and in fact there is also time enough. The other reasons given do, however, have some justification, quite apart from the natural reluctance of all concerned to give a price signal that a film is a flop.

This latter consideration is put forward by the authors as a separate fourth point, which they label ‘unstable demand’. Where quality is variable, as is undoubtedly the case in the film industry, uniform prices may be fundamental to the seller’s strategy. The suits of the film industry are concerned that cinema-goers may regard ticket price as a signal of quality and avoid cheap films.

Here we come to the crux of the matter. The answer to the riddle of uniform prices is simply that business wants to avoid giving out any signals which might discredit its goods. This is a topic to which we shall constantly return: pre-contractual opportunism, flourishing in an environment of carefully fostered ignorance of consumers.

Einav and Orbach do not give this factor its due weight, and indeed do not consider there to be any insuperable reasons for not differentiating prices. However, instead of the muted appeal to ‘unstable demand’ which they propose, we may resoundingly accuse the industry of a disingenuous information strategy, and indeed of concealing evidence.

One other aspect which Einav and Orbach do not mention is that price-cutting could lead to wars of attrition.⁵¹ Breaching the price taboo might put this unwelcome thought in the minds of your competitors.

⁵⁰William Goldman, *Adventures in the Screen Trade: a Personal View of Hollywood and Screen-writing*, Warner Books, 1984; Richard E. Caves, *Creative Industries: Contracts Between Art and Commerce*, Cambridge, MA: Harvard University Press, 2000.

⁵¹The concept of a war of attrition was introduced into theoretical biology by Meynard Smith to explain the battles between animals for prey. Two animals fighting over prey can be compared to

For all that, the underlying reason for price uniformity is a conscious desire on the part of commercial interests to avoid information transparency, as the representatives of business will themselves privately admit. They naturally regard this as a purely internal matter and no concern of the outside world. The more prudent remain completely silent on the subject, evidently preferring to let sleeping dogs lie. They gently chide Bronfman, the already mentioned chief of Seagram, with his populist calls to break down the system of homogeneous prices, uneasily aware that no good may come of it.

This price screen which masks quality is, however, more damaging than mere cover for the tricks of entrepreneurs seeking to drive up their profit. It has disastrous consequences for culture as a whole, not the least of which is the predominance of all manner of rascally players. It lets off the hook not only conscientious manufacturers whose striving after quality occasionally ends in failure, but also provides cover for hordes of producers with very little interest in or ability to deliver good quality.

Einav and Orbach point out that the postulates of unstable demand and perceived fairness are to some extent contradictory. The logic of fairness suggests that raising prices may lead to rejection by consumers; but at the same time, the concept of unstable demand suggests they will be put off by low prices. On one thing, however, the two theories agree: they both favour uniform pricing.⁵² The authors propose what they see as a straightforward marketing approach: disguise differential prices by discounting. If consumers object to the raising of prices, let them rejoice at being given discounts. The philosophy appears to have been borrowed from clothes sales.⁵³ Why sellers who aspire to raise their profits should obstinately persist with an imperfect price policy remains a mystery to the researchers.

And yet, how easy the answer is. Why do people not saw off the bough they are sitting on? Small gains in one area threaten ruinous losses in another. Business understands this intuitively without needing to have a theoretical explanation of why it is profitable to keep consumers in the dark.⁵⁴ The serious money is on keeping consumers bamboozled. The entrepreneur quite rightly calculates that the only way to make a profit out of culture as such is by concealing quality behind a price screen. Under today's business model there is no alternative. Either buyers spend

two firms fighting for control of their sector, their determination increasing in proportion to the scale of the battle. The fight costs animals dear: in the end they reject all other possible actions and are reduced to total exhaustion. In just the same way duopolistic competition can be expensive, since it creates negative profits. In both cases the aim of the fight is to force the rival to surrender. The victorious animal obtains the prey: the victorious firm gains monopoly power. The loser can only regret he ever became involved. Cited in J. Tirole, *Rynki i rychnaia vlast'*, vol. 2, p. 187.

⁵²Einav and Orbach, "Uniform Prices for Differentiated Goods".

⁵³The theory and practice of sales price-cutting is described in the next Section.

⁵⁴Courty, as also Lewis and Sappington, point out that a monopolist may have a strategy of concealing information from consumers. Pascal Courty, "Ticket Pricing Under Demand Uncertainty", pp. 627–652; Tracy R. Lewis and David E.M. Sappington, "Supplying Information to Facilitate Price Discrimination", *International Economic Review*, vol. 35 (2), 1994, pp. 309–327.

their money blind,⁵⁵ or sellers face an unacceptable risk that ‘sighted’ customers will buy far fewer goods and put them out of business.

The explanation of the paradox of uniform prices is not that some people might be put off by low prices or because others might find higher prices unaffordable. It would not be the end of the world if losses on unsold films had to be covered by raising the price of popular films. The real reason is that a transparent market could unbalance the entire sales system. If the consumer quality of works were guaranteed at the outset by a premium price, or by Einav and Orbach’s discounts, the situation would be radically different. The culture market has, however, evolved without any sobering feedback signals. Accordingly it is based on indiscriminately churning out a huge amount of stuff and selling it all at the same price. Mountains of marketing capacity have been generated in the process, which now need to be given work to do. Who could tolerate signals of quality if a rogue price tag might torpedo an entire advertising campaign, to say nothing of the threat to all the contingent sources of revenue which have sprouted up around culture?

2.5.6.1 Block Booking in the Cinema

Not differentiating prices in accordance with quality is also common in business-to-business deals. Wholesale selling is perfectly normal in commerce, particularly in the fashionable clothing sector. In the same way, film producers and studios sell film exhibitors a package under a system known as block booking. The US Supreme Court has twice declared this practice illegal: in the case of the United States vs Paramount Pictures, Inc. (1948); and in the case of the United States vs Loew’s, Inc. (1962). In the Paramount lawsuit contracts between film-makers and film exhibitors were in the spotlight, whereas in the Loew’s lawsuit the issue was selling old films to television stations. The verdict was based on the principle that block booking obliged exhibitors to acquire films they did not want. Producers in their defence claimed that wholesale selling arrangements ensured a sufficient quantity of the product could be delivered. In their research into this topic, Kenney and Klein conclude that block booking is actually intended to get round the problem of exhibition risks of films with their unknown prospects.⁵⁶ Without it cinemas would be able to cherry-pick, whereas block booking ensures they accept even mediocre films.

Kenney and Klein liken batch selling of films with the way in which De Beers markets diamonds: only in sets, with the price determined by the average value of

⁵⁵DeGraba notes that a monopolist may favour pushing consumers to make a purchase while still uninformed as to the value of a good. Engineering a situation of insufficient supply to satisfy demand produces ‘buying frenzies’, where customers do not wait to become informed before making their purchase. Patrick DeGraba, “Buying Frenzies and Seller-Induced Excess Demand”, *RAND Journal of Economics*, vol. 26 (2), 1995, pp. 331–342.

⁵⁶Roy W. Kenney and Benjamin Klein, “The Economics of Block Booking”, *Journal of Law and Economics*, vol. 26 (3), 1983, pp. 497–540.

the diamonds it contains.⁵⁷ Purchasers can inspect the package before buying it, and are then free to turn the deal down, but any who do so even once do not get invited back. The authors hypothesise that this scheme protected De Beers from being accused of concealing the diamonds' quality while not allowing purchasers to value them realistically. This enabled De Beers to reduce costs associated with the sorting of stones.

At present economists generally accept Kenney and Klein's interpretation, but Hanssen, having closely studied the detail of contracts between producers and exhibitors, has come to different conclusions.⁵⁸ In his opinion Kenney and Klein base their conclusions on an assumption that block booking contracts are imposed when demand for a film is already known.

He shows that in reality this is not the case. He presents three arguments. In the first place, the practice of block booking arose when the films released were very similar in quality, and no new information about their commercial prospects became available after screenings began. In the second place, block booking contracts were much more flexible than the task of imposing a selection would require. In the third place, the agreements in reality left exhibitors many opportunities for manoeuvre which block booking, as understood by its critics, would have seemed to have needed to prevent.⁵⁹ In Hanssen's opinion, producers were not lying to the court: block booking really was primarily intended to cheaply provide films in quantity. That is, it was simply an effective method of wholesale selling of the good.⁶⁰ When the system was banned, exhibitors of films immediately ran into the problem of a shortage of films.⁶¹ They also discovered that negotiating each film separately was too time-consuming and that they preferred to buy films in blocks.

Block booking reveals the logic of uniform pricing as a regulator of commercial transaction costs. Hanssen observes that, although many exhibitors were probably satisfied with the block booking system, those who were dissatisfied complained to the court that the fewer films they acquired the higher the unit price they had to pay. The producers admitted this, but in their defence pointed out that the fewer the number of copies marketed, the higher the unit cost of the film.⁶² Exactly the same

⁵⁷Major gems are sold separately and the price is negotiated individually.

⁵⁸F. Andrew Hanssen, "The Block Booking of Films Re-Examined", *Journal of Law and Economics*, vol. 43, No. 2, October 2000.

⁵⁹As Hanssen writes, "Post-contractual review of the obligations of renters (in particular extending the period of rental of the film, or shortening it in the case of unpopular films) was perfectly normal, although this is precisely what, according to the hypothesis of Kenney and Klein, was supposed not to be allowed." A. Hanssen, "The Block Booking of Films Re-Examined".

⁶⁰See also, Arthur de Vany and Ross Eckert, "Motion Picture Antitrust: The Paramount Cases Revisited", *Research in Law and Economics*, No. 14, 1991, pp. 51–112.

⁶¹On the subject of what replaced block booking after it was banned, see Hanssen, "The Block Booking of Films Re-Examined". According to Hanssen, the film studios were required to sell the film rental networks they owned. They were also prohibited from entering into franchise contracts with other cinemas and discriminating between cinemas in terms of the date when films were made available for exhibition, territorial zones and much else besides.

⁶²A. Hanssen, "The Block Booking of Films Re-Examined".

relations obtain today between providers of culture and their end-users: the latter can either settle for batch selling at a low price, or be selective and pay a higher price. De Beers' system for trading diamonds benefited not only the company, which economised on the labour-intensive operation of precisely assessing each individual stone, but also the wholesale buyer, to whom a part of that economy was passed on in the form of a discount. In effect, De Beers was forcibly operating a mutually beneficial symmetrical lack of information about quality. Consumers of culture also gain financially by buying products wholesale at an averaged price, but is this really of benefit to them? Yes, if they are content with average goods and services; and no if they are not.

2.5.7 The Main Thing About Price

What conclusions can we draw from price uniformity? That question is of crucial importance for all mass segments of culture. Uniform pricing of works of different quality which misleads the purchaser to the advantage of the seller is serious evidence that a process of adverse selection is operating in the culture market. We should not put the fact that the symbolic aspects of a product are not reflected in its price down to a fundamental non-marketable peculiarity of culture. The industries of taste and the theatre show that this argument is not sustainable. Culture mediated by a rare object or exceptional performance can be very highly valued, but the mass-orientated markets are not able and, as is by now clear, are not motivated to charge a premium for quality. No institution has bothered to ensure that quality is reflected in prices. Institutions for inspection (audit), insurance, and guaranteeing exist precisely to increase predictability and reduce risk. If anybody were to add value by providing information, their work should be rewarded and reflected in the price. So far nobody has volunteered, and the market is flooded with substandard goods which are outwardly indistinguishable from high quality items. Those producing the best quality lose out in competitiveness, and consumers lose interest in culture. Both the former and the latter are filtered out, giving weight to one of the less common names for adverse selection: 'negative screening'.

2.6 Market Agents' Reactions to Adverse Selection

Adverse selection does not just happen. It is implemented by market agents, and accordingly we need to study how they react within the specific circumstances of commerce in culture. It is not enough to assert that quality has fallen and tastes have been spoiled: we need to establish the role played in this by the various participants. Only after we have analysed their motivations will we be able to come up with the optimal way of combining their different interests.

Let us look first at the behaviour of the principal participants: the producer or manufacturer, the creative artist, the consumer, and the critics. We shall consider

only certain aspects of the role of the state;⁶³ and the priorities of illegal producers and pirates are perhaps clear enough already. The market behaviour of the participants is mutually conditioned, because they are all to some degree pursuing commercial interests. The main economic player, business, is able to set the pace, and the other protagonists have to adapt their approaches to achieve an economic and symbolic equilibrium. Let us spell out the five main actions of the market agents which promote adverse selection in culture:

1. Business standardises production. Talented creative artists are replaced by craftsmen who can be relied on to provide output at the rate business requires.
2. Creative artists, in order to compete, work worse and/or move out to where they can find better conditions of work and pay.
3. The public decamps to other spheres, prompted by high selection costs and excessive risk of dissatisfaction.
4. The territory of culture is overrun by unprincipled participants.
5. The institutions certifying quality lower their standards.

The commercial logic at work in the digital sectors of culture has already been explained: the high cost of creating and promoting the prototype and the low cost of replicating it leads to a growing emphasis on scale and an attempt to maximise output. This encourages firms to grow larger⁶⁴ and leads to oligopolisation of the markets.⁶⁵ Major corporations have a parallel presence in many markets in order to optimise summary indicators. Content serves as a platform for commerce. At the behest of commerce, technologies of distribution are created (see Fig. 2.2) and of replication, and advertising orbits the whole shenanigan. Culture is not intrinsically all that profitable,⁶⁶ but it is a catalyst for many businesses, sport driving the sports equipment and clothing industries, museums and architecture stimulating tourism, and so on. Often the production of content becomes a wholly subsidised sector within a corporation, as seems currently to be the case with haute couture houses. These may produce no profit themselves but, promoting a brand, they can

⁶³Culture is acknowledged to be a social good, so if there is underproduction on a commercial basis, the state should intervene to liquidate the market failure. The problems of state cultural policy stem from a lack of clear priorities for distributing resources. This question is addressed below.

⁶⁴Hundreds of billions of dollars were invested in an unprecedented wave of mergers and takeovers intended to create the synergies which would take advantage of digital convergence, a process of interpenetration and merging of digital computer technology and digital data transfer systems. Digital convergence was expected to create new revenue streams while driving down the costs of production and distribution. See N. Parker et al., "What I Want When I Want It: An On Demand Vision for Media and Entertainment Businesses", IBM Institute for Business Value, 2003, p. 4.

⁶⁵On mergers and takeovers in the sound recording industry, see Appendix 1, Sect. A1.4.1.1.

⁶⁶Generally speaking, culture is not even supposed to be profitable in all its segments and undertakings. That is not its first priority. In just the same way there can be departments in the bowels of an enterprise engaged in fundamental research and preparing technological breakthroughs. In accountancy terms these may not appear to be profitable just because their contribution is not visible at every stage. Unfortunately, at the present time financial indicators are the only tool used by management to coordinate the interests of the business and its creative participants.

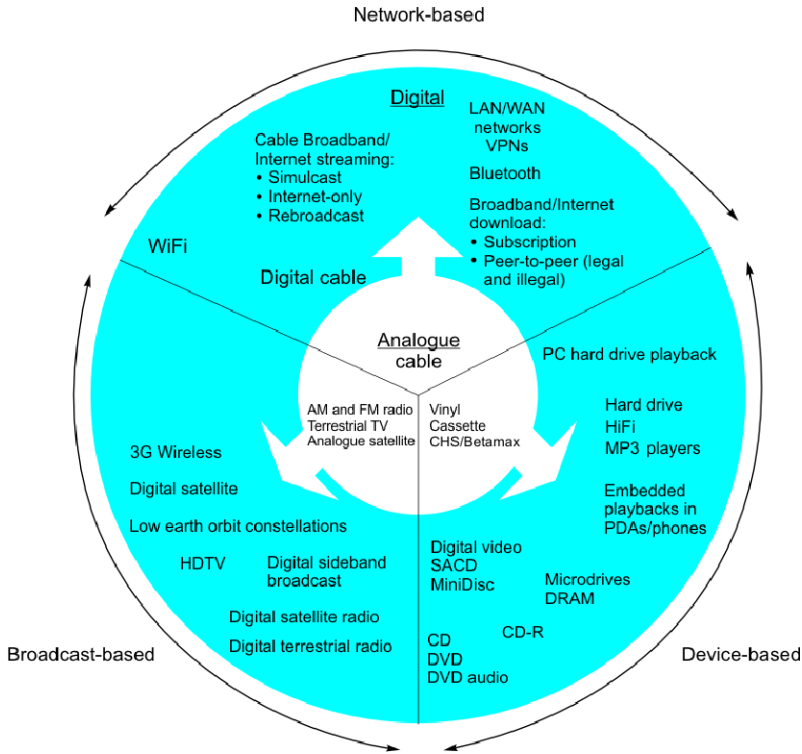


Fig. 2.2 Music and video content distribution technologies, 1970–2003. (N. Parker et al., “What I Want When I Want It”, p. 6). Source: IBM Strategy and change analysis, 2003

tow the manufacture of perfume and spectacles behind them. Creative interests can be sacrificed in favour of more pressing commercial priorities, so it can prove difficult and even futile to attempt to analyse the economy of culture in isolation from its attendant businesses. Because of the amount of business it is carrying, art needs to be resilient. Uniform prices and concentration on mass-market products ensures effective marketing through advertising.

2.6.1 Degeneration of Creative Artists

In the past nobody has suggested a link between the phenomenon of adverse selection and the fact that fewer talented people and high quality works are appearing. The only negative effects noticed were a cluttering up of the cultural environment and consequent increasing difficulty in discovering worthwhile works. In Russia, for example, there are potentially hundreds of thousands of readers of non-fiction literature, yet by our standards print runs are minuscule—an average of 2,000 copies. In some cases authors and readers fail to come into contact, while in others would-be

readers lack the time to discover an interest in non-mass market publications. Distributors find it unprofitable to supply a geographically dispersed demand and this chronic failure of supply and demand to meet, results in the dismal economic state of high-brow book publishing. Writers in this area have little prospect of obtaining serious royalties. A balance needs to be restored by raising the price of books published in small editions, but this conflicts with the low price expectations of book-buyers. As result, some who might write brilliant non-fiction books never do so because they cannot afford the luxury of living for one or two years without a source of income. They might find a niche in the non-commercial market, but more commonly authors have no wish to be so marginalised and retrain as foot-soldiers of glossy magazines or political journalism.

In this situation, adverse selection would seem to be reducing not only the proportion of high quality books among the vast numbers of crowd-pleasing publications, but also their absolute number, since the financial incentive to write them has been reduced. It seems likely that the percentage of talented people remains more or less constant, but the conditions for talent to come to fruition and the sphere in which it can be applied clearly depend on the social and economic context. People say that talent will always make its way, but it must first be able to find the beginning of the road. We hear only of those who have made it, and know nothing of those who, despite having all the requisite gifts, have been unable to break through, who have not been able to adapt to the demands of the market. The environment for discovering talent is provided by institutions and links between the generations, but even if both of these are present we have to ask whether market mechanisms are facilitating the discovery and flowering of talent. Are they encouraging creative dedication? What kind of predicament does adverse selection place the genius in?

As a result of global economic changes the numbers working in the creative sectors are increasing. Modern information technology and ready access to the achievements of creative people (for both of which, incidentally, we have to thank business) make it easier for talent to be discovered. These two factors would seem very positive, but no improvement in the situation is evident. The consumer is not being offered that many really good cultural products. This suggests that either they are lying around undiscovered, or very little is being created, or we are being unreasonably choosy. It is, however, also entirely possible that the commercial system is preventing new talent from emerging.

Let us look at literature from the viewpoint of the publisher.⁶⁷ Large numbers of books have to be published if infrastructure costs are to be covered. This desire to maximise output comes up against a shortage of good writers who, in any case, write slowly. In this situation, how can maintaining quality not conflict with ensuring the necessary rate of output? Any idea of improving quality falls by the wayside. A labour market opens up with an enormous appetite for 'writers'. The

⁶⁷For further detail, see Alexander Dolgin, "Ukhudshaiushchii otbor na rynke literaturny" ["Adverse Selection in the Literature Market"], *Knizhnoe delo*, 2004, No. 1, pp. 52–58; Dolgin, "Platsebo-effekt v literature" ["The Placebo-Effect in Literature"], *Kriticheskaia massa*, 2004, No. 2, pp. 40–43.

same thing occurs in other spheres, like the film industry. As the director Andrey Konchalovsky testifies, ‘Dilettantes have been pouring in to films and music. They have a rudimentary knowledge of the profession and its techniques, but the language and content, the things in which an artist’s individuality shows through, are in their case an amorphous mess. On a present-day film set everything can take care of itself: top professionals in different specialities could perfectly well make a film without a director. The actors would act, the cameraman film, the sound recordist record the sound, and the cutter edit the film.’⁶⁸

This raises the question of whether technicians in the arts are assisting talented artists or replacing them. An outstanding author, when he takes his place on the production line, is in the same situation as those who are merely filling a gap in the labour market. His priority is necessarily to be no less productive than they are, since his books cost no more than theirs merely because they are more talented.⁶⁹ They do, of course, require a greater investment of effort. The book’s price is determined by the cost of production and marketing, not by its content. The print runs of the past which used to provide an author with a decent livelihood are out of the question today. As an example, if a book is published in Russia even in ten thousand copies then, at a retail price of five dollars, the writer can expect to receive no more than five thousand dollars. How much time can he afford to spend writing a book if he wants a decent standard of living? Little more than three months, in all probability, and unless he is a Balzac, that is not long enough. To expect an output of four books a year, or even two, is inhuman. One of George Bernard Shaw’s characters, to be sure, asserted that a real artist is insensible to deprivation. ‘The true artist will let his wife starve, his children go barefoot, his mother drudge for his living at seventy, sooner than work at anything but his art.’⁷⁰ But how much truth is there in these words? The majority of artists, particularly those enjoying success, who are, of course, those most commonly interviewed, will publicly deny that they work for the money. Those who, because of a lack of money, have not made it do not give interviews, but say quite the opposite in private.

In order to keep the wolf from the door, an author is obliged to jolly his muse along, or to dispense with her entirely. This shows in the final result. After a time the writer too begins to resemble a squeezed lemon. In the pursuit of economies of scale both managers and authors find themselves like squirrels in a treadmill: the imperatives of capital force the former to publish more and the latter, goaded by their publishers, to write faster and more frequently than is reasonable. Quality is almost always sacrificed.

Although there have been instances in the history of culture when poverty created geniuses, these have been happy exceptions. The pace of production-line book publishing rarely coincides with the tempo of creativity, and since box-office takings

⁶⁸A. Konchalovskii, “Pobeda rynka nad iskusstvom. Kak marketologi berut verkh nad tvortsami” [“Victory of the Market over Art: Marketing Managers Are Defeating Creative Artists”], *Rossiiskaia gazeta*, 9 February 2005.

⁶⁹This applies to fiction, but not to business or coffee-table books.

⁷⁰George Bernard Shaw, *Man and Superman*, 1903, Act 1, l. 184.

are usually a greater priority than creative aspirations, business imposes its will on the artist. The publishing house resorts to all manner of devices and blandishments, tying the writer's hands with advances, buying the rights to his future works at the outset of his career. The businessman does not find it advantageous for a famous author to be unencumbered; an author, knowing he will be forced to walk at least part of his way in leg-irons, does his best to adapt and tries to turn the situation to his advantage, at least financially.

Thus he embarks on the ruinous strategy of being economical with the meanings with which he endows his work. This is no longer merely rushed writing, but a cold, calculated choice. Knowing that he is going to have to produce a lot at frequent intervals (the harvest having been sold in advance), the author takes to spreading his creative ideas more thinly. He no longer pours out all that is in his soul every time, before waiting for the creative well to refill. Instead his writing is thrifty and judicious. Not all authors deliberately follow this path. Some stoically resist the temptation to maximise their earnings, and for others the fakery is subconscious. The commonest result, however, is a dilute solution in place of the alchemy of art. This is how the economically based motivation of the key agent in the market (the businessman, the publisher) leads to dilute literature. It is an area particularly vulnerable to filling up with dishwater. The entry barriers to publishing are not high, requiring neither vast sums of money nor an extensive material infrastructure, and the numbers aspiring to fame by taking up the pen are constantly growing. Out into the arena come uncountable hordes of graphomaniacs, to the great joy of printers and booksellers.

Is enslavement by contract a good or a bad thing? The discipline of having to earn your keep is beneficial for many activities, so it is surely not necessarily harmful for an author to be mindful of money? And of course it is absolutely essential that a publisher should be. The problems come when both of them think about nothing but sales and these determine the artistic concept.

One alternative to the market is, of course, patronage.⁷¹ Until modern times it was the only option, before being almost replaced by a commercial alternative as it came to be considered humiliating for an artist to put himself at the service of a patron. The market, impersonally commissioning work, was at first seen as a liberator. Which actually is better for the art: a patron or the box office?

2.6.1.1 Patronage or the Market?

There are several first-rate works by economists which ask whether the creative artist is more productive when working for a patron or in market conditions. William and Hilda Baumol support the view that patronage is considerably more effective in developing art.⁷² They claim this is demonstrated by the example of Viennese opera

⁷¹Patronage implies a lengthy period of employment of a creative artist. It can also refer to a situation where one or several aristocrats commissioned work privately.

⁷²William J. and Hilda Baumol, "On the Economics of Composition in Mozart's Vienna", *Journal of Cultural Economics*, vol. 18 (3), 1994, pp. 171–198.

in the second half of the eighteenth century⁷³ when, under the sponsorship of the royal court, outstanding operas were created and Vienna came to be regarded as the music capital of the world. They employ two criteria to assess the quality of an opera: is it still performed today? How highly is it rated by music critics?

The Baumols give three explanations for the excellence of operas driven by a patron rather than by the market:

1. A patron paid talented composers more in order to entice them to work for him, much as today's wealthy sports clubs buy star players.
2. A patron furnished conditions favourable to creativity: specifically, the composer was not obliged to work in a rush.
3. A patron was not risk averse and welcomed innovation.

These explanations appear to coincide with what common sense would lead us to expect, but another researcher, Timothy King, decided to check his colleagues' conclusions. Recognising that the first (possibly the most weighty) and third arguments were largely speculative, King concentrated on the second. He tried to establish whether operas funded by ticket sales were different in quality from those funded by a sponsor.⁷⁴ This is a fairly rare instance of an economist attempting to operate with the category of artistic quality and as such deserves our close attention.

King compared Vienna and Italy over the same period (1751–1790). The former demonstrates patron-driven art and the latter art driven by market forces.⁷⁵ King tabulated data about the number of premieres taking place in the major theatres of the time, the works still performed today, and critical assessments of them. Collating this, he found that although fewer than six percent of premieres took place in Vienna, they accounted for one-quarter of those still being performed today. Most others fell by the wayside much sooner.⁷⁶ This appeared clearly to confirm the beneficence of

⁷³Throughout history, opera has been financed both by patrons and commercially. This makes it a particularly suitable area for investigating whether the nature of its financing influences the quality of cultural production.

⁷⁴Timothy King, "Patronage and Market in the Creation of Opera Before the Institution of Intellectual Property", *Journal Of Cultural Economics*, vol. 25 (1), 2001, pp. 21–45.

⁷⁵The first opera to be totally dependent on ticket sales was staged in Venice in 1637. The experiment rapidly spread to the rest of Italy. It was adopted most successfully by itinerant companies of artists, and a few years later saw the opening of opera theatres which proved very popular. Although the Venetian opera houses operated as businesses, they did not always make a profit, and indeed this may even not have been expected of them. The requisite subsidies tended to come from the theatre owners who were members of patrician families. They financed opera as a hobby or in order to enhance their social status, supporting the impresario who rented the theatre from them. In other regions of Italy subsidies might come from local rulers or prominent citizens who were regular subscribers to boxes. Partial data on revenue and costs for Modena in 1701 and for Bologna for various years in the eighteenth century indicate that the theatres' revenue covered 60–84 percent of their running expenses. Timothy King, "Patronage and Market in the Creation of Opera", p. 24.

⁷⁶King warns that 'It should not be thought that this is simply due to the popularity of operas by Mozart and Gluck. In Mozart's case, only four of the fourteen operas in the list were first performed in Vienna, and in Gluck's case, only five out of eight.' King, "Patronage and Market in the Creation of Opera", p. 28.

the patronage of Emperor Joseph II, who ruled 1756–1798. King ingeniously went on to compare the destinies of a number of works created by the composers who had worked both at the court and commercially. (The Titans tried their strength in different locations.) This too appeared to confirm that patronage was preferable.

A court composer was not obliged to produce operas at great speed, unlike one working commercially. By and large there was no effective system of copyright in Europe at this time. In Italy a composer working commercially usually received a one-off payment irrespective of his work's success. The situation was similar in Germany. This obliged composers to produce new works frequently.

For example, Giovanni Paisiello composed more than 80 operas, 47 of them in Italy, in 1764–1776, working commercially. On three occasions during this period he wrote five operas in a single year. In 1777 Paisiello took a position at the Court of St Petersburg and at first lowered his rate of output to three operas a year in 1781–1784 he slowed down further and wrote only one. Two of his most famous compositions, *Il barbiere di Siviglia* (1782) and *Il re Teodoro in Venezia* (1784) were written during this period of respite. He subsequently returned to Naples to a position at the court of King Ferdinand. His rate of annual output again increased, but only to two to three per year, and only one of these, *Nina* (1789), has become well known.

A similar example is Domenico Cimarosa who was even more prolific in Italy than Paisiello. Between 1781 and 1784 he composed no fewer than 22 operas. In 1787 he was engaged by the Russian Court and there produced a mere three new works in the course of the next three years. He left Russia in 1791 for a position at the Austrian court, where he created his masterpiece, *Il matrimonio segreto*.

The obvious conclusion would seem to be that commercially funded operas composed in Italy fail the survival test and are not highly rated by the experts because they were written in haste. Composers had no time to come up with something original and polished to perfection. We cannot, of course, be 100 percent certain that composers did actually spend more time on their compositions. We can only say that they worked under less challenging conditions than in Italy, and that their work was far less monotonous. Verdi was to describe the period 1839–1853, during which he wrote 18 operas, as 'years in the galleys'. Niccolò Piccini wrote 56 operas in a single decade (1761–1770), including eight in 1761–1762, and nine in 1770. His best work is considered to be the comic opera *La buona figliuola*, created at the very beginning of that decade of non-stop composition, and following a year in which he wrote only two works.

If we take the period 1751–1790, most premieres took place under market auspices, but the compositions which have stood the test of time and enjoy critical acclaim today are those financed by patrons. Composers who worked within both systems created their best work under royal commission, whereas the operas they wrote for the music markets of Italy and England have mostly been forgotten.

King almost confirms the findings of the Baumols about the baneful influence of the market, but when he came to study the second decade of nineteenth-century Italy he came across an apparent anomaly. In just a few years the young Gioacchino Rossini put Italy back in the lead. More than two-thirds of all the operas he wrote

between 1811 and 1840 are performed to this day. Saverio Mercadante and Giovanni Pacini, who worked at virtually the same time as Rossini, composed 60 and 90 operas respectively. Such a rate of composition could only be achieved by, for example, re-working librettos. Sometimes Rossini re-cycled music from his own earlier operas. His arias followed a standard format. These techniques were soon being imitated. Rossini was followed by such other composers as Gaetano Donizetti and Vincenzo Bellini who kept Italy ahead. In the late 1820s Donizetti was composing three or four operas a year, and in 1830 created *Anna Bolena*, a work which remains in the repertoire today. It was his fourth opera that year, and the twenty-eighth in his career.

This would appear to put the kibosh on the conclusion that the Italian system of mass production of opera hopelessly compromised quality. King concludes, with undisguised regret, that economics is ill-equipped to explain why geniuses have arisen when and where they did. Even this negative result, however, is of value to us in indicating the limitations of traditional economics and encouraging the further development of tools to enable economists to work with the material of culture. King may, nevertheless, have been jumping to conclusions. It is, after all, possible that some geniuses have immense productivity among their other talents, or a gift for putting unfavourable circumstances to good use. More probably, however, certain ideal conditions are needed if creative potential is to unfurl fully: for example, the artist's freedom to decide for himself the rate at which he will work. If a businessman is hassling him over this, he hinders proper self-expression and some creative artists will be completely demotivated. The fact that a number of composers succeeded in coping with the exigencies of the market does not mean they are not damaging.

Business cannot obtain optimal results in terms of volume of output and richness of content at the same time. This poses a real threat of a draining away of talent, which is the real cost of relentless manufacturing and standardisation of products. Business needs a way of filling the gaps between the bursts of spontaneous inspiration of geniuses. It is perhaps only doing its best to satisfy demand by re-using stereotypes which have already proved successful, but production geared to this has little need of originality.

2.6.1.2 State Patronage or Private Patronage?

Perhaps the nurturing of talent is a task for the state, whose financial situation is different from that of business. Can the authorities compensate for market failure here? What kind of relationship should a government build with the arts if it wants to go down in history as an effective patron? Which sectors should it subsidise, how and on which conditions? Bruno Frey sidesteps the usual discussion of the merits of state support of the arts⁷⁷ by asking what kind of state is needed for its support to

⁷⁷Cultural economists usually focus on the influence of direct and indirect subsidies (through tax concessions) on the arts and social wellbeing. A survey of the methods of subsidising art is given in Werner W. Pommerehne and Bruno S. Frey, "Public Promotion of the Arts: A Survey of Means",

be effective.⁷⁸ He identifies two key factors: the level of democracy, and the level of decentralisation. Authoritarianism is generally thought to be a bad thing for the arts, since dictators are apt to impose their own tastes. Clearly, however, this is not always the case. The autocratic Pope Julian II (1503–1515) hired Bramante, Bernini, Rafael and Michelangelo to build St Peter's Cathedral in the Vatican, and gave a powerful impetus to the arts in the process.

Dictators do not welcome opposition, but democratic countries where power is highly centralised and where cultural affairs are managed by the political elite are little better in this respect than authoritarian states. Artists who fail to conform to the tastes of the party in power will wait long for their subsidies since, from the viewpoint of the authorities, they are not producing good art, or not producing art at all. Under such circumstances expenditure on culture, great as it may be, is distributed very unequally.⁷⁹

In authoritarian states the quality of works varies more markedly than in democratic states, which orientate themselves on the average tastes of the electorate. In democratic states this is more pronounced in those which are centralised. According to Frey, the authoritarian state's influence on art is closer to that of royal patronage: there is less variety, but the range of quality is greater. Democracy is closer to market oligopoly: while the art is more varied, the quality of works is more uniform.

The second question Frey addresses is whether the state is capable of stimulating creative people at all, and this raises questions about the nature of creativity and the artist's inner motivation. Frey inclines to the view that all state intervention undermines inner motivation. Financial help in return for an expected result, and bureaucratic dealings with the recipients, harm creativity.⁸⁰ If subsidy is guaranteed, a number of factors which stimulate creativity disappear, and this leads to ossification of the arts. The artist puts a higher priority on retaining the source of his finance than on creating something new. At best, the outcome of state support is neutral. Private individuals are better benefactors of culture, and Frey considers that the task should be left to them. State support should be extended indirectly by reducing taxation on sponsors and artists.

The question of whether an artist should be given money, quite apart from the question of who might choose to give it, is wide open to debate. Orthodox econo-

Journal of Cultural Economics, vol. 14, December 1990, pp. 73–95; and also in the monographs of David C. Throsby and Glenn A. Withers, *The Economics of the Performing Arts*, London and Melbourne: Arnold, 1979; James Heilbrun and Charles M. Gray, *The Economics of Art and Culture: An American Perspective*, Cambridge University Press, 1993; and in Ruth Towse, ed., *Cultural Economics: The Arts, the Heritage and the Media Industries*, Cheltenham: Edward Elgar, 1997.

⁷⁸Bruno Frey, "State Support and Creativity in the Arts: Some New Considerations", *Journal of Cultural Economics*, vol. 23 (1–2), 1999, pp. 71–85.

⁷⁹As examples Frey points to the financing of the construction of the Pompidou Centre, the Bastille Opera, the Arc de Défense and Bibliothèque nationale in Paris, and in Austria to the huge subsidies received by the Viennese Opera and Vienna Philharmonia. In Russia the Bolshoy Theatre is evidently targeting the record for devouring the largest slice of the state arts budget and has generated considerable public controversy in the process.

⁸⁰Frey, "State Support and Creativity in the Arts".

mists who do not take the idiosyncrasies of the arts into account take the view that money has a role to play where a positive link can be identified between the financing and the results of an activity. Frey identifies two current views on this. Art experts and artists themselves tend to believe that creativity is an inner function of personality which cannot be influenced externally. Economists for their part have no doubt as to the effectiveness of external leverage. Inner motivation arises in response to external stimuli, in the arts as everywhere else. If this implies that artistic creativity increases in line with an artist's income, however, credibility is strained.

Psychologists also are in two minds as to whether external financial motivation is beneficial or harmful for creative artists. Some argue that, although artists appear to work more diligently in anticipation of assured payment, what they produce is stereotyped and of lower quality than the output of those working without any certainty of reward. A plausible explanation might be that an artist working to a deadline, fearing that inspiration may not appear on time, will not wish to take risks and will settle for the first halfways reasonable solution which comes to mind. It may not be the best he is capable of, but it is safe. In the absence of an outside sponsor the artist is serving only one master, his own talent. The freedom to listen to his inner tuning fork without constantly worrying about fulfilling an economically based agreement helps talent to flourish. Other psychologists take the view that a finely judged dose of financial encouragement is beneficial.⁸¹

Frey comes up with what he regards as the golden mean. He argues that, while external incentivisation does tend to displace inner motivation, if the subsidy is perceived as selfless support it can in fact enhance inner motivation. Economic stimulation should not be overdone, but the main thing to avoid is control, sponsorship only in return for strict regulation.⁸² If the state provides subsidies but retains levers of control, it promotes the creation of mediocre art. Financial aid, to be effective, must be unconditional, leaving artists complete creative freedom but, as Frey adds, ensuring that resources are not squandered. He is unaware, apparently, that this is precisely the kind of control he is condemning.

Psychologists specialising in the motivation of creativity will doubtless find Frey's approach fairly vague and unsophisticated, but they themselves have yet to provide persuasive guidelines on how best to assist as many genuinely creative artists as possible. They coyly refrain from generalised recommendations, acknowledging that a standard dose of economic remedies will only prove harmful. The state, meanwhile, needs to act, so it does the best it can with only one, financial, control lever and hopes no one will have the gall to accuse it of wasting scarce resources on culture.

⁸¹See, for example, *Sovremennaia psikhologiya* [*Modern Psychology*], ed. Vladimir N. Druzhinin, Moscow: Infra-M, 1999; Vladimir Druzhinin, *Psikhologiya obshchikh sposobnostei* [*The Psychology of Common Abilities*], SPb: Piter, 1999; Evgenii Il'in, *Motivatsiia i motivy* [*Motivation and Motives*], SPb: Piter, 2000.

⁸²Bruno S. Frey, *Not Just for the Money: An Economic Theory of Personal Motivation*, Cheltenham, UK and Brookfield, USA: Edward Elgar, 1997.

If the experts are unable to provide the state with foolproof recipes for stimulating the arts, they can at least warn against what is likely to do harm, and that is any neat contract spelling out the obligations of the two parties. This, of course, is precisely the relationship between the artist and the businessman. It might be possible to observe the fine distinction between good incentivisation and bad incentivisation if the individual circumstances of the creative artist were given full consideration every time, but in the meantime the state has no satisfactory formula for optimising cash injections and there is no reason to suppose it ever will.

If the well-worn approaches to subsidising culture are ineffective, is it not perhaps time to try a different approach by mobilising the resources of the consumer community? The problem of financially motivating creative artists can be solved by devising a fundamentally new source of finance and a different logic of recompense – gratuitous monetary payments by consumers direct to the artists, performers, et al. Funds could be generated within the framework of monetary collaborative filtering, and the same technology makes it possible to allocate contributions to the correct individuals.⁸³ This would mean that the finance was largely independent of commercial interests. Today the creative artist receives perhaps one-tenth of the price for which his product is sold. We can already see that consumers have no objection to a 15–20 percent supplement on the price of a ticket to cover, for example, the services of ticket retailers. They are prepared to pay even more than that to speculators: between one and a half to two times the face value of the ticket. If even a proportion of such amounts were channeled to the creators of works which had been appreciated, their income would increase several times over while their creative freedom remained completely unaffected. The arts would be beholden only to their public, which is, after all, something they seem to long for.

2.6.2 Degeneration of the Public

Business, blindly following commercial imperatives, standardises the quality of cultural production, but how does the public react to this? Does it turn away in disgust? Alas, as a rule, nothing of the sort occurs. The predictability of cultural goods seems to be regarded as a good thing, and it is not difficult to guess why. You know from past experience what to expect from a standardised product. When you go to see a blockbuster movie you know what you are paying for. As far as the market is concerned, the aim has been achieved: people are buying the product, so they must like it. This argument is valid, however, and even then only to a certain degree, in respect of long familiar products aimed at producing a predictable reaction. If the good is something original, the risk that consumers will be disappointed is very high. They have paid in advance for an unknown quantity, and they read or view it only afterwards. Loss is inevitable, even if it is disguised.

⁸³There is provision for this in the plan for creating a general recommender service using money-based collaborative filtering as outlined in Chap. 1.

In Russia, for example, fiction is sold relatively cheaply in comparison with the rest of the world. Price variation between books is almost negligible. This might seem good news for book-lovers with their modest purchasing power, but since literary merit is not reflected in the price, counters are piled high with book-shaped waste paper. In full accordance with the law of adverse selection, primitive typographical items crowd out authors and publishers who worry about quality. In order to buy an enjoyable book, one is forced to browse through (or buy and then browse through) ten, twenty or thirty low-grade offerings. Quite apart from the cash cost of wasted purchases, the reader is additionally burdened with the time cost of sampling texts.

Although the culture industry in its present form has de-sensitised the consumer to non-monetary costs, reading something you do not enjoy is still an entirely real cost. The public do not notice what is plain to an economist: cheap books are by no means as cheap as they seem. Let us suppose that someone buying a book manages, with improbable precision, to hit the bullseye one time in four. This implies that, if the book industry were differently organised, he could derive equal enjoyment from buying only this fourth book at a price four times higher. He would additionally save on disappointment and wasted time. Anyone who values their time should find the higher price not unreasonable.

The wasting of money, time and emotional energy is not the full extent of the problem. A less tangible loss is also being suffered, taste. Malleable by nature, it becomes deformed and less fastidious. At first glance people seem to choose only what appeals to them, but the reality is that taste adapts to what is on offer, and that is determined by what the publishing industry finds it convenient to sell. Quality is pushed to one side. Setting the standards, commerce gives the seal of approval to pseudo-art, debasing the taste of consumers. Their receptors of artistic quality react just as the digestive system reacts to a diet consisting solely of easily digested food: by atrophying. Underlying aesthetic taste is a subtle discriminating ability which needs to be kept in trim. In order to keep fit, it needs a steady supply of challenging works of art. How many books published in recent years are capable of meeting this need? People get used to trashy reading matter just as they do to poor-quality tea, and all the while the belief that book prices should be low etches itself in the mind, together with a decline in esteem for literature itself. Ultimately the general public can become so fazed that it gets used to buying any old garbage at a rouble a bucketful, in much the same way that Hollywood films were sold by the foot in the early twentieth century.

A discriminating reader does of course detect the deception and adjusts his reading. The author with a literary quota to produce, like a child concealing the stewed fruit he has scoffed, fills his creative saucepan to the requisite level with water. The consumer reacts to this in accordance with Le Chatelier's principle of chemical equilibrium to restore the status quo by counteracting the variation. He adapts in such a way as to compensate for the deficit of aesthetic value. The author writes his book in aesthetic energy-saving mode, and the reader reacts; the man of letters spreads his creative ideas thinly, and his reader skates the surface; the writer distributes his bait frugally through the text, the reader ups his scanning speed and hurtles at express speed from one substantial passage to the next. Cultural GDP is not increased,

and all that happens is that transaction costs go up because of the initial dilution and subsequent distillation of meaning. The whole thing results in a great deal of wasted effort on the part both of authors and readers, which serves only to keep the millstones of business grinding.

If the situation is repeated time and again, sophisticated readers will opt out of modern literature altogether. They will refuse to settle for 'saleable products' and the ever rarer satisfaction to be had from a text. The market's rules condemn these people to greater costs or greater risks than they are prepared to accept. With the passage of time the market for literature empties, abandoned by the more demanding readers so crucial to its prospering, and shortly afterwards by the best authors. The more restricted the circle of genuine book-lovers, the more difficult it becomes to serve them with any degree of economic profitability—and the fewer altruists there are prepared to engage in this unrewarding business.

This pattern is repeated in every segment of culture. If a highly original film is made with a potential audience of 100,000 cinema-goers and can be viewed for \$5, financial losses are virtually inevitable. Often, of course, the would-be consumers are not so few in number, but they are dispersed and it is expensive to inform them of the existence of something good and to market it to them. With very few exceptions, films of the generally expected level of technical quality cannot be made and promoted for less than half a million dollars. The only hope is non-commercial sponsorship. Niche films have to be low-budget and lose out in quality, in certain important respects at least.

Refusing to take the risks involved in any departure from the standard behaviour dictated by market rules—which is the lifeblood of writers and readers—leaves literature struggling. If outstandingly good works are not created in sufficient quantity, the pulse of culture weakens. Talented, innovative works are like a ship's propellers. Without them the ship of culture floats downstream, monetary flows prevail and carry it away in the wrong direction.

2.6.2.1 A Pragmatic Definition of Art

Commercial culture aims to please the public. Is that such a bad thing? Do businessmen ruin people's tastes by pandering to them? Students of culture like to debate this topic, and invariably arrive at the 'dichotomy between the arts and commerce'. Arguments about mass versus elite culture, high-brow versus low-brow have been going on for years and are no longer fruitful. One of the reasons is that these are false antitheses. In the real world you cannot do without either. This, however, does nothing to inhibit the debating, which is based not only on a conflict between the interests of commerce and creativity but also on simple terminological confusion. 'High' and 'low' are not characteristics of a single entity called art, and neither are they variants of it. They are different *kinds* of art.

The kinds of art are different, but the criteria applied to them are the same. 'Art' can be defined rigorously, art as it is viewed by art critics, or it can cover anything which, for a variety of reasons, produces an aesthetic effect on an individual. In

the view of most critics, ‘the artistic vision ought to reveal something new, that is, something which does not already exist in an art archive’.⁸⁴ But a work does not have to be original in terms of art history in order to be original for a particular consumer, no matter what the critics say.

It is not a simple matter to reconcile these different approaches. Another critic says of music, ‘On the one hand it needs to be highly recognisable and memorable, a new tune filled with deep and genuine feeling; on the other hand it needs to be understandable at first hearing, not boring, wholly pleasing. Unfortunately these two requirements are never met simultaneously. A tune is either new, or it is recognisable and easily swallowed first time.’⁸⁵

The different storeys of the edifice of art should correlate in much the same way as fundamental science and engineering co-exist—in relative harmony. Popular art and elite art are like interconnecting vessels, with business pumping problems, tasks, equipment and technologies from lower to higher, and ideas and solutions coming down in the other direction.⁸⁶

It is often a mistake to ask what is better without asking, ‘Who for?’ Is the work of the genius which can be understood only by a few select individuals better than the work of an averagely skilful writer who has won the hearts of millions? Much more germane is the question of how a particular public should identify the works suited to it, and also what the nature of the link between elite and popular art is: which of them is the symbolic donor and which the recipient? What is the optimal proportion of each of them, and is business capable of sustaining that ratio in a market suffering from adverse selection?

In the past, exemplary works were created for elite circles and were assimilated as they trickled down through the layers of society.⁸⁷ Today the situation is more complicated and we have to address the question of how, alongside economically viable ‘low’ art, production of high quality artefacts for restricted groups of consumers can be made profitable. How can they be notified of its existence? The task is to ensure that the proportions of high-, middle-, low-brow and all the intermediate categories of art are optimal for society. What is supplied should not only satisfy different tastes, but stimulate their development. Adverse selection distorts the balance in favour of low-brow art. Those businesses which cater for the mass market are immeasurably more successful than those producing a high-quality product for a narrow stratum of a demanding public. If we can successfully introduce a money-

⁸⁴B. Groys, *Kommentarii k iskusstvu [Comments on Art]*, Moscow: *Khudozhesvennyi zhurnal*, 2003, p. 251. Groys goes on to write, “The economics of innovation restrains rapid artistic growth... A large amount of what is created, or perhaps one should say, put forward as art, if compared with existing archival materials appears tautologous, derivative, superfluous, and is accordingly rejected. This is not always the fault of the art” (p. 252).

⁸⁵This is the opinion of the well-known music expert, A. Vargaftik. See “Muzykal’nyi protsess: v ozhidanii nevozmozhnogo” [“The Music Process: Anticipating the Impossible”], *Apologiya*, No. 1, p. 162.

⁸⁶Patent rights retard this process.

⁸⁷In accordance with the Veblen-Simmel trickle-down theory.

based system for post-consumption rating of works, it will help to counteract adverse selection and to bring the supply and demand for cultural goods back into balance.

2.6.2.2 The Placebo Effect in Culture

A cultural product which displays no major originality in terms of universal appeal, or even just a little originality which could appeal to one or two consumers, can, if it is competently exhibited in the culture markets, produce a strong reaction in the public. It can do so despite the fact that its creator invested precious little creative effort in it. An analogous medical phenomenon is the placebo effect, when a patient feels better after taking tablets which contain no drug. Just the fact of taking something you believe will heal you mobilises the organism's resources.

Pseudo-cultural products can produce a similar effect. Even if experts could readily demonstrate that they possess not an atom of artistic originality, providing they are convincingly packaged and presented they can trigger the relevant consumer reflexes. Aesthetic experiences are born of the imagination and memory, in an individual's willingness and ability in particular circumstances to aestheticise and animate any object. Without invoking the placebo effect it is impossible to explain the success of low-grade soap operas and those unfeigned emotions they engender in the mass viewer.

People take the counterfeit coin for real currency and use it accordingly. When everybody around them is reacting in the same way, the deception is unnoticeable. This does not mean, however, that nothing is amiss. Counterfeiters whip up inflation. They do the same in culture, but registering the extent of the devaluation is immeasurably more difficult. Society has no means of doing so.

Something favouring the appearance of the placebo effect is the lack of criteria in present-day art.⁸⁸ There are also the commercial pressures driving creative people to 'create' more output. In different circumstances an author would have the resolve to burn what he had produced, but contractual obligations stop him; and since the border between art and non-art is fluid, authors allow themselves to transgress it.

The spectator/viewer/reader does his best to unearth significance where none was ever put, and this process of scrutiny and interpretation is an end in itself. Expectations are a kind of trampoline which propels even a puny gymnast in the right direction. It is not all that crucial where the initial impulse comes from. The author and the reader as his co-author are in a single harness as they move forward the burden of cultural communication; and if for any reason the former starts slacking, the latter is obliged to work harder. This can produce good results, since the process is less about transportation than spiritual effort.

⁸⁸In particular, Boris Groys notes the absence of criteria for judging whether something is or is not art: "When we turn to assessment and the criteria by which contemporary art is assessed, we find there are no criteria left other than the market price." Groys, "'Bol'shoi proekt' kak individual'naia otvetsvennost'" ["'The Grand Project' as Individual Responsibility"], p. 43.

Treatment using a placebo is the more effective if there is faith in the reputation of the doctor; in the cultural placebo the overall reputation, the ‘brand’, of culture itself is at work. It is generally believed that by becoming a parishioner of culture you are doing something positive for yourself.

Is the placebo effect harmful? It can be if it replaces genuine treatment, but even a placebo is probably better than nothing. Reliance on a cultural placebo results from an absence or ignorance of genuinely effective art ‘medicine’. For many, free time is burdensome and there is unfortunately no means of preserving it. This no-win situation produces a demand for cultural dishes which would otherwise have little prospect of making it on to the table.

Having paid their money people sit out a film purely because they have nothing better to do. In parallel, new ways of behaving become commonplace. A visit to the cinema is augmented with contingent activities: people play with their mobile telephones, munch crisps, walk about carrying trays of drinks. In short, they switch between the action on the screen and activities which enhance their enjoyment, thereby making a very rude gesture in the direction of the film-maker. If things continue in this way, buffet revenue will provide a more reliable measure of a cinema’s success than its takings at the box office. Those in the press who award films their asterisks will be able to check their assessment against the sales of popcorn.

The new modes of behaviour are hardening into stereotypes and being carried over to serious cinema, which is ceasing to be appreciated at all. The problem is not that dilute art is targeted at the less demanding consumer—that is perfectly legitimate. More worrying is that business sees the production of such output as its sole priority. More worrying still is that the audience itself is degenerating, which makes it increasingly risky to stake money on trying to produce anything different.

2.6.2.3 Price as a Guide in Fostering Good Taste

Placebos are sought after in inverse proportion to the availability of real medicine. It makes no difference whether there actually are none, or whether for some reason it is just very difficult to find them. The price system for digital works makes the search no easier, with a consequent worsening of the opportunities for developing good taste. In traditional culture, for example in fashion, prototypes are coded and ranked by a system of price and social mechanisms. Purchasers ascertain the quality of items from the price and from the circle of people who choose to wear them.

Striving to interpret these signs on how to dress, the beginner makes mistakes at first. He or she fails to understand all aspects and nuances of the system of coding. Over time, making one purchase after another and observing the choices of others, the consumer becomes expert. In the course of a systematic and in many ways rational process he develops better taste. Not every offering is accepted, only those which for some reason are judged preferable. Usually this stems from the desire for a particular look, measured against affordability. Thanks to differentiated prices and the availability of role models, good taste can be developed step by step and among friends. The tasks to be accomplished are not too easy or too difficult. They

are interesting and are accompanied by emotional reinforcement. The game of good taste is played in public to coherent rules. The items with which people surround themselves tell us about them, serving as indicators of their status and taste and as a touchstone for those around. We observe a variety of collaborative filtering in which the buyer has the benefit of seeing the preferences of people with whom he or she can identify. The hierarchy of quality goods is plainly visible. The link between quality, price and the status of their owners can be discerned without difficulty. Anybody wishing to can join in the game, and succeed in accordance with their diligence and financial resources.

Improving taste requires a carefully staged transition from simple to complex matters in what physicists call quantum transitions. In the digital segments there is no standard provision for training taste (by indicating success, controlling exposure to originality, providing clear guidelines and sequential stages). The only exception here is computer games, which are unique educative programmes which can adjust the complexity of the task to be resolved precisely and organically to the abilities and interests of each individual player. He himself regulates the rate of his advance from one level to the next, and this is basic to the popularity of these games. In most of the digital segments, however, consumers have no systems of this kind by which to regulate the rate or direction of their progress. 'Another's heart is a mystery', and you can only guess at the extent to which a work of art has been appreciated by a particular person, which rules out profiting from someone else's experience.

In order to develop taste, a system of guidance is needed, and this can be provided by prices and role models. If, however, prices are uninformative and the role models hidden from view, then examples suitable for evaluation by those at primary school and examples appropriate to university graduates get hopelessly mixed up. The result is that entry barriers to developing good taste are extremely high. To attempt to appreciate everything in the order it is presented to you is almost certainly to rush between some tasks which are excessively elementary and others far beyond the limits of one's understanding. In both cases the effort is being made with less than optimal efficiency.

In order to acquire the skill required for appreciating serious music, for example, the listener is going to need to invest considerable personal effort and to be systematically instructed. The bulk of consumers are 'incapable of adequately appreciating the music products created today. They merely hear noise. . .'⁸⁹ The higher the entry barriers to music, the narrower the circle of connoisseurs. Most people never progress beyond entry level, and their leisure time becomes an easy prey for sub-standard art.⁹⁰ Having repeatedly encountered insurmountable obstacles, the consumer loses interest in continuing his quest.

Lowering the entry barriers to high quality cultural consumption is something that would have a major impact on consumers' interests, and this is precisely what

⁸⁹A. Vargaftik, "Muzykal'nyi protsess" ["The Music Process"], p. 163.

⁹⁰The expression 'nobrow', designating 'the space between high and low culture', belongs to John Seabrook, *Nobrow: The Culture of Marketing, the Marketing of Culture*, NY: Knopf, 2000.

can be expected from a large-scale introduction of money-based collaborative filtering. By removing the scales of uniform prices from consumers' eyes, this method is capable of facilitating the development of good taste in both the physically mediated and the digital sectors.

Although the mechanism of collaborative filtering is based on people having similar tastes, there is no danger that it will average them out. Quite the opposite: through observing other people's preferences, the consumer will be able to identify kindred spirits and this will lead to differentiation of the public. Each participant will be able to decide for himself which taste community he fits into. Each act of consumption and his subsequent rating of it will advance his personal development of good taste. The whole system of cultural exchange will be put on a different intellectual level. Collaborative filtering will enable the consumer community to assume its rightful place in the market as an institution which indicates to creative artists what kind of product is expected of them.

2.6.3 *Overworking the Critics*

We have thus far been presenting the consumer, with his malleable taste tending to atrophy, as completely at the mercy of the businessman. We have, however, been keeping an important player in reserve: the critic or, in a broader sense, the institution which points out worthwhile works to the public. The figure of the art critic appears in the late eighteenth and early nineteenth centuries, called upon to legislate on taste and sit in judgement over the artist. Unlike philologists and art specialists, economists⁹¹ view the institution primarily as a provider of information to potential consumers, and see it as performing an essentially navigational function.⁹²

If the underlying cause of adverse selection is information asymmetry regarding the quality of works, any institutional activity tending to reduce that will help to counteract adverse selection. Expert institutions need to be recompensed for their service and accordingly, openly or covertly, they are susceptible to pressure from those who pay them: film-makers, distributors, advertising agencies, sponsors etc. Although consumers do not contribute directly to their upkeep, they are the target audience and, as the aims of the public are often at variance with the aims of the professional participants, the critics have to maintain a balance of interests. Their success can be judged by the extent to which they facilitate consumer navigation.

⁹¹The art or science of literary criticism compares, analyses, interprets and evaluates literary works. J.A. Cuddon, *Dictionary of Literary Terms and Literary Theory*, Penguin Books, 1991, p. 207.

⁹²The first collections of articles on cultural economics, edited by Throsby and Withers, had no articles about the part played by criticism in the consumption of works of culture and art. See C. David Throsby and Glenn A. Withers, eds., *The Economics of the Performing Arts*, London: Edward Arnold, 1979; and Harry H. Kelejian and William J. Lawrence, *Estimating the Demand for Broadway Theater: A Preliminary Inquiry*, in William S. Hendon et al., *Economic Policy for the Arts*, Abt Books, Cambridge, 1980, pp. 333–346.

Rating and attestation of works makes use of different technologies and the institutions differ in the extent to which they can be automated and how the manpower is allocated. We can identify three kinds of rating institution: individual experts (critics); collective institutions like prizes and competitions; and rating systems. The first group independently select and review items. A significant proportion of the available information is processed by critics who are a kind of intellectual labourer. No doubt they cooperate with each other and make full use of contiguous institutions like reputable publishing houses, festivals, ratings, and box-office information. Even so, the expert is faced with an enormous amount of reading. A literary critic writing a weekly column will need to check out some twenty books in order to select two or three for review, which must place a severe strain on his intellectual digestive system. Over time there is a danger he will get bogged down in routine and come to resemble a mere information bureau on the current repertoire. It is no easy task to know more than the titles of thousands upon thousands of songs, books and films.

The sheer drudgery would be immeasurably greater if the art community did not operate a system of mutual alerts, which is a pre-digital form of collaborative filtering. As a result, in nine cases out of ten the professionals knows in advance what to focus their attention on.

The second form of attestation comes from competitions, festivals, biennales, tournaments, literary prizes and so on. These sift out the most interesting artists and work on a collaborative basis and their work is in some ways more comprehensive. The judges, like the critics, have to 'manually' examine everything entered for the competition. Some rationalisation is possible by having the material systematically pre-selected, for example by regional commissions.

The work of rating systems which generate information about quality is automated. It includes rankings, charts, billboards, and statistical sources where data is collected and processed automatically. The primary assessments come from consumers themselves, or from carefully balanced focus groups. Among these providers of information on quality we should no doubt include bookmakers, ticket touts and pirates, although this is a side product of their main business.

2.6.4 The Cost Disease of Manually Attesting Art

2.6.4.1 Consumer Navigation and the Role of the Critic

The usefulness of expert institutions for the consumer depends primarily on the quality of their recommendations. Does their trawl net the best works, is their advice accurate and relevant? These questions are considered by Eliasberg and Shugan on the example of film criticism. They ask whether critics influence a film's box-office success or merely predict it. This is not an idle question, particular for film distributors. Representatives of the film industry need to adjust their marketing plans depending on what they can expect from the critics: a cold shower or a building-up of expectations, help with promoting the film or nothing at all. If critics are

influencing consumers, they need to be cosseted, if not there is no point in wasting money on them. Their only real use in the latter case would be as a source of advice during the making of the film.

Eliasberg and Shugan claim to have found a novel approach which makes it possible to give an answer to this question on the basis of empirical evidence. If critics are exerting influence, this should be particularly evident from box-office takings when screenings first begin, since at that moment the grapevine among cinema-goers has had no time to start working.⁹³ Accordingly, rather than confine themselves to consideration of total box-office revenue as is customary, Eliasberg and Shugan analyse the dynamics of a film's takings. Comparing weekly ticket sales data with the volume and content of reviews,⁹⁴ they reach the unexpected conclusion that the effect of what the critics say on initial box-office takings is statistically insignificant: the critic is a weak motivator for getting people to go and watch a film. On the other hand, he is a good predictor, since reviews are found to correlate quite well with later and total box-office revenues.⁹⁵ If the conclusion of Eliasberg and Shugan is correct, are film-goers ignoring their writings when deciding what to see? Certainly, not everyone reads reviews. Surveys have shown they rank tenth with students and other young people (on whom the film industry relies to make its money) in influencing choice. The most important influence on them is the film's trailer,⁹⁶ and as we shall see, there are good grounds for taking critics' opinions with a pinch of salt. Boris Groys has noted in a slightly different connection that after a long history of revolutions and abrupt changes of direction in art the public has concluded that it is immaterial whether a review is positive or negative. A negative review may even be a better recommendation. Today's reader takes note only of which artists are mentioned, where, and at what length. This tells him how important the artist is, and he discards the rest.⁹⁷

There is of course an elite band of consumers well able to read between the lines of a review, but their reactions have yet to be studied. Researchers question whether negative reviews diminish interest in a film. The role of positive reviews is unfortunately also open to doubt.⁹⁸ In certain sectors and in particular cases, critics can, however, make a great deal of difference. It is claimed that a negative review by

⁹³Michael H. Burzynski and Dewey J. Bayer, "The Effect of Positive and Negative Prior Information on Motion Picture Appreciation", *Journal of Social Psychology*, 1977, pp. 101, 215–218.

⁹⁴The authors compiled a database which included indicators of box-office revenue for films in 1991–1992 and showed the percentages due to distributors, the number of cinema auditoria in which they were screened, and analysed the information by the week.

⁹⁵Myron Buor shows that the assessment of films by critics and cinema-goers correlates well, in his article, "Reliability of Ratings of Movies by Professional Movie Critics", *Psychological Reports*, vol. 67, August 1990, pp. 243–257.

⁹⁶Catherine Levene, "Marketing Art-Films to College Students", Working Paper, The Wharton School, University of Pennsylvania, 1992.

⁹⁷Boris Groys, "Kommentarii k iskusstvu", p. 19.

⁹⁸Robert O. Wyatt and David P. Badger, "How Reviews Affect Interest In and Evaluation of Films", *Journalism Quarterly*, vol. 61, No. 4, Winter 1984, pp. 874–878. They later revised their conclusion, having discovered that an informative review stimulates more interest in a film than does a

a respected critic can be fatal for a Broadway production.⁹⁹ It is, however, virtually impossible to torpedo a blockbuster like *Terminator*.¹⁰⁰

The minor influence of experts can, of course, be partly explained by instrumental causes: it can be difficult to lay your hands on a review by a critic you trust just when you need it.

Despite all this, the media hire hacks to keep tabs on films and review new releases, hence the myth of the omnipotent critic whose hold over his readers affects success at the box office. Film-makers scare each other with tales of films brought low by negative reviews. The promotion campaign for *Sleep With Me* is said to have collapsed as the result of a malevolent press. The fear of negative reviews can seem almost to lead promoters to regard the critics as a more important marketing target than cinema-goers. The techniques for sweetening them up were devised long ago. Some are invited to previews, introduced to the stars and mentioned in advertising. Attempts are made to neutralise ill-disposed hacks.

Eliasberg and Shugan¹⁰¹ question the effectiveness of this engineering of positive reviews. They accord critics a role as indicators of consumer reaction but deny them any great impact on box-office takings. The experts can predict success, but not make it happen. If a review can assuredly exert some influence, the choice of which film to see is affected mainly by the buzz surrounding it: the trailer, the advertising, and word of mouth. Cinema-goers pay scant attention to what the critics say, so spending good money in the pursuit of laudatory reviews is little more intelligent than bribing the Meteorological Office in order to improve the weather forecast. This is not to deny that consumers of culture have an interest in the weather forecast.

Critics in the media try to adapt their reviews to the tastes of their readers so that the latter should find them interesting to read. If they fail they will have no option but to seek a different audience in a different media outlet. Accordingly, a consumer intending to rely on a journalist's recommendation needs to know who the critic is writing for. If his review is intended for adolescents, an older film-goer is unlikely to understand the language. The same is true of specialist publications. This is perhaps why so few people read reviews as a guide to action.

Criticism is, of course, not only of value as a navigational aid. A review is often a work of art in its own right, and not infrequently more interesting than the work

positive one. Robert O. Wyatt and David P. Badger, "Effects of Information and Evaluation in Film Criticism", *Journalism Quarterly*, vol. 67, summer 1990, pp. 359–368.

⁹⁹Although credible, this theory has yet to be confirmed convincingly. See Samuel Cameron, "On the Role of Critics in the Culture Industry", *Journal of Cultural Economics*, vol. 19, 1995, pp. 321–331.

¹⁰⁰The results of the "Cinema" experiment conducted by the Pragmatics of Culture Foundation indicated that cinema-goers did not like *Terminator 3*, even though these were in the main enthusiasts of the genre. The average monetary assessment of participants in the experiment was 16.21 roubles [32 pence]. Reviews were also lukewarm, but the film was a box-office success. Revenue from screenings in Russia was \$12.2 million, and in terms of the box-office takings it was the fifth most successful film in the history of the cinema in Russia (as of late 2005).

¹⁰¹Jehoshua Eliasberg and Steven M. Shugan, "Film Critics: Influencers or Predictors?" *Journal of Marketing*, vol. 61, No. 2, April 1997, pp. 68–78.

under review. This second function of criticism is to extend and deepen the lines of communication. Criticism in this sense encompasses the whole spectrum of comment on a work, analysing it, placing it in context, and possibly using it as a peg for expounding the critic's own artistic or socio-critical views. This function, which the philosopher Merab Mamardashvili calls a broadening of the act of reading,¹⁰² lies outside the boundaries of our analysis.¹⁰³

Modern criticism is trying to develop into an autonomous art form, so is it any wonder if surveys indicate that people rarely rely on reviews as a means of navigation? They are more likely to read them purely for pleasure. Such a critic needs to write more interestingly and strikingly than the work which is the subject of his review, but the sheer volume of artistic material he has to process works against the honing of every phrase. The critic has to choose between the roles of a former or a predictor of opinion. Most genuinely professional critics have a clear picture of the tastes and preferences of their readership, and hence are able to accurately predict the commercial future of a film. In the eyes of their readers they acquire a reputation similar to that of a supermarket which, targeting a particular category of consumers, does not sell items which fall below a certain level of quality. Nor, it has to be said, which rise above it.

2.6.4.2 Where Do Critics Find Pure Water?

I have been persuaded in the course of my "Theatron" and "Cinema" experiments that it is in fact possible to predict cinema-goers' reactions.¹⁰⁴ In order to carry out the experiments I needed a spectrum of films so as to obtain polar assessments: outstanding successes, dismal flops, controversial films, and films which were neither flesh nor fowl. This made it possible to identify possible types of reactions of cinema-goers, from 'a total disappointment', when a participant, as agreed under the conditions of the project, decided to take back the money paid for the ticket, to 'absolutely fantastic' where he voluntarily paid a supplement out of his own pocket. In order to select the necessary range of films, it was necessary to try to anticipate the audience's reaction¹⁰⁵ by studying between five and ten reviews of each film. Additionally, data was collected on box-office takings over the first weekend, and average ratings of the films were compiled. The ratings of critics and consumers

¹⁰²Merab Mamardashvili, "Literaturnaia kritika kak akt chteniia" ["Literary Criticism As an Act of Reading"], in M. Mamardashvili, *Kak ia ponimaiu filosofiui* [How I Understand Philosophy], Moscow, 1990, p. 161.

¹⁰³He also says that criticism is always a form of elucidation. This raises the question of what kinds of commercial pressure there are on the critic. The market does not always see elucidation as being in its interests.

¹⁰⁴For more detail see Appendix 4.

¹⁰⁵The aim of the experiments was to test the present book's central hypothesis of the feasibility of using voluntary additional payment by spectators as a means of registering their ratings.

generally coincided quite closely, as Wanderer, for example, also found.¹⁰⁶ As the experiments were conducted in actual cinemas, there could be problems in finding films of the requisite character.¹⁰⁷

One minor disaster occurred when we urgently needed an unambiguously bad film. We were confident this would not present any difficulty. *Dirty Pretty Things* and another film with an equally off-putting title had just been released. There was no time to check the press in advance, and we put our trust in the title. How great was our consternation when it transpired during the showing that the 'pretty things' were not at all what the cinema-goers or the organisers of the experiment had assumed. They were much more dire, and the film itself was outstandingly good.¹⁰⁸

Apart from that one glitch, however, our choice of films, based mainly on reviews, proved fairly accurate. Preliminary navigation required approximately one quarter of an hour collecting reviews on the film, and up to a further half hour reading them. There would seem to be no good reason why anybody going to the cinema would not do the same, but as far as we know, with rare exceptions, nobody does. Why?

Having to spend half an hour preparing for a visit to the cinema strikes most people as bothersome. Even if we classify and price such navigational work as unskilled, the cost is close to the price of a cinema ticket. Interpreting reviews is in fact skilled work, particularly in the case of a film on general release, or nominated for a prestigious prize, or made by a cult director. Critics cannot ignore such events and they all write reviews. One can find information in any newspaper, but the impression of easy navigation in cases like this is deceptive. When the stakes are high, reviewers are particularly evasive in their judgements. Even if they are sincere (i.e., not cutting their suit according to someone else's cloth), the film industry, having mounted a massive advertising campaign, is going to make this particular film a major event. By the very fact of writing a review, which flows into an already mighty flood of publicity, the critic misleads the consumer.

An example is *Aviator*, to which, to their eternal merit, the academicians did not award a dozen Oscars (although it was nominated), but which is, in my opinion a weak, boring film in many respects. Or Tarantino's *Kill Bill* diology, about which the critics were very forbearing in their reviews. Nobody so much as hinted they might be thinking the Tarantino brand was overrated. In expressing here my purely personal opinions, I make not the slightest claim to be professing absolute truth, beyond suggesting that these are demonstrations of navigational failure.

The critics not only camouflage failure, if only because the fact of a review is more important than what it says, they also obstruct works deserving of attention.

¹⁰⁶Jules J. Wanderer, "In Defense of Popular Taste: Film Ratings Among Professionals and Lay Audiences", *American Journal of Sociology*, vol. 76, September 1978, pp. 262–272.

¹⁰⁷Particularly in July, when the release of good films is held back because of the holiday period.

¹⁰⁸Film information: budget \$10 million, overall takings throughout the world \$13,904,766. Russian cinema-goers were evidently disappointed not to find the film living up to its title and did not rate it highly. The average monetary rating by participants in the experiment was 1.88 roubles [37 pence]. See the Diagram in Appendix 4.

Works of high quality but with no pretensions to stylistic innovation are particularly vulnerable. The critics have already seen and dissected everything many times before. They remember in the minutest detail who pioneered what, when, and in which film, and long for something new, which for them and for the creative artists, becomes ever more unattainable. Conscious of the dangers of carping, the experts, in order to maintain a balance, note something good. The end result is rather like a horoscope from which everyone can read whatever they want. One has to sympathise with the critics: it is impossible to absorb so much material and survive without armour plating. Wine-tasters do not drink much wine, but when they do in the course of duty, they rinse their mouths with pure water to restore their palate.¹⁰⁹ Where are film critics to find their pure water? Perhaps they read Shakespeare.

Vladimir Sorokin has accused critics of being turned off by life, worn out by literature. He is not entirely fair, but his philippic deserves to be repeated here: ‘Some sensitive writers have a vague belief that critics have a third eye which in the text of a novel boldly espies something hidden from ordinary mortals. The writers’ tetchiness leads philologists and critics themselves to believe that this third eye really exist, and that with it they can see things hidden from the writer and the uninitiated reader. [...] I merely wish to ask whether philologists do in fact have a third eye. My own view is that they do not. Indeed, I do not believe they have even the two eyes possessed by the ordinary reader who is not burdened with the status of a professional devotee of the written word. The trouble with philologists is simply that they evaluate books with the aid of dozens and hundreds of other books they have read. They have no other means of assessing literature. Accordingly, I suggest that philologists have in fact only one eye, entirely literary and capable only of comparing texts. The second eye, which sees real life, has for the majority of literary specialists been gradually dulled by a glaucous textual membrane, its thickness directly proportional to the number of books they have read. Philologists’ heads are crammed full of books. They see life only through texts, and are proud of the fact. Having gorged themselves on literature, and been poisoned by it, they see real life as a continuation of literary texts, as an appendage to them.’¹¹⁰

Perhaps it is unfair to deny all literary experts the ability to see real life, but it is a fact that critics are obliged to put on spectacles with the same dioptré as their readers. Wearing somebody else’s glasses is, as we know, bad for your eyesight. For this to be avoided, they need to possess remarkable common sense and knowledge of life, since there is no other way for them to know what people are interested in. The important thing, however, is for them not to forget now and again to take their glasses off.

¹⁰⁹An impressive number of wines are tasted during such sessions: more than 100 if our information is correct. Wine-tasters appear to have an easier task than critics, since they are not expected to drink the whole bottle. There are persistent rumours that critics themselves sometimes only take a quick gulp.

¹¹⁰Vladimir Sorokin, “Mea culpa?”, *Ex Libris NG*, on-line, 14 April 2005. Cited 22 April 2006, available from URL: http://exlibris.ng.ru/tendenc/2005-04-14/5_culpa.html.

2.6.4.3 Collective Professional Assessment

Authoritative institutions in which decisions are arrived at by committees—competitions, festivals, prizes and the like—issue not critical reviews but rankings and hierarchies. How effectively do they do this? Glejser and Heyndels have sought the answer in the Belgian archives of the Queen Elisabeth Music Competition, a paragon of impartiality from the point of view of lack of prejudice and the neutralising of extraneous circumstances.¹¹¹ After studying the results of the competition for the piano and 'cello for the years 1956 to 1999, the researchers conclude that the final ranking of the performers is far from objective. They find that musicians who happened to perform later, both later in the day and later in the competition, had an overall advantage and obtained more favourable assessments. Performers of new compositions were viewed more favourably by the jury than those who chose well-known pieces. They thereby empirically confirm the banal but pertinent truth that experts too are human. They get tired and may, as a result, overlook slips in execution, or scrutinise technical virtuosity less closely as a result of lapses of attention. This may be the explanation of their greater leniency towards later performers, although no doubt fatigue also increases irritability. Doubtless, too, experts get tired of listening to the same thing over and over again.

The patterns Glejser and Heyndels detect are perhaps not the most worrying aspect of collaborative selection. More troublesome is extraneous influence which jeopardises the judges' independence and impartiality. It is clear that, to be effective, judges must be incorruptible and immune to pressure from the artistic community but, as Douglass C. North, a specialist in institutional economics who won the Nobel Prize in 1993, assures us, institutions are not atoms, or to put it more bluntly, not without their own agendas. The judges' decisions have a direct impact on the success or failure of business, political or artistic projects, so there is no reason to doubt that ulterior motives are in play. Even by selecting a shortlist the assessors are advertising those selected, much as a critic does merely by writing a review. The judges are similarly operating like an agent within the artistic community.

It is, in any case, impossible to be completely objective: even members of a panel of judges are human and likely to be swayed, not so much by mercenary, as by ordinary social motives. The art expert is not only a member of a professional community but also the inhabitant of a small world full of mutual obligations and

¹¹¹Herbert Glejser and Bruno Heyndels, "Efficiency and Inefficiency in the Ranking in Competitions: the Case of the Queen Elisabeth Music Contest", *Journal of Cultural Economics*, vol. 25 (2), 2001, pp. 109–129. This competition is considered one of the most difficult and prestigious in the world. A panel of some 15 leading international experts is the mainstay of its reputation. The competition was first held in 1951 to select the best twelve musicians in various fields. It consists of three rounds and the registration fee is modest (€55 in 1999). The order in which participants perform is determined by drawing lots and remains the same throughout the heats. The judges assess the performances on a scale of 50 to 100, and the points are totalled to determine each candidate's final rating. The judges are not allowed to confer about their assessments. If any of them award points which deviate by more than 20 percent from the average they are ignored. Participants have to present an extremely difficult programme. They spend about five weeks in Brussels and must also prepare a previously unpublished composition for performance in a single week.

politics. He has opponents it is best not to anger over minor matters, he has friends it would be strange for him to upset, he has the proteges of friends and other interests to consider. These are people he has known for many years and accordingly, if somebody is not quite up to the mark, it may be better to say nothing, and even to give a helping hand along the way. In a court of law nobody is expected to testify against their own family, and by analogy that should not be expected of an expert. It is worth noting that statistically the majority of reviews are not negative. It is impossible to discount the circumstances of the critic's personal life, because they are woven into the cultural fabric. Bonding within the professional community inevitably leads to mutually favourable reviews. Whether that is a good or a bad thing, it is inevitable because the strong links within a close circle outweigh the weak and depersonalised links with a more remote circle. If the interests of the consumer are pushed to one side, is that not only to be expected?

In any voting procedure there are loopholes which make possible the advancing of particular interests. From the perspective of institutional economics critics are economic players pursuing their own aims. What mitigates the uncharitableness of this view is its universality: economics regards everybody as agents acting to their own advantage and giving no thought to the welfare of society. Accordingly, if we want to believe that markets are progressive, rules are needed to ensure they work to the benefit of all. In cases where this proves impossible we are faced with market failure. It is important to be able to tell the difference between a situation where good rules have not yet been introduced and one where to do so is fundamentally impossible.

No matter how self-interested the experts may be, it is in their own interests to strike a balance between financial gain and reputation, since future earnings are conditional upon retaining their reputation. It does, of course, happen that a reputation is bought, and great efforts are then made to keep the deal secret. Institutions often are created with the intention that they should subsequently regulate the distribution of goods and earn income (so-called revenue-orientated behaviour). Thus, sports referees have been known to raise all manner of objections and to lower the score of challengers who threaten their favourites. Similar examples can be found not only in the arts but throughout the leisure and entertainment markets. Lavishly funded forms of sport appear to be particularly susceptible: European football has been shaken by investigations into alleged match-fixing.

In early 2005 Robert Hoyzer was arrested for taking money to deliver the result required by bookmakers in matches he was refereeing.¹¹² He let this slip to two colleagues, who informed on him to the German Football Union. Hoyzer confessed his guilt and admitted that on 21 August he had unfairly refereed a match in which Hamburg SV had been leading SC Paderborn 2:0, only to lose unexpectedly 2:4. In the middle of the match Hamburg had a player sent off, and two penalties were awarded against them. Under questioning, Hoyzer admitted seventeen matches had

¹¹²A. Zhuk, "Hamburg zaplatiat €2 milliona za proigrannyi match" ["Hamburg to Be Paid 2 Million Euros for a Match It Lost"], *Kommersant*, 14 February 2005. Available from URL: <http://www.kommersant.ru/doc.html?DocID=547102&IssueId=23326>.

been fixed in the first and second German leagues, and implicated other referees, football players and officials. More than twenty individuals found themselves under suspicion.

This example can be generalised beyond German football,¹¹³ and indeed beyond sport in general. Any judge will be aware of economic pressures and may succumb to human weakness even if he does not actually do anything provably illegal. There was a very public scandal over less than objective refereeing in the Olympic Games in Athens, where politicians were openly demanding favourable results. Even the most technically regulated sport where everything would appear to depend on the measurement of fractions of a second or centimetre, there is still room for unfairness. Penalties for technical infringements of the regulations can be imposed or not at the discretion of judges. This applies particularly to individual performance sports, and especially to artistic sports like gymnastics and figure-skating. Here the favouritism is built in when the criteria are decided, and an important element of the competition takes place not in front of the public but among the judges for the right to award points in accordance with their own criteria. Much scope for arbitrariness comes when the weighting of points for artistic merit, novelty and complexity is negotiated. If the judges confine themselves strictly to technique and do not encourage innovation, many sports will cease to develop and become uninteresting. If complexity is given too much weight there are other dangers. One of the competitors may have learnt an exceptionally complex routine and simply be unstoppable, even if by other criteria and on overall impression he is not the best. Lobbying for exceptional weight to be given to complexity can create an artificial advantage.

Such plotting appears to go on in artistic gymnastics. Russian sportswomen focus their efforts on unprecedentedly complex pirouettes, and the principal coach lobbies for this to carry premium points. The criteria of assessment, like any major element in the rules, determine the nature of the sport. Many amateur boxing enthusiasts felt the sport was ruined when a mechanical totting up of the number of punches landed became the main determinant of the result. This criterion has something in common with the role of box-office revenue in culture: there can be a lot of contact without there anything of interest to the spectator.

Examples of biased refereeing or over-emphasised criteria, while dangerous for sport, are less than catastrophic. People play sports and will continue to do so. Fans turn up to watch them, and are not about to stop. Some degree of unfairness in the refereeing is accepted as inevitable, and even adds spice to the contest. The rot can be kept under control. Sport accepts that obvious cases of corruption are discovered and dealt with, both by officials and by the fans. Luckily sport is very public. If the officials did not react, popular anger would sweep away the organisers of a dishonest competition and, if need be, the entire federation governing the sport and all its business interests. It is clear enough why, when Hamburg demanded a revision of the result of its match with Paderborn, the Bundesliga refused, not wishing to

¹¹³In summer 2006 Italian football was shaken by major match-fixing scandals, resulting in a criminal investigation.

create a dangerous precedent. Nevertheless, in order to bring the scandal to a close, it awarded them compensation of €2 million.

The more blurred the criteria of judgement, the more difficult it is to detect corruption and keep it within bounds. Biased judging by an art critic on the panel of a prize is not as easily identifiable as in sport, but devalues the competition nonetheless. Since by definition there are no clear rules in art, nobody can be caught red-handed and disqualified like a football referee who awards an unfair penalty.

But if some degree of corruption is probably unavoidable, for the time being it is not out of hand in the cultural community. Even so, the judges have the same questions to answer as the individual critic writing his review. What are the criteria by which they are judging, who are their judgements addressed to? If the individual critic has to bear the overall interests of his readership in mind, the same problem is even more acute for a panel of judges. Assessment by committee, the very concept of a balanced representation of group interests, creates the conditions for cautious, middle-of-the-road decisions. An international panel may have members following conflicting state policies or acting as protagonists of conflicting artistic schools, leading to contradictory criteria; finally, the members may be of differing ages and have quite a different understanding of the spirit of the times. Unless a dominant coalition is present in the way the panel of judges is initially set up, it is likely that only very average, compromise works will have any chance of winning. Radical, uneven, edgy works will not get a look in. It is difficult to obtain a balanced panel of judges.

For all their faults, competitions do assist consumer navigation. Film festival prizes are a reasonably reliable signal that a film will be worth watching, even if the judges are sometimes unduly impressed by advertising and marketing budgets; the US Academy of Motion Picture Arts and Sciences is considered to be guilty of this when awarding the Oscars. As Ginsburgh and Weyers have established, of 174 films which won or were nominated for awards between 1950 and 1970, only 47 appear in a list of 122 films subsequently regarded as the best of all time.¹¹⁴ This

¹¹⁴Quality assessments are taken from lists of the ‘best films of all time’: two international and three of the best-known national lists of Great Britain, the USA and Germany:

- Cinémathèque Municipale du Luxembourg (1995)—a list of 100 films based on the judgement of 100 key figures of world cinema;
- Fédération International des Archives du Film (FIAF, 1995): a list of favourite films drawn up by 37 film archives in 29 countries. They were asked to choose as many films as they liked which, in their opinion, were the best films in the world.

The three national lists were:

- Barry Norman, *100 Best Films of the Century*, London: Chapman’s, 1992;
- *Movie Guide: Critics Picks: 100 Best Movies of All Time*, 1997. One hundred films chosen by American cinema critics;
- Th. Koelsner, ed., *Filmklassiker*, vol. 1–4, P. Reclam jun., Stuttgart, 1995. Volumes 2 and 3 have been used during the present research. Films selected by a group of German experts.

Consumer opinion was gauged from data on box-office takings and television broadcasts. See Victor Ginsburgh and Sheila Weyers, “On the Perceived Quality of Movies”, *Journal of Cultural Economics*, vol. 23 (4), 1999, pp. 269–283.

could be due to the fact that recent films squeeze out older ones, but that would not explain why 75 of the 122 received no awards or were not even nominated. On this basis Ginsburgh and Weyers damningly conclude that the judges in Cannes and Hollywood are 'shortsighted and unselective'.¹¹⁵ The reproach is of course made from the standpoint of high art and may not reflect consumer perceptions.

Whatever the failings of the judges of films, navigation in this segment is relatively satisfactory because the number of films aspiring to aesthetic excellence and eligible for such competitions is relatively few, and they are all large-scale projects. The ability of the industry to produce films and the capacity of experts to assess them are commensurable. It is not impossible for those working in films to select a few dozen films out of a couple of hundred more or less significant works. The remaining output of almost 6,000 films aim not to shine in competitions but only to part the cinema-goer from his cash. Endorsement by a festival is economically worth while because the output of suitable cinematographic products and their market value are sufficient to cover the costs of assessment. If, however, there were a hundred times more films and they brought in considerably less money, there would not be the resources for expensive judging and its quality would fall. We see this in award ceremonies in the music and publishing industries, which are less effective and attract less public attention. Nevertheless, the Grammy Awards ceremony is watched by billions of television viewers,¹¹⁶ and the MTV Europe Music Awards are sufficiently well known¹¹⁷ to be called the 'music Oscars', albeit with the addition of a caustic 'for housewives'.

Without wishing to belittle the role of critics, we must repeat that it is beyond their analytical capacity to cope with the sheer volume of present-day cultural production. To paraphrase what Baumol said about the cost disease¹¹⁸ in the performance segment, a similar diagnosis can be made of the mass-market culture industries. They have succumbed to the disease of the increasing cost of manual attestation of art. New releases come with increasing rapidity, while ranking them continues in the old way. This results in a straightforward overloading of the critics and a clogging of filters. In an attempt to deal with the situation, critical institutions proliferate and redouble their efforts,¹¹⁹ but this in turn creates new problems:

¹¹⁵In the opinion of the authors, the quality assessments made during the Cannes Festival and, to a lesser degree, by the US Academy, are 'short-lasting'. Ginsburgh and Weyers, "On the Perceived Quality of Movies".

¹¹⁶The 'Grammies' is an annual music prize awarded by the American Recording Academy, one of the most prestigious in the world. It was founded in Los Angeles in 1957.

¹¹⁷MTV is a television station created in 1981 for round-the-clock broadcasting of music videos. It destroyed the monopoly of radio in the music industry. The MTV Europe Music Awards were held for the first time in 1994. For a number of nominations the awards are made by a European 'MTV Academy', a panel consisting of approximately 1,000 people which includes major figures in the European music industry and MTV viewers from the whole of Europe. For other nominations the winners are chosen only by viewers.

¹¹⁸A term introduced by William Baumol in Baumol and Bowen, *Performing Arts: the Economic Dilemma*.

¹¹⁹The judges of the British Booker Prize recently asked the organisers' permission not to read all the texts in full because of the difficulty of assimilating such quantities of text. This has led

how are critics to maintain the quality of their judgements, how are consumers to find critics suited to their tastes, and how are they to know what may lie behind the pronouncements of a panel of judges? Proliferation of institutions is no solution, and it is in any case a simple matter to render their efforts at filtration ineffective, for example by shamelessly manufacturing awards for one's product from fictitious institutions or by using titles misleadingly. A typical bluff is to print on a video-cassette 'New Zealand' (in small print) 'Oscar' (in large print),¹²⁰ to obfuscate the distinction between nominees and winners, or to seduce the would-be buyer with the number of awards without mentioning the types of nomination. In other words, trying to deceive the customer by brand mimicry.

The critics, of course, deny there is any such cost disease. For them being overburdened is just part of the territory, something to which they have to adapt. The result, however, is that much that is of value but which the experts have had no time to identify is thrown out with the bathwater and pours down on the consumer's head along with everything else. The latter seems to accept this situation with the kind of stoical resignation appropriate to a natural phenomenon.

2.6.4.4 Ratings

The third form of attestation relies on the rating efforts of consumers themselves and includes charts of sales statistics, constantly renewed lists of the most popular media products (the Ten Most Popular Albums, the Five Most Popular Software Programs, the 100 Best Discs, and so on). The fundamental difference is that here the information is being provided not by professionals but by the public, and is for the most part gathered automatically. The ratings are usually sales based and, accordingly, tell us more about the fact of consumption than about the rating by consumers of their purchase. However doubtful the navigational utility of the data, consumers actively make use of them. Despite their obvious disadvantages,¹²¹ such chart ratings are accessible and provide a quick-fire way of organising one's leisure. The mechanism is highly productive and there is no danger here of a cost disease.

Unfortunately, the simplicity and democratic nature of such ratings is deceptive. Their main users are not the public, but the professional players.¹²² Performers and

to a tendency to limit the long list of submissions for the prize. In the "Booker-Open Russia" competition in 2004, 39 works were admitted to the long list, but in 2005 only 22.

¹²⁰The 'New Zealand Oscar' is the name given to a prize awarded by the Academy of Film and Television Arts of New Zealand. The procedure for the award copies the American version, hence the title. The prize is awarded to approximately one of fifteen nominated feature films, and one of fourteen nominated short films. There are also about 20 nominations for television. In 2003–2004 the prize was not awarded, after which the ceremony was revived under the title of the New Zealand Screen Awards. In 2006 the name of the main sponsor was added and the prize became the Air New Zealand Screen Awards.

¹²¹One of the alternative ways of establishing popularity is through polling, but here representativeness is often not great. A random selection of the more responsive consumers gets surveyed.

¹²²See, for example, Eric A. Strobl and Clive Tucker, "The Dynamics of Chart Success in the U.K.," *Journal of Cultural Economics*, vol. 24 (2), 2000, pp. 113–134.

sound recording studios are desperate to get into the hit parade, because this has a direct bearing on their income.¹²³ Those who use the charts are much more interested in what is right at the top, and manufacturers compete fiercely for the top 20–30 slots. Celebrities are anxious not only about their current position, but also about moves from week to week. Moving up or down one point may make a greater impression than the absolute position in the chart itself. This produces an interest in discreet manipulation of the ratings. Suppose that albums in adjacent slots have a slight divergence in their sales. The fact that one of them has moved up produces a bandwagon effect on purchases,¹²⁴ which increase at disproportionate speed. This is why it is important to go in close to the top, and in order to achieve this all manner of means can be employed, not excluding buying up your own recording. In just the same way, it is advantageous for writers to exaggerate demand for their works in the Amazon portal. There is no proof that writers are guilty of this, but we certainly do know that ratings are systematically inflated.

A group of companies headed by the retailer, Lane's Gifts & Collectibles, brought a lawsuit against a number of Internet companies in February 2005, including Google and Yahoo, accusing them of knowingly overcharging some of their advertisers and of conspiring with each other to continue to do so.¹²⁵ The defendants were accused of ratcheting up the number of clicks on advertising links.¹²⁶ Advertisers were paying around fifty cents for each click and some of their competitors employed staff using special programs to increase the number of clicks and increase their competitor's advertising bill. The Internet companies were accused of knowing of the problem but doing nothing about it, and pocketing the revenue from the false clicks. Since sales of advertising are the main source of the defendants' revenue, and even more importantly, fundamental to the stock market's assessment of the capital value of the search engines in the event of their being sold, it would perhaps not have been surprising if the Internet companies were reluctant to put a stop to this mechanised clicking. To do so would mean writing off a large proportion of sales enquiries and oblige them to return money overpaid by the advertisers. This, however, is just what they were obliged to do. A British company, Speedy Registrations, which sells personalised number plates to motorists, became concerned when the number of clicks on its banners in the Overture search engine trebled with no concomitant increase in sales. They managed to prove this was the result of fraud and had \$5,000 refunded. In general, however, the search engine companies refuse to provide information about abuse, claiming the need to preserve confidentiality.

¹²³Performers are interested in the charts not least because their contracts provide for a royalty on the volume of sales.

¹²⁴The bandwagon effect is widely referred to in the economic theory of stardom. See Moshe Adler, "Stardom and Talent", *The American Economic Review*, vol. 75, No. 1, 1985, pp. 208–212.

¹²⁵Kevin J. Delaney, "Internet Firms Face Legal Test on Advertising Fees", *The Wall Street Journal*, 5 April 2005.

¹²⁶In addition to Google and Yahoo, the writ also names Time Warner and its America Online unit, Walt Disney Co's online unit, and the search engines AskJeeves, Lycos, FindWhat.com and LookSmart.

The research company Alchemist Media calculates that false clicks could account for as much as 20 percent of clicks on search ads. To believe in the reality of these scams you don't need to catch anybody red-handed. Since the motive is plainly there, we may be sure that opportunities will always be sought to implement them. Insiders often admit in private that machinations occur wherever they are possible and economically advantageous. Is there really no similarity between feting critics at a buffet supper and employing people to click a mouse?

In order to prevent malpractice, supervisory bodies are created, like The Official UK Charts Company in Britain.¹²⁷ This serves the interests of the music industry, as they are understood, needless to say, by those at the helm. A code of practice has been established with the aim of preventing a particular single or album from receiving an unfair advantage. A product of non-standard format will not be allowed into the official charts. The most popular and typical music chart is the 'Hot 100', published in the journal *Billboard*.¹²⁸ Data is automatically received from shops selling recordings,¹²⁹ and published each week by the magazine. It takes account of regional variations, since what is popular in New York may be less in demand in the mid-West. Curiously, the technique by which chart position is established is kept secret.

In 1958 *Billboard* brought together (using a secret technique) the data from retail sales and radio broadcasts, and the Hot 100 became the top weekly chart for the songs of America.¹³⁰ It would be difficult to overstate its influence within the music

¹²⁷The Official UK Charts Company is an institution formed by the British Phonographic Industry and Entertainment Retailers Association which commissions, markets, distributes and manages the UK's official music and video charts in order to ensure objectivity and accurate rating of popularity. Sales data is received from 5,600 retailers, including all the major commercial chains and 600 independent shops, comprising 99 percent of the singles market, 95 percent of the albums market, and 80 percent of the video market. The rules regulate the format (the number of tracks in a single or album, how long they last, and how they are packaged). Information from the site of The Official UK Charts Company.

¹²⁸*Billboard* is today the world's most authoritative professional journal covering the music and entertainment industry. It was founded in 1896 in Ohio, USA and initially specialised in information about agricultural fairs, shows etc. With time the profile of the journal changed and it started writing about the music business, video- and showbusiness. During the first half of the twentieth century *Billboard* published numerous charts and lists, such as retail bestsellers, the most popular songs on radio, the highest selling sheet music, the most frequently played songs on jukeboxes. In addition to hit parades of different music styles the magazine regularly prints a Hot Ten.

¹²⁹In the US and Canadian markets music ranking is done by Nielsen SoundScan. Its ratings reflect sales of compact discs in 14,000 trade outlets, including online shops. Any vendor can put a device on his cash register which will read the barcodes of a recording and register its sale. In 2003 the Nielsen SoundScan system began monitoring Internet purchases of digital music. The company's information is used by many popular publications, radio stations and television stations (*Billboard*, and the MTV and VH-1 channels), and also by sound recording firms.

In Great Britain this business is the province of The Official UK Charts Company. The majority of UK hit parades are compiled from its researches, including the 'Official British Chart' (the Top 40 on BBC Radio).

¹³⁰Shortly after that, *Billboard* stopped compiling many other charts and concentrated on the Hot 100. In 1984 the magazine again began publishing separate charts for sales and radio broadcasts,

industry and American popular culture. In particular, the position of a song in the Top 40 of those 100 is crucially important for performers' reputations, fees and overall place in the sun.

The press delight in revealing the marketing tactics music labels use for boosting their songs' chart position, and the stories make good reading for music lovers. How useful the charts are for consumer navigation, which is the focus of our interest, has been little researched. Indeed, we have been unable to unearth any research articles on the subject. Nobody has ever directly asked consumers whether they felt choices they made on the basis of chart position had lived up to their official rating. The facts suggest that a high chart position stimulates sales, but how effectively it signals quality remains to be seen. Experienced consumers tend to view chart position rather wryly, seeing success as a sufficient warning of very average quality. For a beginner it would be better to judge singles and albums on the basis of how long they have stayed in the charts. This information can be paid for, which is expensive for an individual consumer, or arrived at after lengthy research. Even economists evidently find the task too time-consuming and confine themselves to a restricted selection of data.¹³¹

One further source of rating is through professional media metrics,¹³² a tool for regulating relations between the press and marketing services. It can only be of indirect assistance to consumer navigation, and there are many problems associated with it: the measures of perceived quality are indirect, the reliability of the information open to question, and the data averaged. The same problems arise with morality ratings issued by the Motion Picture Association of America.¹³³

Ratings of this kind relate to content, but give no indication of quality. They are intended primarily for parents as an indication of which films are suitable for children; and also to shield those of a sensitive disposition from indecency. They were born on a wave of public protest against the showing of indecent scenes to minors. The major companies created the Hays Code and the associated Hays Office, a regulatory agency which functioned from 1930 until 1967.¹³⁴ Among its duties was rigorous restriction in American films of bad language, violence, sex, material

but neither these nor dozens of other charts published by *Billboard* were as comprehensive or influential within the music industry as the Hot 100.

¹³¹Eric A. Strobl and Clive Tucker, "The Dynamics of Chart Success in the U.K."; Eric T. Bradlow and Peter S. Fader, "A Bayesian Lifetime Model for the 'Hot 100' Billboard Songs", *Journal of the American Statistical Association*, vol. 96, No. 454, 2001, pp. 368–381.

¹³²Media metrics is research for the purpose of establishing the size and demographic composition of an audience in the mass media. See I. Fomicheva, *Industriia reitingov. Vvedenie v mediametriiu* [*The Ratings Industry: Introduction to Media Metrics*], Moscow: Aspekt Press, 2004, p. 138. Here the rating is the size of the actual audience of a particular medium expressed as a percentage of the total population or of the medium's potential audience or readership.

¹³³Jeremy Hubble, "The Effectiveness of Movie Ratings", Working Paper, on-line, 7 May 1997. Cited 14 July 2003, available from URL: <http://www.geocities.com/Athens/6378/pols306.html>.

¹³⁴Named after its director, Will H. Hays.

likely to offend religious sensitivities, incitement of ethnic hatred, and depiction of drug abuse.¹³⁵

Initially the rating consisted of four categories: G, M, R, and X (M was subsequently replaced by PG). The first two categories allowed universal access, M merely warning parents that the film might be considered unsuitable for the youngest children. The third category, R, allowed children to watch the film if accompanied by an adult, and the last, X, was considered unsuitable for any minors.¹³⁶ With time the X category came to be equated with pornography and was banned in many states. Films rated G were considered childish and produced in limited numbers; the majority of films released were in the categories of PG and R. As a result the initial 4-category system was, with rare exceptions, reduced to a 2-category system. In an attempt to broaden the scope of the system a new PG-13 rating was introduced in 1984, halfway between PG and R. Later the NC-17 category was introduced as an alternative to X with the intention that this should designate art films while pornographic films would continue to be designated X. However, the producers of pornographic films soon began to submit their works for classification just as art-house films did. In this way NC-17 effectively replaced the X rating. At the present time more pictures with the R rating are produced than any other type, and the year's most successful film is almost always in the PG-13 category. Far from being a neutral classifier, PG-13 now influences the kind of films made. In 1996 films with a PG-13 rating comprised 18.9 percent of all the films made, but accounted for 34.1 percent of the total revenue from screenings. Subsequently PG-13 was transferred to the category of films for family viewing, enabling the film companies to introduce more spice, sex and violence in their film without losing competitiveness. Producers decide in advance the category they need to aim for and make the film to fit the classification framework. Quite recently the task of preserving morality among the viewing public was presented with an effective technical solution in the form of a special program which enables the viewer of films on DVD to make cuts in them himself to make them suitable for family viewing.

The significance of film classification for the economist is enormous, and unambiguously positive. It has provided a firm foundation for business in the form of feedback enabling supply to be coordinated with demand, without creating negative external factors for entrepreneurs. For culture its value is less certain. It too has a vital need of feedback, but requires something more meaningful than these classifications provide. By creating an illusion of reflecting consumer tastes they tend to deflect culture from its proper path rather than show it where it should be headed. They are of minimal assistance to cultural navigation, and serve more like buoys marking out the channel of adverse selection.

¹³⁵Upon becoming Chairman of the Motion Picture Association of America, Jack Valenti abolished the Hays Code and introduced a new system of classifying films after they had been made.

¹³⁶J. Valenti, *The Voluntary Movie Rating System*, MPAA, December 1996.

2.7 A Survey of Recommender Systems¹³⁷

At its most general, recommendation is a prediction of a person's reaction before he himself has sampled an item. The prediction is based on analysis of previous preferences of the buyer or any other information about him.¹³⁸ The service consists of selecting a product for a particular consumer from the great abundance of books, CDs, films, restaurants and so on which has the highest anticipated utility.¹³⁹

For each customer the recommender system¹⁴⁰ builds a personal profile taking account of his preferences and also, if necessary, of his age, sex, income, marital status and so on. In parallel, goods are classified according to definite rules. For example, in a recommender service for films each movie may be represented by its title, genre, director, year of release, and principal actors. Initially consumer ratings of goods which a person has sampled before joining the system are entered in the database. In the MovieLens¹⁴¹ system, for example, users start by awarding points to a particular number of films they already know. The systems are capable of issuing recommendations either in the form of a list of goods most suitable for the consumer, or of a list of consumers likely to prefer a particular good. As already emphasised in Chap. 1, this distinction proves crucial in practice. Recommendations can be generated using three methods:

1. Content: goods are recommended similar to those which a customer has chosen previously;
2. Collaborative filtering: goods for recommendation to the consumer are identified from assessments already given by users with similar tastes;
3. A hybrid method combining elements of both of the above.

There are also collaborative systems (briefly mentioned below), and systems of social navigation which are not recommender systems and are not considered here. In these, users' preferences are identified on the basis of direct and indirect data: In-

¹³⁷This section is partly based on materials from the survey article by Gediminas Adomavicius and Alexander Tuzhilin, "Towards the Next Generation of Recommender Systems: A Survey of the State of the Art and Possible Extensions", *IEEE Transactions on Knowledge and Data Engineering*, vol. 17, No. 6, June 2005.

¹³⁸From the mid-1990s recommender systems became an independent topic of research, based on advances in cognitive science, experience gained from information retrieval systems, prediction theory, etc.

¹³⁹This can be noted in the following manner:

$$\forall c \in C, \quad s'_c = \arg \max_{s \in S} u(c, s). \quad (1)$$

Where C is the number of users (up to many millions), S is the products offered (also millions of items), u is the utility function describing the utility of object S for users c .

¹⁴⁰For further information on recommender systems see Appendix 1, Sect. A1.11.

¹⁴¹See Appendix 1, Sect. A1.11.8.

ternet communications, history of use of the system, hyperlinks etc. They visualise how a person interacts with a computer and assist those surfing the Web.¹⁴²

2.7.1 Content Methods of Generating Recommendations

In content-based recommender systems the utility of the item is deduced from the consumer's rating of similar products. For example, in order to advise a user on films, the content system seeks similarities with other movies to which he has already given a high rating (which have the same actors, directors, genre). Such recommendations follow the principle of finding things for the user resembling those he has liked in the past. Content recommender systems are based on the methods of information retrieval,¹⁴³ comparison and filtering.¹⁴⁴ This approach is most often used on texts: documents, websites, blogs etc. The preference profile is built up from information received from the consumer either directly by questionnaire or indirectly. The content is usually described using keywords.¹⁴⁵ The profile indi-

¹⁴²Loren Terveen and Will Hill, "Beyond Recommender Systems: Helping People Help Each Other", in John M. Carroll, ed., *HCI In the New Millennium*, Addison-Wesley, 1989.

¹⁴³Ricardo Baeza-Yates and Berthier Ribeiro-Neto, *Modern Information Retrieval*, Addison-Wesley, 1999; Gerald Salton, *Automatic Text Processing*, Addison-Wesley, 1989.

¹⁴⁴Nicholas J. Belkin and W. Bruce Croft, "Information Filtering and Information Retrieval", *Communications of the ACM*, vol. 35, No. 12, 1992, pp. 29–37.

¹⁴⁵For example, the Fab system, which specialises in recommendations of Web pages, presents their content in the form of the 100 most important words. The Syskill & Webert system describes documents with the aid of the 128 most informative words. Various methods exist for determining the 'importance' and 'informativeness' of words. For example, the method of frequency/reverse frequency. Its essence is: let N equal a certain quantity of documents which may be recommended to users. In part of these documents (n_i) a keyword (k_j) is encountered. Moreover, let us suppose that f_{ij} is the number of times that keyword k_j is encountered in a certain specific document d_j . Then TF_{ij} is the frequency of use of the keyword k_j in document d_j defined as

$$TF_{i,j} = \frac{f_{i,j}}{\max_z f_{z,j}}, \quad (2)$$

where the maximum is calculated from the frequency f_{zj} of all the keywords k_z encountered in document d_j . However if the keywords are extensively present in many documents, the system is unable to select the required text correctly. Accordingly the measurement of inverse document frequency (IDF_i) is often used together with measurement of term frequency (TF_{ij}). Inverse document frequency for a keyword k_i is usually defined as:

$$IDF_i = \log \frac{N}{n_i}. \quad (3)$$

Then the weight of keyword k_i in document d_j is defined as:

$$w_{i,j} = TF_{i,j} \times IDF_i. \quad (4)$$

And the content of document d_j is defined as:

$$Content(d_j) = (w_{1j}, \dots, w_{kj}).$$

cating the consumer's preferences is created by identifying keywords in the content which the user has previously rated. The consumer's profile and the profile of the content may be represented as vectors, and the utility of content for the consumer is determined by the size of the angle between them.¹⁴⁶ In particular, a person interested in a specific topic will have articles recommended which contain many of the keywords in his user profile.

2.7.1.1 Drawbacks

There are several drawbacks to the content or search-based method. In the first place, machine analysis is not suitable for all items. Thus, it is made very difficult to work with multimedia attachments, graphics, audio and video materials, although rapid progress is being made in this area. Another problem of this method is that different objects with identical profiles cannot be told apart. For example, a content-based system is unable to distinguish between a good journal article and a bad one if their vocabulary is similar. This problem extends also to consumer profiles, so that recommendations based on the choices of supposedly similar users can be wide of the mark. Profiles may appear similar while the individuals behind them are quite different. Another obvious drawback is the restrictiveness of recommendations. There is no provision for recommending goods to the consumer which differ from those he already knows. He may have items insistently offered to him which are too similar to those he is already familiar with.

2.7.2 Collaborative Systems

Collaborative systems cannot generate recommendations. Their purpose is instead to facilitate the exchange of recommendations. The first recommender system in the world, Tapestry, devised by Xerox PARC, was of the collaborative type.¹⁴⁷ The weblogs popular today are a further example.

Source: Adomavicius and Tuzhilin, "Towards the Next Generation of Recommender Systems".

¹⁴⁶This can be noted as:

$$u(c, s) = \cos(\vec{w}_c, \vec{w}_s) = \frac{\vec{w}_c \cdot \vec{w}_s}{\|\vec{w}_c\|_2 \times \|\vec{w}_s\|_2}.$$

Other content-based methods exist, like the Bayesian classifier, machine learning, including decision tree clusters, and artificial neural networks.

¹⁴⁷Tapestry was an electronic messaging system which allowed users to either rate messages 'good' or 'bad', or associate free text annotations with them. Messages could be retrieved based not only on their content, but also on the opinions of others. For example, one could retrieve documents rated highly by a particular person or persons, or could retrieve documents whose annotations contained particular keywords. Loren Terveen and Will Hill, "Beyond Recommender Systems".

The snag with collaborative systems is that they are effective only where a sufficient number of volunteers are prepared to generate information of value to their community.¹⁴⁸ In most cases the work has been unpaid, although commercial search services are about to make it a possible source of income.¹⁴⁹ So far the recommenders' motivation has been non-commercial: perhaps a wish to broaden their knowledge, to establish contact with other users, or to enjoy expert status. Often they expect no more than gratitude for an explanation, advice or a witty reaction.

2.7.3 Collaborative Methods of Generating Recommendations

Collaborative filtering systems are based on two principles and accordingly come in two varieties: memory-based and model-based.¹⁵⁰

Memory-based algorithms produce ratings for a customer based on his earlier ratings¹⁵¹ and the totality of ratings given to a good by other users. This is a typical scheme for an individual customer, a user-to-user scheme of collaborative filtering. In order for these suggestions to be accurate, two tasks must be resolved: high quality recommenders must be filtered; and their ratings must be summarised. Similarity of tastes between clients is established on the basis of the ratings they give the same goods.¹⁵² This similarity can be identified either using the Pearson correlation

¹⁴⁸The task of summarising reviews is examined, for example, in Minqing Hu and Bing Liu, "Mining and Summarizing Customer Review", *Proceedings of the 10th ACM SIGKDD*, 2004, pp. 168–177.

¹⁴⁹The Google search engine announced its intention of paying freelance experts for assessing products.

¹⁵⁰John S. Breese et al., "Empirical Analysis of Predictive Algorithms for Collaborative Filtering", *Proceedings of the Fourteenth Conference on Uncertainty in Artificial Intelligence*, July 1998; Daniel Billsus and Michael J. Pazzani, "Learning Collaborative Information Filters", *Proceedings of the International Conference on Machine Learning*, 1998.

¹⁵¹Atsuyoshi Nakamura and Naoki Abe, "Collaborative Filtering Using Weighted Majority Prediction Algorithms", *Proceedings of the Fifteenth International Conference on Machine Learning*, 1998; Joaquin Delgado and Naohiro Ishii, "Memory-Based Weighted-Majority Prediction for Recommender Systems", *Proceedings of ACM SIGIR'99, Workshop Recommender Systems: Algorithms and Evaluation*, 1999; Paul Resnick et al., "GroupLens: An Open Architecture for Collaborative Filtering of Netnews", *Proceedings of the 1994 Computer Supported Co-Operative Work Conference*, 1994; Upendra Shardanand and Pattie Maes, "Social Information Filtering: Algorithms for Automating 'Word Of Mouth'", *Proceedings of the Conference on Human Factors in Computing Systems*, 1995.

¹⁵²In the linear similarity method, the customer and potential recommender are represented by two vectors in m -dimensional space, and the similarity between them is determined by the vector cosine angle;

$$\text{sim}(x, y) = \cos(\vec{x}, \vec{y}) = \frac{\vec{x} \cdot \vec{y}}{\|\vec{x}\|_2 \times \|\vec{y}\|_2} = \frac{\sum_{s \in S_{xy}} r_{x,s} r_{y,s}}{\sqrt{\sum_{s \in S_{xy}} r_{x,s}^2} \sqrt{\sum_{s \in S_{xy}} r_{y,s}^2}}, \quad (5)$$

where $\vec{x} \cdot \vec{y}$ is the scalar product of the two vectors.

coefficient, or by the method of linear similarity. The simplest way of measuring similarity between users is by the average quadratic deviation.

In order to improve the system's operation, a number of modifications of the above methods are employed.¹⁵³ In particular, in order to overcome a shortage of ratings of a particular user and to select suitable recommenders for him 'default voting' is used. This is suitable where everybody is consuming the same item and rating it similarly. It has been empirically established that the accuracy of prediction increases if non-rated goods are allocated a hypothetical rating and this can be done by finding similarity not between users but between goods.¹⁵⁴

Although the tastes of those in the recommender group selected by the program for a customer may be close, they will not be identical, and some means is necessary for generalising their rating. At its simplest, this is calculated as a straightforward average. Clearly, however, the closer the match in tastes between the customer and one of his recommenders, the more weight should be given to the rating of that person when generalising the group's opinion. Different users also interpret the scale of ratings differently, so if a particular recommender shows a marked overall positive or negative bias relative to the average, allowance can be made for this.

In addition to customer-to-customer systems, there is also model-based collaborative filtering.¹⁵⁵ In this scheme an index of similarity is used to group users into clusters. The purchases and ratings of the users from one such segment are used to generate recommendations. According to Greg Linden and his co-authors, cluster

Let us assume for simplicity's sake that we have only three works (of literature or art) for the sampling of tastes. Each recommender can be schematically represented as a dot in a rectangular three-dimensional Cartesian coordinate system (x, y, z) , and its position will be entirely determined by assessment of the particular works. The customer's taste can also be represented by a point in accordance with his expressed preferences. If a vector is drawn from the origin of the coordinates to these two points, then the angle between them will represent the degree of proximity of the taste of the customer and recommender.

¹⁵³Such as default voting, inverse user frequency, weighted majority prediction, etc.

¹⁵⁴Badrul Sarwar et al., "Item-Based Collaborative Filtering Recommendation Algorithms", *Proceedings of the Tenth International WWW Conference*, 2001. In the opinion of these researchers, systems based on analysis of ratings given to items show better results than collaborative algorithms based on analysis of consumers. This view is shared by Mukund Deshpande and George Karypis, "Item-Based Top-N Recommendation Algorithms", *ACM Transactions on Information Systems*, vol. 22, No. 1, 2004, pp. 143–177.

¹⁵⁵Daniel Billsus and Michael Pazzani, "Learning Collaborative Information Filters"; John S. Breese et al., "Empirical Analysis of Predictive Algorithms for Collaborative Filtering"; Lise Getoor and Mehran Sahami, "Using Probabilistic Relational Models for Collaborative Filtering", *Proceedings of WEBKDD'99*, 1999; Ken Goldberg et al., "Eigentaste: A Constant Time Collaborative Filtering Algorithm", *Journal Of Information Retrieval*, vol. 4, No. 2, July 2001, pp. 133–151; Thomas Hofmann, "Collaborative Filtering via Gaussian Probabilistic Latent Semantic Analysis", *Proceedings Of The Twenty-Sixth Annual International ACM SIGIR Conference*, 2003; Benjamin Marlin, "Modeling User Rating Profiles for Collaborative Filtering", *Proceedings of the Seventeenth Annual Conference on Neural Information Processing Systems (NIPS-2003)*, 2003; Dmitry Y. Pavlov et al., "A Maximum Entropy Approach to Collaborative Filtering in Dynamic, Sparse, High-Dimensional Domains", *Proceedings of the Sixteenth Annual Conference on Neural Information Processing Systems (NIPS-2002)*, 2002.

models scale up better (that is, they are better adapted to working with large data sets) relative to customer-to-customer collaborative filtering, because they compare the user with a relatively small number of segments rather than the entire customer base.¹⁵⁶ The complex and expensive generation of clusters is conducted off-line in order not to overload the system, but a result is that the quality of recommendations is lowered. The cluster model groups users into a segment, compares a specific user with this segment and gives all members of that segment general recommendations. Since the users grouped in the cluster are not identical people, the recommendations are not ideal. The quality can be raised by breaking users down into highly homogeneous segments, but there will then be so many of these that online analysis of the link between user and segment will be almost as expensive as finding similar customers using customer-to-customer collaborative filtering.¹⁵⁷

Work on improving collaborative filtering is being carried out at top speed throughout the world. We know of attempts to implement a statistical scheme,¹⁵⁸ and also more complex probabilistic methods.¹⁵⁹ Combining the memory-based and model-based principles produces better results than either of them on their own can manage.

2.7.3.1 Snags and Drawbacks

Collaborative recommendations are better over a whole range of parameters than content-based ones. In particular, they can be effective even with products which do not belong to any category already rated by a particular user. Technology can even

¹⁵⁶Greg Linden et al., “Amazon.com Recommendations: Item-to-Item Collaborative Filtering”, *IEEE Internet Computing*, February 2003.

¹⁵⁷Each item may be regarded as one of the nodes of a Bayesian network, and the position of the node corresponds to the hypothesised rating of the item. The problem here is that each user may be allocated to a separate cluster, although certain systems are capable of considering the user in several roles simultaneously. For example, in a system recommending books the user may be interested in one topic for work and quite a different one for leisure. The KF method is proposed, based on machine learning, for example, a system of artificial neural networks), along with methods for retrieving relevant attributes, e.g., algebraic models for minimising matrices while retaining representativeness). Some provisional assessments suggest that more accurate recommendations are produced using model-based rather than memory-based approaches. See, for example, Daniel Billsus and Michael Pazzani, “Learning Collaborative Information Filters”; and John S. Breese et al., “Empirical Analysis of Predictive Algorithms for Collaborative Filtering”.

¹⁵⁸Lyle H. Ungar and Dean P. Foster, “Clustering Methods for Collaborative Filtering”, Technical Report WS-98-08, *Proceedings of the Workshop on Recommendation Systems*, Menlo Park, CA: AAAI Press, 1998.

¹⁵⁹Specifically, there is a proposal to use Markov Chains for generating recommendations. G. Shani et al., “An MDP-Based Recommender System”, *Proceedings of the Eighteenth Conference on Uncertainty in Artificial Intelligence*, San Francisco: Morgan Kaufmann, 2002. There are also attempts to utilise latent semantic analysis and a group of methods based on generative semantics. It has been shown that collaborative filtering can be applied even where there is relatively little information about the user. Ravi Kumar et al., “Recommender Systems: A Probabilistic Analysis”, *Journal of Computer and Systems Sciences*, vol. 63, No. 1, 2001, pp. 42–61.

be used for expert analysis of experts.¹⁶⁰ If a critic is contributing professionally to a recommender service, it is important to know his area of expertise and how authoritative he is.

The main merit of collaborative filtering is that recommendations are personalised. Moreover, the service does not simply base itself on the routine acts of consumption of its participants, but prompts them to reflect on their actions. Those devising commercial recommender systems, for entirely understandable reasons, try not to burden the consumer and to reduce his need to think to a minimum, but there seems no doubt that thinking through his choices is beneficial for the buyer himself. Indeed, the actions of consumers of culture can cause interest communities to spring up, and this is a positive development,¹⁶¹ providing that real, off-line, acquaintance of users with their 'taste' neighbours does not come into conflict with morality and the principle of not interfering in people's private lives.¹⁶²

Collaborative services do, however, have limitations, including the problem of the new user. In order to provide him with accurate recommendations, the system needs firstly to elicit his preferences. This obstacle is surmounted by using the hybrid method, combining the strengths of the content-based and collaborative principles.¹⁶³ Techniques have recently appeared for building a consumer profile using automatic processing of texts (data-mining), analysis of the Net behaviour of the customer and so on. These make it possible to take account of the interests and preferences of users without burdening them with needless questioning, and thereby enhance both their personal profiles and the profiles of items. These new approaches resolve, at least partly, one other problem of recommender systems: their intrusiveness. Most of them require action on the part of the user. For precise targeting it is essential to have the ratings of a large number of previously sampled products. Attempts are being made to obtain this information indirectly.¹⁶⁴ For example, the length of time spent reading an article can be analysed. Indirectly obtained data is,

¹⁶⁰Mutual filtering can be used to form circles not only of admirers of a particular work but even of a particular critic.

¹⁶¹It may be that bringing together kindred spirits and forming communities of interest will prove to be the main value of collaborative technology, which will thereby radically change the world for the better.

¹⁶²The ethics of facilitating the setting up of user groups of interest is analysed in particular by Loren Terveen and Will Hill on the example of the PHOAKS system. The main priority here is to adhere to the rule of non-interference in private life. Terveen and Hill, "Beyond Recommender Systems: Helping People Help Each Other", J. Carroll (ed.), *HCI in the New Millennium*. Addison Wesley, 2001.

¹⁶³For further detail, see Al Mamanur Rashid et al., "Getting To Know You: Learning New User Preferences In Recommender Systems", *Proceedings of the International Conference on Intelligent User Interfaces*, 2002; Kai Yu et al., "Probabilistic Memory-Based Collaborative Filtering", *IEEE Transactions on Knowledge and Data Engineering*, vol. 16, No. 1, 2004, pp. 56–69.

¹⁶⁴Alper K. Caglayan et al., "Learn Sesame: A Learning Agent Engine", *Applied Artificial Intelligence*, vol. 11, 1997, pp. 393–412; Joseph A. Konstan et al., "GroupLens: Applying Collaborative Filtering to Usenet News", *Communications of the ACM*, vol. 40, No. 3, 1997, pp. 77–87; Stuart E. Middleton et al., "Ontological User Profiling in Recommender Systems", *ACM Transactions on Information Systems*, vol. 22, No. 1, 2004, pp. 54–88; Douglas W. Oard and Jimnook Kim, "Im-

however, less exact and cannot completely replace direct ratings by the user. Accordingly, decreasing the intrusiveness of recommender systems while retaining a high degree of accuracy is a priority. MovieLens asks new users to provide their assessment of a couple of dozen films straight away.¹⁶⁵ The same difficulties arise with a new item: it is impossible to recommend it until it has accumulated a sufficient number of ratings.¹⁶⁶

There is another obstacle, known as sparsity of ratings. Demand for recommendations usually exceeds the availability of ratings in the system. People prefer not to give ratings but to receive them, not to contribute to forming a database, but to use it. This is the problem of the first provider of ratings, the cold start. How can users be persuaded to give ratings when they will at first receive nothing in return and could just wait until all the hard work has been done by somebody else?¹⁶⁷ The spontaneous activity of Webloggers tells us that we should not overstate this problem, and yet, a critical mass of users is essential. In recommender systems for the cinema, for example, some films will be rated by only a few cinema-goers and accordingly those films will rarely be recommended even if they are awarded high points. As a general rule, if the number of experts in a database is small in comparison with the number of items, predictions will be inaccurate. This problem can be alleviated by slotting supplementary information into the user's profile, for example, demographic data. This is known as demographic filtering. Thus, it is proposed to boost recommender systems for restaurants by adding information about the user's age, place of residence, education and employment.¹⁶⁸

Collaborative filtering faces some purely technical problems because of the difficulty of working with large data sets. As the developers of the various competing systems comment, 'Almost all existing algorithms were evaluated over small data sets. For example, the MovieLens data set contains 35,000 customers and 3,000 items, and the EachMovie data set contains 4,000 customers and 1,600 items.'¹⁶⁹ Time-consuming calculations are best performed off-line because they are otherwise too costly, but traditional personalised e-commerce filtering is almost ineffective off-line. On-line one can only manipulate relatively modest quantities of data, but that reduces the quality of recommendations. Otherwise the operating costs of the recommender system prove unjustifiably high.

plicit Feedback for Recommender Systems", *AAAI Workshop on Recommender Systems*, Madison, Wisconsin, Technical Report WS-98-08, 1998.

¹⁶⁵Such a requirement demands a certain amount of effort from the user but each additional rating improves the accuracy of the analysis and benefits the customer. Developers need to minimise the number of ratings required so that a user will invest time initially in order to obtain effective results subsequently.

¹⁶⁶Nathaniel Good et al., "Combining Collaborative Filtering with Personal Agents for Better Recommendations", *Proceedings of the Sixteenth National Conference on Artificial Intelligence*, 1999.

¹⁶⁷Chris Avery et al., "The Market for Evaluations", *American Economic Review*, vol. 89 (3), 1999, pp. 564–584.

¹⁶⁸Michael Pazzani, "A Framework for Collaborative, Content-Based, and Demographic Filtering", *Artificial Intelligence Review*, December 1999, pp. 393–408.

¹⁶⁹Greg Linden et al., "Amazon.com Recommendations", *IEEE Internet Computing*, p. 79.

Another problem encountered by collaborative filtering is how to recommend something fundamentally different. Many current systems fall down at this point.¹⁷⁰ For example if, when working with Amazon.com, you indicate that you have Shakespeare's *Macbeth* in your library, the response will be a flood of helpful recommendations of other plays by Shakespeare.¹⁷¹ Equally banal advice is forthcoming for music. In content-based systems goods are searched for by shared characteristics (they are written by the same author, have the same actor or director) or by shared keywords. Item-to-item collaborative filtering is also based on similarity of goods, so that a customer who has bought the DVD Collection of *The Godfather* might find the system recommending a list of other crime drama titles, films starring Marlon Brando, or movies directed by Francis Ford Coppola. The recommendations are often either too general (such as best-selling drama DVD titles), or unduly narrow (such as all the books by the same author), whereas the individual is looking for help with finding new products deserving of his attention. In an attempt to get round this problem, some systems, like Daily-Learner, reject items on the basis of excessive similarity to what the client already knows.¹⁷²

The user-to-user version of collaborative filtering does not have this shortcoming. The customer can ask for a selection of works highly rated by his circle of recommenders, and discover something completely new.

Staff at Amazon report that they have overcome a number of inadequacies of existing recommendation algorithms by developing a scheme of their own (although the experiment with Shakespeare suggests their discoveries have not yet been fully implemented).¹⁷³ They have developed an item-to-item collaborative filtering algorithm for working with enormous data sets, something which Amazon.com certainly needs,¹⁷⁴ and which is capable of delivering what the authors claim are high quality recommendations in real time. The idea is that the system correlates each of the goods acquired by the customer with similar goods bought by other customers and forms a list of recommendations.¹⁷⁵

Having created (off-line) a table of similar goods, the algorithm finds items which correlate with each of the purchases and ratings of the particular customer. He then has recommended to him the most popular analogous products which he has not yet

¹⁷⁰Terveen and Hill, "Beyond Recommender Systems".

¹⁷¹Terveen and Hill, "Beyond Recommender Systems".

¹⁷²Daniel Billsus and Michael J. Pazzani, "User Modeling for Adaptive News Access", *User Modeling and User-Adapted Interaction*, vol. 10, No. 2-3, 2000, pp. 147-180. Zhang and others have proposed five rules of redundancy to determine whether a product which corresponds to the profile of a consumer contains any new information for him. Yi Zhang et al., "Novelty and Redundancy Detection in Adaptive Filtering", *Proceedings of the Twenty-Fifth Annual International ACM SIGIR Conference*, 2002, pp. 81-88.

¹⁷³Linden et al., "Amazon.com Recommendations".

¹⁷⁴Amazon.com has tens of millions of customers and products.

¹⁷⁵In order to calculate the similarity between two items the same cosine method is used as in traditional customer-based collaborative filtering but with the difference that the vector corresponds to an item rather than the customer, and the vector's M dimensions correspond to customers who have purchased that item.

bought or items similar to those he has already bought. Nobody actually asks what kind of recommendations he wants. The computation takes very little time, since the bulk of the work, compiling the similar-items table, is done off-line, and this is the secret of the scalability of this item-to-item approach. The authors assure us that only goods which are highly correlated and similar are offered, although it is not clear where, given such a high degree of similarity, recommendations of new and original works of art could come from.

2.7.4 Hybrid Methods of Generating Recommendations

These methods are a combination of collaborative and content-based approaches and make it possible to avoid the limitations of each system in isolation.¹⁷⁶ The advantages of the hybrid approach¹⁷⁷ can be seen from a simple example. Let us suppose that a certain user rates a Web page summarising a film festival very highly. A second user has studied a different Internet source on the same topic. Collaborative filtering of a customer-based type will not unearth anything of value from these facts, but content-based analysis will show up the similarity of the items and identify the link between the users.

There are different ways of making these combinations. Computations can be made within the collaborative and content-based schemes separately and the predictions then brought together. Some elements of the content-based approach can be built into a collaborative methodology and vice-versa.¹⁷⁸ Finally, within a hybrid approach one can construct a unified recommender model.¹⁷⁹ The difficulty here is the need to obtain information about the items to be recommended.

Table 2.2, compiled by Adomavicius and Tuzhilin, provides a classification scheme for recommender systems.¹⁸⁰

¹⁷⁶Yan Zheng Wei et al., “A Market-Based Approach to Recommender Systems”, *ACM Transactions on Information Systems*, vol. 23, No. 3, April 2005, pp. 227–266.

¹⁷⁷For further information on hybrid recommender systems, see Appendix 1, Sect. A1.11.3.

¹⁷⁸Thus, some hybrid recommender systems, notably Fab, are based on collaborative filtering but in addition make use of content-based profiles of users. The latter are needed to establish closeness between clients, which makes it possible to solve the problem of sparse ratings.

¹⁷⁹Chumki Basu et al., “Recommendation as Classification: Using Social and Content-Based Information in Recommendation”, *Recommender Systems: Papers from the 1998 Workshop*, Technical Report WS-98-08, AAAI Press, 1998; Alexandrin Popescul et al., “Probabilistic Models for Unified Collaborative and Content-Based Recommendation in Sparse-Data Environments”, *Proceedings of the Seventeenth Conference on Uncertainty in Artificial Intelligence*, 2001; Andrew I. Schein et al., “Methods and Metrics for Cold-Start Recommendations”, *Proceedings of the Twenty-Fifth Annual International ACM SIGIR Conference*, 2002.

¹⁸⁰Taken from a survey by Gediminas Adomavicius and Alexander Tuzhilin, “Toward the Next Generation of Recommender Systems”, *IEEE Transactions on Knowledge and Data Engineering*, vol. 17, No. 6, 2005, pp. 734–749.

Table 2.2 Classification of recommender methods

Approach	Recommender methods	
	Heuristic	Model-based
Content-based	Widely accepted methods <ul style="list-style-type: none"> ● direct frequency-inverse frequency ● clustering 	Widely accepted methods <ul style="list-style-type: none"> ● Bayesian classification ● clustering ● decision tree ● artificial neural networks
	Examples of research <ul style="list-style-type: none"> ● Lang 1995 ● Balabanovic and Shoham 1997 ● Pazzani and Billsus 1997 	Examples of research <ul style="list-style-type: none"> ● Pazzani and Billsus 1997 ● Mooney et al. 1998 ● Mooney and Roy 1999 ● Billsus and Pazzani 1999, 2000 ● Zhang et al. 2002
Collaborative	Widely accepted methods <ul style="list-style-type: none"> ● closest neighbour ● clustering ● graph theory 	Widely accepted methods <ul style="list-style-type: none"> ● Bayesian networks ● clustering ● artificial neural networks ● linear regression ● probabilistic models
	Examples of research <ul style="list-style-type: none"> ● Resnick et al. 1994 ● Hill et al. 1995 ● Shardanand and Maes 1995 ● Breese et al. 1998 ● Nakamura and Abe 1998 ● Aggarwal et al. 1999 ● Delgado and Ishii 1999 ● Pennock and Horwitz 1999 ● Sarwar et al. 2001 	Examples of research <ul style="list-style-type: none"> ● Billsus and Pazzani 1998 ● Breese et al. 1998 ● Ungar and Foster 1998 ● Chien and George 1999 ● Getoor and Sahami 1999 ● Pennock and Horwitz 1999 ● Goldberg et al. 2001 ● Kumar et al. 2001 ● Pavlov and Pennock 2002 ● Shani et al. 2002 ● Yu et al. 2002, 2004 ● Hofmann 2003, 2004 ● Marlin 2003 ● Si and Jin 2003

Table 2.2 (continued)

Approach	Recommender methods	
	Heuristic	Model-based
Hybrid	Combined content-based and collaborative methods <ul style="list-style-type: none"> ● linear sequence of predicted ratings ● various voting systems ● incorporation of one element on a heuristic basis 	Combined content-based and collaborative methods <ul style="list-style-type: none"> ● Model-based incorporation of one element into another ● Construction of a unified model
	Examples of research <ul style="list-style-type: none"> ● Balabanovic and Shoham 1997 ● Claypool et al. 1999 ● Good et al. 1999 ● Pazzani 1999 ● Billsus and Pazzani 1998 ● Tran and Cohen 2000 ● Melville et al. 2002 	Examples of research <ul style="list-style-type: none"> ● Basu et al. 1998 ● Condliff et al. 1999 ● Soboroff and Nicholas 1999 ● Ansari et al. 2000 ● Popescul et al. 2001 ● Schein et al. 2002

Source: Adomavicius and Tuzhilin, "Toward the Next Generation of Recommender Systems"

2.7.5 Effectiveness and Dimensionality of Recommendations

Although this problem has been thoroughly considered,¹⁸¹ the experts have yet to reach definite conclusions. The question of effectiveness is often reduced to coverage and accuracy. Coverage is the number of items for which a recommender system can give a prediction. Accuracy is quantified as the deviation of predicted from actual ratings, and is something any user can do for himself by comparing recommendations with his own rating of works he already knows. Plainly, recommender systems are not yet so established that their effectiveness can be taken for granted, and evaluation found in the literature has to be regarded as provisional. It is also clearly mistaken to try to compare directly recommender systems which handle very different quantities of material. It is one thing to make suggestions for reading in an area of highly specialised research, but quite another to do the same for mu-

¹⁸¹Jon L. Herlocker et al., "An Algorithmic Framework For Performing Collaborative Filtering", *Proceedings of the Twenty-Second Annual International ACM SIGIR Conference on Research and Development in Information Retrieval (SIGIR '99)*, 1999; Jonathan L. Herlocker et al., "Evaluating Collaborative Filtering Recommender Systems", *ACM Transactions on Information Systems*, vol. 22, No. 1, 2004, pp. 5–53; Raymond J. Mooney and Loriene Roy, "Content-Based Book Recommending Using Learning for Text Categorization", *Proceedings of the ACM SIGIR '99 Workshop on Recommender Systems: Algorithms and Evaluation*, 1999; Yinghui Yang and Balaji Padmanabhan, "On Evaluating Online Personalization", *Proceedings of the Eleventh Workshop on Information Technologies and Systems*, December 2001, pp. 35–41.

sic, and something else again to make recommendations in the sphere of cultural consumption overall.

Plainly, recommender systems will be further developed in the near future and adapted to complex tasks in such adjacent areas as giving travel advice, and providing educational and medical services. The great problem is that today's systems avoid contextual information, without which predictive accuracy falls away rapidly. Thus, if in the course of producing recommendations for films we can take account of when, where and with whom films are seen, the effectiveness of predictions will rise. Clearly too the value of a whole series of undertakings, but in particular holiday trips, depends on time (the season, time of day, day of the week), and also on the company and circumstances in which someone uses the service. There is good reason to attempt to include all this additional data.¹⁸² Interesting prospects are appearing in respect of including information about the task which the user is attempting to accomplish.¹⁸³

2.8 Tendering for Expert Advice

Traditional evaluation is either slow and thorough (the manual labour of the critic) or rapid but superficial (rating). Neither approach satisfactorily resolves the problem of navigation. If a monetary element is introduced into a system of collaborative filtering, as is proposed in this book, a fundamental qualitative breakthrough will occur. Money-based collaborative filtering produces accurate recommendations efficiently. The high productivity of the method is achieved because the works to be assessed are divided between a large number of consumer critics, and its accuracy results from the special logic of eliciting taste communities.

How will the arrival of this new institution affect the existing critical institutions? Will collaborative filtering simply replace traditional criticism some time in the future? Quite certainly not. Despite the fact that nothing can beat the navigational value of monetary collaborative filtering, automated recommender systems are not envisaged as an alternative to existing critical practices. These will remain highly respected since each is a master of specialised functions which only it can perform. Critics will write their criticism, panels of judges will continue to select only the very best, and rankings and ratings will continue to serve advertisers. All that they produce can be usefully incorporated into the recommender systems. A critical review, for example, like any content, can be evaluated and, if the demand is there,

¹⁸²Gediminas Adomavicius and Alexander Tuzhilin, "Multidimensional Recommender Systems: A Data Warehousing Approach", *Proceedings of the Second International Workshop on Electronic Commerce (WELCOM '01)*, 2001, pp. 180–192; Gediminas Adomavicius et al., "Incorporating Contextual Information in Recommender Systems Using a Multi-Dimensional Approach", *ACM Transactions on Information Systems*, vol. 23, No. 1, January 2005, pp. 103–145.

¹⁸³Jonathan L. Herlocker and Joseph A. Konstan, "Content-Independent Task-Focused Recommendation", *IEEE Internet Computing*, vol. 5, No. 6, November/December 2001, pp. 40–47.

sold in the market. Recent developments in collaborative filtering demonstrate the fantastic potential in terms of quality and accessibility of such services.

Internet services like Yahoo's Launchcast, MusicStrands and others¹⁸⁴ which work by using collaborative filtering, invite the consumer to listen to a number of songs and, as his ratings accumulate and the customer's profile becomes more accurate, provide an increasingly high quality service. The program takes account of repeat listening to the same song, which in the case of music is entirely justified.¹⁸⁵ With time the customer no longer even has to rate content, receiving something like a personal radio station automatically attuned to his individual tastes.¹⁸⁶ All these delights cost a mere \$4 a month, or \$3 if you take out an annual subscription. The service looks like digging the grave of the sound recording industry in its present-day incarnation more effectively than Napster since, if music lovers start buying only what they like and stop paying for musical ballast, the industry's revenues will plummet.

A recommender service is, however, relatively secure only for as long as it does not have too many users. When high-speed broadband becomes widespread, the industry will need to fight back and may well decide that attack is the best form of defence. One possible approach might be semantic hacking and sabotage, degrading the accuracy of the services and in general the reputation of free collaborative filters. It will then be time to turn to monetary coding of consumer signals of quality, since other methods of defence are unlikely to prove effective.

¹⁸⁴See Appendix 1, Sects. A1.11.4 and A1.11.8.

¹⁸⁵This is a peculiarity of music not applicable to films and books, which are generally products consumed once only.

¹⁸⁶For further information, see Appendix 1, Sect. A1.11.4.

Chapter 3

The Economic Logic of Creative Reputations

3.1 The Impossibility of Insurance and Guarantees

Strange as it may seem, the institutions we looked at in the last Chapter are not directly commissioned by anyone to do their work of assessing quality. Consumers do not pay critics for their services, and are accordingly neither their customers nor their employers. Most of their financial support comes from the business community, but this is carefully concealed. They are paid through intermediaries, and their paymasters go to great lengths not to be identified with particular reviews. It is, nevertheless, they who benefit. From a legal point of view, the quality monitoring institutions are independent and autonomous, as they need to be if they are to be capable of doing their job, which requires the right to express opinions without fear or favour, in the interests of consumers. These are not the people paying them, however, so the critics are not financially accountable to them for the quality of their product, that is, for the accuracy of their recommendations. Indeed, this seems to be regarded as little more than a side-effect of their work, although critics and other assessors are accountable to themselves to the extent that they value their colleagues' opinions and are keen to protect their own reputation. For all that, they are also under an obligation to their sponsors, which means there is clearly a potential for divided loyalties. Somehow or other this rickety vessel stays afloat, but its effectiveness is highly debatable.

There are other ways for consumers to be reassured about quality, that is, to overcome the problem of information asymmetry. That is through guarantees, insurance, branding, stock market valuations, and audit. In utilitarian markets these institutions carry great weight, although they are thoroughly commercial. They do not trumpet their contribution to social welfare but get on with the job in return for an appropriate level of remuneration. These systems are widespread, and there is no mystery about the identity of the paymaster, who is either the reputable section of the business community who bear such costs of a system of guarantees as advertising and branding, or end-users who pay directly for insurance or advice. In the latter case, a business is collecting and forwarding information on quality. Those using and paying for the service are party to a business deal, and those providing the service are required to provide them with accurate information. They are being paid for their work, and are under an obligation to refund fees if they fail to fulfil the terms of the contract. In the real world, 'lemons' did not wreck the used car market in the United States because a business solution, car showrooms, was found which undertook diagnostic testing of cars and offered guarantees. A system where payment is straightforwardly made for a good supplied is mutually beneficial. It is more efficient than a trilateral model where work is paid for by one person, performed by

another, and the results used by a third, where the work done only benefits the third party through a kind of ricochet.

There are arguments in favour of both bi- and trilateral advisory systems, but in culture only trilateral systems have developed. Why has not normal commercial practice become established in this sphere, where those providing information are paid directly by the end-users? Why do guarantees and insurance not appear to function in culture? Are they replaced effectively by brand reputation?

As regards guarantees, the obvious problem is that you cannot prove a cultural product is defective, not least because there are no objective criteria of quality, and take it to be repaired. We are not, of course, talking about things like the conservation of paintings, sculptures or other high-value cultural items, but about the consumer quality of newly created works. It is difficult to prove there has been a failure to provide art of satisfactory quality when there is not even agreement about what is and is not art. This would make for a very difficult and expensive lawsuit.¹ A St Petersburg couple did indeed sue over Valerii Fokin's production of a play after Gogol's "The Government Inspector". The point at issue was the disappointed expectations of theatre-goers who had not been warned that no shred of the original remained in this particular interpretation.² In general, nobody is going to sue for compensation if a low-cost item proves unsatisfactory, because the cost of enforcing a guarantee would be disproportionate to any likely compensation. The game is simply not worth the candle. This on its own would be enough to explain why guarantees have not taken root in culture.

The same is true of insurance. A digital work does not deteriorate physically in the course of consumption, and how a consumer perceives it is entirely subjective. One can hardly record a user's body language as material evidence that a work left him cold. It is impossible to register the loss, so you cannot sue for compensation. If you could, anybody might sue without the slightest justification. One further obstacle to insuring against the risks facing consumers of culture is the lack of a scale for quantifying loss. It might just about be possible to register disappointment (perhaps by measuring brain activity), but the idea of quantifying it takes us into the realms of science fiction.

¹Not only culture but many other areas of everyday life cannot be comprehensively guaranteed. One reason is the subjective nature of perceptions of quality, of which the classic example is whether the colours on a television screen are judged still to be satisfactory after it has been in use for a year.

²Afficionados of Gogol took particular offence at a number of scenes they considered obscene. In view of the fact that this production of *The Government Inspector* had played to full houses in many countries and been awarded the State Prize of Russia, the court found against the plaintiffs. See M. Seleznev, "The Court Does Not Find *The Government Inspector* Obscene" ["Sud ne priznal 'Revizora' obraztsom poshlosti"], *Novye izvestiya*, 28 March 2005. Dan Brown's bestseller *The Da Vinci Code* caused a storm of indignation on religious grounds.

3.2 Selling Shares in Art

If insurance and guarantees don't work, what can be done instead to protect consumers? Perhaps we should get the public to buy shares in art projects, or seek a way of making end-users into co-investors in the factory of art? There have been precedents. Specifically, the public have been invited to subscribe as a way of raising money for film making,³ but the idea failed to take off because no way was found of making it possible to exert a positive influence on the making of the film. One can invite public involvement in financing cultural projects, for example, by putting up venture capital for a film, but it is impossible to improve artistic quality that way. The shareholders' or subscribers' investments may ensure more satisfactory working conditions for the creative side, and there is a PR effect, but they cannot dragoon the muse. Neither can they do the artist's job for him, any more than amateur chess players can play like a grandmaster even if a dozen of them pool their resources.

There are other drawbacks. Fund instruments require financial accountability, audit, and this involves facilitating institutions with all their associated problems. What might the audit of the management quality of an art project look like? It could only look like a travesty of art or a travesty of audit.⁴ What could the shareholders do if the audit suggested things were going badly: rewrite the screenplay? For financial players the approach might have its merits, especially over a portfolio of projects, but it is difficult to see what cultural benefits there could be for anybody else. Selling shares could only strengthen the commercial orientation of culture and create yet another way of speculating on the stock market. It is not obvious how it would improve a cultural product's quality.

Attempts along these lines have been made, initially as a game when the "Hollywood Stock Exchange" was established in 1996.⁵ You could buy and sell virtual shares in films which were in production or in the first four weeks of being exhibited, and also shares in the film's actors. Everybody who registered on the site was given 2 million virtual Hollywood dollars in their account and, depending on how successfully they called the film market, could gain or lose capital. Those who reached, say, \$640 million, were considered cool forecasters. The "Stock Exchange" allowed players to bet on box-office takings over the first weekend, on who was going to get an Oscar nomination, and on the total box-office take. Interestingly enough, the amateurs were better at predicting the first two than the cinema industry's professionals.

In 2001 Cantor Index Holdings, the London division of Cantor Fitzgerald of Wall Street, bought the game from its developers and invited the British to speculate for real money on film futures. Basing themselves on the Hollywood Stock Market indices, Cantor offered their prediction of the takings of a particular film, and

³A model for doing this is described in Chap 4.

⁴In film studios regulations and financial tracking are not rigorously enforced, which makes audit very difficult. See Wayne E. Baker and Robert R. Faulkner, "Role as Resource in the Hollywood Film Industry", in the *American Journal of Sociology*, vol. 97, No. 2, 1991, pp. 279–309.

⁵It was created by stockbroker Max Keiser and a former merchant banker, Michael Burns.

customers bet on whether the reality would exceed this or fall short of it. The company also announced its intention of trading in media futures in the United States, which would allow American film studios, distributors and networks to hedge their investments in film production.

Another possibility is auctioning tickets for sporting and entertainment events on the Internet. This can indicate how the graph of demand is developing and, to some extent, facilitate consumer navigation. For the mass segments this approach has little to offer, and the same is true of the electronic futures market in tickets which is considered towards the end of this chapter. A stock market has clear benefits for business, but we should not expect it to make the arts flourish. The consumer who becomes a shareholder or speculator gains little in the way of useful information he could share, although a stock market does reveal people's overall expectations. It gives little influence over the process of creating a work. It is an axiom that risk and profit are best shared between those who can genuinely influence them. Non-professionals tend to be relegated to the rank of cannon fodder and used mainly for sharing losses. Nevertheless, bringing artistic projects to the stock market may create a platform for gambling no less popular than casinos or bookmaking.

The bookmakers are already cashing in on an epidemic of punters keen to guess how stories end. Eight months before the sixth part of the Harry Potter series was published, betting opened on the fate of Professor Dumbledore. J.K. Rowling had mentioned that she was going to kill off one of her characters, but at that time nobody knew whom. Shortly before the book was published betting had to be suspended because information appeared to have leaked. The Blue Square Betting site announced that most of the bets were coming from Bungay in Suffolk, where the book was being printed. Bloomsbury, who publish the Harry Potter series, advised fans to be sceptical about rumours. Betting on the fate of the professor resumed, but at less favourable odds.⁶ It is an unsatisfactory situation when a book's author holds sway not only over the fate of her characters but also over the online community's financial prospects.⁷

3.3 The Economic Nature of Cultural Goods

3.3.1 *The Role of Brands*

Selling shares, insurance and guarantees, then, have not been a success in the cultural sphere. If they had, we would be seeing cinemas routinely returning admission charges to irate filmgoers, although the economic cost of queueing might also make this less likely. Brands, however, are a kind of guarantee and are almost ubiquitous in the creative realm. The guarantors are often star performers: famous actors, singers,

⁶Information from the BBC, May 2005.

⁷Bookmakers do, of course, change the odds up to the beginning of a race in the light of how bets are being placed.

dancers, sportsmen, film directors, composers, authors, architects, or painters. In the production and distribution of cultural goods brands come in the shape of publishing houses, film and sound recording studios, also television and radio stations, television channels, museums, and theatres. Any number of public figures can become brands: referees and television commentators, but also fictional characters, the heroes and even titles of books and films.

What is the function of a brand? If consumer effect cannot be gauged from the external characteristics of a work, it is at least possible to produce positive expectations of cultural quality by revealing who created or is otherwise associated with it. The goal of brands is to direct consumer choice, and this they do in different ways in different sectors and with different degrees of success. In the performance sector—sports, theatre, opera—the importance of reputations and venues can hardly be overstated. Venue is less pertinent in the case of films and, indeed, celebrities are not that reliable a guarantee of quality. The differences relate to the economic characteristics of these cultural segments and the specific nature of the products. Let us, therefore, before considering how successful brands are in dispelling choice uncertainty, analyse the nature and sources of the uncertainty inherent in cultural products.

3.3.2 The Distinctiveness of Cultural Goods

We have already mentioned the first, uniquely distinctive feature of cultural goods: there can be no certainty about consumer effect (impressions, experiences, meanings) on the basis of the product's external attributes. The publicity promoting a good and how it is actually perceived may be very different, especially in the changeable mass-market segments. Moreover, in culture, unlike the utilitarian sphere, it is very difficult to devise criteria for predicting utility of consumption. For business this is all bad news. Business likes things standardised and predictable. An audience which has enjoyed a work of a particular genre wants to derive the same enjoyment next time. The whole problem with cultural production is finding the right balance between 'same' and 'enjoyment'. If you aim at a target you have already hit one time (by copying a work which was ecstatically received first time around), there will be far less enthusiasm the second time. On the other hand, aiming significantly away from what has been tried and tested risks altogether missing the mark of popular taste. It is much easier and less risky to give the consumer something familiar rather than try too hard to be original and end up being rejected by an uncomprehending public. In any case, repetition is cheaper. People usually reply to market researchers' questions on the basis of what they have consumed previously and know. Cynthia Heimel comments irascibly on this characteristic that producers find out what people want and give them it. Unfortunately this does not work, because when people get back what they said they wanted, those ideas have invariably been changed in some way, emasculated, and what they get is not at all what they had in mind. They already know this stuff. It is the stuff they told the market

researcher about. It is boring to re-discover what you already know.⁸ Baudrillard expressed the same thought more succinctly when he wrote that yesterday's answer is already included in today's question. The path of repetition may reduce quality uncertainty, but it increases the risk of producing mere unloved clones.

The second distinctive feature of artistic products is that no two are ever identical so there can be no repeat purchases. As a rule, they cannot even be consumed a second time. This really marks them out from ordinary goods. Inimitability, uniqueness typify different arts to differing degrees: for the performing arts more so, for the digital arts less. The possibility of repeat deals is crucial for any market because it makes representative prices possible, which only come from the knowledge of a consistent and balanced supply and demand. Frequent feedback between producer and consumer is a vitally important market mechanism.⁹ When considering the purchase of an item for a second time, buyers can build on whether their choice proved satisfactory in the past. In the absence of repeat transactions, however, one can only rely on reputation. You cannot be sure what the next cultural product will be like but, if the provider has given satisfaction in the past, why not trust him again? Both from a practical and from an economic point of view, reputation rests on two simple things: the knowledge that an individual or institution is highly rated in their field, and faith that someone with a good reputation will intend to keep it.

One final unusual feature of cultural goods is that they are not necessities. Utilitarian needs are biologically, and to some extent socially, determined; cultural needs, however, are determined solely by society, and less than rigorously at that. This issue has been studied at length by Jean Baudrillard, who was dismissive of existing views on the subject. He does not believe in the existence of a universal "anthropological subsistence level".¹⁰ "One tribe in New Guinea, having acquired wealth through contact with Europeans, squanders everything on festivals and continues to live below 'subsistence level'. It is impossible to identify any abstract, 'natural' level of need or in any absolute sense to determine what people need in order to live... Today's 'poverty line' is a standard package, an imposed minimum of consumption."¹¹ Baudrillard is right when he says that the biological needs of man can

⁸Cynthia Heimel, "How to Be Creative", quoted in David B. Clark, "Consumption and the City, Modern and Postmodern", *International Journal of Urban and Regional Research*, vol. 21, 1997, No. 2, pp. 218–237.

⁹The number of repetitions is a key consideration in many collective processes. Multistep, or multi-period, games during which participants can improve their effectiveness by reacting to the observed actions of others, are radically different from single-step, or single-period, games.

¹⁰"The legitimacy of this concept is based on the idea that there exists some anthropological subsistence level which is supposedly the minimum of 'primary needs', an indestructible area in which the individual knows what he wants: to eat, drink, sleep, make love, have somewhere to live, etc." Jean Baudrillard, *For a Critique of the Political Economy of the Sign* [*K kritike politicheskoi ekonomii znaka*], 2nd rev. ed., Moscow: Bibliion-Russkaia kniga, 2004, p. 82.

¹¹Baudrillard, *For a Critique*, p. 84.

vary widely, but nevertheless hunger, cold, and thirst, which are felt as a deviation from normality, cannot be denied, whereas the longing for beauty can.¹²

3.3.3 *Unobservable Quality Plus Non-repeatability*

The fact that it is virtually impossible to categorise a number of attributes of a product does not mean we have to give up on price signalling of quality. If a succession of purchases of a similar good is made, prices are informative. In such segments as perfume, wine, and food where taste is highly individual it is difficult to establish objective quality criteria, but prices can still be indicative. The consumer may know little about a fragrance's chemical composition or the ingredients of beverages, and nothing at all about production standards (in haute cuisine, unlike in wine-tasting, there is not even any generally accepted terminology). This, however, is not a major impediment because there is repetition.¹³ The first purchase is made on spec, but subsequent purchases are guided by the result. The risk of a disaster is faced only once and, since the goods may be consumed on many occasions thereafter, the consumer risk is economically justified. It is because of repeat business that the quality of food in restaurants with a regular clientele is usually higher than in tourist locales, where the churn of customers and casual trade makes maintaining a reputation less of a priority.

In practice, some cultural firms behave like good restaurants while others follow a slippery path approximating to the second approach, profiting from the non-repeat nature of consumption. A rational correlation between quality and price does not magically come about in culture through the operation of the invisible hand the way it does in markets where the same good is purchased on many occasions. This is particularly evident in a segment like the cinema where, almost by definition, there are no repeat purchases, and where cultural fast food is no less in demand by the mass audience than exquisite dishes à la carte. The warnings of predecessors are often not heard, or are heard too late. The market does not register instances where the film fare has been rejected as unsatisfactory, with the result that in the film entertainment business 'low' cuisine displaces haute cuisine. Given that prices are much of a muchness, it is plainly more profitable. The 'tourists' in this case, although they may have a fair idea of what is going on, have little choice.

Consumers of culture could nevertheless affect each other's choices and the overall demand for these products if they could exchange quality assessments actively and efficiently. A lot depends on the life-cycle of a work and how effectively quality information can be distributed. Where it is difficult to establish quality in advance

¹²"Man no longer knows what he wants, so for the economist he becomes truly 'social', that is alienated, susceptible to manipulation and mystification." Baudrillard, *For a Critique*, p. 83.

¹³This applies where purchases are made regularly. The efficacy of repeat purchases is also evident even if they are not made by the same customer in the same place but by consumers who communicate among themselves, see Sect. 3.6.3.

and repeat deals do not occur is precisely where the tendency to adverse selection is at its greatest. The seller of a good with unobservable, unquantifiable attributes who is serving a one-off consumer is under no pressure to strive for high quality. A producer of culture may well succumb to the temptation to churn out potboilers. It is a rule that the quality of one-off purchases is usually lower.¹⁴ In Venice for instance, the 10-dollar umbrellas sold in the street fall apart even before the first shower of rain and there is rarely anybody to complain to. The same as with a mediocre film.¹⁵

Repeat purchases do give consumers some degree of control over quality. Tirole indicates two kinds.¹⁶ The first is where the quality of a good is consistent: if a consumer likes of certain appellation of a particular vintage then, most likely, he will like other bottles of the same vintage.¹⁷ Past experience of consumption provides information about quality. The second kind of control, for example over the quality of food in a restaurant which can change over time, the mechanism of repeat business can operate only indirectly through the supplier's concern for his reputation.

3.3.4 *The Economic Approach to Determining Quality: Search, Experience, Interpretation and Credence*

To what extent do the present rules of commerce allow the consumer to predict the value of cultural goods? There are two possibilities, depending on the type of goods. In the first instance one predicts after inspecting samples and hearing the description of the product. This is never exhaustive information, but at least you get some idea about the item in advance. Clothing, accessories, works of fine art can first be inspected and/or researched and then bought. Appropriately enough, they are categorised as 'search goods'. Economists call products where the quality can be determined only in the process of consumption 'experience goods', and our example of wines falls in this category. Almost all the products of the media and entertainment industries are experience goods.

Experience goods where there is no pattern of repeat consumption are the most difficult to choose, and this applies in particular to films and books whose outward appearance tell us little about their quality. Even the experience of consumption fails to aid prediction, because each time the product is different and the risk of failure

¹⁴Jean Tirole, *Markets and Market Power: the Theory of Industrial Organization* [*Rynki i rynochnaia vlast': teoriia organizatsii promyshlennosti*], vols. 1, 2, 2nd, revised, ed., SPb: Ekonomicheskaya shkola, 2000.

¹⁵It is important to distinguish between two concepts: 'non-observability', when quality cannot be established by looking, and 'untestability', when failure to deliver the quality promised cannot be proven in court.

¹⁶Tirole, *Markets and Market Power*, vol. 1.

¹⁷'Appellation' is a regulatory system guaranteeing the authenticity of wines produced in a particular region. Under a law introduced in 1935, a considerable number of French vineyards were divided into appellations. A. Kuptsov, *Vina Frantsii*, Moscow: Izd. Zhigul'skogo, 2001.

Pure search goods/ reliable experience						Pure experience goods				
<----->										
Radio, TV	Newspapers	Popular magazines	Recorded music	Home video	Cinema	Popular literature	Opera	Classical music	Theatre	Ballet

Fig. 3.1 Classification of experience cultural/media goods on the basis of experience

has to be faced again and again. The category of experience goods is subdivided into ‘reliable experience goods’ and ‘pure experience goods’, and we shall describe these in detail in the next section.¹⁸ For the present, let us note that neither variety of cultural ‘shopping’, through search or through experience, is by any means guaranteed to produce the desired result. Quite apart from objective causes, subjective expectations are often disappointed because of errors of interpretation on the part of the consumer, unsuitable context of contact with the work, inadequate background knowledge, and so on.

A further peculiarity of cultural goods is that their value is partly taken on trust. If the experts fail to detect a forgery, it can circulate in the market as the authentic work of an acknowledged master. The authenticity and rarity (i.e. the size of the edition) of a work has often to be taken on trust. Trust, or credence, can be applicable not only to cultural but also to conventional goods, like insurance policies, where there be may never be any call to discover whether the insurer is really reliable. Another widespread example of ‘credence goods’ is medicine. In culture, the situation is complicated by the fact that within credence goods there is a sub-group of ‘interpretation goods’ whose perceived value depends how they are regarded, and whether the consumer is capable of appreciating them fully.

Differences between search and experience goods are necessarily reflected in how they are purchased. There are usually fewer problems with search goods since there is less information asymmetry about. Consumer demand is accordingly better adjusted and predictable, and this impacts on prices.

Anna Della Valle has proposed classification of cultural experience goods in accordance with their predictability on the basis of experience. (See Fig. 3.1.)¹⁹

What is original about this diagram is the further classification of experience goods in accordance whether a single experience makes it possible to predict the result of consumption of the same type of good in the future. One pole of her continuum Della Valle calls ‘reliable experience goods’, the other ‘pure experience goods’. For example, radio and television programmes which specialise in a particular type of music or chat-show format have clear features of reliable experience goods. One need only to listen to or watch a programme of this kind once in order to know whether to spend time on it in the future. The same applies to television sitcoms, soap operas and the like. Plays, however, Della Valle categorises as pure experience

¹⁸The division in economics of goods into search goods and experience goods is extensively applied to everyday wares.

¹⁹Anna P. Della Valle, *The Search vs. Experience Aspects of Cultural Goods: From Mass Media to the Performing Arts*, Chicago: ACEI, 2004.

goods, especially if the production is the work of a new director with unknown actors. The distinctive feature of pure experience goods is not only that it is difficult to form an impression of them in advance, but that the fact of experiencing them provides no protection against future mistakes. A number of cultural products fall between these two extremes.

Della Valle has calculated consumers' direct monetary costs in terms of how much the user pays for one hour, and has found that the closer a good is to the pole of pure experience, the more expensive it is.

Let us disregard a certain arbitrariness in the differentiation of goods by their 'experience' rating. The correlation Della Valle points out between the experience rating of a good and the price of an hour's consumption is intriguing. The higher the experience rating, the higher the price. Interpreting this is not easy as she does not take account of the scale of production, the 'size of the edition'. In some cases, the more closely a good corresponds to the pure experience category the smaller its edition; in others, however, that link is absent. Is there a correlation, then, between the edition and the pure experience category of a good? If there is, then size of edition is a significant variable, which the structure of this classification is obscuring. No direct correlation is evident between video cassettes and theatre performances, although both are classified as pure experience goods; and yet, the more limited the audience (edition), the higher the price. This is a predictable pattern for many wares which benefit from economies of scale. What is it that raises the hourly price of consuming experience goods? Is it the degree to which they fit the category of pure experience good, or is it simply a matter of size of edition? Della Valle does emphasise the link between price and audience size, or edition, but should price be sensitive to the number of seats in a theatre and completely unaffected by the number of cinema-goers? An art house film costs consumers no more because they are a select few, and this fact is not reflected in Della Valle's classification. Are plays more expensive than films because they are less predictable, or because the quantity of consumers of the good in a theatre, but not in the cinema, is limited? Or are theatre-goers perhaps more relaxed about price because they feel under an obligation to recompense the company performing specially for them? Film fans do not privately commission an art house movie for their limited community, and are hence disinclined to pay extra, particularly since there is no prior restriction on the size of the audience. If a film had been made specially for them, would the film buffs be more inclined to pay a higher price if suppliers suggested it? Film production would then be taking account of consumers' preferences and operating in accordance with normal market rules. In the theatre the prevailing rule is that if a group of people wants a high quality, expensive good produced to their requirements, they have to be prepared to pay accordingly, taking into account the number of potential paying theatre-goers. The same rule operates in the fashion industries, as we shall see below. But not in the cinema, where there is never any negotiation over price because neither the number of consumers of the film nor its quality are known in advance. Until we get out of this rut, cinema-goers will just have to curb their appetites and live with the consequences of uniform prices.

Rather speculatively, Della Valle does draw an important insight out of the tangle of data: as the risk of moving away from the user's preferences increases, experi-

Table 3.1 Consumption costs of cultural/media goods

	Radio	Broad- cast TV	Recorded music	Cable, satellite, other pay TV	Broadcast TV (prime time)	Popular litera- ture	Newspapers, excluding advertising	Popular magazines	Home video	Newspapers including advertising	Cinema	Theatre
Spending on cultural/media goods (\$ per hour of use)	0	0	0.22	0.24	0	0.89	0.33	0.47	1.65	0.33	2.4	20
Cost of watching advertising (\$ per person per hour, 1998)	0.07	0.22	0	0.07	0.31	0	0.57	0.6	0	1.41		0
Spending on cultural/media goods, incl. cost of watching advertising (\$ per person per hour, 1998)	0.07	0.22	0.22	0.31	0.31	0.89	0.90	1.07	1.65	1.74		
Consumption of cultural/media goods (hours per person per annum, 1998)	1050	884	284	689		95	156	82	45	156	13	

We give here a Table summarising Della Valle's data. The sources she refers to are: *The Veronis, Suhler and Associates Communications Industry Forecast 1999-2005*, 1999, pp. 58-59, cols 1-8; *The League of American Theatres and Producers, Inc.*, 2000, cols 9-10. All data relate to 1998 apart from performing art, for which the data relate to 1997

Table 3.1 (continued)

	Radio	Broad- cast TV	Recorded music	Cable, satellite, other pay TV	Broadcast TV (prime time)	Popular litera- ture	Newspapers, excluding advertising	Popular magazines	Home video	Newspapers including advertising	Cinema	Theatre
Spending on consumption of cultural/media goods (\$ per person per annum, 1998)	0	0	62.48	165.36		84.55	51.48	44.65	92.4	51.48		31.2
Spending on cultural/media goods incl. cost of watching advertising (\$ per person per annum, 1998)	73.5	194.48	62.48	213.59		84.55	140.4	104.5	92.4	271.4		

ence goods become correspondingly more expensive. This makes it clear why the mass producers of culture are attracted to the predictable products she classifies as reliable experience goods. Large markets are incapable of constantly persuading the consumer to try a new experience, forming his attitude to a work from scratch. It is too risky and too expensive. A surefire way of losing money is to bring to market a hitherto unknown product, especially a low priced, one-off product. Experimentation is affordable only on a small scale. The mass consumer is not prepared to pay more, and manufacturers do not like unnecessary risks. This bind is central to why culture and business do not see eye-to-eye. To satisfy a highly dispersed demand while keeping prices relatively low is possible only if distribution can be targeted; and the most effective way to do that may well prove to be monetary collaborative filtering.

3.3.5 *The Time-Money Scale of Cultural Consumption*

Anna Della Valle's article is a rare attempt to look at the cultural market from two points of view: those of product price and of the time cost of consuming cultural goods. Her data shows that the cost of an hour spent on cultural activities varies widely, from 7 cents for accessing universally available television and radio stations²⁰ to 9 cents for reading daily newspapers, from \$2.40 for watching a film to over \$20 for sitting in a Broadway show. If we multiply that average hourly price by the number of hours people spend on particular cultural goods,²¹ we will obtain an annual budget for cultural consumption per head of the population. This is the final column, which we have added to Della Valle's Table. To an economist the result is predictable but nonetheless interesting: people more readily consume cheap goods than expensive ones. Free radio and television are in the lead with 1,050 hours and 884 hours respectively. Cinemas, averaging 13 hours a year, are well down the league, and theatres are bottom with just 2 hours per year.

Unfortunately Anna Della Valle does not go on to compare the time-money costs of cultural leisure with the outcomes of consumption, because it is not only economists who lack appropriate tools for assessing these but everybody else as well. The classification she proposes, like any incomplete system, leaves a good deal out. If there were a clear link between the size of the audience (the edition) and the predictability of the product, that is, whether it is a search good or a pure experience good, more precise conclusions could be drawn, but for the present what her calculations show is the truism that what sells best in large volume is predictable, standardised cultural wares.

²⁰Excluding the cost of television and radio sets, but including the time taken listening to or watching advertisements.

²¹These data are given in the Table "Consumption of Media Products". See Appendix 1, Sect. A1.7.1.

3.3.6 *Experience vs. Search Goods: Some Difficulties of Classification*

In reality there are considerably more than two factors influencing the cost of a unit of time of cultural leisure. Not all cultural products can be squeezed into the search/experience pigeonholes without a certain amount of brute force, as Della Valle herself admits.²² For such digital products as photographs and computer games she was unable to find any place at all on her scale. If she had, they might have change the picture. She also excluded items of fashion, luxury, taste, and fine art, presumably because it is difficult to establish how much time a consumer spends on them.

For all that, in attempting to classify cultural goods in economic terms Anna Della Valle chose a difficult but rewarding topic. It is easy enough to lose one's way when classifying the goods encountered as one walks from one shop counter to the next, let alone while trying to negotiate the labyrinths of culture. It is far from easy to classify ordinary everyday goods in terms of search, experience, credence and interpretation, since their quality is partly ascertained before purchase, partly after, and partly never. Market researchers tell us that most purchases are made without any attempt to obtain all available information.²³ As a rule people know only a few specifications, and even then usually only when making an expensive purchase. As a result, products which economists classify as search goods, in terms of the way purchasers choose them, would often be better categorised as experience goods. This should not surprise us. So much of everything is being produced that it is often simpler to try a number of things out than take the trouble to make an informed choice. Consumers' criteria in any case may well differ from those of the manufacturer. Royal Dutch/Shell, which owns filling stations throughout the world, recently discovered that customers were more interest in how clean the toilets were than in the quality of the petrol.²⁴ Categorising wares as search or experience goods certainly has its uses, but it is not a simple matter.

Phillip Nelson classified wares which used over a lengthy period of time as search or experience goods depending on how the cost of repair relates to the purchase price. It is not always possible to know repair costs in advance, but if they turn out to be high it is makes sense to refer to the item as an experience good, and if low to refer to it as a search good.²⁵ By Nelson's logic, if a cheap Chinese bicycle breaks down, it will be an experience good, while if an expensive German one does so it will be a search good. (Where would that leave us if a German bicycle had been

²²Anna Della Valle does mention the difficulty of classifying cultural goods objectively.

²³David Arnold, *The Handbook of Brand Management*, New York: The Economist Books, 1992, pp. 6–9.

²⁴Kevin Drawbaugh, *Secrets of a Strong Brand: How To Attain Commercial Uniqueness* [*Sekrety sil'nogo brenda: kak dobit'sia kommercheskoi unikal'nosti*], Moscow: Alpina Business Books, 2005.

²⁵Phillip Nelson, "Information and Consumer Behaviour", *Journal of Political Economy*, vol. 78 (March/April, 1970), pp. 311–329.

made in China?) Is a mobile telephone a search or an experience good? If we view it as a communications device, it will be seen as a search good because one reads the detailed technical specification and the options described in the catalogue and make one's choice.²⁶ How useful that information proves is questionable. Much is learned in the course of using the phone over time, which makes it more of an experience good. If what really matters is the social marking function of this fashion accessory, however, it should go back into the category of search goods because what you need the latest model and to hell with the price.

Or take a tie. All its attributes might seem to be on display: you can look at it, feel it, try it on. Having bought it as a search good, however, you find from experience that it does not suit you. The fault lies with you, not with the tie. It is the purchaser who is the unknown variable in this cultural transaction and who, if you like, is being discovered through experiencing himself.

In the performance sector the situation is even more muddled. Theatre-goers may take exception to Della Valle's ruling that a performance is a pure experience good. For many people what they know about the play, the director, and the company is tantamount to a fully researched and informative set of data for predicting the quality of the performance. The same ambiguity extends to the cinema: some films clearly belong in the category of pure experience goods while others, through the exertions of directors and promoters, become highly predictable.

3.4 The Repute of Brand Reputations

We might seem to be labouring the obvious by going to such lengths to explain why the mechanisms, which adequately protect the consumer in other spheres, fail when we come to artistic culture. Such widely used instruments as guarantees, insurance, and stock market quotations have failed to be accepted in cultural practice. What more remains to be said? Either they are of no benefit here, or it is too difficult to adapt them, or their time has yet to come. Or could it be that nobody has addressed the issue because the problem of asymmetric information in culture has not been recognised? Perhaps it does not really exist? Perhaps, indeed, there is nothing wrong with the current situation and we should stop making a fuss?

The one form of cultural protection that does deserve serious consideration is brands. The modern definition of a brand is the totality of concepts and expectations a consumer has in respect of a ware and its producer.²⁷ A brand is a kind of promise

²⁶Consumers not infrequently find that the advertised specification does not square with reality. There have been much publicised court cases over this.

²⁷One should not confuse brands with trademarks. If the former is the sum of consumers' concepts about a make, trademarks are simple or complex elements which enable consumers to rapidly pick out a brand among other similar brands. Trademarks can be verbal—'Mercedes', for instance—or non-verbal, like the three-rayed Mercedes star or the recognisable shape of a Coca-Cola bottle. See O. Chernozub, "The Value of a Brand: Reality Exceeds the Myths" ["'Stoimost' brenda: real'nost' prevoskhodit mify"], *Marketing i marketingovye issledovaniia*, No. 1 (43), February 2003.

of appropriate quality, a promise reinforced by the highly recognisable nature of the trademark and the powerful (or at least, apparently powerful) incentive the brand holder has not to err, on pain of disappointing his customers and seeing them shun his products in future. Brands are being used all over the place and it would be nonsensical to deny that we rely on the reputation they represent. We put our trust in brands and, more often than not, they live up to our expectations. When they do not we forgive the lapse because we recognise how fickle the muse can be and how unpredictable the results of cultural projects are. If we go along unquestioningly with this gratifying picture of the cultural economy we will persuade ourselves that hard-working stars and managers are doing their best, sacrificing themselves on the altar of art, and if consumers grumble that is because they always do. Actors, writers, directors, recording and film studios, television and radio stations are all doing their best. If things go wrong sometimes, and nobody is perfect, that is just the way things are. These are the actors and these are the major labels we have. No more whingeing, then. Nothing needs to be changed. What better means of consumer navigation could anyone devise than reputation?

Unfortunately, we do need to take a closer look at reputation.²⁸ When and how are they used? Are they justified and, if so, in whose eyes? Are they ever shamelessly exploited? What makes for a good reputation? In which cultural sectors are brands built reliably, and where are they built on sand?

Matters are relatively simple where there is repeat consumption of a product with consistent qualities, as is the case with conventional goods. But what if qualities are changeable, as they can also be in spheres other than culture? What would happen if we needed to find a drink with a new taste every time we were thirsty? How would Coca-Cola build its brand then? What would happen if every day fruit juice were put out for sale in the supermarket in different packaging and under a new name? The consumer would have to spend a great deal of money if he had to try them all, and would most probably just shop elsewhere. But what if things were no different in other shops? Or what if the packaging looked the same but the contents were different in taste and ingredients? This is quite close to the situation in the digital sector (and sometimes perhaps even in the beverages market). How can you hope to avoid making wrong choices? In the hard liquor segment, the pricier the label the greater the likelihood you are buying a bogus product. Brand has an enormous impact on price, which makes it highly tempting to cosy up to someone else's trademark. The problems with alcohol is more or less under control thanks to institutions for monitoring quality. It is, after all, a matter of life and death, and the state keeps a vigilant eye on the situation. The art and entertainment you choose is, less radically, a matter of life, unless, of course, you choke on an excess of emotion. Part of your life may, nevertheless, be spent less than optimally.

²⁸In this context there is no distinction between brand and reputation and we are discussing them as informative market tools and immaterial economic assets. Needless to say, creative reputations can be established and exist outside of the market.

3.4.1 *The Traditional View of Advertising*

Let us take a relatively simple example of advertising: a utilitarian product used over a lengthy period of time, a car. This is a typical example of a search good. The manufacturer gives the consumer plenty of opportunities for inspection by providing the technical specifications, describing the options, showing off the design, organising a test drive, and so on. The buyer finds out all he wants to know about the car, and makes his choice. This is the purpose of the information component of advertising which, in this case, plays a positive role.

“Advertising is seen as the provision of information to consumers, giving them the opportunity of making a rational choice. Advertising informs them of the existence of a product, indicates its price, location of sales points and describes quality. It reduces consumers’ search costs and helps them to choose between makes (...) Advertising facilitates entry into the market of new suppliers who may take over demand from established firms. Moreover, advertising stimulates the production of high-quality goods. Companies producing high quality are incentivised to declare the quality of their products through advertising, putting firms with low quality at a disadvantage.” This is a quotation from a textbook by Jean Tirole.²⁹ The favourite examples quoted by those who support this view are spectacles, medicine, and food products. It is claimed that advertising stimulates competition and that, where it is permitted, average prices are lower. As regards the information component of advertising, everything is fairly straightforward, except that a substantial part of an advertisement is saying nothing of importance about the goods. Its goals must therefore lie elsewhere.

An alternative view sees the aim of advertising as being to cajole and trick consumers. To cajole them by influencing their decision to purchase through getting them into the right mood; tricking them by selling them goods of lower quality at a higher price, or even goods they do not need at all. Those who support this view believe advertising increases information asymmetry rather than reducing it.³⁰ It weakens competition between goods by raising entry barriers into the market for new participants.³¹ Thus, since the early 1920s cigarette manufacturers have competed with each other in advertising and by increasing the number of cigarette brands, rather than by attempting to reduce prices or improve quality.

²⁹Tirole, *Markets and Market Power*, vol. 1, pp. 152–153.

³⁰Ibid. Tirole refers to the work of John K. Galbraith and Robert M. Solow which alleges that Madison Avenue manipulates consumers.

³¹Entry barriers are obstacles to the appearance of new participants in the market, and enable established firms to enjoy high profits. Types of obstacles are:

- Old-established firms control a share of the market and enjoy economies of scale;
- Consumer conservatism; Control of raw materials supplies, technologies, and marketing through direct ownership, patents, franchises, and exclusive dealerships;
- Large capital expenses for new participants.

Accordingly, advertising may or may not be to the consumer's advantage. Which is the case in practice depends on the particular circumstances: the nature of the product, the nature of consumer needs, and much else besides. It is difficult to judge without knowing all the factors and what their relative weight is in a given situation, but we can say with confidence that the good reputation advertising has deservedly earned in some spheres, including culture, can be transferred by inertia and for no good reason at all to other spheres. If the system of stardom has proved successful in a particular sector of culture, it is promptly imposed everywhere else without a second thought. A meaningless abstraction is exploited, and people take the bait because, with the unaided eye, they are unable to establish the genuine luminosity of the stars. A moment's reflection will tell us that an internationally acclaimed operatic maestro and a mega-filmstar are in radically different situations to influence the quality of the product in which they figure. The singer's influence is due largely to his unique vocal abilities which are more or less consistent. While much undoubtedly depends on the star in a film, he or she is by no means so crucial. A great actor can be the saving of a film, but only within certain limits, and certainly only if he is not merely glimpsed in the film in order to justify his featuring on the DVD cover. Even if he has a major role, not every film-goer will find his acting enough if it is not backed up by the other artistic components of the picture. An example is the torment to which cinema-goers were exposed, as in all probability were the stars themselves, when the brilliant John Travolta and Uma Thurman participated in the vacuous film "Be Cool".³²

"Be Cool" was, according to one cinephile, a lifeless constellation which included John Travolta, Uma Thurman, Harvey Keitel, James Woods, Danny DeVito (who tripped across the screen at the very beginning accompanied by Anna-Nicole Smith), Steve Tyler from Aerosmith playing Steve Tyler from Aerosmith, and a host of luminaries of the American hip-hop scene from Wycliffe Jean to RZA. As one critic remarked, the film disproved the theory that, given enough celebrities, a crime comedy thriller could develop without a plot, a denouement, humour, or drive, and that spectators would automatically be in raptures. Of four reviews discovered in the Russian press, all were negative.

If buyers and sellers see a brand as having a different set of functions and messages, misunderstandings and disagreements are inevitable. The same ructions arise when those to whom the advertisement is addressed fail to recognise the difference between a situation in which straightforward information about goods is being communicated and one where it can't possibly be. This can also apply to today's No. 1 brand, the institution of money. Its reputation, founded in the material sphere, is wittlessly transferred to the cultural in a way alien to its nature. People are used to the idea that high prices signal high quality, and this is quite often exploited by a

³²Film facts: Director, F. Gary Gray (sequel to Barry Sonnenfeld's "Get Shorty" made 10 years previously); rights holder, Metro-Goldwyn-Mayer; producer Danny DeVito; the film was released on 3,216 screens in the USA on 4 March 2005; budget, \$53 million; takings on the first weekend, \$23.5 million, overall takings in the USA \$52.3 million; worldwide takings, \$93,852,099; rating on IMDB website: 5.5 out of 10.

deliberate policy on price signals. Cultural economists even term this the ‘Pavarotti effect’: the price is raised to impress everybody with the special nature of the event.

One further thing to remember about the navigational utility of brands: branding is an, admittedly fallible, rudder in the hands of business, allowing it to steer a chosen course.³³ Only occasionally does the consumer check up on the real quality behind a brand name, and even so with a certain delay, as if viewing the tale of a comet which may no longer exist. How a brand is being manipulated is not something the public knows about, which makes the risk of deception much greater than most people suppose.

3.4.2 *How Economics Currently Views Advertising*

To inform, to condition, to cajole, to trick: these purposes of advertising are well known, but it is not easy to tell which role is envisaged for a consumer watching a particular advertisement. Let us first look at what is meant by ‘conditioning’.

3.4.2.1 What Does ‘To Condition’ Mean?

In a great many instances consumers discover the utility of a ware from experience. Experimenting is, however, expensive so people usually only have personal experience of one or two makes. They assume there is a difference between the products have experienced and those they have not, even if they are in fact exactly the same. This leads to consumer inertia and gives an advantage to familiar makes over those which have appeared more recently.³⁴ The point of a brand as a competitive tool is to gain a toehold in the consumer’s mind. Purchasers tend to remain loyal to products once they have chosen them. A manufacturer of low-quality products, once he has become established in the market, can exploit this psychological quirk as a barrier to the appearance of new players who offer better quality goods. We could limit ourselves to simply asserting that brands direct consumers’ thinking into a familiar

³³The trials of brand management are testified to by the fact that when, approximately from the mid-1980s, managers and shareholders began taking a greater interest in huge marketing budgets, every attempt to establish the economic effectiveness of advertising expenditure showed that this was problematical. Auditing suggests that for most companies the money would be better invested in a bank deposit account. Kevin J. Clancy and Peter C. Krieg, *Counterintuitive Marketing*, Free Press, 2000, pp. 25–27. The same conclusion is reached in a book by former Coca-Cola chief marketing officer, Sergio Zyman, *The End of Marketing as We Know It*, New York: Harper Business, 2000.

³⁴This explanation is given by Tirole in *Markets and Market Power*, vol. 2, p. 173, quoting the opinion of Joe S. Bain in his *Barriers to New Competition: Their Character and Consequences in Manufacturing Industries*, Cambridge, Mass.: Harvard University Press, 1956. This is confirmed by Richard Schmalensee in “Product Differentiation Advantages of Pioneering Brands”, *American Economic Review*, vol. 72, 1982, pp. 349–365.

channel, thereby leaving competitors out in the cold. There is, however, more to brand management and media campaigns than this. Buyers' habits are not without costs for sellers, and these can be measured in monetary terms. This is basic to finding the appropriate balance between advertising expenditure and its returns. The barriers advertising erects in the mind are analogous to the way, as we remember from school, electricity behaves in terms of how current reacts to the resistance of conductors. Increasing the conductivity of certain circuits detracts from the current flowing through others. Just as electric current flows through conductors in direct proportion to their conductivity, so the flows of commerce are directly proportional to the conductivity of the emotional and psychological channels which advertising has established in the minds of consumers. In other words, the probability of a consumer choosing in favour of a particular make is directly proportional to its positive presence in his mind, and it is the volume and effectiveness of advertising which influences that.

3.4.2.2 Attention Economics

Why choice is closely associated with the memory of consumers is explained by the concept of bounded rationality developed by Herbert Simon.³⁵ In particular, he emphasises, "the question is not how the search is conducted, but how the decision is taken to terminate it. In other words, the question is how many options are reviewed."³⁶ Simon bases himself on the fact that collecting and processing information has its own price and cannot be continued indefinitely. Moreover, what prevents a person from taking a decision is often not a shortage of information but a superfluity of it: within a limited period of time he needs to select the informative signals from all the rest. In a world where attention is a scarce resource, information can be an unaffordable luxury, since it diverts our attention from the important to the secondary.³⁷ (The communication of disinformation is a tool of adverse selection.) Ideally, and this is possible only for an imaginary omniscient observer, the search should be terminated at the moment when a balance is attained between additional costs on continuing it and the anticipated increase in the number of options deserving of attention. In reality what is most common is not optimal but acceptable decisions.³⁸ "The search is terminated when the best of the options proposed

³⁵Herbert A. Simon was awarded the Nobel Prize for Economics in 1978 for his 'pioneering research into the decision-making process within economic organisations'.

³⁶Herbert A. Simon, "Rationality as Process and as Product of Thought," Richard T. Ely Lecture, *American Economic Review*, vol. 68, No. 2, May 1978, pp. 1–16. Translated as "Ratsional'nost' kak protsess i produkt myshleniia", *Thesis*, issue 3, 1993, p. 30.

³⁷Simon, p. 13.

³⁸The concept of behaviour on the basis of the principle of rational sufficiency ('satisficing behaviour') is proposed by Simon. Optimality is replaced by satisfactoriness: an agent, operating in accordance with rules of search and assessment he has himself devised, chooses the first satisfactory option, second revis. ed. Moscow, Bibliion-Russkaya kniga, 2004.

excels the level of the demands being made, which itself is gradually adjusted in the light of the options being offered.”³⁹ Put more simply, the search continues for as long as it promises to provide more than it is using up. What is preferable is not an abstract optimal choice, but an option which is acceptable after taking account of search costs. What is really important in what Simon says is that the consumer adjusts the level of his expectations to the value of the options he is being offered. When the prospects are unclear and trivial, demands are reduced. In culture this manifests itself in the degradation of tastes.

3.4.2.3 Branding and ‘Cheap Talk’

Birgner Wernerfelt has drawn attention to a recurrent and important feature of branding, namely the fact that brand choice is used as a means of signalling that people belong to a particular socio-psychological type.⁴⁰ This causes consumers’ sympathies to be distributed unevenly between wares even if their quality is similar, and the greater part of demand homes in on a limited number of makes, selected because of particular communities’ desire for self-identification. Market players can build a profitable strategy on this by initiating so-called ‘cheap talk’, a term borrowed from games theory which designates inconsequential communication before the beginning of a game which determines its further course.⁴¹

When a particular firm proclaims that those who buy its brand have great style and are adored by the opposite sex then, even if their assertions are entirely without foundation, consumers may be pointed in their direction of their product. It is quite commonly not the attributes of the goods which are advertised, but the youthfulness, beauty and social success which they supposedly confer. Such a claim almost randomly tossed out to a community can acquire momentum, and the brand’s signal may become a self-fulfilling prophecy. Advertising functions as a megaphone advising the early supporters of a particular offering where to converge. An initial nucleus of customers forms and it is then relatively easy to get others to join. The tactic concentrates consumer choice on the most successfully branded makes, even if the wares of other manufacturers are by no means inferior. Cheap talk thus acts as a starting pistol for mutually imitative behaviour and the process develops until a critical mass is achieved and it begins to snowball.⁴²

³⁹Simon, p. 30.

⁴⁰Birgner Wernerfelt, “Advertising Content When Brand Choice Is a Signal”, *Journal of Business*, vol. 63, No. 1, 1990, pp. 91–98.

⁴¹‘Cheap’ here does not mean free of charge but that to verbally assert some attribute is easier than to actually provide it.

⁴²The snowball theory suggests that an object which attracts attention before others continues to accumulate it at an accelerated rate. This is analysed below in Sect. 3.6.1.

3.4.2.4 Whom Does an Advertisement Tell About What?

At first sight advertisements would seem more applicable to search goods, since they are easier to describe and often fairly simple to display, but in fact it is primarily experience goods which are intensively advertised. Much television advertising seems to do little more than announce the existence of a product, so what is the point? The hidden agenda is to reassure the viewer about the supplier's status. In addition to, and sometimes in place of, hard information about the product, the advertisement conveys soft information about the producer. The consumer, possibly without realising it, sees the message, "We are spending a mint of money on this advertising campaign",⁴³ as proclaiming the supplier's reliability and that he is offering his wares in good faith

3.4.2.5 Branding as a Rational Modern Version of Sacrifice

Nelson has demonstrated how spending on advertising signals quality.⁴⁴ His main thesis is that advertising signals brand reliability to purchasers. Effectively, by advertising, the manufacturer is telling them, "I am going to be in the market for a considerable time because my products are high quality. In order to prove this to you, I am prepared to lose money initially. You know it would not be in my interests to advertise if my products were not good quality. Try them." The main thing is to persuade the consumer to make a first purchase, after which the product can speak for itself. It makes much better sense for a high-quality manufacturer to sacrifice current profit in order to attract consumers through advertising. A low-grade manufacturer has less reason to spend a lot on promises he will be unable to keep. Advertising thus separates producers into those for whom it makes economic sense and those for whom it doesn't. Consumers can interpret an intensive advertising campaign along the lines of playing "I know you know I know" what your advertisement is getting at. Of course, 'wicked' manufacturers are no less aware of how advertising is perceived and may play the same game. This is particularly easy in the case of credence goods, goods of interpretation and taste, where the person consuming them may not be entirely sure of his own judgement. There is money to be made here even by mediocre producers of one-off goods, to whom Nelson's logic does not apply. People who take advertising too literally are easily exploited.

Apart from advertising which gives information about a ware, and advertising which provides no hard information but which vouches for the producer, a quality signal can also be provided by offering a low starting price for a good and ostentatious expenditure to enable the supplier to demonstrate his intention of remaining in the market in the long term.

⁴³Paul R. Milgrom and John Roberts, "Price and Advertising Signals of Product Quality", *Journal of Political Economy*, vol. 94, issue 4, 1986, pp. 796–821.

⁴⁴Phillip Nelson, "Advertising as Information", *Journal of Political Economy*, vol. 82, No. 4, 1974, pp. 729–754.

3.4.2.6 ‘Hand-Made’ as Sacrifice

One variation of the above game is widespread in fashion: giving a quality signal by indulging in manifestly unnecessary expenditure on the material medium. The attractiveness and value of an item for the purchaser is compounded from its observable and unobservable qualities. By needlessly splashing out on the observable, the supplier sends the consumer a signal about the value of what is unobservable. Pretty things have traditionally been manufactured from expensive materials, the sumptuousness of a fabric confirming the aristocratic signal of the garment. Today making a garment by hand and then emphasising this by labelling it ‘hand-made’ enables a manufacturer to signal that it is deserving of special respect. Labour-intensive, expensive, and inessential hand sewing indicates quality in a special way. The excess labour invested in the item is an informative signal to the consumer. By realising the design in an expensive manner, the manufacturer takes the risk of offering a non-returnable deposit. The gesture says, “I beg your favourable disposition and trust that my act will be duly appreciated”. Just like a card player signalling that he believes in the strength of his hand by betting heavily on a card, the intention is to create an impression of inexorability and to force the other side to concede. “I have burned my bridges,” the signaller warns, “and will fight to the last”. As Tirole points out, the value of leaving oneself no options and of burning one’s bridges is often met outside the framework of economics. The example is often given of armies wishing to occupy an island situated between their two countries and linked to them by bridges. Each of the armies would actually prefer to surrender the island to the enemy rather than have to fight for it, but the army which knows a bit about games theory invades the island and burns its bridge. The other army then has no option but to abandon its ambitions since it now knows that if it attacks, the other side will have no choice but to fight to the death. This is the paradox of compulsion: the army’s best course is to reduce its options.⁴⁵ The signal sent at the start of the game makes its course and outcome more certain.

This kind of ceremonial destruction is irrational only at first sight. In reality it fits well into a broader and more ancient system of rationality. The Indians of the northwest coast of America would burn their villages and hack their boats to pieces, the Chukchi cut the throats of valuable dogs—all as a challenge to their rivals, to impress or dismay them.⁴⁶ Today’s ostentatious expenditure, including the needless labour behind hand-making a product, is essentially a modern version of this kind of archaic sacrifice. It signals intention and, specifically, testifies to the benevolence of the person signalling. The act has deep roots: rituals, sacrifices, potlatch, gifts—everything that anthropologists call reciprocity.⁴⁷ Reciprocity is mutuality: I scratch

⁴⁵Tirole, *Markets and Market Power*, vol. 2, p. 196.

⁴⁶Georges Bataille, *Accursed Share [Prokliataia dolia]*, Moscow: Gnozis-Logos, 2003.

⁴⁷Reciprocity (from the Latin ‘to give back’, ‘to move backwards and forwards’) is a term introduced by Bronislaw Malinowski. In general it refers to the circulation of material goods and services between people as a manifestation of mutual obligation. In practice several quite different types of relations are grouped together under the term: 1) any form of egalitarian redistribution; 2) any exchange of gifts; and 3) mutual assistance.

your back, you scratch mine. The forms, recipients and purposes of reciprocity may vary but the, only relatively, voluntary nature of the giving remains the same.

The ancients communicated in this manner with their gods, with their fellow tribesmen, and with those of other tribes. Examples of this behaviour are found among the North American Indians and the Trobriand Islanders. In one of its more amazing manifestations, kule, non-functional ritual items (bracelets and shell necklaces) changed hands over an enormous territory.⁴⁸ The Aztecs used cloaks and skirts, but the objects could be different coloured feathers, polished stones, shells, fans, tortoiseshell spatulas, or painted animal skins. The exchange value of the items was well known, and in effect this was an archaic luxury industry. Most probably the practice was borrowed from the leaders, who had derived it from sacrificing to the gods. A leader was in fact spending prudently, strategically: he was signalling his power to his fellow tribesmen, the expenditure a means of consolidating his status. Pharaohs, emperors, and successful merchants all signalled their prosperity and power to acquaintances near and far. When “a merchant became rich and considered himself now prosperous and a man of substance, he would arrange festivities or give a banquet to merchants of the highest level and grantees, considering it a disgrace to die without having indulged in some dazzling display of expenditure to increase the lustre of his personal fame and testify to the benevolence of the gods who had given him everything.”⁴⁹ The right to spend is of value as a right to publicly display one’s generosity; it has the value also of self-indulgence, a signal not only to one’s acquaintances but also to oneself.

3.4.2.7 Reciprocity of Cultural Exchange

‘Pointless’, non-productive expenditure is the central preoccupation of Georges Bataille, the precursor of symbolic exchange economics. What Claude Lévi-Strauss said of Marcel Mauss is fully applicable to him: “Only the neglected state of the sciences of man can explain the fact that an enormous area, the entrance to which had been opened and signposted, did not immediately become a topic of research”.⁵⁰ Bataille, with his left-wing inclinations, saw in this needless expenditure a vital principle which, he believed, had subsequently been undermined by small-time

⁴⁸Claude M. Mauss, “An Essay on Giving” [“Ocherk o dare”], in *Societies, Exchange, Individuality: Papers on Social Anthropology* [Obshchestva. Obmen. Lichnost’: Trudy po sotsial’noi antropologii], Moscow: Vostochnaia literatura, Russian Academy of Sciences, 1996. See also the works of Bronislaw Malinowski: *The Scientific Theory of Culture* [Nauchnaia teoriia kul’tury], Moscow: OGI, 2005; *Selected Works: The Dynamics of Culture* [Izbrannoe: Dinamika kul’tury], Moscow: Rossiiskaia politicheskaiia entsiklopediia, 2004; *Magic, Science, Religion* [Magiia. Nauka. Religiia], Moscow: Refl-Book, 1998.

⁴⁹B.F. De Sahagún, *Histoire générale des choses de la Nouvelle-Espagne*, tr. D. Jourdanet and R. Siméon, Paris: Éditions La Découverte, 1991, 1, IX, Chap. X. Quoted in Bataille, *Accursed Share*, p. 57.

⁵⁰Claude Lévi-Strauss, “Foreword to the Works of Marcel Mauss”, in Marcel Mauss, *Social Functions of the Sacred* [Sotsial’nye funktsii sviashchennogo], St Petersburg: Eurasia, 2000, p. 412.

traders. “All that was generous, orgiastic, and immoderate disappeared. . . the bourgeois from the middle classes, clerks and petty traders who accumulated a fairly ordinary (or indeed minuscule) fortune totally devalued ostentatious expenditure because they calculated it so exactly that nothing was left. . .”⁵¹ Bataille regrets that the “grand and free social forms of unproductive expenditure” are a thing of the past.⁵²

From the height of our experience today, it would be more accurate to say that they were converted into, for example, luxury, sport and advertising. Indeed, a crucial role in all this was played by that very commercialisation which, in Bataille’s view, engenders only evil. Outbursts of vital energy which took the form of the irrational expenditure which he so admired, found an outlet in the development of brands, the markets of culture and entertainment. By inventing advertising, the markets provided society with a mechanism for concealed reciprocity—a symbolic exchange mediated by money, depersonalised and often impersonal. Just as before, considerable resources are lavished on what would appear to have no practical purpose. It has to be admitted that today the process of expenditure is given an outwardly rational form, and this readily digestible coating (unlike the ‘insane’ sacrifices of the past) suits the pragmatic mentality of our contemporaries. The markets of luxury, entertainment and art have implicitly and democratically combined gift with functionality.

The distinguishing feature of today’s civilised sacrifice is its impersonal form. The giver often does not know who is to benefit from his gift, and for the recipient the giver is similarly wholly depersonalised. Indeed, people are often completely unaware that they are even participating in a sacrifice. Thus, the old lady living in some godforsaken rural backwater has no inkling, when she buys an electric kettle, that part of her savings will be credited to the account of a Japanese design bureau on the other side of the world. In the same way, a wealthy citizen acquiring a top-class watch or haute couture garment may have no desire whatsoever to invest in designers. The television viewer regularly sacrifices his time, and a part of that expenditure is nipped from the advertising pie and in ways beyond comprehension redistributed to the benefit of creative people. Bataille would have appreciated the modern anonymity of giving. He insisted that, “In a certain sense genuine consumption should take place in private”.⁵³ In practice, however, the apotheosis of consumption requires that it should have an effect on another person, and that effect is precisely the power which a gift possesses. To give is to gain power. . . in order to retaliate, the recipient should not only liberate himself of the burden but even in his turn impose the power of a gift on his rival. In a way, reciprocal giving is gifts aggressively returned with interest. . .”⁵⁴

⁵¹Bataille, *Accursed Share*, page 197.

⁵²The Second World War and all the endless local wars and armed conflicts since then show that he need not have worried.

⁵³Bataille, *Accursed Share*, p. 61.

⁵⁴Bataille, *Accursed Share*, p. 62.

The underlying aim of apparently non-functional expenditure is thoroughly pragmatic. In selflessness there always has been and invariably still is an element of self-interest. The sacrifice, signifying debit and loss in the here and now, is in reality a tactical move within a far-sighted strategy. (There is significance in the fact that a leader often spent more than he possessed, reducing his already far from brilliant treasury to a completely ruinous state.⁵⁵ In return, his status was consolidated.) As viewed by economics, donating meant displaying to oneself and others a surplus of power, resources, courage, and the predisposition towards oneself of the Almighty. The two main forms of sacrifice—sabre rattling and burning bridges—come full circle, the former proclaiming a fullness of power, the latter an unyielding will and a readiness to fight to the death.

3.4.2.8 Genetically Engineering the ‘Hand-Made’

All the above is relevant not only to non-informative advertising and branding, but also to the concept of items being ‘hand-made’. By having a product made by hand, and drawing public attention to the fact, a manufacturer has made a pledge, which is a market mechanism for guaranteeing quality. People may not register the subtleties of the economic and other logic, but they are aware of the associations.

That moniker ‘hand-made’ on a label is to persuade the public that the item is of superb quality and great rarity. This is not always the case. Manual work is associated with quality only if a garment is being made to measure, and even here the point being made is not that handiwork is superior to mechanical manufacture, which it isn’t. The real message is something different. When producing items in very small numbers it may not be competitive or profitable to use machinery because it is expensive to set up. In the case of one-off items, making them by hand is economic common sense. The customer does not need to be burdened with these subtleties, so ‘hand-made’ is represented as betokening customised VIP service. In reality there are few occasions when an item is genuinely unique.

These occasions do, however, include extremely expensive ties made to order, which take account of the customer’s personality, physique, outlook, and personal style. Here we really can talk about exclusivity, not only of the item but more in terms of the relationship with a skilled tiemaker. It might, indeed, be more appropriate not to refer to a product as hand-made so much as head-made. The price of such ties can reach \$500 and more, and the premium is paid for access to the realms of creativity. The customer buys a small share of a craftsman’s inspiration and talent.

When we look at limited edition ties priced in the \$150–300 range, it is less easy to be persuaded of the merits of hand sewing, and in any case there is very little about them that is genuinely hand-made: only the central seam holding the tie together from inside. Other seams are machined.⁵⁶ In order to have the right to affix

⁵⁵See Marshall Sahlins, *Economics of the Stone Age* [*Ekonomika kamennogo veka*], Moscow: OGI, 1999.

⁵⁶*Men’s Ties and Accessories*, Mintel International Group, March 2001 (research materials acquired by the Pragmatika Kul’turny Foundation for use in the present publication).

that ‘hand-made’ label, however, it is almost sufficient to give the item a prod. All the talk about hand-made items create the aura needed if items are to be positioned in the higher price brackets. It is even questionable whether hand-made is qualitatively better than machine-made. You cannot achieve better accuracy, evenness, or strength by hand than by machine. No doubt, of course, in an age of mechanical standardisation minor irregularities impart a sense of authenticity, of products with a soul, a history, a geographical provenance. A modicum of crudity and roughness has aesthetic value in a world of dehumanising industrial perfection. As Tibor Scitovsky writes, “As a source of visual stimuli the output of mass production is really no worse at all than hand-made items; it accumulates its tedious monotony gradually, as an increasing number of people acquire identical or similar objects and thus increase the frequency with which each owner of such an item meets another totally identical to it. The ultimate victory of tedium may take decades, that is as much time as is needed for a mass produced product to totally drive out an object of craft or manual production. This is the moment when that magical transformation occurs of old junk into valuable antique”.⁵⁷ The mistakes made by the hands of an artisan are seen as enchanting marks of subtle distinctiveness and give the item a desirable sensuality. To reconcile themselves to these affecting faults is a kind of reverse sacrifice to which the manufacturer invites the purchaser.

A tie, for example, requires special care and skill when being tied. “A well-tied tie is the first serious step in life,” Oscar Wilde declared. In the nineteenth century a whole science of tie-knotting arose, textbooks were written on the subject, and even Balzac contributed his mite. The knot should look firm, not loose, but at the same time you must not strain the material. This was no simple science. If you did not undo the tie every evening, did not iron it and clean it, it would turn into a useless scrap of cloth. The mere monetary signal, the ability of a gentleman to lay out some \$150 for a tie, or \$5,400 for the essential three dozen, was not enough. You needed to toil with your own hands. A tie, like a pet, demanded not only money from its owner but also reciprocated hand-made time costs. We see here hand-made reciprocity uniting manufacturers and customers into social groups. The minutes spent daily on tying your tie mount up into the sacrifice of weeks and months over a lifetime. As Baudrillard remarks, this is not free time: it is being spent on status production, and no member of society can opt out of the obligation.⁵⁸

To give top-of-the-range hand sewing its due, a certain latitude in adjusting the constituent parts of clothing which makes for greater comfort can be seen as a clear advantage of hand-sewn seams. When, however, handiwork is extolled in mass produced items, a different logic is at work. It can hardly be called deception, and merchants would probably not survive for long if they were relying on the gullibility of customers to go on believing in the abstract value of hand-made wares. The mention of handiwork does, however, also imply a limited edition but, since the proportion of

⁵⁷Tibor Scitovsky, “What’s Wrong with Mass Production?”, in Ruth Towse (ed.), *Cultural Economics: The Arts, the Heritage and the Media Industries*, vol. 1, 1997, Aldershot and Lyme, NH: Edward Elgar, p. 99.

⁵⁸Jean Baudrillard, *For a Critique*.

handiwork in a product is never spelled out, if it is relatively minor there are no guarantees that a large number of identical items will not be churned out. Even where the proportion of manual work is large, mass production is possible: hairdressers trim billions of heads with almost no recourse to mechanisation. There are components in quartz watches, a typical mass product, which are worked on by hand. And Swiss designer watches, whose *raison d'être* is that they are hand-made, are by and large assembled from ready-made components and mechanisms. In industrial production generally, a huge amount of work is still done by hand which nobody waxes lyrical about. So when the firm of Olivier sells their olives at a 150% premium on the basis that they have been put in their cans by hand rather than by machine, this seems to be taking the hand-made cachet to extremes.⁵⁹ The purchaser may ignore this explanation for the premium, or see not the least connection between hand packaging and taste, but this does not detract from the effectiveness of the myth.

There is probably more than one explanation why the 'hand-made' cachet is such a marketing success. It is found everywhere in the industries of luxury and taste, and functions on many levels. It not only brings together the four main pillars of consumption: "caring for oneself", "aspiring", "desire to socialise" and "personal style",⁶⁰ but adds the further category of "caring for others". Those buying the olives may feel a warm glow on reflecting that, by having paid a little more, they have provided work for the packers' hands.

Exploiting philanthropic attitudes, the recently introduced T-shirt brand, American Apparel,⁶¹ is growing rapidly. The entire manufacturing process, from design to sewing in workshops which produce more than 200,000 T-shirts a day, is concentrated in Los Angeles. The make's effective marketing ploy has been to state that "We do not exploit cheap labour". The workers in the factory, most of them legal immigrants, are paid approximately \$15 an hour (twice the US minimum wage) and additionally enjoy medical insurance and other benefits. Untypically, American Apparel T-shirts do not carry advertising slogans and, at \$15–20 are fairly expensive. Purchasers pay a few dollars more to fund the company's social welfare programme and 'fair' working wage, which they do willingly and thereby demonstrate their socially responsible attitude.⁶²

The 'hand-made' label implies limited quantities of output and that each item is unique (even if that is barely discernible). This is what is seen as justifying a higher price. There may or may not be a measure of disingenuousness behind this but, as we shall see below, how far the hand-made claim corresponds to the truth is

⁵⁹The example is taken from Michael J. Silverstein and Neil Fiske, *Trading Up: The New American Luxury* [*Zachem plaitit' bol'she? Novaia roskosh' dlia srednego klassa*], Moscow: Alpina Business Books, 2004.

⁶⁰Quoted in Silverstein and Fiske, *Trading Up*.

⁶¹In 2005 American Apparel was seen as one of the fastest growing clothes brands in the United States. V. Zolotukhin, "A 'Fair' T-shirt", *Polit.ru*, 11 June 2005. Cited 1 May 2006. Available from URL: <http://www.polit.ru/culture/2005/07/11/tshort.html>.

⁶²The company is planning to open factories in China and Africa, but strictly on the basis that wages will be at the same level as in the Los Angeles factory.

not crucially important for the functioning of the markets of luxury and taste. There is an exchange taking place here which balances out, on the one hand, scarcity or surpluses of time and money and, on the other, taste and status. The symbolic realm comprises all the reciprocation into which each individual, like our old lady with her electric kettle, is inexorably drawn. The money and creativity put into aesthetics can be seen as joint investments by creators and their admirers in the creation of new games, new symbols, codes, interpretations, and emotions.

Of all the institutions which mediate in cultural exchange, brands are perhaps the least ceremonious: they do not ask for reciprocity but impose it. Do they in return provide the desired quality of symbolic exchange? Does not the success of brands lead to the failure of the affected cultural markets? Cultural brands, like any others, attract the resource of attention, which people are often careless of and fail to protect. It can easily be exploited, and there is even a danger of its being monopolised, a form of monopoly not yet reliably regulated by law. On the other hand, although consumers' attention is freely accessible, there is strong competition for it and access comes at a price. Is competition under the present rules perhaps really the best arrangement for the cultural markets and are they flourishing under it? Our aim is to examine this possibility, and to weigh up the pros and cons of a possible major change in the rules. This would consist of setting up a feedback mechanism between producers and consumers of culture which would provide an alternative to advertising.

3.4.3 Entry Barriers for Some, Exit Barriers for Others

The choosing of a product involves the purchaser in transaction costs, and brands manipulate the process to the best of their ability. Prompting the customer, they handicap consumers who try to transfer their attention to a different product. They reserve for themselves the top entries in the brain's chart, and try to make sure that at the crucial moment it is information about them which is the first to surface in the memory. Other options will be lucky to get a look-in at all. Brands thus form something like the consumer's active vocabulary in a particular subject, and deter efforts to enlarge it. The insignificant number of purchases which go to their competitors are insufficient for them to enter the market and start to break even at the point where investment begins to yield a return. The function of branding is not only to familiarise people with a product and a manufacturer, but to deprive competitors of that opportunity.

For the barriers in the mind to function, prior barriers are erected on the approaches to it. Rivals' access to channels of communication and the advertising media is blocked and, simultaneously, space is taken up on shop counters. This effectively obstructs the entry of competitors from two directions: consumers do not remember their product or buy it, and retailers do not put on display products for which there is no demand. Only a firm very sure of its strengths and with sufficient resources to overcome these barriers can risk embarking on the production of

even a high-quality product which has no clear prospect of being saleable. If there is already a pool of major brands in the market, newcomers have little chance of breaking through their defences. Secure in this knowledge, the giants may take less trouble over quality. This is particularly damaging for artistic culture, where it is impossible to deliver quality through the consistent application of technology, and where constant innovation is essential.

High spending on erecting entry barriers through advertising does not necessarily lead to inflated prices and low quality. Consumers sometimes benefit. If the sales volumes grow faster than the spending on barrier building, profits can be high even when prices are low. Economically it is in consumers' interests to stay loyal to one particular manufacturer. They thereby both enable him to realise economies of scale and earn themselves the prospect of a reduced price.

It is also possible to buy high quality products without any brand overheads at all. These are brands which are distributed exclusively, and they are also known as private or store brands. The products are devised specially for retailers like Wal-Mart, and first appeared in the USA on the shelves of the Great Atlantic and Pacific Tea Company more than a century ago. By the early 1950s, however, widely distributed national brands were dominant everywhere except Great Britain, where major retail networks like Marks and Spencer were exceptionally popular. In the 1970s American retailers started selling unbranded, so-called white box goods, but this ran into problems with quality. Exclusive distribution brands nevertheless retained a share of the market and are now growing in popularity again. White box goods are produced even by such giants as Unilever, Nestlé, and Proctor & Gamble. They are 10–14% cheaper than analogous branded goods, and sit side by side with them on the shelves. By comparing the two, the average brand constituent of price can be calculated. Sometimes, indeed, the two are produced by the same manufacturer without purchasers being aware of the fact.⁶³

3.4.4 *The Ratio of Quality to Advertising*

If a significant proportion of costs relate not to the product at all but to advertising, this suggests an “intriguing and largely unresearched topic regarding the complementarity and interchangeability of quality and advertising, and the optimal strategic mix of the two”.⁶⁴ In our efforts to establish how informative brands really are, this is a very important question. If the mix of quality and advertising can be varied, and if indeed quality and advertising, as seems entirely possible, may be in inverse proportion to each other, then where does informativeness come in? We seem more probably to be looking at ‘negative informativeness’ in advertisements. If, in order to understand the brand logic of conventional products, the consumer needs the skills of a practised code-breaker, what are we to say of cultural products where

⁶³Drawbaugh, *Secrets of a Strong Brand*, Moscow, Al'pina-Biznes Buks, 2005.

⁶⁴Tirole, *Markets and Market Power*, vol. 2, p. 163.

everything is far more complicated? A revealing example is the practice of sumptuous restaurants, which not infrequently dismay their customers with disappointing cuisine.

3.4.4.1 Interiors Instead of Cuisine

As a rule, if the food is good so is the interior decor, since its purpose is to signal that the cuisine is of high quality. As a rule, but not always. Any restaurant can set out to deceive customers by mimicking this strategy. Véronique Chossat and Olivier Gergaud have analysed restaurant guides and noted a correlation between the environment (including the staff, the service, and the wine list) and the cuisine.⁶⁵ The experts who rate restaurants assure us that they take account only of the food (the devising of dishes, the skill of the chefs, the quality of the ingredients),⁶⁶ but the chefs themselves see the restaurant's environment as important and, as Chossat and Gergaud show, are right to do so. Although the chef's skill ranks above the decor in arriving at the overall rating, top marks from the experts are awarded only if the cuisine is matched by the surroundings. The two in combination are more effective than either on its own. Customers are more susceptible to surroundings than the experts and, knowing this, owners provide luxurious interiors as an effective method of attracting diners and encouraging them to tip generously.⁶⁷ Does money spent on interiors come off the food budget? In economic terms, are these strategies complementary or interchangeable?

This is essentially the same issue as building commercial success on false quality signals. Chossat and Gergaud have also demonstrated that, in the champagne and sparkling wine market, firms attain their goals either by manufacturing high-quality wine or through massive advertising.⁶⁸ Thus the popular sparkling wine Asti Martini is, in the opinion of experts judging on the basis of taste, unjustifiably expensive.

⁶⁵Véronique Chossat and Olivier Gergaud, "Expert Opinion and Gastronomy: The Recipe for Success", *Journal of Cultural Economics*, vol. 27, 2003, pp. 127–141. They used data on 185 leading French chefs in the GaultMillau restaurant guide.

⁶⁶A typical detail: restaurant guides are published privately and do not reveal their methods of assessment. Thus the Michelin Red Guide limited itself in the past to awarding stars without providing any kind of explanation. Since 2000, however, it has added a short three-line annotation describing each restaurant's surroundings and history. The Bottin Gourmand, Champéard and GaultMillau guides provide comments but keep the basis of assessment top secret. Restaurant guides are an example of effective recommender institutions, since a statistically significant link is discovered between the assessments of restaurant and the prices in their menus. On average the simple correlation coefficient between prices and ratings is 0.63.

⁶⁷Thus Georges Blanc invested €23 million in Vonnas; Mark Veyrat €10 million in Annecy and Megeve; Bernard Loiseau €8 million in Saulieu. Examples taken from Chossat and Gergaud, "Expert Opinion and Gastronomy".

⁶⁸Olivier Gergaud and Annick Vignes, "Émergence et dynamique du phénomène de réputation. Le vin de Champagne: entre savoir-faire et faire savoir", *Revue d'Economie industrielle*, vol. 92, No. 1, 2000, pp. 55–74.

3.4.5 *What Influences the Informativeness of Brands and Prices?*

The full range of information services which brands provide for their owners and consumers is:

- stating the specification of the product (including the image constituent);
- ensuring recognition;
- conditioning consumers to choose the product; establishing a positive emotional association;
- declaring the manufacturer's intention of surviving in the market for a lengthy period and of maintaining consistent quality;
- offering communities an opportunity for self-identification.

In respect of competitors, a brand's tasks include:

- positioning itself among numerous other products and types of consumers, and claiming particular niche markets;
- erecting entry barriers by occupying channels of communication.

Under what circumstances may (and do) brands perform these services? The answer depends on the kind of product behind the brand. For the brand of an auction house, a computer games manufacturer, or a publishing house different advertising strategies will be appropriate. Depending on the nature of the product and its actual qualities, rather than those claimed for it, advertising may give consumers true or false signals. Sometimes it is advantageous for sellers to claim certain qualities for their product without having very solid grounds for doing so. It is obviously easier to present the desirable as the real in the case of one-off and credence goods, and also interpretation goods, which are specific to the creative sphere. All three of these latter categories are found mostly in culture.

In order to understand how the branding policy is constructed in a particular area, a whole succession of economic factors need to be borne in mind. For the mass sectors of culture we have already identified two major axes of coordinates, namely the extent to which a product can be classified, and the extent to which choice is repeated. Another set of coordinates is which category of goods the product belongs to: search, experience (reliable or pure), credence, or interpretation. A number of other factors also affect the informativeness of brands. These are:

1. How far the producer is in fact in a position to control quality. Plainly, this is easier in the perfumery business than in television, and a great deal easier than in football. Hollywood and the mainstream music industry trail woefully far behind.
2. How the length of a product's life cycle correlates with the speed of word of mouth. Whether exaggerating a product's virtues makes sense depends on how great the threat of exposure is. The life cycle of a blockbuster film is considerably shorter than that of a Broadway show.
3. The social utility of the branded good: how effectively it marks people out as belonging to a particular circle (the associative effect, the snob effect, exclusivity, conspicuous consumption). This is extremely important for cultural markets and will be discussed in more detail below.

4. How manufacturing costs correlate with the cost of promoting the product. This factor determines the returns from economies of scale and how fierce competition is for media access; that is, it effectively predetermines the economic structure of the particular segment: distribution, copyright, the pricing system, and so on. This is highly evident in the sound recording industry.
5. The ratio of expenditure on producing the original to that of making copies. Because of piracy and counterfeit production this parameter is the most sensitive of all in the cultural markets. In the luxury segment the products best protected against counterfeiting are the expensive leather bags and footwear produced by Louis Vuitton and Gucci. The most vulnerable are digital products.
6. Price sensitivity. This obviously overlaps to a large extent with point 3.

We can base our analysis of cultural reputations on this list, and can already see that suppliers have considerable room for manoeuvre in order to maximise profit within a particular time frame. Their tools are price, quality (with its associated manufacturing costs), and advertising.

3.4.6 Branding Strategies

Having established a structure into which we shall hope to fit both conventional and cultural products, we may classify the various segments of the cultural sphere by how effectively brands signal quality within them.

For consumers, the greatest transparency can be expected when suppliers are realistically able to vouch for quality and have a strong incentive to do so. Examples from the utilitarian sphere might be car manufacturers, and from the symbolic sphere sports stars. The opposite situation is where the owner of a brand is unable to guarantee quality, either because he is unsure how to do so, or has no incentive to do so because quality cannot be checked or because of piracy. The subjective factor of the brand manager's personal approach is also relevant: he may choose to emphasise his immaculate reputation and strive to protect it, or he may risk shamelessly exploiting a reputation he had previously earned or which was enjoyed by the sector as a whole in earlier times.⁶⁹

It can happen that reputation and quality correspond closely for a while and are fairly reflected in price, but then quality falls while prices remain the same by inertia. We shall look at this risky game in more detail below, but for the present let us note that there is no universally applicable method of modelling brands without having detailed knowledge of the sector's microstructure and the exact nature of

⁶⁹When interpreting the branding policy of firms we need to allow for careerism on the part of top managers and the divergence of their goals from those of owners. Although both have an interest in achieving a number of indicators, of which the most important is profit, managers may nevertheless be eager to obtain bonuses by meeting targets specified in their contract, and may accordingly act against the interests of the brand's shareholders and its supporters. As Tirole points out, if incentivisation issues are not resolved, shareholders can end up bearing all the risk when it comes to sharing out the profits. Tirole, *Markets and Market Power*.

the competition within it. Where the actions of certain agents are contingent on the reactions of others there are numerous alternative scenarios. Businessmen do, however, manage their firms, so they must be able to work out how to act in each specific situation.⁷⁰ Observing how they handle reputation can move our analysis forward.

Brand strategy is constructed at the point where the desirable and the objectively possible meet. Within this logic, brands can be categorised by whether or not a producer has genuine grounds for branding and an incentive to avoid moral risk (that is, to pursue a strategy of delivering high quality).⁷¹ There are four possibilities:

1. The brand, for example an opera singer or a virtuoso violinist, is capable of delivering the promised quality and in fact does so: the branding is fair.
2. The brand could in theory operate fairly, but other considerations take priority. The following may incline to opportunism: a fashion brand, a sports star, or an opera singer in the twilight of his or her career.
3. The quality of a product or service is low and there are no grounds whatsoever for trumpeting it, yet the brand is energetically promoted. This may be the approach of a concert singer or film actor.
4. There is no justification for branding, and no attempt is made to do so. This may be the case with young actors.

Our aim is to establish when advertising works in favour of consumers: more precisely, when it is more likely to do so, and when less.

3.4.6.1 Brand Management: Playing by the Rules and Playing Outside the Rules

Let us begin with the first and simplest case, when quality is genuinely high and readily verifiable. The producer promoting such an offering has two tools: the price

⁷⁰Although possibly, like the billiard players in a well known example by Milton Friedman, they pocket the balls without knowing Newton's equations of motion. Milton Friedman, "The Methodology of Positive Economics" ["Metodologiya pozitivnoi ekonomicheskoi nauki"], *Thesis*, issue 4, 1994, pp. 20–52.

⁷¹They are viewed from the standpoint of the consumer, bearing in mind that there can be a divergence between a desire and its being satisfied by a purchase. Jacob Viner drew attention to this problem back in 1925: "Customers' ignorance of the degree of correlation of goods put on sale to the purposes for which they are intended facilitates the practice of deception, fraud, and evasion by suppliers. In short, the entire complex of problems of dishonest methods of trading... the modern development of aggressive trading methods is directed at increasing the non-correspondence between desire and satisfaction. The desire to have goods marketed by means of intensive trading methods is exaggerated by comparison with the satisfaction they confer. These goods bring about a disproportion in the consumer's budget relative to those few goods which to this day remain attractive in themselves." Jacob Viner, "The Utility Concept in Value Theory and its Critics" ["Kontseptsiia poleznosti v teorii tsennosti i ee kritiki"], *Landmarks of Economic Thought: The Theory of Consumer Behaviour and Demand [Vekhi ekonomicheskoi mysli: Teoriia potrebitel'skogo povedeniia i sprosa]*, 3 vols, ed. V.M. Galperin, vol. 1, St Petersburg: Ekonomicheskaiia shkola, 2000, p. 107.

of his product and demonstrative, or ostentatious, expenditure, for example on an advertising campaign which does not communicate information directly about the attributes of the product (what in marketing is called image advertising). There would seem to be no problem: a conscientious supplier is within his rights to choose a high price bracket and reinforce his strategy with advertising. There is, however, the problem that a less conscientious competitor can hi-jack the strategy by delivering high quality for a time, gaining a reputation for reliability,⁷² and then cashing in on it by selling low-quality goods at a high price. “Such a strategy entails initial losses as a consequence of investing in reputation, compensated for by the profit which reputation subsequently brings. This calculation might apply to a restaurant serving good food for one or two years which then lowers its standards and finally closes”.⁷³

We can see that, even in this simplest situation, where the quality of a product is readily verifiable, manipulation of market signals cannot be ruled out. Whether it in fact happens depends on the size of the investment in production and the accumulated capitalisation of the brand. If these values are high, as, for example, in car manufacture, there is a minimal incentive to behave fraudulently.

3.4.6.2 The Example of Mercedes

The car-manufacturing industry has the prerequisites for solidly based reputation since:

- the basic quality criteria are public knowledge, and the manufacturer can genuinely control them;
- the consumer can verify that advertising promises are true (the good has a low amount of credence);
- the purchase is sufficiently major to justify information search costs, and sufficiently infrequent for word of mouth to reach the purchaser in good time;
- the product is expensive to manufacture; the manufacturer has made huge investments of capital and immaterial assets, in production and distribution, and the consumer knows it. The manufacturer has a lot to lose;
- the brand is backed up by such institutions as guarantees and a stockmarket quotation.

In such ideal conditions it would be foolish of a manufacturer to try to play tricks, since anything underhand would certainly come to light and result in a collapse in demand and a fall in the share price. The brand is almost 100% effective. This is why, when structural defects are discovered in components, car manufacturers recall tens of thousands of vehicles at their own expense. Similarly, if the latest Mercedes model, developed at a cost of more than a billion dollars, does not pass the elk test,⁷⁴

⁷²For example, a ware bought from others may be promoted as being manufactured by oneself in order to enhance reputation.

⁷³Tirole, *Markets and Market Power*, vol. 1, p. 189.

⁷⁴A test simulating the need to swerve and/or survive collision with a moose.

consumers will immediately hear all about it. Any attempt to conceal failure here is as unthinkable as it is unthinkable that the failings of a film project might be publicly acknowledged.⁷⁵

3.4.6.3 Common Situations in Cultural Branding

Compared with cars, medicines and food products have poorly formulated quality assessment criteria. These are largely credence goods, which means that a number of their attributes have to be taken on trust, but brands do nevertheless fulfil their navigational function. In these sectors reputation is too important for the owner of a brand to allow lapses in quality. The case of Coca-Cola demonstrates this well. In 1999, hundreds of Belgian schoolchildren were mildly poisoned by an unsatisfactory, locally bottled batch of the beverage. The brand was hit hard. Shortly afterwards, France announced similar cases, then Luxembourg, and sales of Coca-Cola were immediately restricted in these countries. Huge batches of the product were returned, thousands of Coca-Cola workers lost their jobs, and the chief executive resigned.

Artistic markets are a whole different ball game. Anyone can position himself as the producer of a unique taste product.⁷⁶ The result is that all reputations are open to challenge, and any advertising policy provokes a contrary opinion. The price levels chosen by producers may relate less to quality than to firms' desire to avoid price competition with each other by positioning themselves in different niches of demand. A low price can sometimes signal high quality,⁷⁷ or, on the contrary, the producer may decide on a higher price in order to signal that his product is so good you should buy it at any price.⁷⁸ These tactics can also be copied by low-quality manufacturers mimicking the price strategy of conscientious players. They can fund them from resources saved on quality.⁷⁹

For cultural brands the second and third strategies mentioned in Sect. 3.4.6 are the most common, that is, reputation has a genuine foundation but it cannot be verified (the second possibility), or reputation is largely inflated (the third possibility). We do of course also encounter the first, ideal variant, for example with the producers of computer games, or restaurateurs. The second strategy is found more widely in segments where output is limited in scale, repeat purchases (or protracted use of the

⁷⁵Exceptions are possible even here. For a long time Mitsubishi supplied cars with a known significant defect.

⁷⁶This is a situation to which the concept of monopolistic competition, introduced by Chamberlin should apply admirably. Edward H. Chamberlin, *A Theory of Monopolistic Competition [Teoriia monopolisticheskoi konkurentsii]*, Moscow: Ekonomika, 1996.

⁷⁷Tirole, *Markets and Market Power*, vol. 1.

⁷⁸Tirole, *Markets and Market Power*, vol. 1.

⁷⁹A brand fulfils its function not only by being associated with high quality, but also through recognisability, which encourages consumers to make impulse purchases, especially if they have confidence in their own taste.

product) are common, and materials account for a large part of the product's cost, as in the industries of luxury and taste, and the performing arts. The third case is more often found in mass production segments where the product is used only once and the material medium is cheap.

Let us look more closely at the second strategy on the basis of the industries of luxury and taste but, in order to interpret firms' advertising and price strategies correctly, let us first establish the precise nature of demand in these segments.

3.4.7 (Non-)Functional Demand as the Patrimony of Cultural Brands

As ordinary, everyday products become more aestheticised, price formation becomes more complicated, increasingly influenced by psychological and social considerations⁸⁰ which fall outside the purview of conventional economics.⁸¹ This is particularly evident in the fashion markets, where the situation is further confused by the indefinability of quality, consumer error in perceiving it, a number of social effects which have nothing at all to do with the quality of products, the dissimilarity of preferences, and much else besides. In this connection, Harvey Leibenstein has proposed distinguishing between functional and non-functional demand.⁸² The former is generated by qualities inherent in the product itself. Non-functional demand is determined by extraneous factors, like speculative attitudes (the urge to make money in a rising market), or status considerations, or by the stimulating of irrational purchases. In the fashion industry, two-thirds of all sales are impulse purchases. These impulses can be channelled by the seller. For example, if in an expensive men's tailoring shop you release the fragrance of cigars or tanned leather, sales rise by approximately one-third. In a sportswear shop, the scent of flowers increases turnover up by almost two-thirds. Music too can help to regulate demand. Merchandising experts quote the marvellous example of a shop selling classic fashions in New York. Sales fell when the area in front of its entrance became frequented by marginal-looking adolescents and its regular customers stayed away. The owner appealed to consultants, who recommended he should play classical music which could be heard outside. The next day the entrance was free.⁸³

⁸⁰According to Baudrillard, the pragmatic component is not a primary element on which the social signing value is subsequently superimposed, but quite the reverse: the starting point is the symbolic constituent. A proper theory of objects and consumption should be based on the theory of social ostentation and signalling. Baudrillard, *For a Critique*.

⁸¹As Tirole notes, it is in respect of advertising that the traditional assumptions of economic theory about consumer behaviour are most distorted. Tirole, *Markets and Market Power*, vol. 1.

⁸²Harvey Leibenstein, "Bandwagon, Snob and Veblen Effects in the Theory of Consumers' Demand" ["Effekt prisoeidineniia k bol'shinstvu, effekt snoba i effekt Veblena v teorii pokupatel'skogo sprosa", 1950], *Landmarks of Economic Thought*, vol. 1, pp. 304–326.

⁸³See Alexander Dolgin and Anush Gasparian, "Who Dictates Fashion?" ["Kto povelevaet modoi?"], *Kriticheskaja massa*, No. 4, 2004, pp. 20–30.

The most important element in non-functional demand, and the most difficult to analyse, is socially motivated status and taste positioning. Two principal effects can be identified, and one subsidiary one. The bandwagon effect means that demand for a product grows because other people are buying it. Consumers are driven by an urge not to fall behind, to be up-to-the-minute, to fit in to the circle to which they would like to belong, or a reluctance to seem the odd man out. Customers' imitative urges help brands to reap the rewards of large-scale production. For consumers, following the choice of the majority is economically beneficial because the goods they choose cost them less. There is, however, an opposite urge which produces the snob effect: demand can fall because a product is being bought by too many other people.⁸⁴ Within the force field of these two motivations—to be like and to be different from everybody else—there comes a point of equilibrium between cultural homogeneity and heterogeneity. The Veblen effect is a variation of the snob effect,⁸⁵ where demand increases because the product is manifestly expensive and its price signals status. The latter effect is the engine driving the industries of luxury and taste.

It is not easy to apply Leibenstein's classification when analysing products with a substantial aesthetic constituent, clearly differentiating between functional and non-functional demand. On the one hand, all demand for cultural products can be considered functional, it is just that it is not utilitarian functions which are being valued but functions producing social signs and distinctions. On the other hand, Théophile Gautier remarked that "everything that is useful is ugly", and one can equally claim that the need for beauty is non-functional. It is perhaps just a question of terminology. To understand the cultural markets a different view of functionality is required from that proposed by Leibenstein. The present book defines as functional whatever bears within it the potential of quality time for the individual.

If we view utilitarian items from the narrow, traditional standpoint, any aesthetic value they may have appears to be a kind of extra added on to the basic good, but for cultural products everything is the other way round: what really matters is the non-functional constituent, which is in essence functional, while the utilitarian component, if present at all, is there as an extra. "Objects are constantly playing a game. . . the functional object pretends to be decorative, burdens itself with useless elements and fashion signs, whereas a trivial and inessential object shoulders the task of realising some practical intention. . ." ⁸⁶ The aesthetisation of everyday life has led to objects intended to assist the consumption of food or protecting one from the cold becoming markedly more expensive than they would be if less pretentiously designed. This makes a nonsense of viewing objects in the conventional terms of primary natural needs. The economics of goods and services is replaced by the economics of meanings, experiences and social signification, where what is functional is what produces a desirable state. A car, a writing table, china—which component

⁸⁴Leibenstein, "Bandwagon, Snob and Veblen Effects".

⁸⁵Thorstein Veblen, is one of the founders of classical institutionalism and wrote the groundbreaking *Theory of the Leisure Class*, 1899.

⁸⁶Baudrillard, *For a Critique*, p. 13.

is mainly creating the demand for them, the utilitarian or the socio-cultural? The criterion for classifying them might be the proportion of the cost of the material medium (the manufacturing cost) in the price of the product. For utilitarian goods the proportion varies approximately from 30 to 70%, while for cultural goods it is under 10%. Following this line of argument, quartz watches are logically classified as utilitarian products, while watches of haute horlogerie, where the costs of the Swiss manufacturer average 6% of the retail price, belong firmly in the category of cultural products.

If we rank products in order of the proportion of the immaterial in their price, then towards the bottom we shall find ordinary household wares which, for all their ordinariness, are nevertheless imbued with a modicum of aesthetics. These are items whose main purpose is to save time and effort. At the top of our list would be luxury items, which change the quality of time. In the middle we shall find medium-priced items whose functionality corresponds closely to their price. Significantly above the average will be the de luxe category. This will be below luxury, and perceived by users of luxury as ordinary, while those for whom luxury is unaffordable will regard it as luxury.

If we consider all cultural demand to be functional, it is helpful to discriminate personal functionality (bearing in mind that all this is only approximate). A particular item has utility for an individual irrespective of whether others consume it or not, and social functionality is that part of utility which is associated with the process of communication. The same aspect of the product may be both socially and individually significant. What is really striking is when the most important attribute of a product is its price, when what is consumed is primarily the price, and only after that the product's inherent attributes. Here what matters most is how the price is perceived by the purchaser himself and by those around him. This is again the Veblen effect of conspicuous consumption, which is much in evidence in the case of haute horlogerie watches.⁸⁷

Three target groups can be identified for whom watches give price signals about their owner.⁸⁸ The first, and most numerous, group is those for whom the watches of familiar expensive makes are intended. The second is an elite circle who position themselves by buying watches of exotic makes which few will recognise. A bonus here is the opportunity of telling the story (or legend) of one's possession, which imbues it with the additional advantage of being a conversation piece. (If you buy

⁸⁷Thirteen makes are traditionally regarded as producing *haute* watches: Patek Philippe, Vacheron Constantin, Audemars Piguet, A. Lange & Söhne, Breguet, Jaeger-LeCoultre, Piaget, Parmigiani, Franck Muller, Ulysse Nardin, Girard-Perregaux, Blancpain, Chopard. A number of firms like Jaquet-Droz, Arnold & Sons and Graham which have a long history of watch-making are also trying to gain a foothold in this segment. There is only a working definition of what constitutes *haute horlogerie*. There are 4–5 major characteristics and another 10 optional attributes. For a make to be considered *haute*, the firm should produce only exclusive watches; all components should be manufactured in Geneva in their own factory; there should be no 'bread-and-butter' technology, that is, functions simply bolted on to the existing mechanism; and the price should be above €2,000.

⁸⁸The actual measurement of time is the least sought-after function of *haute* watches.

a make familiar to everyone, what more is to be said?) And the third group of people motivated to acquire an expensive watch are sending a signal to themselves, informing themselves, as it were, of the future lifestyle they desire.

How should price be approached in such a case? What part is determined by ordinary, everyday functionality, what part by the need for ostentation, and what part by a non-price message? Here we need to divide the price of a product into two parts: the real price and the ostentation price. The real price is what the buyer would have paid for a non-public object, an object playing no part in the game of social signification. The ostentation price is the price laid out for the item, the value known to the public. More precisely, the ostentation price is that which the buyer believes will be taken at face value by those around him and will thereby determine the social utility of the item. The picture is confused by the fact that luxury goods are often sold at a discount, so that the high price signalled has not actually been paid, a \$5,000 suit, for example, having been bought for \$2,000.

De luxe is normality for those who possess high net worth. The upper boundary of de luxe corresponds to a high level of physical quality of manufacture, and is also the lower border of luxury, which is usually priced substantially above it. Luxury costs two, three or more times more than de luxe, and this increase is wholly down to social functionality. The defining feature of luxury is investment in the non-utilitarian above the norm for a particular social stratum or habitus.⁸⁹ A \$2,000–\$3,000 man's suit qualifies economically as de luxe, but not as a luxury. For people of a certain status this is merely a normal, good-quality item. The economic gulf between de luxe and luxury is expenditure over and above the social norm of a given circle which, to the uninitiated, appears unjustifiable. There are also distinctions in symbolic terms.

De luxe is primarily a clearly defined commercial price bracket, whereas luxury is a relative concept more linked to how the individual feels about himself, although also, of course, to status. Luxury marks the distance between the situation a person is in and where he would like to be. If a product corresponds to his current financial position, that is de luxe for a particular individual. If the price is one or two rungs higher, it is luxury. Accordingly, for different income groups different items fall in the luxury category: for some this might be a middle-range car.⁹⁰ In order not to drive themselves into a corner over starting points, specialists try not to tie luxury in to particular monetary levels independent of consumers' claims to status and

⁸⁹A slightly straitened definition of habitus is the conventional, ordinary run of consumption by an individual and includes possessions, furnishings, leisure, etc., internally harmonious and arranged to suit the social and financial situation of its adepts. According to Pierre Bourdieu, habitus is "systematised models of perception and assessment... the result of long experience on the part of the subject and determined by a particular position in society". Pierre Bourdieu, "Social Space and Symbolic Power" ["Sotsial'noe prostranstvo i simvolicheskaia vlast'"], *Thesis*, vol. 1, issue 3, 1993, p. 143. In terms of perception, thinking and behaviour, habitus evinces the lifestyle of different social groups.

⁹⁰As Baudrillard remarks, "In the African provinces a broken television, non-functioning fan, defunct watch or car with no petrol may nevertheless be prestige goods". Baudrillard, *For a Critique*, p. 47.

style. They naturally prefer a symbolic definition of luxury to a financial one, one which implies a firm link between status concerns and high-quality experience for the individual. The same items fit both the symbolic and financial definitions of luxury in the case of wares for the moneyed elite.

3.5 Information Economics of the Fashion Industries

Our examination of how branding functions in the segments of luxury and taste, which have relatively fewer problems, has not been a digression from our initial goal of investigating adverse selection in the mass cultural industries and finding ways in which the problem could be alleviated. “The logical processes of fashion should be extended to the whole of culture, to all social production of signs, values and relations,” Baudrillard declared.⁹¹ We not only agree with him,⁹² but would add that such an extension is possible and justified because different cultural markets conform to the same informational and economic logic, although they do so in their own ways.

The value of fashion for us is that it is a tangible example, and because its economic constitution is moving ever closer to that of the digital sector, because wares are constantly moving out of the search goods category and into the category of experience goods. With the increase in quantity—not of output but of the number of fashion labels and classifications—this whole segment appears to be succumbing to the same malaise as digital culture: inability to discern quality, insufficient production of high-quality goods, and a narrowing of the circle of people capable of properly appreciating them.

The engine driving these processes is that familiar urge of business to increase sales volume by increasing the product range. Accessories and clothing can be inspected, felt, tried on, and, if necessary, returned; some people devote a huge amount of attention to choosing clothes and are extraordinarily skilled at it. This might lead one to suppose that there would be little scope for advertising and price manipulation of the consumer. In actual fact, although suppliers have the prerequisites for successful branding and incentives to pursue a strategy of high quality, in a number of cases different motives take priority in accordance with the second strategy mentioned in Sect. 3.4.6 above. The situation in the fashion world is moving inexorably in this unfortunate direction.

The purchaser of a fashion item may have doubts on at least two scores: firstly, its rarity, the size of its ‘edition’; and secondly, how long it is going to remain fashionable. From the manufacturer’s point of view, these two unobservable quality attributes, essentially those of a credence good, are precisely what he can and must manage in the interests of his business. Naturally there is here in potential that same information asymmetry which, according to Akerlof, triggers adverse selection.

⁹¹Baudrillard, *For a Critique*, p. 80.

⁹²Let us recall the parallels between developments in contemporary music and fashion traced by T. Cohen (see Sect. 1.1.12).

Let us first examine the matter of how many items are put into circulation. The two sides have divergent interests here: purchasers want to see limitation of the number of items, since the fewer the number of potential owners the greater their privileged status; while for sellers it is profitable to increase production to include all possible consumer segments. For the fashion industry the size of the edition of a product is a crucially important constituent of quality.

More than that, the number of items produced is the main criterion in the world of fashion, in the same way that potential availability or scarcity rules the markets in general. Ideally, the number of items stratifying people and encouraging them to spend in accordance with their status and taste preferences should be equal to the number of those desiring to enter the circle and identify each other by this particular signal. Different life situations require different positioning with the use of clothing: in some circumstances it is necessary to merge with those around one, while in others standing out is the main thing. Accordingly, the optimal edition for different items will vary. Extreme scarcity is by no means always needed, but some limitation of the size of the edition is invariably required. An uncontrolled increase in the size of the edition decreases consumer value: if an item is accessible to all and sundry, then for those to whom it belongs as of right because of their position in society, its signalling function is lost. When the size of the edition is inflated, the garment loses part of its social marker functions.

A natural regulator of edition is price, which restricts the circle of buyers through affordability. A problem is that price changes as time passes. If it didn't there would be no blurring of the communities which a particular category of signalling items was intended to serve. Clothing would indicate status and would be read in that way by those one met. A seller is, however, under no obligation, and has no particular wish, to keep prices stable since the cost of sewing (and the wholesale price) is several times lower than the price tag initially displayed in retail outlets. The seller is thus able to (and usually does) gradually lower the price, earning a measure of profit on each item sold. This is why clearance sales are arranged, which from the standpoint of economics represent second degree price discrimination.

3.5.1 Price Discrimination: A Result and Source of Asymmetric Information

Price discrimination occurs when the same ware is sold at different prices either to the same or to different consumers.⁹³ Thus a doctor may charge a rich patient more than he charges a poor one. Something similar is occurring when a film star adjusts his fee in the light of a film's budget. Even though costs are much the same, the price of wares may be varied between regions as a supplier tries to take account

⁹³Not every variation of price is discriminatory, and uniform pricing does not always preclude discrimination. For example, if the price includes transportation, different prices for different regions may not indicate discrimination.

of differing purchasing power of his customers. Discrimination is an attempt by a manufacturer to obtain a higher return than he would from a single price. The differentiation of classes in trains, planes and concert halls is a technique for accessing consumer surplus.⁹⁴

According to Alfred Pigou,⁹⁵ there are three types of price discrimination, reflecting a seller's ability to predict the value of his ware for different consumers. First degree price discrimination is where the manufacturer in some way discovers his purchaser's price expectations for the ware or service being offered, and the quantity he requires. Such instances are rare but not unknown. The price is then set accordingly. If resale is not possible, for example in the case of the services of architects, doctors, lawyers, or filmstars, the producer obtains the whole consumer surplus.

Where the seller has insufficient information about individual consumers' preferences and is unable to establish their exact ability to pay, that is, where he does not know the price elasticity of their demand, he offers the same price structure to everyone and leaves it to them to decide on purchase volume and/or specific conditions for making a purchase. This is second degree price discrimination, also known as self-selection. In practice it often takes the form of discounts or price reductions for larger deliveries, for example when selling subscriptions. Another such discount may relate to the time of the sale, as in the case of prior ticket sales for performances, or clothing clearance sales.

During clearance sales customers have less choice than was enjoyed by earlier clients, and risk not finding the colour, size, or ensemble they want among the remaindered items. The mechanism operating is, lower price in return for a lower probability of finding what you need, the principle mentioned above when we were describing flea markets. Part of the utility has been lost because of a reduced ability to co-ordinate items, to say nothing of the fact that the environment in which the purchase is made may be less agreeable and that the fashion season is coming to an end at the time of the sales. Be that as it may, the discounted items bought in the sales are physically identical to their siblings, for which someone else paid full price. Over a brief period of time the value has depreciated by the size of the discount. It is plausibly argued that describing this as price discrimination is dragging a term in by the ears which bears little relation to reality since 'identical' goods sold before and during the sales simply are of different value.⁹⁶ Sales can only be classified as price discrimination with certain reservations. This can be seen more clearly if we take the example of seasonal discounts in hotels. Although a room in the celebrated 'seven-star' Burj Al Arab Hotel costs five times less in July than at New Year, this

⁹⁴Clearly, pure price discrimination is limited, since wares delivered at different times to different locations under different natural conditions or with different levels of quality are, from an economic standpoint, different wares.

⁹⁵Alfred C. Pigou, *The Economics of Welfare* [*Ekonomicheskaja teoriia blagosostoianii*], 2 vols, vol. 1, Moscow: Progress, 1985.

⁹⁶See V.M. Gal'perin et al., *Microeconomics* [*Mikroekonomika*], 2 vols, vol. 2, St Petersburg: Ekonomicheskaja shkola, 2002.

can hardly be regarded as price discrimination because far fewer people want to stay there during the oppressive heat of summer.

Finally, a manufacturer who knows the particulars of demand and segmentation of his market may occasionally himself separate customers into groups and set his own price for each, thereby implementing a policy of third degree price discrimination.⁹⁷ Examples of this are reduced rates for children, old age pensioners and others entitled to concessions, differential admission charges of museums, subscription rates for publications which discriminate between libraries and individual readers, and cinema ticket prices which vary depending on the time of day.⁹⁸

How advantageous price discrimination is depends partly on the probability that the ware will be resold in a so-called arbitrage operation. If the transaction costs of dealing in the ware between consumers are low, differential prices may tempt those who have obtained the item at a low price to resell it at a higher price. It is, for example, impossible to resell premium television services without setting up a local network. To completely prevent reselling is nevertheless very difficult. Thus, individual traders buy up clothes in Italy, Hong Kong and other countries and resell them in Moscow, helping themselves to a share of the market.

3.5.1.1 Bundle Selling

Bundle selling is selling two or more items together for a single price. In bundle sales in their pure form, wares are offered only in a block, and cannot be bought separately. In mixed bundle selling the wares can be bought either together or separately. Compare with buying the items separately, any bundle offers a discount. Bundle sales makes it possible to implement price discrimination in the absence of information about the distribution of consumer valuations, and at the same time they hinder arbitrage. Moreover, bundle sales make it possible to conceal the price of the individual components.⁹⁹ According to Bakos and Brynjolfsson, bundle selling of a large number of wares which are unconnected with each other can be profitable for a multi-product monopolist, and as the assortment of wares included in a single bundle increases, so does the profit.¹⁰⁰ By selling low-quality wares within the bundle it is possible both to enter a market and to obtain higher returns than you would for high-quality items sold on their own. Bundle selling helps to erect entry barriers for

⁹⁷Third degree price discrimination relies on direct signalling of demand, whereas second degree discrimination allows for indirect selection of consumers through their choosing of different bundles.

⁹⁸In the USA, tickets for daytime performances are usually offered at two-thirds of the evening price. Peter Davis, "The Effect of Local Competition on Retail Prices: The US Motion Picture Exhibition Market", Working papers, London School of Economics, October 2002.

⁹⁹Barry Nalebuff, "Bundling, Tying and Portfolio Effects", *DTI Economics Papers*, No. 1, London: Department of Trade and Industry, 2003.

¹⁰⁰Yannis Bakos and Erik Brynjolfsson, "Bundling Information Goods: Pricing, Profits And Efficiency", *Management Science*, 45, 1999, pp. 1613–1630.

competitors, leaving them a smaller market share.¹⁰¹ For the entertainment markets, where competition for content is acute, a company which has already assembled a large bundle has an incentive to pay more for a new product than a new entrant has. This leads to oligopolisation of the market.¹⁰²

Along with pure bundle selling there also exists customised bundle selling.¹⁰³ The idea here is to determine only the size and price of the bundle and leave it to the customer to select his products. McDonald's at one time offered a McPick Value Meal, a choice of main meal plus any two side dishes, chosen from seven options by the customer, at a fixed price. Columbia House sold any five DVDs at a discounted price of \$4.96 each, plus a further four DVDs at the usual price¹⁰⁴ which, taken together, gave a saving.

Where tastes vary, offering a large number of customised bundles is more profitable than pure bundle selling or selling products separately.¹⁰⁵ It would seem that the organisers of clothes sales are following this rule instinctively.

3.5.2 *The Economic View of Fashion Sales Reductions*

The literature in economics on the theory of fashion sales is fairly sparse.¹⁰⁶ According to Lazear, sales are dictated by the uncertainty of tastes and hence of demand.¹⁰⁷

Preferences for style, colour or cut are difficult to predict. Lazear examines the situation where a shop acquires a fashion collection before it is finally known what the favoured colours of the coming season are to be.¹⁰⁸ Uncertain of what will sell at a high or a low price, the retailer displays a 'starting price' for the items. Anything which does not sell in this initial period he tries to sell at a reduced price while maximising revenue. Lazear's theory explains why premiums and discounts for fashion clothing are higher than for ordinary clothing: fashion items are more exciting and

¹⁰¹Barry Nalebuff, "Bundling as an Entry Barrier", Working Paper, School of Management, Yale University, New Haven, CT, 2004.

¹⁰²Yannis Bakos and Erik Brynjolfsson, "Bundling and Competition on the Internet", *Marketing Science*, vol. 19, No. 1, 2000, pp. 63–82.

¹⁰³Shin-Yi Wu and G. Anandalingam, "Optimal Customised Bundle Pricing for Information Goods", *Proceedings of the Workshop on Information Technology and Systems*, Barcelona, 2002.

¹⁰⁴Depending on the distributor, the price of a single unbundled disc varies from \$10–15.

¹⁰⁵Shin-Yi Wu and G. Anandalingam, "Optimal Customised Bundle Pricing".

¹⁰⁶Examples are: Hal R. Varian "A Model of Sales", *American Economic Review*, vol. 70, September 1980, pp. 651–659; Steven Salop and Joseph E. Stiglitz, "The Theory of Sales: A Simple Model of Equilibrium Price Dispersion with Identical Agents", *American Economic Review*, vol. 72, December 1982, pp. 1121–1130.

¹⁰⁷Edward P. Lazear, "Retail Pricing and Clearance Sales", *American Economic Review*, vol. 76, March 1986, pp. 14–32.

¹⁰⁸Lazear's model ignores strategic behaviour on the part of consumers, that is, a willingness to bide their time. Evidently this is no longer in evidence.

varied, but also carry more risk for sellers. In economic terms, they are tending towards being experience goods, and their high price strikingly supports Anna Della Valle's calculations (see Sect. 3.3.5). Lazear's theory postulates that discounts are higher at the end of the season (the peaks for discounting are July and January), rather than at the beginning (obviously); and secondly, that the markup is higher for wares particularly subject to the vagaries of fashion, but these figure more frequently in the sales.

Peter Pashigian has empirically tested the theory of sales.¹⁰⁹ He was puzzled by the fact that they became much more frequent in the early 1970s than they had been during the preceding 40–45 years, while at the same time the initial price premium was higher. He also noticed that for certain wares the level of markup and discounts was greater than for others. Having traced retail markups and discounts over the period 1925–1984, he verified the theory of how fashion influences commerce. His data show that from the mid-1960s the popularity of fabrics with a printed pattern grew rapidly for the next ten years. Over this period sales of white sheets fell to a quarter of their former level, from 65% to 16%, while sales of decorated items rose from 15% to 75%. Sales of men's white shirts also fell sharply, from 72% in 1962 to 19% in 1970. (In the 1980s the proportion was in the range of 19–22%.) Thus, from the mid-1960s until the 1980s, customers' preferences moved from white fabrics to coloured and patterned fabrics.¹¹⁰ Clearly, forecasting demand for patterned and coloured items is more difficult than for white. Discounts for women's fashion clothing in 1965 were also higher than for other tailoring items and for the same reason: it was more difficult to predict demand.

What matters most, according to Pashigian, is that the theory of sales makes it possible to anticipate a number of processes: an increase in uncertainty as a result of the caprices of fashion will cause both a rise in the markup at the beginning of the season, and an increase in the proportion of discounted goods in the overall sales volume. Pashigian sees the acceleration of changes in fashion in the 1970s as proceeding from the technological achievements of textile manufacturers. They reduced the cost of manufacturing new forms of textiles on their looms, thus making small-scale production of fashion materials viable. It was already clear by then that fashion was an excellent line of business.

3.5.2.1 Ethical Aspects of Sales: Two Negative External Effects

The term 'discrimination', which describes the markdown pricing of clearance sales, has negative connotations. The clear implication is that the principle of fair pricing is being neglected. If consumers see the same ware on offer at different prices, they will understandably become suspicious and suspect that the seller has been defrauding them. In this respect, clothes sales which, with certain reservations, are classified

¹⁰⁹B. Peter Pashigian, "Demand Uncertainty and Sales: A Study of Fashion and Markdown Pricing", *American Economic Review*, vol. 78, No. 5, 1988, pp. 936–953.

¹¹⁰Although, as the author comments, real income per capita rose throughout the post-war period.

as second degree price discrimination, are considered to be above reproach. At the very least, they seem the least injurious form of discrimination, since the same thing is on offer to everybody. This is not, however, the case. It is, in fact, still discrimination, no more or less honourable than other forms of price discrimination, only better disguised.

It is unsold remainders, the manufacturer's nightmare, inevitable because of the unpredictability of demand, which obliges sellers to arrange clearance sales. One can hardly expect wares which physically are in perfectly good order to be thrown away. If it were felt that unsold goods should be destroyed, their cost would have to be added to the price of those which did get sold, pushing it still higher. By putting on sales, fashion retailers are simply gliding down the price ladder, exploiting the mechanism of customer self-selection and reaping the harvest on each rung. They thus "make the rich pay, while simultaneously selling their wares to the poor". Obviously this can prove disorientating for customers' sense of pricing, since the price can vary many times over without any difference in quality. Moreover, a negative external effect, which is of great importance to the customer and about which he has no information, is the dumping of wares on the market. The consumer value of items with what Leibenstein would call a high proportion of non-functional demand, or as we would say, socially functional demand, depends on how many more people can acquire them. By leaving this question open at the moment when the deal is done, suppliers subsequently deprive their first customers of the snob and Veblen effects sold to them.

Manipulation of price and the size of the edition do not affect the quality of a particular item, and they are unobservable at the moment of purchase. We shall note below occasions when they can exert influence. Even if with the passing of time the consumer begins to notice that the item seems unduly common, he will be unable to sue because there is nothing about a limited edition in the sales agreement. The arrangement is that this is a trade secret withheld from customers. Even in the case of an expensive watch it is difficult to discover the size of the edition. The situation is paradoxical: because of the high price a barrier is erected which limits the edition, but then the barrier is dismantled and the edition increased. There are no technical difficulties in the way of numbering items of clothing in the same way that limited edition prints, collectable books, sculptures or designer watches are numbered, but this is not done.¹¹¹ Accordingly, despite the fact that both value and price are largely determined by scarcity, it is no simple matter to prevent abuse by suppliers.

Why is information about the edition kept secret? The first motive is to facilitate the disposal of unsold goods and earn extra revenue through third degree price discrimination, that is through segmentation of consumers. Bearing in mind that people with differing income levels make their purchases in different locations, the product is distributed to counters of a different social level and there displayed at a different price. Since well-off citizens delight in expensive items not only for their own sake but also because of the agreeable circumstances in which there are selected (the atmosphere in a boutique, talking to a consultant, and so on), the practice of buying

¹¹¹Abuse is possible here too, but is far less common.

goods cheaply in a remainders shop and subsequently reselling them at a higher price is not widespread.

One further variation of the edition game is based on the fact that fashionable wares have two fundamental attributes: design and execution, how the product looks and how faultlessly it has been manufactured or sewn. Design is more obvious than the quality of execution, and is not infrequently of more importance to consumers. The extent to which production costs vary, however, largely depends on the quality of the making up, while design costs can be spread over the whole edition. This makes it profitable to increase the sales of popular models by manufacturing them to less exacting standards and marketing them to the masses through non-status shops at an affordable price. This is the basic strategy of major firms like Zara and H&M which invest in frequently renewed collections of fashion clothing in a fairly low price bracket.

Something similar is undertaken, very cautiously, by international car manufacturers in respect of their most expensive models. No car is designed without reference to the style of the entire range, and design distinctions between them are barely perceptible. The car manufacturers are able to some degree to take advantage of the priority of style over substance. This enables them to stimulate demand for more modest cars, although customers purchasing the most expensive vehicles are partly deprived of the privilege of visible differentness. Those who buy expensive clothes are similarly deprived of some of their perks if a model is copied and unloaded on the mass market in a cruder but more affordable version. It is not only an exact copy but also similarity which detracts from exclusivity.

Besides the size of the edition, a fashionable item can lose its value in one further, largely unpredictable way: the fact that the length of time for which it will stay fashionable is rapidly decreasing. We have technical progress and the perfecting of logistics to blame for this. If formerly it might take an exclusive haute couture dress costing \$2,000 several years to be reduced to a shop model costing \$100, now the interval has been reduced to a few months, and in some cases weeks.¹¹² At the showing of its Spring-Summer 2000 collection in September 1999, Prada presented a skirt in ostrich skin which cost \$2,800. The middle-income consumer did not have to wait two years to catch up with the new fashion: by spring 2000 the designer bebe had already produced an ostrich skin handbag which retailed at \$78, and by the autumn Victoria's Secret shops were selling an 'ostrich embossed' leather skirt.¹¹³

This has led elite consumers to cease to regard a high fashion item as an expensive, privately commissioned product with a future. It has now become an object with a severely impaired life expectancy which extends only until it hits the mass market; that is, it has become virtually a throwaway item (although classic designs

¹¹²It is now technically possible to take a designer's sketch and turn it within 24 hours into a dress in full production. The chain is: the designer sketches the item, the patternmaker develops it, the technician works out the appropriate manufacturing technology, the seamstress makes up an experimental model (which must be replicable), and the product-manager in China puts the experimental model into mass production.

¹¹³The example is taken from Silverstein and Fiske, *Trading Up*.

are worn for years). From this we can calculate the price which the top trendsetters pay for the quality time of wearing an exclusive outfit. It works out at several hundred or even thousand dollars an hour. There is no denying that is vastly more than intangible culture can hope to emulate. For some time now the traditional buyers of luxury and de luxe clothing have known that they cannot stand out by wearing a tastefully styled outfit. What is required is a sassy, modish, totally up-to-the-minute number. Why should manufacturers be putting themselves out over the quality of a throwaway article? The process comes full circle, because the main beneficiaries are those who from the outset never aimed for deathless quality: companies like H&M.

3.5.3 Competition in the Fashion Industry

A crucial factor in making all this happen has been the correlation between the cost of producing an original and copying it; in other words, the ratio of nominal fixed to nominal variable costs. This underlies the main developments in contemporary cultural markets. It is directly relevant to the defence of copyright and the ability of a vendor to control the size of the edition of his model. If a design is customised and the edition limited, as used necessarily to be the case because of technical constraints, the proportion of non-manufacturing costs in the price of an item can be raised limitlessly. Consumers will pay almost any price for the Veblen effect. If the material medium is cheap, however, and there is no protection for concepts, dishonest copiers (pirates) and less respectable producers will have such an economic incentive to help themselves to highly saleable designs that there is no stopping them. Designer originals are highly vulnerable to plagiarism.

Now that, as a result of developments in information technology, there are virtually no obstacles to the free flow of ideas, the market has been unable to defend itself against participants with shoddy manufacturing standards, manufacturers in Third World countries, and companies like Zara (whose manufacturing standards are far from shoddy). The new competitive situation has been developing gradually, aided by the following factors:

- In Third World countries rapid growth in productive capacity has been accompanied by capital import and extensive industrial investment.
- Cheap labour gives these states a major advantage over 'old Europe', and this is particularly evident in the labour-intensive garment sector.
- The fashionable clothing markets have expanded inexorably and appear to have a limitless growth potential. This has attracted big business to the sector.
- The financial resources of this business, together with the latest equipment and technologies, make it a simple matter to surmount the fashion industry's entry barriers.

To make matters worse, traditional brands have themselves proved vulnerable to entry barriers. Established firms headed by charismatic creative personalities lagged behind in developing their managerial side and orientated their pricing policy on the

1–2% of consumers with the highest incomes. Given a very small sales volume, the greater part of the added value was eaten up by fixed costs, including the cost of creating the original. Anybody who could reduce costs, for example by stealing an idea or lowering manufacturing standards while simultaneously increasing the size of the edition had found a competitive business model. There was, of course, no longer any talk of exclusivity. Through this gap competitors squeezed, poaching the middle of the demand pyramid while the top firms continued resting on their laurels at the zenith. Possessing great financial strength as a result of their low manufacturing costs, the new competitors are able to invest some of their resources in disinformation, signalling non-existent quality or inculcating different quality standards and different ideas about the nature of fashion. They are, moreover, completely free of moral restrictions in respect of the size of their editions and the distribution channels of their products.

The top firms found themselves drawn into a war of attrition on two fronts. On the one hand they were plagued by pirates, and on the other attacked by new brands which were helping themselves to chunks of the mass market. To make matters worse, the legislators of fashion had few defences against industrial spies armed with photographic weaponry. Copyright law was of little help here, because it protects not concepts but only their specific embodiment. It is difficult to prove plagiarism, since the concept is almost invariably realised in slightly different fabrics and there is no mechanism for measuring how much this difference is contributing, that is, the 'aesthetic distance', and establishing that two designs are identical. It is also physically difficult to catch the pirates. A newly created original design can be promptly copied on the other side of the globe by anyone so inclined. A defence against this was, for a time, increasing the pace at which new collections were issued. Firms hastened to make their old designs obsolete before they could be copied and released to the mass market. However, it became possible to copy ever more rapidly, and European designers simply could not keep up with creating and manufacturing new models. It had been traditional to create two collections a year, but from the mid-1990s several firms moved to four a year. Nowadays many produce a dozen or more collections a year.

The record for the rate at which it changes its collections is held by Zara. The chain has over 1,000 stores in 54 countries and has changed the rules for the world of fashion. The standard period from creating the sketch for an item to its appearance on shop counters is around nine months: for Zara it is two weeks. Wares are replaced more than 11 times a year (two to three times faster than the average for the sector). Rapid replacement makes it possible to avoid clothes which lie around and to dispense with clearance sales. Customers know there is no point in waiting for them because there won't be any. They need to buy now before the collection changes, and are all the more willing to do so because the products are cheap and can be renewed frequently without breaking the budget. The company has a team of 200 anonymous fashion designers who keep a close eye on new trends and selling successes, which enables them to keep ahead of the market. The company manufactures up to 10,000 new designs each year. Zara's example has been followed by Asda, a gigantic chain in Great Britain owned by Wal-Mart, and the same tactics

have been adopted by the mother corporation in the USA. In Russia it has partly been copied by the firm ‘Zh’, which imports extremely cheap and, in the opinion of specialists, poor quality footwear from China. The goods are positioned as fashionable, and the fact that they are throwaway is compensated for by a systematic discounting policy. This is reminiscent of Ikea’s strategy of selling cheap furniture which it meticulously positions as designer goods. Designers from several countries have formed anti-Ikea coalitions in protest at what they see as a devaluing of the creative component.¹¹⁴

In terms of the turnaround of collections, only the technology of H&M and Zara is currently competitive. Traditional brands have difficulty keeping up and are not finding any salvation in their reputation for quality, since Southeast Asian manufacturers and their workers are rapidly catching up (not without the assistance of European firms). They already often achieve the same levels of craftsmanship as the renowned manufacturers, and in five or ten years there will be no difference at all.

In a real sense, the brands themselves have played into the hands of Southeast Asian manufacturers by extolling the virtues of hand-made articles. In that part of the world the cost of handiwork is extremely low and there are only too many available hands. There is no problem with skill, since people have always sewn by hand there, and at the present time and for the foreseeable future their hands appear more nimble than those of Europeans. The only operational entry barrier remaining is the exclusive quality of European materials. In the *haute horlogerie* industry the barrier is built of precious metals. The Swiss chronographs with their gold and platinum bodies are rarely imitated, since demand for counterfeit products is highly price-sensitive.¹¹⁵ A further barrier to the *haute horlogerie* market is made of wood but provides less protection than the precious metals barrier. Originals are sold in a box made of expensive varieties of wood, whose cost is comparable to the total cost of a counterfeit watch which, necessarily, is sold without it. Accordingly, anybody buying a fake watch in the street should at least have no illusions.¹¹⁶

The same developments are clearly evident in the tie sector.¹¹⁷ Until recently some nine-tenths of the world’s tie output came from Italy where around thirty factories adjoined Lake Como. There ties were sewn for the likes of Giorgio Armani, Kenzo, Emilio Pucci, Paul Smith, Gianfranco Ferré, Gianni Versace, Ralph Lauren, and Brooks Brothers. In the 1980s the first tie-sewing factory started up in Shengzhou in China, and subsequently turned the city into a necktie empire. Today 50,000 people sew more than three-quarters of the world’s total output of ties in

¹¹⁴Yu. Idlis, “You Too Were Made on Our Bed” [“Vas tozhe sdelali na nashei krovati”], Polit.ru [online], 12 July, 2005. Cited 13 May 2006. Available from URL: <http://www.polit.ru/culture/2005/07/12/ikea.html>.

¹¹⁵Evidently consumer notions of utility are such that few people wish to own a fake costing thousands of dollars. The extremes are acceptable: something should be either very expensive, or a fake, in which case it should be a hundred times cheaper.

¹¹⁶When buying over the Internet, however, a fake watch also arrives in a wooden case, but this is of lower quality than the real thing.

¹¹⁷Data from Mintel International Group, “Men’s Ties and Accessories, March 2001”.

300 local enterprises. In the environs of Lake Como workers earn \$1,800 a month, while in Shengzhou they receive less than that in a year. The manufacturing cost of a Chinese printed silk tie is two dollars, which is impressive when compared with the prices in European shops.

The new players in the fashion market are unrestricted by obligations towards the customers of European and American fashion houses and, needless to say, place no limit on the size of editions. Unable to contain the armada of competitors, the respectable and dignified established brands have no option but to play by the new rules. They have begun commissioning semi-finished products in Third World countries, and illustrious Italian brands are following Ermenegildo Zegna and Pierre Cardin in transferring production there, where they have less control over quality and none at all over the size of editions.¹¹⁸

3.5.3.1 How Shock-Proof Are Brands? The Case of Pierre Cardin

Pierre Cardin probably saw all this coming before others did and decided his business should sail with the wind. From the moment he sold his franchise in other countries and his hundred-dollar shirts flooded lower class counters at one-fifth of the price, they ceased to betoken high status. The brand was cashed in for what it could bring. It took customers some time to react to this unannounced stepping down from the pedestal, because mass dumping on the world market was not immediately evident. The ingenuity of the strategy lay in exploiting unexpectedness, which brands occasionally do. Customers old and new, the latter attracted by the low price, for a time purchase the prestigious ware by inertia, not noticing that it is being inordinately mass-produced. The brand in the interim makes a pile of cash, but as adepts of the brand ever more frequently encounter their favourite haute couture items on people who plainly do not belong to their circle, and in inappropriate places, and at a puzzlingly low price, they realise they have been taken for a ride. The brand accelerates natural depreciation. In the short term, a firm can trade on its old reputation by lowering the unobservable, and then the observable, quality of its wares.

3.5.3.2 The Gucci Story

A number of companies followed Cardin's example. In the 1980s this brought, Gucci, the legendary Florentine manufacturer of bags and footwear, to the brink of ruin.¹¹⁹ The brand had become famous back in the 1950s, and a decade later numbered Jacqueline Kennedy and Queen Elizabeth II among its clients. In the 1970s

¹¹⁸Tailormade items are sewn mainly in Italy, but second, third, and other lines, and accessories may be manufactured anywhere: in Eastern Europe, Turkey, China, or South Korea. The pirates sew their products in the same places.

¹¹⁹The Gucci story is related after Drawbaugh, *Secrets of a Strong Brand*, Moscow, Al'pina-Biznes Buks, 2005.

and 1980s, however, the managers, left unsupervised because of turmoil within the Gucci family, issued an unreasonable quantity of licenses and failed to monitor quality.¹²⁰ The Gucci moniker started turning up on baseball caps and cheap sportswear. Break dancers wore gilded plastic badges with the word ‘Gucci’. The brand was torn apart, and at its nadir the Gucci emblem was to be found on toilet paper, issued in 1975 by the Oh Dawn! company. The brand appeared to have been irrevocably discredited in the eyes of its target group of *soignée* young women. However, Gucci succeeded in restoring its aura of uniqueness and respectability, and is possibly the most famous case in history of the rehabilitation of a reputation. The firm was saved by a duo consisting of Domenico de Sole and Tom Ford, the former restructuring the management while the second created a *furor* in design. They enabled the fashion house once more to occupy its niche in the market of exclusive fashion. In order to do so:

- they revoked licenses issued to companies which had placed the brand name on low-grade wares;
- all production was concentrated in Tuscany, and wages at the local factory were raised;
- they bought out the franchise network and shut down unsuitably located retail outlets (in 1997, 31 shops were closed);
- they increased the advertising budget tenfold (\$70 million in 1997 against \$6 million four years earlier), and communicated information only through prestigious channels;
- they intensified the battle against counterfeit products.

By 1999 Gucci’s profits exceeded \$300 million. The group took over Yves Saint Laurent, where the situation was reminiscent of that out of which Gucci itself had just climbed.

Gucci appeared to have executed an impossible pirouette: a lost reputation is extremely difficult to retrieve. A brand which has lost face turns into an anti-brand and encounters persistent consumer resistance. Past merits are soon forgotten.

The money a supplier invests in advertising is generally regarded as a non-returnable deposit to show he can be trusted. A readiness to sacrifice it can, however, be amply compensated if large quantities of poor quality goods can be sold off at a low price, and also by selling licenses. The advertising budget will not have been wasted, although the belief that advertising guarantees quality may have been dented. A gambler who decides to go for broke needs to exploit the advantage of surprise to the full, since he can’t be sure of having a second chance, let alone a second game. Nobody is going to play a second time with a known card sharper. An alternative is for a firm to change its positioning and operate in a lower consumer segment, but even if a compromised brand remains in its original niche, time is working in its favour. Old hurts get forgotten, a new generation of admirers of the

¹²⁰This is precisely the situation mentioned above where the interests of managers and owners diverge.

brand grows up who have nothing to be offended about. Indeed mishaps, or misdeeds, do not always necessarily work to the brand's disadvantage. Sometimes its popularity actually increases.

Lapses in quality, difficulties in use, even dysfunctionality may do little harm and may even attract customers. Super-expensive cars are famously unreliable, capricious and expensive to run, but this is readily forgiven them because their social signalling is irreproachable. In any case, giving up certain comforts and sacrificing utilitarian value is a way of declaring one's allegiance to values of a higher kind. Social games are highly convoluted.

3.5.3.3 Assimilation of Fashion Brands

Brands with a pedigree and back history are economically vulnerable. Confronting a new competitive situation, they may compromise their principles and begin to retreat. Even ten years ago some 10,000 haute couture clients were ordering their clothing from the top fashion houses: today barely 200 of them remain. (A few years ago analysts put the number at 2,000.) These are celebrities who need something to wear when being awarded an Oscar, and Arab princesses. This leaves the fashion houses no option but to take a leaf out of their competitors' book. The labels on today's designer items may honestly admit they were 'made in Tunisia', but that hardly compensates for the shortcomings of local tailoring. Quite often, however, there is no warning: a pair of sandals glued together in Italy from Far Eastern semi-finished products which costs \$8 to manufacture and for which the top price should be \$30, is put on sale at \$200. How else is a firm to survive in a battle which is being fought in a familiar arena but under strange new rules? Production begins to be marketed through channels which would previously have been considered unthinkable. Price cuts are scheduled far in advance, which dampens the ardour of early customers and encourages them to play a waiting game. A few, like Chanel, never reduce their prices. In the past, high-end ready-to-wear clothes were never discounted, but today this is common practice, as is the fact that expensive designs turn up in discount stores. By autumn the entire spring collection can be bought at half or even a fifth of the original price. Nobody finds this shocking any more: the pirates have done their job. For many brands they are no longer only their competitors; they are also their fig-leaf, legitimising the channels through which an excessively large edition can be sold off without repercussions. The counterfeit market is a double agent, providing reputable firms with an alibi.¹²¹

Seeing the price barriers swept away and the gates wide open, large numbers of people have decided they want to possess prestige signals they could not previously have afforded. From the economic standpoint, these are gatecrashers in the theatre of fashion. They are buying on the cheap into status symbols which others have paid big money for. Price is no longer a filter. Anyway, why buy top quality and exclusivity from a couturier if everybody knows that he is letting rip with the edition? Why

¹²¹Where there are several miscreants, it is more difficult to prove a misdemeanour.

pay to belong to a club to which others are admitted free? Club theory denies the legitimacy of such entities.

The formerly invincible flagships of fashion are not doing well and the haute couture houses are no longer profitable. They find themselves reduced to the status of subsidised research and development departments. Almost all the couture lines operate today within the framework of the advertising budget of multi-brand corporations.¹²² The top-of-the-range line provides publicity for the second and third lines and, most importantly, for accessories, perfume, and spectacles, which is where the main money is made. The middle-market tiers are breaking down. One floor down from the top line, where the prices are in three rather than four digits, the same contest with pirates and low-quality clothing with no reputation (confections) is being played out. Many consumers now know that a middle-class item costing \$300 can be bought in China for \$20–30; they know all the ins and outs of discounts and sales. When everybody is aware that by waiting three weeks or three months they can purchase items several times cheaper, when everybody understands the rationale behind clearance sales, everyone will start playing a bear market. This is already beginning to happen.

Needless to say, not all customers are attracted by discounts. Some are rightly concerned that discounted items may have hidden drawbacks. The goods in a sale may only appear to be branded. If you make a succession of cut-price purchases, the likelihood is high that defects will be overlooked or that, seduced by cheapness, one may purchase a no longer fashionable article and end up saving a good deal less than anticipated.

3.5.4 *The Overall Trend of Changes in Fashion*

It is not easy to neatly pigeonhole what is happening in the world of fashion because the old categories are thoroughly mixed up, the wares involved come from all over the place, and players are all stealing each others' strategies. An overall logic can, nevertheless, be deduced when we understand the strengths and opportunities of the market players. The major driving force is the desire of brand owners of (like any other producer) to increase sales by hierarchically extending the product line. "First you build the brand and then you extend it," is how easyJet entrepreneur Stelios Haji-Ioannou formulates the generally accepted strategy.¹²³

3.5.4.1 **Stretching a Reputation: The Case of Polo Ralph Lauren**¹²⁴

Ralph Lauren started his business in 1968 with a brand name which happily combines his own name with the game of polo in order to associate the brand with

¹²²See, for example, the opinion of Anush Gasparian, director of the Fashion Consulting Group. Dolgin and Gasparian, "Who Dictates Fashion?"

¹²³Drawbaugh, *Secrets of a Strong Brand*, p. 68.

¹²⁴Information from David Aaker and Erich Joachimsthaler, *Brand Leadership: The Next Level of the Brand Revolution [Brend-liderstvo: novaia kontseptsiiia brendinga]*, Moscow, Grebennikov, 2003, p. 184.

the country lifestyle of the aristocracy. In 1974 he introduced a new brand, Chaps, which targeted a lower market segment, because supplying more modest wares under the Polo moniker would have risked diluting the brand. Throughout the 1980s lines for women were extended vertically, with the Ralph Lauren Collection positioned in the premium segment while Ralph Lauren Collection Classics were simpler, but nevertheless sold only in upmarket shops. In the 1990s it was the turn of less expensive labels, which were endowed with capital and the words ‘Ralph’ and ‘Lauren’ by the mother company. The women’s brand Lauren, like Chaps, was targeted at customers for whom the Ralph Lauren Collection was too pricey. The Ralph brand (later renamed RL) provided a more modest version of Collection Classics. As the Lauren and Ralph/RL lines were targeted at less well-heeled customers, a premium line of men’s suits was created. These were mainly made in England, and served to counteract any weakening of the brand as a result of more democratic and affordable recent collections. The label of each suit was personally signed by the master which, together with the burgundy colour of the garments, re-emphasised the haute couture association. This collection was a silver bullet, as a brand is called which positively influences the image of all the firm’s other labels.

In the 1990s the company launched several more lines, targeting the sectors of work, youth and sports clothing: a denim line (Polo jeans from Ralph Lauren), a men’s sports line (Polo Sport from Ralph Lauren), and the same for women (Polo Sport Ralph Lauren). The word ‘Polo’ served to separate moderately priced work clothing from the expensive lines of Ralph Lauren. A trademark was devised which consisted of the American flag with the initials RL in place of stars. In 1993 Ralph Lauren issued a premium line of ‘worn’ jeans, Double RL, but with only modest success. Finally, in autumn 1999 the RLX Polo Sport label made its appearance, denoting functional sports and everyday items. We can see, then, that from the early 1980s Ralph Lauren proliferated sub-brands one after the other. At the present time there are eighteen of them (see Fig. 3.2). Whether this is a good or a bad thing for devotees of the top lines, the designer had every right to experiment with variations of style and moving into different market niches with appropriate positioning. Incidentally, the Laurent brand was stretched not only downwards, as is common, but also upwards, which is extremely rare. He managed the experimentation responsibly and maintained a clear zoning of sub-brands, respecting the social distinctions they communicated.

How discerningly did clients react to the stretching of the Laurent brand family? Did they recognise the distinctions being made in respect of the brand’s new recruits, or did they feel they had been let down? Brands send out messages, but do customers hear them? Bearing in mind that in the clothing segment alone several dozen brands have been introduced, each with a dozen sub-brands, accessories, underwear, perfumery, wine and cigars, interior decoration items and much else, it would be surprising if consumers found it easy to differentiate between all of them. Moreover, not wishing to narrow the circle of their customers, brands employ all manner of twee phrases like “Clothing for the Self-Confident Woman”. To whom is this referring? To half the female population? What kind of self-identification

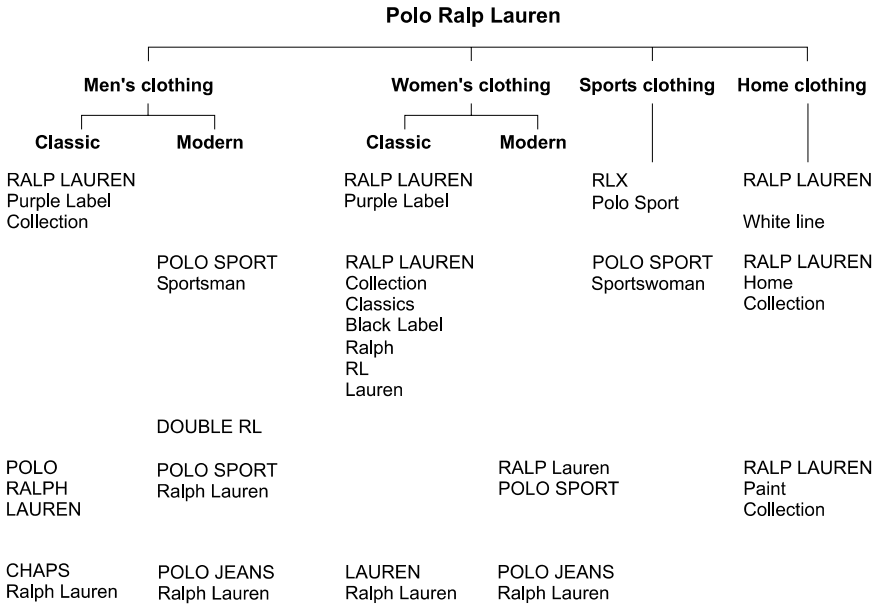


Fig. 3.2

is this? As a result, schoolgirls enquire the price of Chanel items and pensioners home in on the Donna Karan youth range. The clothes brands are embedded among hosts of other brands. Drawbaugh proffers the improbable sounding statistic that a person encounters no fewer than 10,000 brands every day.¹²⁵ It is difficult to believe they are all equally informative and communicating an intelligible message. Unilever, having stuffed its portfolio with 1,600 brands, thought again and rejected three-quarters of them. “We have 1,600 brands, but we do not have 1,600 great ideas,” Clive Butler, the development director, openly admitted.¹²⁶ He added, “It is impossible to maintain a multitude of brands, which tear the budget to shreds. Where there is no real difference between goods, people do not need variety. It just confuses them. Consumers are supposed to like having a choice, but I am not so sure. It may be true of mobile telephones, but with toothpaste I am sure it is not!” We can only breathe a sigh of relief: brands have decided against waging total war to take over the minds of higher mammals. Even the largest firms are feeling the financial strain. If everybody follows in Unilever’s footsteps, the dictionary of brands may even be reduced to the size of an average human being’s vocabulary.

¹²⁵Drawbaugh, *Secrets of a Strong Brand*, p. 18.

¹²⁶Drawbaugh, *Secrets of a Strong Brand*, p. 140.

3.5.4.2 What Determines the Pace of Change in Fashion?

Institutional economics holds the keys we need for solving the puzzle of what determines the pace of fashion change and establishing the shape of the sine curve of fashion. Stretching brands in the clothes sector enabled grey markets to merge with official markets. When brands moved downmarket they provided new opportunities not only for themselves but also for the counterfeiters. If brand owners who decided to extend their brand initially kept a safe distance from that critical line where identity begins to blur, in the new competitive situation they finally lost control. Pirates unhesitatingly rushed over the dangerous boundary, and in the process opened customers' eyes to the fact that items could be very nearly as good and socially functional while costing a great deal less. The established brands shifted up a gear in order to move the fashion on before their designs could be mass produced by their new competitors. Simultaneously, the old firms found themselves facing an influx into the already turbulent and turbid waters of new retail brands which utilised nameless designers, cutting edge logistics, and consumer feedback obtained directly at the sales counter. (Zara's sales assistants and managers efficiently communicate customers's wishes to central office, and implement proposals for rationalisation.) All that such brands need is to efficiently sense the way fashion is moving. Their technology is then so efficient that no pirate stands a chance of keeping up.

It is difficult to establish the exact logic of all the players' actions and the processes they have unleashed, but despite their asynchrony, the market participants resonate together at one point—they are increasing the torque on the crankshaft of fashion. This in turn encourages hyperactivity among consumers. We have to ask whether this acceleration and democratisation of fashion is actually benefiting customers. Do people really want to change their outfits so frequently, or are they mere pawns in a game played by blind market forces? Is the way the business is organised not leading to a fashion-based nervous breakdown, a kind of garment bulimia? "Items proliferate, become increasingly varied, and are renewed ever more frequently. This calls into question the whole ideology of fashion. Outwardly its logic [more precisely, the logic of the market—A.D.] imposes an increased mobility of all discriminatory social signs, but does this correspond to a genuine mobility of social structures, professional, political, and cultural?"¹²⁷

If the combat between the market players dictates the pace of fashion, are we approaching the point where neither the supply side nor the demand side can keep up? There are a number of signs which suggest that limit has almost been reached. Initiates are wearying of the fashion game on the terms currently proposed. It is becoming increasingly difficult to show distinction through dress, and increasingly difficult to place a person from the social signs of clothing, because these are now within reach of nearly everybody. People's wardrobes are full, and they are reluctant to throw out items they have only just bought and hardly worn. They cannot always find anyone to give them away to. It is not only wardrobes which are overfull: so is everyone's emotional capacity. In many cities, 20 year-olds, both men and girls,

¹²⁷Baudrillard, *For a Critique*, p. 40.

dress as inexpressively as the Chinese during the era of Mao. Is this not evidence that the game of using clothes to register social distinctions is on the way out, and that communities are switching their attention to different puzzles? Fashion statements are becoming trivial and uninformative. The human body, the accessories one chooses, and the interior and exterior decoration of the place you live are the last bastions of individuality. It is revealing that in a recent crime thriller, the plot revolves around the body art tattoos of cult personalities who, because of their popularity, have become targets.

As usual, while some give up playing the fashion game others start in. Fashion's new recruits are mainly motivated by the fact that they have money and time to spare and, needless to say, a passion for crossword puzzles consisting of clothing items. These are the economic engines driving fashion. It is not that people choose to buy, but the pressure of money forces them into a certain level of purchasing. So far, the fashion tachometer is not registering red. There are signs of cognitive overheating, but it is bearable. The market is supported by the fact that clothing and accessories are an important part of people's personal and public lives and up to a third of disposable income is spent on them. Moreover, if people have invested time and effort in developing good taste, they want to harvest the fruits of their increasing competence.

In theory, if the pace of change in fashion goes just too far, there is nothing to stop the consumer from applying the brakes. This is what will happen when people completely cease to understand the flickering signals, or anything else, emanating from the fashion industry. So far the bounds of reason have not been transgressed and, no matter how complex the games of conspicuous consumption have become, we are still able, more or less, to 'read' people from the signs they wear. Although the old cultural codes are losing their force, the functions performed by fashion are so significant that people contrive to renew and memorise the hieroglyphic systems. A glance at a tie, watch, haircut, and assessment of general demeanour is enough to tell us whom we are dealing with.

Ties are particularly revealing, since they are wholly non-functional and have from the outset served only to distinguish people belonging to a particular group from outsiders.¹²⁸ A tie can signal the financial and social status of a new acquaintance. There is a fairly tight correlation between price of tie—overall expenditure on clothing—annual income. We estimate that in Russia ties costing between \$250–400 are worn by people who on average are earning \$1–2 million a year or more. Ties in the \$150–250 range point to income of over \$500,000 a year. \$100 ties are purchased by managers earning over \$80,000 if they are looking for promotion, while \$40 ties suggest someone is earning more than \$18,000 a year. Although these figures are only approximations, an increase in the money invested in a tie of 150–200% signals a much greater increase in income. Those who need to know (headhunters, say, or negotiators) have no trouble in reading this indicator of personal economic health.

¹²⁸In the seventeenth century Croatian mercenaries fighting for the King of France wore distinctive neckerchiefs. Two centuries later the fashion spread to English clubs and schools and then to the rest of the world.

Conversely, anyone so inclined should in theory be able to exploit this approach by substituting neckwear for deficient professional competence. The technique does not seem to have caught on, however, because it requires no less professionalism than that the absence of which one is trying to conceal.

In recent years a fusion style has become dominant, the combining of different styles. De luxe items are mixed with popular, mass-produced articles, the latest thing with scraps from grandmother's clothes chest, which allows the expression of a post-modern attitude, anti-elitism, and general independent-mindedness. Its simplicity and easy accessibility are deceptive, however, as anyone will know who has ever tried matching the rags characteristic of this style with some elegant item from the wardrobe. Successfully practising fusion demands not just money but sophisticated taste, without which disasters are possible on a scale which could lead to your being taken for a tramp, since it is from them that the style was initially adopted.¹²⁹ There is logic behind the elite's welcoming of fusion. It is difficult to learn and difficult to imitate even if you have a lot of money. Hence the social functionality of the fusion style: given the destruction of price barriers to entry, social discrimination is implemented by replacing them with barriers of taste which keep out people who don't belong to the right circle. The new fashion is like a finishing school to which students are admitted only if they pass the entrance exam in terms of money and taste. If the classes are too full, the codes become more difficult and the intake is thereby reduced.¹³⁰ The innovations "are devised precisely so that the majority should not understand them (despite a naive belief to the opposite), or at least not understand them immediately. Their primary social function is, after all, to be

¹²⁹Couturiers often admit to a weakness for the homeless. There was an opportunity recently to repay their contribution to the couturier's art. The authorities in the South Korean town of Pusan confiscated Gucci and Saatchi fakes and decided to punish the fashion pirates by distributing the confiscated goods to the homeless. One wonders whether the officials really knew who it was they were punishing.

¹³⁰Games often evolve when too many people have mastered the old rules and interest falls off. A striking example of this is chess, whose rules have not changed for thousands of years. With the development of computer technologies all openings up to the twelfth to fifteenth move were worked out on a computer and archived. The play of human intellect was reduced to a competition to find out who had the better memory and had done their homework best. Then Grandmaster Bobby Fischer, world champion in 1972, came up with an elegant solution called Chess960: instead of the classic starting position, the chess pieces in both players' second row are shuffled by computer program. The pieces are placed symmetrically but randomly, although the two bishops are always placed on opposite-coloured squares, and the king is placed somewhere between the two rooks. The game is called Chess960 because that is the number of possible starting positions. The clever thing is that, unlike other attempts to modernise chess, this one in no way spoils the game and solves just the one problem of how to defeat automation. With such a large number of variations, a player cannot possibly memorise all combinations. Imagination takes the place of memory. There is no need to prepare for the match for years, because no theory exists in this game. Fisher unveiled his new variant of the game in 1996 in Buenos Aires. A Chess960 Federation has been formed in Germany. For the time being, however, the potential of the classical game seems not to have been exhausted, and accordingly Chess960 is not particularly popular.

discriminatory signs, items which will distinguish those who can distinguish them. Others will not even see them.”¹³¹

3.5.4.3 Luxury Superseded by New Luxury

A relatively new trend called ‘new luxury’ is in some respects the antithesis of fusion. Traditional luxury is fixated on status, class and exclusivity, while the New Luxury, as its heralds Silverstein and Fiske, authors of *Trading Up: The New American Luxury*, tell us, is based on emotional fulfilment.¹³² Articles should be outstanding in terms of their design and functionality and should make you fall in love with them. Then it is no disgrace to pay three times over the odds for them.

How is the averagely funded citizens to find enough money to pay three times as much as usual? Easy! Don’t ruin yourself by trying to afford everything, concentrate on one item. Don’t try to achieve a balance beyond your means, just choose the right mobile phone or anti-wrinkle cream. Commerce confirms that the market analysts have got it right: many people are buying one or two supposedly luxury items, and stinting themselves on everything else.

The authors of this humane book give the impressive example of a washing machine. The Duet, a product from Whirlpool, which costs over \$2,000, where the price of an ordinary washing-machine hovers around \$600. Believe it or not, the authors say, customers spoke very emotionally about these washing-machines made in a European style: “I adore it”, “It is part of my family”, “It is a little mechanical friend; it has a personality of its own”. The authors distance themselves from the considerable falsity in the replies of ordinary Americans (or are the respondents mocking their interviewers?). “We are not making this up. The people we surveyed were not hired advertising representatives of the company. A great variety of men and women again and again alleged that thanks to the Duet and its integral drier they felt happier, better than they are in reality, they experience less stress, are more proud of their children, feel themselves more loved, valued, and simply better people.”¹³³ Well, glory be! There it is in black and white: “more proud of their children”. That is surely something worth paying extra for.¹³⁴

Until quite recently luxury was unaffordable, but today it is knocking at the door, waiting to enter every home in the form of an electric iron with loudspeakers. Perhaps the brand name is not quite right, perhaps the finish is not what it might be, but what does that matter if the new luxury is doing its job of putting a spring in the step of ordinary people? How can we resist recalling an episode from Russian literary history when the poet Vladislav Khodasevich was conducting a poetry workshop

¹³¹Baudrillard, *For a Critique*, p. 37.

¹³²Silverstein and Fiske, *Trading Up*.

¹³³Silverstein and Fiske, *Trading Up*, p. 22.

¹³⁴In the Russian market the Miele washing machine is positioned in the price bracket above \$2,000. It is said to be of excellent quality.

for revolutionary sailors. After his wards started trying out their own abilities as writers of belles lettres, the poet tried to correct and instruct them. They didn't like that. They ignored his recommendations and rapturously read their doggerel aloud to each other, feeling no need of elevated standards or, for that matter, of Khodasevich.¹³⁵

Marketing gurus are teaching people to approach fetishes discriminatingly, falling over themselves to fill their flocks' minds with sound ideas (for example, investing in what is emotionally satisfying) and false (the idea of finding the necessary funds by switching to cheap goods in every other respect, or indeed going without). But selective luxury is an oxymoron! How are you to put together an ensemble consisting solely of a top quality shirt teamed with plebeian items from the rest of your wardrobe? Not even the fusion style is likely to help. The shirt will put the ordinary articles in the shade. It will be no pleasure to wear them, and that will cancel out any delight the expensive item might have imparted. Selective luxury is a treacherous mirage, although the idea behind 'New Luxury' may make sense when applied to leisure items like golf clubs or fishing gear. Applied to ordinary consumer needs, however, a polarised budget is economic nonsense.

By trebling the figures on price tags, business has reacted sensitively to an emotional deficit. The very price tags make you feel better, especially after being touched by the stardust of the magic word 'luxury'. This body lotion from Bath and Body Works is nothing of the sort, even if it costs four times the price of analogous products from a different firm. The offerings of new luxury are quite rightly labelled 'masstige' goods. They are simply good quality wares which have been cleverly positioned.

3.5.4.4 How Is Fashion Born?

If falling demand does not rein in fashion's reckless acceleration, will constraints of creative supply perhaps do so? Can the pace of change be slowed because great designers are approaching the limit of their creative capacity? For an artist to cross this boundary means pursuing quantity at the expense of quality, an area we have already examined where creativity comes into conflict with business plans. From the experience of Zara it is evident that collections can be designed impersonally, technically, and accordingly not be associated with the creativity of a couturier, but Zara is not very informative because Zara is not a legislator of fashion but a follower of trends. Who forms the trends, and how?

There are two views on this. The first defends the role of the individual. The second gives priority to the industrial machine. Giving creativity its full due, and it is undoubtedly present everywhere and in everything, let us concentrate on the second

¹³⁵See Ekaterina Men', "Rebirth of the Experts" ["Pererozhdenie ekspertov"], interview with Aleksandr L. Dobrokhotov, Globalrus.ru, 6 December 2005, Komp'uterra [online], No. 28, 10 August 2004. Cited 28 February 2006. Available from URL: <http://www.globalrus.ru/pragmatics/779763/>.

view. This assumes that business holds the reins and that fashion is not independent. The manufacturers of fabrics, leathers and dyes set inflexible parameters. Fabric is dyed with particular pigments because it is technically possible. The artist's job is to use that fabric. After industry has assimilated the new materials available, with new finishes, colourings, constituents, and characteristics, it has made its contribution to the formation of a trend. It is then the turn of the trend book. For the mass market the tendency of the season is formed not so much by fashion designers as by the creative people in the styling office. They filter the ideas floating in the air and crystallise them into the trend book, special albums issued for clothing manufacturers. A trend book consists of illustrations which produce clear sensual reactions and may, for example, look like a collection of phantasmagorical images. The industrial designer begins work on a collection on the basis of the trend book. Thus, according to one account, is the alchemy of fashion dispersed over a succession of technical processes. First, the chemists and textile manufacturers determine the possibilities and limitations. After them come totally unknown creative designers who translate the spirit of the times into pictures. Only then do well known and less well known designers start work as the third and final link in the chain.

The techniques by which the creators of fashion snare the spirit of the times are intriguing. Some conceptualists travel the world, others comb the Internet and television, others again immerse themselves in the thick of contemporary affairs, attending gatherings of extremists and so on. One of the most technically based approaches is for a specialist to ceaselessly film the urban landscape: avenues, pedestrians, traffic... This chronicle is then projected at high speed, so that the picture becomes blurred, and the overall colour ranges are read off it. To this, new spots of colour are added. This is a direct borrowing from gestalt psychology. You need to establish what is the background to today in order to know what consumers need added in order to perceive a new 'figure'. It is a curious fact that a trend book rarely has a single author: it is the product and the property of the fashion house, just one further link in the production sequence. If the process by which fashion is born is indeed technical, it seems unlikely that anything from that side will apply the brakes to the pace of change.

3.5.5 Aura and Price

Until recently the situation in the fashion industry was fairly satisfactory. Although the price of clothing bore little relation to quality, the signals it sent were perfectly reliable for the simple reason that high cost served as an entry barrier and unambiguously differentiated customers by income. Price, by regulating demand, functioned as a social filter. Firms would sometimes try to justify high prices by referring to the visual qualities of their products, but this was not too central since both the consumers and those around them perceived not only the real but also the ostentatious qualities of the ware, including the label of the firm and the price. The two things together determined what was a fair price. Customers were not likely to be too far

out in their expectations and readings of the fashion item, since their calculations centred on money.

Two watches may have very similar specifications, yet one costs \$40,000 while the other cost three times as much. The reason is that 50 copies of the former are sold, while of the latter only 20 are issued. The manufacturer of the larger batch profits from economies of scale, while the manufacturer of the more exclusive batch profits from the Veblen effect. Overall their profit is probably more or less the same. Purchasers of the watches of greater or lesser rarity have gains and losses from swings and roundabouts and accordingly, despite the apparent inconsistency of the system, it is fairly well balanced in terms of price. It is fair economics.

Clearly there are constraints of size and weight to fitting complex mechanisms (complications) into the case of a watch. The class of the product is particularly evident from the number of functions squeezed into a small casing, although other aspects are of course also important. Since each function swallows up its millimetres and grams, it is only possible to fit four or five complications into a watch at the same time. Each one causes a considerable increase in price, whether it is a tourbillon, a minute repeater, countdown timer, sunrise/sunset display, indicator of the sun's position, phases of the Moon, power-reserve indicator, perpetual calendar, leap year indicator, and so on.¹³⁶ As the number of complications increases, so the price rises incrementally and by leaps and bounds. One option might cause the price to rise by \$5,000, the next by \$15,000 the next by \$40,000.¹³⁷ With watches, as with all exceptionally rare items (postage stamps, vintage wines, porcelain and so on), the price varies in inverse proportion to the size of the edition. In general, in the economy of small series a simple arithmetical formula operates: if the price is multiplied by the size of the edition then, after allowing for demand in a given instance, the product of the two will be the same. Artists have demonstrated this empirically when, instead of producing paintings, they started producing multiple art. The original was issued not as a single sample but in a small edition of, say, some hundreds of units. Painters adopted this tactic in order to adapt to the purchasing power of the public and not to have to wait until the end of their days to be discovered by a passionate collector. In this way, symbolic capital, concept, individual style, the artist's name and all the other elements usually subsumed by the not very readily comprehensible word 'aura', was parcelled out and gained liquidity. What, in the process, became of aura? The answer to this question will oblige us to trouble one of the main myths to which the art world has been paying homage for a very long time.

¹³⁶More than twenty complications are listed. These are only the most important and popular.

¹³⁷In the course of our research we unearthed some curious facts. For example, above the \$30,000–\$40,000 price bracket diamonds completely disappear as constituents of a watch. As regards the jewelled watch sector, diamonds add precisely as much to the price as the stones cost, or slightly more. In effect, watchmakers are helping diamond sales along and being rewarded for doing so with a wholesaler's discount.

The fact that price varies in inverse proportion to the size of edition is due to aura. Walter Benjamin theorised that it is aura which turns a work into art,¹³⁸ although the objective properties of this substance and how it reacts continue to puzzle science. Nevertheless, an important question for economists is how aura is divided when an artwork is multiplied. Benjamin is no help here.

To put it differently, does the aura of an original divide in accordance with the price set for it divided by the number of copies? If so, the only remaining question would be price and, from an economic point of view, aura would equal the price paid for a work of art, minus the manufacturing and handling costs. Price can, however, behave in two ways: it may or may not change in proportion to edition. Does aura then depend on the resourcefulness of the dealer manipulating the edition? Which comes first, the price or the edition of a work? The question is complicated by the fact that there is a difference between the actual size of the edition, and the size which the customer knows about. Manipulating aura is the same old game of asymmetric information, this time in respect of edition. The producer knows how many copies there are: the customer does not. We may define aura as the maximum price society will pay for a materialised concept where the correlation between price and quantity is optimal.

A less mystifying name for this is symbolic capital,¹³⁹ which relates to the mental reaction produced by a particular object and also to the density of the interpersonal communication around it. In economic terms, symbolic capital (aura) is determined by the total monetary and time costs, which in turn are subject to information economic conditions.

This can be seen most clearly in those dramatic cases where the attribution of paintings changes. Let us consider what was believed to be a Rembrandt masterpiece, “Man in a Golden Helmet”. It was discovered in 1985 that this jewel in the collection of the Berlin state art gallery was not a Rembrandt at all, and its attribution now modestly reads, “Unknown Artist”. The mere fact that Rembrandt is no longer believed to be the painter of this canvas has in no way detracted from its excellence, and does not mean it is an imitation or a forgery. Nobody believes that. Moreover, nobody question its artistic merit, and the paeans in its praise are entirely sincere. However, the discrediting of the attribution has radically changed the economic situation: the valuation of the picture is now a hundred times less than the hundreds of millions of dollars it was worth when it was believed to be a Rembrandt. Its creator is still a genius, but one whose identity is unknown. Has the aura also been reduced a hundredfold?

Why is it important that a genius should be productive?¹⁴⁰ If “Man in a Golden Helmet” is immanently a product of genius, why is it not valued equally with the

¹³⁸Walter Benjamin, *The Work of Art in the Age of Mechanical Reproduction: Selected Essays* [*Proizvedenie iskusstva v epokhu ego tekhnicheskoi vosproizvodimosti: Izbrannye esse*], Moscow: Medium, 1996, pp. 15–65.

¹³⁹In Chap. 4 the term ‘symbolic capital’ will be defined using the concept of quality personal time.

¹⁴⁰It is also important for an artist’s oeuvre to have come to an end. At this point the total size of the edition is finally known.

works by Rembrandt, which it equals in quality? The answer is simply that, as a result of hundreds of transactions involving Rembrandt, the purchasing power of those who admire his talent has been established. Such knowledge is impossible to obtain in the case of the unknown genius who created “Man in a Golden Helmet”: no other work is attributed to him, and there are no precedents of his paintings being bought and sold. Rembrandt’s canvases are a kind of bond with a predictable revenue-bearing potential. The greater part of the price is explicable in terms of information about the likely sums of money payable in the event of future deals. This information has accumulated as a result of the zeal, enthusiasm and other spiritual investments of thousands of players over several centuries, and it is of no small importance that their investments have extended to hundreds of works by Rembrandt. A single canvas can hardly compete with this. It would be unlikely to find a buyer in this league, since the Rembrandt market amounts to billions of dollars.

What would seem to matter is not “Man in a Golden Helmet” per se, but the fact that it is a one-off. The harsh economic truth is that you cannot create a market for a single painting by an unknown artist. Branding a single work is not economically viable. Collectors have little interest in a single item which has no prospect of becoming part of a series.¹⁴¹ The ranks of devotees of the canvas might be swelled somewhat by the amusing tale of its former attribution to an acknowledged Old Master painter, but there are many such tales. The canon of works by Rembrandt has fallen in the past hundred years from 1,000 to 420.¹⁴²

From such considerations a mathematician might conclude that aura is a fiction, or at best a contingent variable of a process wholly determined by exogenous factors. We see things differently. Aura is identical to star status. It is a brand. Accordingly, the creation of aura is a process managed and regulated with a weather eye kept on economic realities and prospects.

The consumer learns of aura from communications and rumours testifying to the legend and authorship of a work. One can believe that, even where no aura was present and no reliable information about its supposed bearer was available, customers could yet be persuaded of its existence. The private individual has no way of telling whether aura is there or not. How else are we to explain the vast numbers of forgeries circulating among collectors, despite all of today’s facilities for authentication?¹⁴³

¹⁴¹Simmel in *The Philosophy of Money* explains with remarkable clarity why this is so. For a series of objects to enthrall collectors, it should be neither too extensive nor too restricted. The same laws operate here as govern the optimal edition of luxury items: the number of items should equal the number of potential collectors. Georg Simmel, “The Philosophy of Money” [“Filosofia deneg”], in *Theory of Society [Teoriia obshchestva]*, Moscow: Canon Press Center, 1999.

¹⁴²The brilliant Pallas Athena suffered a similar fate. She too was formerly ascribed to Rembrandt. See Arkadii Ippolitov, “The Price of Athena in the Third Millennium” [“Tsena Afiny v tret’em tysiacheletii”], Globalrus.ru, 21 December 2005. Cited 28 February 2006. Available from URL: <http://www.globalrus.ru/pragmatics/779936/>.

¹⁴³One hears it said that, since demand so much exceeds supply, the market as a whole could do with an injection of good quality forgeries.

3.5.6 What Do Fashion and Music Have in Common?

We can see now why some fashion brands cost more than others. If Chanel is targeted at a narrow clientele and Dolce & Gabbana at a broader customer base, the difference in price can be explained by the difference in sales volumes. Economies of scale from greater sales make it possible to be profitable at a lower price. The price may be determined purely by the number of devotees of the brand and their purchasing power. Classic is the style of mature people with savings. They can afford more, and suppliers do their best to take more off them. Ultra-expensive men's footwear in the price bracket of \$1,500 to \$7,000 costs that much because it is targeted at a highly exclusive group.

At least, that was until recently. It was a fair game played to established rules. Suppliers were highly visible, could not escape the judgement and wrath of dissatisfied customers, and took care to get their quality right. The consumer's problem was only to reconcile his taste, his social ambitions, and his budget. The rest was taken care of by the operation of Veblen and Simmel's trickle-down effect, whereby brands sent down from above specimens which were appropriate to different customer types and social strata, these filtered through social classes and, assisted by an effective and generally recognised architecture of sub-brands, structured society in accordance with price brackets and style preferences.

Today the fashion system looks rather different. Prodigious opportunities for bluffing have appeared. When clothes and accessories are search goods they are relatively risk-free, but as credence goods in respect of edition they subject brands to temptation. Consumers used to orientate themselves by price, but it became increasingly obvious that greater caution was needed, as clearance sales and the pirates showed. Where a major company keeps firm control of the entire distribution system of its wares, as does Hermès (and, after its rehabilitation, Gucci), the price gives no grounds for suspicion: the company manufactures the product, sells it in its own shops, determines the price, and bears full responsibility for it.

The House of Hermès has fanatical acolytes prepared to queue for years behind the keeper of the keys to the coveted logo. One renowned handbag made for Princess Grace of Monaco (the Kelly Bag), costs \$40,000 and only three dozen a year are released. There is a waiting list of years for it, and this despite the fact that there are counterfeit bags dozens of times cheaper and that everybody knows where they can be bought. The authenticity of the Kelly Bag is, however, its main value, and accordingly people of a particular disposition can order it only from Hermès. They do this purely for themselves. Some may, of course, take advantage of the fact that the market is open to manufacturers from the Third World, where articles are five, seven, or ten times cheaper and, moreover, indistinguishable from the real thing. The point is, however, that while physically they may be indistinguishable, their symbolic constituent is not the same. The purchase of a status symbol is like a declaration addressed primarily to oneself. People do not like lying to themselves, so they do not play games with fake handbags. Perhaps they fear that, by offering up a forgery, the magical power of the sacrifice will be lost.

Hermès products are extremely expensive and the maker's distribution policy is untypical of the market. On the whole, the price situation is totally confused. A high price may be the price of a couturier, but it could also be the price of plagiarists. An item made by a reputable firm may cost a lot or a little depending on the brand's strategy. Moreover, increasingly, one finds counterfeit wares of high quality at a low price. You cannot immediately tell whether a cut price is indicating low quality or grey-market provenance. A similar ambiguity surrounds a very high price: either it is being paid for haute couture sewing and exclusivity, or it is a trick by a brand which has wilfully ratcheted the price up in order to catch people who judge quality by cost (the Pavarotti effect).

Although in the fashion industry brands are generally informative, the situation can lapse into adverse selection, following the bad example of the digital and mass-produced cultural segments. The difference is that in the digital and quasi-digital art markets (the latter distinguished by a relatively low-cost material medium) the tendency is launched by uniform price concealing quality. In the material sectors the threat comes from non-transparency over the size of editions, which opens the way to a pattern which is harmful to any market, namely increased asymmetric information about the most important consumer attributes of a ware. The brands try to combat this to the best of their, admittedly rapidly diminishing, ability. However, such unobservable and untestable attributes of quality as size of edition and the speed with which an article goes out of fashion create endless loopholes for agents and products, increasing consumer risk. To these we should add consumer misconceptions about quality, uncertainty about their own discernment, manipulation of their tastes, and other misfortunes. There is also the snaring of consumers in sales and their now evident weariness at playing fashion games, and all these factors taken together warn that the markets of luxury and fashion are highly susceptible to adverse selection.

Our analysis of the situation is not motivated by any desire to pass judgement on this area of business. The fact that there are signs of adverse selection does not tell us whether matters are getting worse or better. Let us hold back with our conclusions, even if many fashion industry professionals see the beginning of the end in the games the brands are getting up to (like moving downmarket, conducting sales, exerting weaker control over manufacturing quality in Third World countries). There may be benefits to society in the downfall of the elite mentality, or perhaps the upper classes are merely handing over to the middle and lower classes toys they no longer enjoy playing with. Our main goal has been to demonstrate that brand logic is far less straightforward and innocent than the brand owners like to pretend. Assets valued in billions of dollars, consuming trillions of man-hours of attention, are never straightforward, and managing to sell articles at fifteen times the cost of manufacture undoubtedly demands considerable ingenuity. We have to ask ourselves, however, whether this is not rather expensive for consumers. Is not rather a lot of money, and more importantly, attention, being sacrificed on the altar of the brands, favourite and unfavourite, one's own and those of other people, useful and useless? Music lovers rage at the unjustifiably high price of disks, and yet the markup there is of the same order. But if it turns out that the proportion of information in the price of

such diverse wares as fashion and music is roughly the same, is this perhaps just what has to be paid for the variety people desire? If so, information economics has a vast field of application here, and these industries have huge scope for making savings.

3.6 Cultural Navigation by the Stars

3.6.1 *Economic Astrology*

Those cultural segments in which the product is not physically handed over to the consumer but is pure content (like the cinema, theatre, concerts, symphonic music, showbusiness, sport) rely on brands just as fashion does. Moreover, in one respect their branding is simpler in that the consumers' impressions of the brand develop in the course of the performance. The brand of an event does not need to make vast efforts to get its message across to the public, nor particularly to talk up its ware, which just looks sad and unnatural, nor to be intrusive: identification occurs naturally through the work itself. There are, however, some difficulties. The product is constantly changing, so what is branded is not a particular product but well-known performers or cultural locations: theatres, radio stations, publishing houses, magazines and so on. Like a supermarket they answer with their reputation for the quality of what they present to the consumer. The quality signal comes not from the ware but from the ground from which it springs. How fertile is that ground? What gets sown on it? Is it the star who bears the burden of responsibility towards the public, or is that borne by the theatre or television station? Permanent cultural venues appear to worry about their reputation no less than restaurants or supermarkets, since they want people to keep coming. This is an instance where the brand is capable of ensuring that quality remains within certain parameters and will wish to do so. Where a star is concerned, the situation is less clearcut, and it is this situation we shall analyse. Let us begin by describing the existing economic theory of stardom. Its most striking insights are into the mechanism by which stars are born, the nature of their fabulous fees, and the relationship between star status and talent.

Sherwin Rosen, the pioneer of the present concept of stardom, approached the issue in a pragmatic and practical way: he defined stars as people who earn a lot of money and dominate their fields.¹⁴⁴ He went on to address two questions. The first is, why are people who are only slightly more talented rewarded disproportionately more lavishly than their colleagues? The second is, why is such a large amount of output produced by just those few especially talented people? Rosen identifies two reasons, one of which would be obvious to a non-economist. Plainly, listening to several run-of-the-mill singers is not the same as hearing a single Chaliapin sing.

¹⁴⁴Sherwin Rosen, "The Economics of Superstars", *American Economic Review*, vol. 71, Issue 5 (December 1981), pp. 845–858.

Adam Smith himself had already noted that in a profession where twenty failures stand against one success, that one should receive all the revenue which might have been accorded the twenty failures.¹⁴⁵

Accordingly, demand for talent increases very rapidly as we move up the scale. Alfred Marshall has a slightly different take on this: "... a rich client whose reputation, or fortune, or both, are at stake will scarcely count any price too high to secure the services of the best man he can get: and it is this again that enables jockeys and painters and musicians of exceptional ability to get very high prices."¹⁴⁶ Marshall's observation is probably more applicable to the impresario, who is extremely sensitive to the risk of failure, than to the spectator. According to Marshall's approach, a star's fee would depend on the scale of the enterprise for which he is bringing in the box office.

Rosen accepts that the differences in talent may be really quite small, but nevertheless have a noticeable effect on popularity and fees. Is this really the case? How important are differences in talent for devotees? Before we can judge this, we need a method for assessing talent which is not tied to audience reaction. Although it is difficult to come up with an objective indicator, especially one which lends itself to comparison, William Hamlen has attempted to find a solution. He assumed that the most important aspect of a singer's talent was their voice, and tested it for sound quality, ignoring artistic impression and charisma.¹⁴⁷ He measured the high-frequency harmonic spectrum when the word 'love' was sung in the songs of different performers.¹⁴⁸ He found that the level of the vocal did correlate with revenue from the sales of recordings, but not strongly. This caused Hamlen to doubt the Marshall-Rosen model.

The second issue which Rosen raises is what it is that allows "relatively few sellers to service the entire market. And fewer are needed to service it the more capable they are."¹⁴⁹ Rosen infers his answer from two facts. The first is the increase of audience size: "Motion pictures, radio, television, phono reproduction equipment, and other changes in communications have decreased the real price of entertainment services, but have also increased the scope of each performer's audience. The effect of radio and records on popular singers' incomes and the influence of television on

¹⁴⁵Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. E. Cannan, New York: Morden Library, 1937, p. 126. Quoted in Ruth Towse, "The Earnings of Singers: An Economic Analysis", in Ruth Towse, ed., *Cultural Economics: the Arts, the Heritage and the Media Industries*, pp. 218–226.

¹⁴⁶Alfred Marshall, *Principles of Economics*, 8th ed., New York: MacMillan, 1947, pp. 685–686. Quoted in Rosen, *The Economics of Superstars*.

¹⁴⁷William A. Hamlen, "Superstardom in Popular Music: Empirical Evidence", *Review of Economics and Statistics*, November 1991, pp. 729–733.

¹⁴⁸The top four singers (out of 107), selected on the principle of harmonic range, were (in descending order): Barbra Streisand, Bing Crosby, Frank Sinatra, and George B. Shea. Whitney Houston came eighteenth. A clear shortcoming here is the ignoring of an artist's other attributes, but such was Hamlen's chosen method.

¹⁴⁹Rosen, "The Economics of Superstars", p. 847.

the incomes of news reporters and professional athletes are good cases in point.”¹⁵⁰ The second is telegenicity. Rosen identifies its importance by comparing the competitive advantage of certain types of sport over others: “Television is evidently a more effective medium for American football and basketball than it is for bowling, and incomes reflect it. Nonetheless, television has had an enormous impact on the incomes of the top bowlers, golfers, and tennis players, because their markets have expanded [...] incomes of the top performers in the theatre, motion pictures and television certainly are closely geared to audience size.”¹⁵¹ When both factors, telegenicity and audience size, coincide, talented people are able to command enormous markets and very considerable financial flows.

Rosen thus explains how additional milligrams of talent can convert into tons of additional earnings. The next step is taken by Adler, who claims that a vast difference in earnings can occur even when there is no difference in talent at all.¹⁵² In other words, he attempts to explain why stars emerge from among a cohort of equally talented people. (He omits to mention how he establishes equality of talent.) Adler’s idea is that stars appear when consumption requires knowledge. For example, one can become a music lover by listening to music and discussing it with others who are more knowledgeable. This educative process is the key to understanding the mechanism of star selection. According to Adler, consumers do not want to endlessly extend the number of art forms in which they take an interest, or the number of personalities they know about who represent the arts.

Why do the overwhelming majority of people home in on the same stars? Because, Adler claims, they need to discuss them with a circle of initiates. If none of your friends have ever heard of your favourite performer, no conversation is possible. It is better to like the same, popular, performers as everybody else. Then search costs for someone to talk to will be minimised. If other performers are not vastly cheaper or vastly better, it makes better sense to like a star. Star status is a market tool which makes it possible to economise on costs in obtaining knowledge in areas where “the more you know, the more you enjoy”. The star system can exist completely independently of the actual hierarchy of talent, Adler claims.¹⁵³

But if any of the equals can become the first among them, which is it going to be? Adler believes it is purely a matter of luck, not of talent, but here one would like to take issue with him. Intuition suggests that Adler is wrong in ascribing success to the blind operation of good fortune. What about hard work and professional integrity? What of the ability to combine creative power and a subtle artistic sensitivity with the discipline demanded by a contract. That is, after all, only too rare.¹⁵⁴ If we

¹⁵⁰Rosen, “The Economics of Superstars”, p. 856.

¹⁵¹Rosen, “The Economics of Superstars”, p. 856.

¹⁵²Moshe Adler, “Stardom and Talent”, *American Economic Review*, vol. 75, No. 1, 1985, pp. 208–212.

¹⁵³Adler, “Stardom and Talent”, p. 209.

¹⁵⁴We have touched on this issue in Chap. 1 (Sect. 1.1.11), where we noted the crucial role of stars’ ‘non-artistic’ talents.

include in our definition of talent, strength of character, versatility, and other qualities which facilitate career progression, then perhaps we shall see the individual's merit in achieving advancement is not down to mere luck. Probably Adler is not that far off the mark when he says that talent alone is less important than is popularly believed. Unilever had the courage to admit it does not have enough great ideas to justify all its brands, but we should not hold our breath in anticipation of a similar revelation from the cultural industry. "The show must go on," with or without talent.

Adler drew a parallel between stars and money. "Firstly, banknotes of any colour can serve as money and likewise all performers could be stars. Second, efficiency calls for only one currency and likewise efficiency calls for very few artists with public recognition. Both characteristics exist in the case of money regardless of the process that determines which good would be the medium of exchange. I assert that the same independence exists here: the characteristics of stardom do not depend on the process by which a star evolves".¹⁵⁵ As soon as the popularity of one performer exceeds that of the rest, his popularity will snowball and lead to a dominant position in the market. The reason is because the consumer obtains more utility by taking an interest in stars everybody knows, even if their art is no better than that of others. Thus, the incentive for synchronising tastes is to save consumer capital. The snowball effect directly ties in with Leibenstein's effect of imitating the majority, and Wernerfelt's principles of myth-creation and 'cheap talk' which are fundamental to branding. (See Sect. 3.4.2.5).

Glenn MacDonald explains the unequal earnings of performers through the influx of an enormous quantity of young hopefuls who accept low salaries in return for performance experience and the chance of achieving success.¹⁵⁶ Only those few newcomers remain in the profession who succeed in outpacing the incumbents. It is they who enjoy the rewards of a growing audience.

Ruth Towse, discussing the matter of earnings, shifts the emphasis from talent to the issue of the search costs of looking for it. Taking the example of opera, she observes that superstars do not need to be auditioned, and this reduces selection and information costs for promoters and agents. Central to a singer's contract is the fee.¹⁵⁷ This determines the performer's ranking. When a superstar is performing, ticket prices are ratcheted up providing the public with a signal of the quality of the performance and disposing them to pay a higher amount. If somebody's fee falls, the markets will interpret this as a sign that the singer's popularity is waning.¹⁵⁸

¹⁵⁵ Adler, "Stardom and Talent", p. 211.

¹⁵⁶ Glenn M. MacDonald, "The Economics of Rising Stars", *American Economic Review*, vol. 78, 1988, pp. 155–166.

¹⁵⁷ For more detail on performers' incomes, see Appendix 1, Paragraph A1.4.4.3.

¹⁵⁸ Although ticket prices sometimes vary for concerts given by the same performer with the same repertoire depending on the location of the performance or the venue. The cause is spectators' different paying power. The costs of cultural consumption are in proportion to the time spent and income levels, and a well-heeled public prefers more highly rated theatres. A result of this is that the UK's Royal Opera House can set higher prices than the English National Opera, which attracts a less opulent audience. Ruth Towse, "The Earnings of Singers: An Economic Analysis", in Ruth Towse, ed., *Cultural Economics: the Arts, the Heritage and the Media Industries*, pp. 218–226.

Summarising the economic theory of the star phenomenon, Towse particularly notes the contribution of Adler who, unlike Rosen, succeeds in avoiding one of the pitfalls of the discussion, how to determine and measure talent. In Adler's model idols and little-known performers may be equally talented or equally untalented.¹⁵⁹

This paradoxical postulate throws light not only on the origin of stars, but has wider application to a number of puzzling social phenomena. Why does a situation turn out one way rather than another? Is an event predetermined by circumstances, or do the cards just fall out that way? According to the theory of stars, the most important circumstance is some real need, but what exactly comes to hand at the crucial moment is in the lap of the gods. People need things to talk about and to provide a focus for socialising. Of course that ought to be something worthy of their attention; a work claiming to be a hit should be appropriate to the fashion of the moment. But whether it is one particular item or a different one, whether it is slightly better or slightly worse, is not all that germane.

There is one further unresolved issue. What matters is not only that the snowball which first starts rolling picks up all the snow and leaves little for all the rest. There is also the question of why it started moving in the first place. The luck of being the first among equals to move off may not be random. Even the course of an avalanche can be managed. One can bring a ready-prepared snowball to the starting line and that would seem to be well worth doing. Once launched, everything else will follow and grow of its own accord. If the start can be worked on in advance, conscious that all that follows will be inevitable, this explains a lot about successful branding.

Dissecting the experience of commercial branding, economists bring us to the point of unravelling the mystery of how society evolves. How do doctrines, ideologies, beliefs, moral imperatives and the like crystallise in human minds and determine the conduct of the masses and the course of history? These three seemingly very simple theoretical links join together to form a chain: 'cheap talk' forms the snowball, which in turn helps to formulate the star's message, which then gains ascendancy in the minds of those who feel a need for collectively significant messages.¹⁶⁰

3.6.2 Stars and Perceived Quality

Economists, then, have explained where stars come from, why they are paid their fees and how they influence takings. They have also pointed out the ambivalent nature of the link between popularity and talent, but have gone no further than that. They have declined to discuss the quality of the cultural products created under the star system, because economics is not sure it knows what quality is in culture. Adler's attempt to operate with the concept of talent is rightly considered a weak

¹⁵⁹Towse, "The Earnings of Singers".

¹⁶⁰The process depends on the informativeness of the information cascade, which we shall discuss in Sect. 3.6.3.

point in his model. In economics, quality, to put it bluntly, is whatever people will pay more for. The market puts everything in its place. If, however, you try to define quality in culture in that way, to see it as identical with the numbers in a ledger, you stand no chance of answering the question. Nobody openly claims that cultural quality is the same thing as box-office takings, but actually that is how the sphere is organised. Its efficiency is measured in financial terms. Everybody recognises to a greater or lesser extent that, given such an approach, the mission of culture is mission impossible. To rely solely on monetary indicators is to do culture a grave disservice. When the goods under discussion are consumed once only, the fact that demand has been met tells us remarkably little about perceived consumer quality. There is a gap between the utility anticipated and the end result. This is a universal phenomenon, but in the cultural markets the gap is a gigantic fissure. The discipline of cultural economics is pussyfooting on the brink of this precipice, lacking the means to bridge it and not even sure there is any great need to do so. Symbolic exchange economics is able to provide a way across by relying on signals of perceived quality. It is clear that culture needs to find principles and measuring instruments outside the traditional system of economic concepts. The solution really is in sight. Everything can be regulated with the use of money, only it needs to be used in a different way.¹⁶¹

Let us approach the issue of the star system from another direction. Is it working well? By this we mean, does it justify the expectations both of the public and of business, or only of business? If it does, then how? Do stars achieve this through the excellence of their acting or, perhaps, because having once put themselves in harness, they act in films which are doomed to succeed no matter who acts in them? A second, more subtle, question asks what exactly it is that the public expects from stars. Do stars need to do exert themselves to the utmost in order to meet their audience's expectations?

It is clear enough on an intuitive level what stars mean to their fans. The mere fact of their taking part in a film guarantees a certain level of pleasure, come what may. It is analogous to meeting up with someone you like, which you know will in any circumstances be a delight. Stars are tactful and undemanding. You can easily decide not to go and see them, because you already know about them. If someone doesn't care for a particular star, they don't need to go to films or plays in which he is acting. More usually the public, having tried out an actor as a first experience good (in Della Valle's terminology), and taking to him as a star, looks forward to further meetings. The stars of stage and sport generally live up to expectations. Underwriting this is their talent, knowledge of their craft, and diligence—all factors which are more or less under the control of the star himself. But is this always the case? To what extent is quality under the star's control? What levers does he command, and which does he not?

The answers to these questions largely depend on your understanding of success. Is professionalism, such as you might expect from a cabinetmaker, enough or is there

¹⁶¹How, exactly, is described in Chap. 1 (Sect. 1.3.4), and why this is the sole possibility is analysed in Chap. 4 (Sects. 4.5.2 and 4.8).

something more to star quality, something reminiscent of the hero in a fairy-tale catching the Firebird's tail? As Adler sees him, a star performer is like a darling of the roulette wheel who has hit the big time once and been resting, almost automoton-like, on his laurels ever since.

We know from experience that the accuracy of predictions based on the stars varies between the different segments of culture, but this appears to have escaped the attention of economists.¹⁶² There is no question but that the degree of control a concert pianist has over a solo performance is greater than a film actor exercises over a film, since a film's success depends on a far larger number of extraneous factors. A sports star is also better placed than a film star, but probably has less power than an opera singer or musician. A major sports star keeps his own psycho-physical attributes up to the mark, but some things, the refereeing, the rest of the team, the medical staff, are outside his control. He does not get to choose the opposing team, so the battle on the pitch may not entertain the spectators.¹⁶³ It is, of course, sometimes possible to turn down an unpromising contest, for example in professional boxing, but this is exceptional. Accordingly, despite their best efforts, sports stars are not always able to provide the drama expected. It has to be said though that, given the right circumstances, they do so with remarkable consistency. The spectacle can be truly gripping, and doubts about the justification of their sky-high fees dissipate as quickly as our commiserations for undervalued non-stars.¹⁶⁴ Adam Smith's strictures about remunerating a single success at the expense of twenty failures is wholly applicable here.

Everything depends on how much control the star has over his work, the contribution of the creative artist to the end quality. In the performance sphere his contribution is great, and accordingly leading theatrical actors performing in a repertoire of their own choice are without doubt reliable experience goods in Della Valle's terminology. So, in all probability, is the production as a whole, although this is less certain. For solo musicians this is even more the case than for actors in the theatre, since the latter are performing as part of a cast of other actors. A film star per se is like a solo musician, also a reliable experience good whose talent and charisma are soon apparent, but we cannot overlook the context within which his film is being produced, which makes him dependent on many other people and circumstances. Film stars, unless they direct their own films, like vocalists who do not compose

¹⁶²The only difference between the segments which Rosen identifies is the obvious fact that the biggest fish grow in the biggest ponds.

¹⁶³The world boxing champion, Roy Jones Jr, was so superior to his potential rivals that it was obvious what the result of matches was going to be and attendance fell away (until 2004 when he was knocked out in two matches in succession).

¹⁶⁴In football, for example, as Lucifora and Simmons have shown, the status of a superstar, and consequently his fee, is established on the basis of the number of goals he scores or sets up. Although it can be difficult to separate out the contribution of an individual from that of the team, fans have no doubt that no other footballer could replace the star. Claudio Lucifora and Rob Simmons, "Superstar Effects in Sport: Evidence from Italian Soccer", *Journal of Sports Economics*, vol. 4, No. 1, February 2003, pp. 35–55.

their own songs, are not totally self-reliant. Accordingly, films featuring stars, unlike operas in which a renowned tenor is singing, are more in the nature of pure experience goods. As a general rule, the more complex the creative process, and the more it is administratively and technologically mediated, the less the role of the star in the end product. This automatically weakens the correlation between his individual craftsmanship and the overall quality of the production. The star may, of course, be contributing not only a talented performance, but also choosing the films he is willing to appear in,—and this is the most subtle element in defining the role of stars.

The public may justly expect that artists paid well above the average are free to choose the films they appear in, and will not take part in a production merely for the money. The adulation of their fans should be more important to them. No matter how much they earn, however, maintaining their customary lifestyle and expected degree of socialising inevitably involves constant high expenditure. Idols need prominent, highly paid roles, but the choice is limited, and not only by competition from other actors. The fees paid to stars are economically justified only within a framework of mega-projects with a target audience numbering many millions. The financial demands of the project often makes it impossible for stars to appear in refined, aesthetically complex films which will appeal only to a narrow circle of sophisticates. The mass spectator's reaction is most predictable if the narrative is straightforward, but it is particularly difficult to make that gripping. A constellation of stars grouped around a principal star can achieve a great deal. In Hollywood there are other stars who, unlike those who appear in front of the camera, are unknown to the public. These are composers, screenwriters, cameramen, designers and other professionals who command high fees.¹⁶⁵ Their royalties too depend on sales, which are linked to the popularity of those acting in the lead roles. This brings about a centripetal force which forms stars into constellations. In other words, stars are brought together not only by directors in accordance with Marshall's principles of employing only the best, but it is in the celebrities' own interests to form themselves into groups. Having come together, a group of stars work hard to justify their fees and to remain in demand in future. The strategy is the same as when stretching a brand: quietly give every sister one earring so that nobody is left out.

This involves a great deal of wizardry in concocting a suitably complex sauce for a marketable multi-layered social pie. Each stratum of recipients must be given its appropriate ingredients, for example, a character to identify with socially, and a message. It can only benefit the film if there are messages for contiguous social communities, who may respond, "This is not my thing, but I don't mind finding out what it is in it for others". This is a fiendishly difficult task, and if it can be pulled off even two or three times a year, that is major success.¹⁶⁶ More commonly the

¹⁶⁵Why, of all the creative specialities which affect the quality of a product, is star status conferred on the actor rather than the composer, screenwriter or, more realistically, the director? It is evidently a matter of "media marketability", of being seen on screen. The film markets the filmstar.

¹⁶⁶Although too much weight cannot be given to subjective judgement here, I venture to suggest that "American Beauty" is an exceptionally successful film. More commonly, however, the result is a flop, as, in my view, was the case with Spielberg's "War of the Worlds".

end result is nothing special, a balanced product neither particularly inspiring nor particularly disappointing. Professionals are good at giving a sense that they have wholly earned their fee. That is what professionals do; that is what the technology and the money are there for, so that in one way or another the consumer should be kept happy. The latter has little to complain about—his access to a miracle costing hundreds of millions of dollars has set him back just five or seven dollars. It is a mind boggling ratio: he is consuming a fully fledged product for one twenty-millionth of its cost!

Having toiled on the production line, the leading workers of culture find spiritual fulfilment in the art film laboratories of great directors. For some reason they make considerably less money there.¹⁶⁷ Their public does not wish to see them in such films. The *Hollywood Reporter* reveals that low-budget films with major stars and directors get a lukewarm reception from American film-goers. They are used to their stars specialising in a particular genre. If Robert de Niro acts in a fantasy film rather than a gangster epic, there will be little interest. Does the public perhaps assume that stars only make an effort in return for a commensurate fee? It was Linda Evangelista who told *Vogue* she did not wake up for less than \$10,000 a day. People know the kind of fees being paid, and indeed, what kind of film can you make without a big budget: no special effects, no computer graphics, just dialogue? Geniuses do, of course, sometimes manage to cook up a perfectly decent soup out of an axe, but ever fewer people want to consume it.

3.6.3 *The Blockbuster and the Information Cascade*

Although it remains an open question how much a film star contributes to the final quality of a film, let us now look instead at how effectively the presence of a film star signals its consumer quality. We need to approach the issue from a different angle.

The simplest method of establishing this is to count the percentage of good films acted in by film stars, but we encounter the same problem here as we had with talent: which films are to be regarded as ‘good’? An empirical approach would seem to be to define these as films which film-goers have enjoyed, but this cannot be unambiguously inferred from box-office takings, and we have no other indicator at our disposal. If we decide to rely on ratings by the audience, we have to take account of the fact that the audience is self-selecting: the fact that they have watched the film already indicates a pre-existing favourable disposition towards the picture or the star, which means we are dealing with a skewed sample. The market simply lacks any

¹⁶⁷ Although in the 1930s this was not the case with Warner Brothers. Pokorny and Sedgwick have discovered that using stars had a positive effect on the revenues from middle-budget films, although there was no noticeable effect on high-budget films. Michael Pokorny and John Sedgwick, “Stardom and the Profitability of Film Making: Warner Brothers in the 1930s”, *Journal of Cultural Economics*, vol. 25, 2001, pp. 157–184.

mechanism for directly measuring the perceived quality of its products. Of course, it can be objected that if people go to the cinema at all then, whatever criticism may be directed at the industry, it is self-evidently reasonably competitive: the supply is satisfying a demand. The weakness in that argument has already been noted: people watch the films being screened for want of anything better.

Direct signalling of perceived quality by cinema- and theatre-goers, gathered after the event in the form of monetary gratuities, can bring clarity to the issues of stardom. Until monetary collaborative filtering arrives, however, how can we escape from the present uninformative link between money and quality? How can we ‘feel the quality’ without the involvement of money? Perhaps we should try out an approach we have already examined and which was used by Eliashberg and Shugan in their research into the influence of critics.¹⁶⁸ This argued that, if critics were influential,¹⁶⁹ then this should particularly affect box office takings when screenings first began and before word of mouth had time to kick in. That is why it is necessary to analyse the graph of takings, rather than looking only at the final total as is customary. Although this is a very labour-intensive approach, and the conclusions reached by the researchers were rather vague, nevertheless we can exploit it to determine from indirect data how cinema-goers actually rate the quality of films they have seen, and how stars affect this. It seems clear that the rate of revenue growth over the period of exhibition is sensitive to word of mouth, especially in the first weeks. If box-office takings grow at a below-average rate (which will need somehow to be defined),¹⁷⁰ this can be put down to negative consumer recommendation. An attempt along these lines to establish the real relationship between the takings, the presence in a film of stars,¹⁷¹ and perceived quality was undertaken by De Vany and Walls in an econometric investigation of the blockbuster strategy.¹⁷² Since their work is fundamental to the present project, its approach deserves to be explained in detail.

The blockbuster strategy involves a hefty budget for a film, a star cast, massive advertising, and simultaneous exhibition on a large number of screens. If all this gives the film impressive takings on its first weekend, its commercial success is

¹⁶⁸Jehoshua Eliashberg and Steven M. Shugan, “Film Critics: Influencers or Predictors?”, *Journal of Marketing*, vol. 61, No. 2, April 1997, pp. 68–78.

¹⁶⁹Eliashberg and Shugan discussed this problem after it was first raised by Burzynski and Bayer. See Michael Burzynski and David Bayer, “The Effect of Positive and Negative Prior Information on Motion Picture Appreciation”, *Journal of Social Psychology*, vol. 101, 1977, pp. 215–218.

¹⁷⁰De Vany and Walls discovered that box-office takings from films increase exponentially. Arthur S. De Vany and W. David Walls, “Uncertainty in the Movie Industry: Does Star Power Reduce the Terror of the Box Office?”, *Journal of Cultural Economics*, vol. 23, No. 4, 1999, pp. 285–318.

¹⁷¹In the work mentioned below, a ‘star’ is understood to mean an actor or director who appeared in *Premiere* magazine’s annual “Power List” of the hundred most powerful people in Hollywood, or in James Ulmer’s list of A and A+ actors.

¹⁷²Arthur S. De Vany and W. David Walls, “Movie Stars, Big Budgets, and Wide Releases: Empirical Analysis of the Blockbuster Strategy”, in De Vany, *Hollywood Economics: How Extreme Uncertainty Shapes the Film Industry*, London: Routledge, 2003.

almost assured. The director Robert Evans has likened this moment to jumping with a parachute: “If it doesn’t open, you are dead”.¹⁷³

When “The Godfather” broke all box-office records in 1972 it heralded a new era in Hollywood. “Jaws” was the first real blockbuster. In the course of three days in June 1975 it swam across the industry’s screens devouring \$8 million in cinema-goers’ pockets and changing the business of film-making for the rest of time. As the film was exhibited, it was being energetically supported by television advertising.¹⁷⁴ Producers and directors had already noticed signs of buoyancy from “The Exorcist” and “The Sting”, whose takings were higher than expected, but when a single shark brought home almost \$200 million in its jaws, it was finally obvious that there was no need to pussyfoot around with creativity, you merely had to get the right mix of ingredients to attract enormous audiences.¹⁷⁵

The strategy of blockbuster promotion is built around the fact that audiences respond to advertising and a star cast, that they keep an eye on box-office takings, and that they are relatively insensitive to everything else when choosing a film. Promoters, at least, believe that these levers are sufficient to silence such unwelcome influences on a film’s screen life as negative comments from its audience.

If this were the case, De Vany and Walls argue, the choice of those cinema-goers quickest off the mark would determine the flow of all subsequent audiences. Films which take over a large proportion of screens squeeze out other pictures and pull in a hefty revenue from the outset. Good results on the first weekend serve for many as a signal to go to the top film instead of others which are on at the same time. If subsequent cinema-goers also took their cue solely from box-office sales, a successful launch would guarantee consistently high takings throughout the entire period of exhibition. An initial advantage would inexorably snowball. There would be a standard routine: the star attracts viewers to the premiere, getting the film off to a good start. Other cinema-goers, orientating themselves on box-office takings, would demonstrate a herd mentality, going one after the other to the film for no other reason than that it had been seen by the earlier viewers. Such sheep-like behaviour is characterised by economists as a (non-informative) information cascade. The term ‘cascade’ applies because there is consistent choice being made in response to signals about takings. It is non-informative because the followers choose, not on the basis of the opinion of their leaders, but solely of their actions. If this kind of cascade really did dominate, then box-office success on the first weekend would automatically lead to the overall commercial success of a project irrespective of the quality of the picture. The blockbuster strategy is an attempt to create an

¹⁷³Mark Litwak, *Reel Power: The Struggle for Influence and Success in the New Hollywood*, New York: William Morrow, 1986.

¹⁷⁴Just before the film’s release, Peter Benchley’s best-selling novel, *Jaws*, on which the film is based, was re-issued. Justin Wyatt, “From Roadshowing to Saturation Release: Majors, Independents, and Marketing/Distribution Innovations”, in Jon Lewis, ed., *The New American Cinema*, Durham, N.C.: Duke University Press, 1998, pp. 64–86.

¹⁷⁵James Hoberman, “Ten Years That Shook the World”, *American Film*, vol. 10 (June, 1985), pp. 34–39, 42–49, 52–59.

uninformative information cascade by engineering a convincing start in the belief that audiences can be shepherded into the cinema.

De Vany and Walls do not feel film-goers are so subject to the herd mentality, and recall instances when films enjoyed large takings in their first days only then to disappear rapidly from the screens. The herd evidently does sometimes have a mind of its own, although the authors do not reveal how often. For example, “Daylight” with Sylvester Stallone and “Last Action Hero” with Arnold Schwarzenegger flopped in spite of all the advertising ballyhoo and special effects.¹⁷⁶ As they exchange their views on a film, consumers turn an uninformative information cascade into an informative one. If the quality signals transmitted by box-office revenue are contradicted by how cinema-goers assess the film after viewing it, the pattern of takings can alter. Negative word of mouth breaks through the uninformative information cascade and turns it against the film, but this takes time. As soon as the cascade becomes informative, the influence of the film’s budget, its stars, and all the rest weaken. This is true both of good and bad films. Nothing can save a film if it attracts bad comments from those who have seen it, and whether they like the film or not depends, De Vany and Walls opine, solely on the film.

This raises the question of which factor is the more influential in making people decide to go to see a film or not: the box-office data and signals manufactured by the promoters, or the comments of friends and colleagues? To answer this, the authors resort to statistical methods to establish how different factors affect the graph of takings: the size of a film’s budget, involvement of stars, genre, ratings, time of release, and the role of sequels.¹⁷⁷

3.6.4 *Set a Star to Detonate a Blockbuster*

Stars, then, help to attract the first spectators and ensure at least a return of investments through initial takings. After that it is up to the public to decide whether they like the film or not. This is the conclusion reached by De Vany and Walls, on the basis that stars have virtually no influence on the later pattern of takings. Indeed, they discover that stars, with few exceptions (of which the most striking is Tom Hanks),¹⁷⁸ have no significant influence on takings overall. They find that only

¹⁷⁶Arthur S. De Vany, “Complexity in the Movies”, *Journal of the Santa Fe Institute*, 1997.

¹⁷⁷The information analysed included data on 2,015 films released in North America in 1985–1996. Information on a film’s box-office takings, production budget, genre, rating, cast of actors and members of the film crew were taken from *Entertainment Data International*. The weekly and weekend box-office statistics for films screened in the USA and Canada were provided by the distributors. The resultant corpus of data proved of such fundamental value that it became a primary source for numerous publications on the film industry and is used for decision-making by industry leaders.

¹⁷⁸The authors cite the *Hollywood Reporter* (1998), which awards a rating to film actors in accordance with to their ability to maximise box-office takings. Tom Hanks and Jodie Foster scored 97 and 94 points respectively out of a possible 100. In the same listing for 2002, 100 points went to

twelve stars out of the top one hundred in the Premiere and James Ulmer listings have any effect on box-office revenue at all. In De Vany and Walls's opinion, their data is consonant with the view that films with the participation of stars are successful not because of their acting but because the stars, born of success in a film, remain stars only if they choose movie projects to work in which people are going to like. Signalling the quality of a cinema product may be where their real power lies.¹⁷⁹

Is the role of stars, then, more informational than artistic? In the opinion of another researcher of this problem, Steven Albert, economists often underestimate the role of stars because of errors in their statistical methods.¹⁸⁰ A weak correlation between who is acting in the film and its box-office revenues (which is what the statistics usually reveal) is in marked contrast to the fact that film directors rate stars highly. Albert suggests it is unlikely that directors are all mistaken.

On the basis of the data of De Vany and Walls, it seems more likely that stars are facilitating the self-selection of fans. Cinema-goers use stars as markers of films they are going to enjoy. Actors do choose to be filmed in particular film genres. It is not too much to say that stars provide the rudiments of a primitive object-to-object collaborative filtering. As Albert says, stars are important because they represent the markers least contradictory and least subject to interference for particular types of successful films.¹⁸¹

3.6.5 Stars and the Films on Offer

No matter how compelling the statistics, however, they appear to overlook one important detail. Stars are more than mere touts for their films. Quite clearly, they give their admirers a particular satisfaction, quite irrespective of the director, the studio, the genre of the film, or any of its other attributes. If the star is given the opportunity to show the full extent of his talent, his acting contributes to a film's quality. Unfortunately such opportunities are only too rare. If we compare films which have

Tom Cruise, Tom Hanks and Julia Roberts. In a confidential survey of leaders and analysts of the cinema industry the stars who had the greatest influence on revenues, apart from those mentioned, were: Mel Gibson (98.68); Jim Carey (98.46); George Clooney (95.18); Russell Crowe (94.74); Harrison Ford (94.74); Bruce Willis (94.30); Brad Pitt (92.98); Nicolas Cage (91.23); Leonardo DiCaprio (91.01); Will Smith (89.91); and Denzel Washington (89.04). The category of Maximum Star Power (from 87.50 to 100 points) is reserved for actors who have the greatest ability to attract spectators throughout the world and ensure major commercial success for a film. They virtually guarantee finance and high box-office takings on the first weekend for any film in which they appear. These films are distributed by major studios and guaranteed widespread exhibition. Even a bad press is usually unable to undermine the influence of these stars. Of producers, those who most powerfully affect average box-office takings are Stephen Spielberg and Oliver Stone.

¹⁷⁹ Arthur S. De Vany and W. David Walls, "Movie Stars, Big Budgets".

¹⁸⁰ Steven Albert, "Movie Stars and the Distribution of Financially Successful Films in the Motion Picture Industry", *Journal of Cultural Economics*, vol. 22, 1998, pp. 249–270.

¹⁸¹ Steven Albert, "Movie Stars", p. 251.

contributed in a major way to an actor's reputation with the total number of films in which he has appeared, we will find they have been precious few. Even in the case of an actor as able and popular as Robert de Niro, the proportion will be no more than one in ten, although the films in which he has acted are on the whole quite well thought of. Albert has researched how well stars do,¹⁸² basing himself on the cast lists of the twenty most highly rated American films of 1960–1995.¹⁸³ He discovered that certain stars appeared in these supremely successful films more often than others, Clint Eastwood leading the field with 19 films which made it into the top twenty in various years. It became clear that few actors regularly appear in successful films, so that only a small number of actors can be guaranteeing that a film will be a resounding success.

Research into the institution of film stardom, like most of the work economists undertake in the cultural sphere, is addressed to the business world. This enables it to be fairly straightforward: stars reduce commercial risk. For an all-round assessment of the role of stars, the need remains to establish what they provide for the consumer. It is entirely sensible for directors to 'charter' a star. They hedge their risk, which is an entirely normal business operation. While the film-makers have to pay out on fees, stars raise the certainty of at least a minimum level of revenue, and if the contract is based on paying the star a proportion of profit, the makers are also sharing risk with the actor. Stars are thus part of a conservative (low-risk) financial strategy.¹⁸⁴ The question still needs to be asked, however, how this affects quality.

If predictability is achieved at the price of standardisation, this reduces the consumer value of cinema as an art form. What if the star lowers asymmetric information but in the process quality is also lowered? Or, even if quality is actually raised, what if the likelihood of a really outstanding film being made is decreased? Rosen pointed out that you cannot make a hundred dogs into a single lion, and twenty merely passable screenings do not add up to the equivalent of one outstanding film.

The consumer does not want certainty at the price of quality. Or does he? Perhaps a fairly humdrum but guaranteed gain strikes the consumer as preferable to a greater but less certain one? Kahneman and Tversky's investigation of behaviour under conditions of uncertainty and risk¹⁸⁵ have shown that people are not so

¹⁸²Albert "Movie Stars", pp. 249–270.

¹⁸³For a critique of Albert's methodology, see John Sedgwick and Michael Pokorny, "Movie Stars and the Distribution of Financially Successful Films in the Motion Picture Industry: A Comment", *Journal of Cultural Economics*, vol. 23, 1999, pp. 319–323.

¹⁸⁴David A. Garvin, "Reach for the Stars: Blockbusters", *Wharton Magazine*, winter 1980, pp. 22–28.

¹⁸⁵Daniel Kahneman and Amos Tversky specialise in economic psychology. Kahneman won the Nobel Prize for Economics in 2002 for having integrated insights from psychological research into economic science, especially concerning human judgement and decision-making under uncertainty.

much risk-averse as keen to avoid loss.¹⁸⁶ Research into uncertainty avoidance¹⁸⁷ has shown that the more competent people are, the more willing they are to participate in less predictable situations; and if, on the contrary, they lack self-confidence, they prefer situations with greater certainty.¹⁸⁸

Most people lack the ability to assess probability, and they know it. Alle's Paradox,¹⁸⁹ which Kahneman and Tversky generalise as the 'certainty effect',¹⁹⁰ states that people find a guaranteed gain immeasurably more attractive than a gain with, say, a 95% probability of materialising. Moreover, their assessment of probability is often baseless and inappropriate to the situation.¹⁹¹

It is generally accepted that the urge to avoid loss is stronger than the motivation to make a gain. The whole point of art is that a person is able to experience through it situations and emotions for which he would lack the resolve in real life. It would appear that attitudes towards risk are carried over from real-life situations into culture. This suggests that the whole issue is how to reduce the risks associated with finding worthwhile works, and reduce the number of unsuccessful attempts. It is pointless to hope that the situation will change for the better of its own accord. Purposeful effort is required, and the sole solution would appear to be collaborative consumer filtering.

It is obviously difficult to recoup the fees paid to stars other than by making films intended to produce massive box-office takings. The thinking of the major studios' directors revolves around blockbusters, everything else being regarded as small-time

¹⁸⁶Amos Tversky et al., "The Causes of Preference Reversal", *American Economic Review*, vol. 80, No. 1, March 1990, pp. 204–217.

¹⁸⁷Avoidance of uncertainty means that people prefer risk whose probabilistic outcome is known to risk with an unknown outcome. See Daniel Ellsberg, "Risk, Ambiguity, and the Savage Axioms" *Quarterly Journal of Economics*, vol. 75, 1961, pp. 643–669.

¹⁸⁸Amos Tversky and Craig R. Fox, "Weighing Risk and Uncertainty", *Psychological Review*, vol. 102, 1995, pp. 269–283.

¹⁸⁹M. Alle, "The Behaviour of a Rational Person in Conditions of Risk: A Critique of the Postulates and Axioms of the American School" ["Povedenie ratsional'nogo cheloveka v usloviiakh riska: Kritika postulatov i aksiom amerikanskoi shkoly"], *Thesis*, issue 5, 1994, pp. 230–233.

¹⁹⁰Daniel Kahneman and Amos Tversky, "Prospect Theory: An Analysis of Decision Under Risk", *Econometrica*, vol. 47, No. 2, 1979.

¹⁹¹Paul Shoemaker distinguishes a) a priori (classical) probability which describes dice and more generally rule-governed games which are repeated many times; b) probability as a percentage of favourable outcomes in an infinite series of tests (it is often unclear how to limit the selection of possible ways in which events might develop: for example when assessing traffic risks should one take account of all registered accidents, only accidents involving lorries, or accidents in bad weather; c) probability as a measure of the truth of a certain hypothesis making it possible to link a number of facts together, for example, in trial by jury; d) subjective probability, the degree of confidence that particular recurrent or non-recurrent events will take place. Paul J.H. Shoemaker, "The Expected Utility Model: Its Variants, Purposes, Evidence and Limitations" ["Model' ozhidaemoi poleznosti: raznovidnosti, podkhody, rezul'taty, predely vozmozhnostei"], *Thesis*, issue 5, 1994, pp. 29–80, 47.

and uncompetitive.¹⁹² In fact, of course, backing only large-scale projects impoverishes the repertoire of cinema. It is not that great for the stars either. They pay a price for carrying a brand. Playing the most important role of his career, that of a brand, the artist is no more free than any other brand to choose the products he manufactures. The image of himself which he has created does not belong to him. He becomes the property of his fans, many of whom do not take kindly to metamorphoses. A hard, fighting man in one film cannot be seen slobbering shortly afterwards in some melodrama. How could he fight to defend himself and those depending on him in his next picture? The fans would feel they were being tricked and would simply switch their attention to something else.

A classic example illustrating this banal truth is the great Coca-Cola disaster when the company tried to step out of line.¹⁹³ In 1985 it announced that ordinary Coca-Cola was being replaced by New Coke with an improved flavour. At the period Pepsi was giving Coca-Cola a hard time, enticing consumers away with a sweeter and more appetising beverage. The Coca-Cola team had to recognise that its competitor's claims were not without merit and came up with a sweeter and gentler Coca-Cola, closer to Pepsi. The result of their efforts was a disaster now legendary in the history of branding. Consumers turned their backs on New Coke, and three months later the management returned to their old formula. As Coca-Cola's top manager admitted, from a taste point of view the new product was undoubtedly better, but for the consumer it was no longer cola. The company recognised from this episode that the brand did not belong to it but to the consumers.¹⁹⁴

In the same way, a cinema audience comes to identify with the person on the screen and to look forward to meetings with him, so how can that person suddenly reappear as quite a different character, capable of duplicity and betrayal? Which captain of the cinema industry would allow such a thing? Unless it is absolutely unavoidable, it is unwise to try the patience of an audience by tinkering with the context in which they see their favourite actor. We are back with the economics of information costs. There have been instances in the history of cinema when stars have changed the nature of the roles they play, but they all necessitated heroic resistance to directors' marketing instincts.

3.6.6 *Poor Reception on the Bush Telegraph*

Word of mouth can overcome the information cascade devised by marketing specialists. This is important as objective testimony to the power of the bush telegraph.

¹⁹²As the director Harry Ufland has remarked, the cinema industry is now a business in which everybody is pursuing the same successful project, a blockbuster. Mark Litwak, *Reel Power*, pp. 89–90. One of the United Artists managers also reports that the main goal of the corporation was “locomotives”, films with blockbuster potential. Garvin sees this approach as a conservative (low-risk) economic strategy. David A. Garvin, *Reach for the Stars: Blockbusters*.

¹⁹³Although the example is taken from a different sphere, it has universal applicability.

¹⁹⁴Drawbaugh, *Secrets of a Strong Brand*, pp. 36–37.

Although we all know, without confirmation from anyone's research, that recommendation by people we know influences which film we choose to see, a subjective feeling is one thing and statistics quite another. It does seem that positive comments are more influential than warnings that something is not worth going to see. The methodology of De Vany and Walls¹⁹⁵ does not help us to estimate the navigational effectiveness of an impromptu exchange of opinions. It tells us only that the bush telegraph exists and functions. If it transmits bad news, the graph of box-office takings falls, indirectly indicating that a lot of spectators have not enjoyed the film. The fact that the information cascade has been disrupted indicates that the film has proved massively unpopular. Taking a conventional view, we might come to the opposite conclusion: if the box office takings are fairly large, the public must on the whole have enjoyed the film. That would be sadly mistaken. The whole problem is that, analysing total revenue rather than the rise and fall of box-office takings does not allow us to judge customer satisfaction at all reliably, since consumers part with their money before they see, hear, or read the work. Only too many people regularly find themselves in a situation of 'consumer insufficiency', a term which we suggest should be legitimised, since the situation occurs rather frequently, as an antonym of consumer surplus.¹⁹⁶ By analogy with surplus, consumer insufficiency is the sum of money which, if returned, would compensate a customer for their sense of dissatisfaction with a cultural product. Even the most predictable and low-risk projects like blockbusters, sequels and prequels can flop disastrously.¹⁹⁷ It would be unwise to believe that mass disillusionment with a blockbuster is as improbable as mass poisoning by a cola. It happens, and not infrequently. We cannot just write off unfortunate choices as being due to a lack of discrimination on the part of individual customers: the 'insufficiency' arises because of the current market rules. If we had a tool capable of measuring consumer insufficiency and consumer surplus it would, among other things, enable us to form an objective judgement of the extent to which all is well in the cultural sphere.

One further question remains: how much do people respond to negative opinions? De Vany and Walls were working with data from ten or twenty years earlier. Since then the quality of films has changed, and so has what is transmitted over the bush telegraph. Quality has settled at the minimum acceptable level, and the need for supplementary signals has accordingly declined. Most cinema-goers have a pretty good idea of what to expect from a typical film they see advertised. Even if the film is panned, people still go to see it. The choice is not that great, and leisure time has to be filled with something. If nothing else, they can check out how bad it is. If you are in any case in a shopping and entertainment complex, you might as well wander into the cinema to take a break from shopping. Happily, there are screenings beginning

¹⁹⁵De Vany and Walls, "Movie Stars, Big Budgets".

¹⁹⁶Another term used by economists, 'negative utility', is also applicable.

¹⁹⁷In the 'Cinema' experiments, which tested the method of post factum monetary rating of films, *Terminator 3* attracted distinctly negative comments. In accordance with the conditions of the experiment we were obliged to compensate the participants for their consumer insufficiency. For further detail, see Appendix 4.

every quarter of an hour. The economics of the consumer's transaction costs have been calculated down to the last cent. The level of comfort is sumptuous, so would it not be downright ungracious to whinge about the content of the film? Such is the mentality of the contemporary cinema-goer whom the industry is targeting.

The role of the bush telegraph may be declining but the system has not yet fallen silent. It is constantly muttering in the background and people are half-listening to it. People draw their conclusions, but as time passes the niggling seems to be forgotten and the film most probably gets to be watched on DVD. It would be interesting to repeat De Vany and Walls's research and see whether the level of interference on the bush telegraph wavelengths has changed. At a deeper level, collaborative filtering is word of mouth under a different guise, only highly automated and improved by the use of monetary coding of the signals. This is a high-speed technology with excellent filtering out of interference and pinpoint targeting of the signal sent to the consumer. Just think how damaging it could be for the marketing executives' cascades of purchases, and how therapeutic for culture!

De Vany and Walls's research is valuable and instructive in one further respect. It shows how sophisticated and labour-intensive a methodology has to be if it is to discern what is happening in culture through the way money is spent and, more specifically, to detect what people really like out of all the goods and services they pay for. However, even their basically very useful methodology is at best a tool for theoreticians which does nothing to facilitate consumer navigation. It is a pity too that they limit their analysis to blockbusters and exclude exemplary low-budget films.

3.7 Arbitrage in the Ticket Market¹⁹⁸

3.7.1 *Speculators as Pilots in the Sea Lanes of Culture*

As we have seen, the only aid to consumer navigation, and that with reservations, is brands, the reputation of suppliers and critics. These reservations grow when we move from the industries of luxury and taste, which are search goods, and performing arts (theatre, sport, etc.), which are reliable experience goods, to such digital sectors as cinema and other pure experience goods.

One other source of information, admittedly indirect and rarely regarded as such, is the market of ticket resale. Speculators have no interest whatsoever in consumer navigation but, albeit unintentionally, they are very helpful. Because they have to evaluate the current repertoire for their own purposes, resellers provide informative signals about demand. The phenomenon of ticket speculation is a keyhole through which we can peep at some important aspects of how the cultural markets function.

¹⁹⁸In this section we avail ourselves of facts from Stephen K. Happel and Marianne M. Jennings, "Creating a Futures Market for Major Event Tickets: Problems and Prospects", *CATO Journal*, vol. 23, No. 3, winter 2002, pp. 443–461.

It is not a keyhole which researchers often look through, or if they do then only on behalf of someone organising a show or the owner of a cultural venue who needs advice on price formation for a limited number of seats. It is generally believed that organisers knowingly pitch their prices low, putting up with speculation in order to obtain certain other advantages for themselves.¹⁹⁹ Their reasoning is said to be that:²⁰⁰

- it is preferable to price tickets too low than too high and then to be unable to sell them;²⁰¹
- a full house is important if the performers are to give of their best;²⁰²
- consumers regard the pricing as fair;²⁰³
- it attracts the performers' fans.²⁰⁴

Organisers could engage in price discrimination (see Sect. 3.5.1) if there were no reselling of tickets in secondary markets, but ticket touts have moved into this niche. They help themselves to part of the consumer surplus, which might otherwise go to organisers.

We are primarily interested in speculators because of their contribution to providing information about culture. In the fashion market, resellers do business; in the entertainment market the same role is played by ticket touts and speculators. There is a distinction to be made between legal agents/brokers and touts, who are street speculators. For a number of reasons it is the touts who are better at predicting demand and, to some extent, the perceived quality of performances. They are better able to do this because they do not have to worry about maintaining the reputation of the concert hall or sports arena; or of particular actors, musicians, or sportsmen; or about coordinating income from contiguous markets like cinema and video rental; or by the need to maintain a balance between sales of the principal and contingent products. Speculators have none of the interests which encourage uniform pricing, their hands are not tied, and accordingly the prices they set tend to be informative. Needless to say, they are not in business out of altruism, and paying for their services reduces consumer surplus. What do consumers get in return?

The utility obtained from ticket speculators is twofold. In the first place, they help people to organise their free time better: they increase the 'liquidity' of leisure by

¹⁹⁹Deirdre N. McCloskey, *The Applied Theory of Price*, New York: Macmillan, 1982.

²⁰⁰See the survey of causes of this behaviour in Alan B. Krueger, "Supply and Demand: An Economist Goes to the Super Bowl", *Milken Institute Review*, vol. 3, No. 2, 2001, pp. 22–29.

²⁰¹James L. Swofford, "Arbitrage, Speculation and Public Policy Toward Ticket Scalping", *Public Finance Review*, vol. 27, No. 5 (September, 1999), pp. 531–540.

²⁰²Gary S. Becker, "A Note on Restaurant Pricing and Other Examples of Social Influences on Price", *Journal of Political Economy*, vol. 99, No. 5, 1991, pp. 1109–1116.

²⁰³David Kahneman et al., "Anomalies: The Endowment Effect, Loss Aversion and Status Quo Bias", *Journal of Economic Perspectives*, Winter 1991, vol. 5, No. 1, pp. 193–206.

²⁰⁴David J. Salant, "Price Setting on Professional Team Sports", in Paul M. Sommers, ed., *Diamonds are Forever: The Business of Baseball*, Washington, D.C.: Brookings Institution, 1992, pp. 77–90.

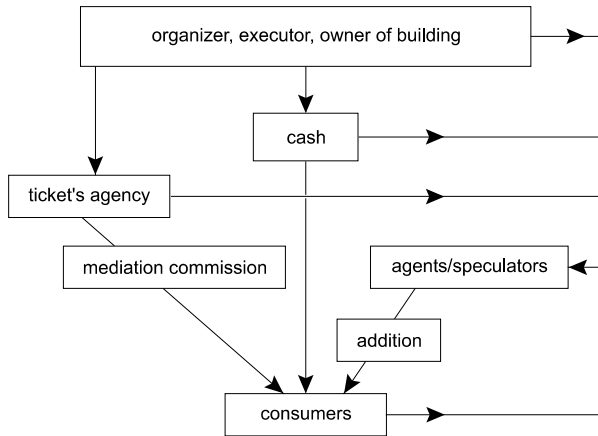


Fig. 3.3 Diagram of ticket distribution (Information from Pascal Courty, “Some Economics of Ticket Resale”, *Journal of Economic Perspectives*, vol. 17, No. 2, 2003, pp. 85–97)

providing an opportunity to choose a cultural event on the spur of the moment in accordance with mood. The planning of leisure time is onerous and risky. Speculators simplify it. A ticket bought in advance is not the same good as a ticket bought on the day. There is accordingly no price discrimination in the change of ticket prices as the level of demand becomes clearer. This is ‘intertemporal differentiation’.

Tickets are purchased in a number of ways (see Fig. 3.3). You can queue at the official ticket counter; you can order over the telephone, or the Internet.²⁰⁵ Alternatively, you can buy a ticket from a legal ticket agent like Ticketmaster or Ticket.com,²⁰⁶ at a kiosk, by telephone or online at a premium of approximately \$4.50 on an average ticket value of \$33. For some events there is no box office and the right to buy a ticket has to be won in a lottery, or you can buy tickets from touts immediately before the event.

A second benefit from the activity of speculators is that, by differentiating price, if in a rough and ready way, they signal quality for consumers. In other words, they do what, for a number of reasons and under various pretexts, the producers of cultural goods decline to do.²⁰⁷ Speculators thus go some way at least towards redressing information asymmetry. By obtaining such information as the pattern of box-office takings and the nature of demand in other regions, they inform the public

²⁰⁵Such music stars as Madonna and Aerosmith are increasingly selling tickets for their concerts over the Internet, thereby making sure that members of their fan clubs or subscribers to Internet services obtain seats. M. Peers and A.W. Matthews, “Plugged-In Fans Buy Hot Tickets in Web ‘Presales’”, *Wall Street Journal*, 21 May 2001.

²⁰⁶According to the Kelsey Group, Ticketmaster represents 94 out of 118 professional baseball, basketball, football, and hockey teams and has 4,300 exclusive contracts with venues and promoters throughout the world. Tickets.com declares 4,000 such contracts. *Online Ticketing Outlook*, Princeton, New Jersey: Kelsey Group, 1999.

²⁰⁷On uniformity of prices, see Sect. 2.5.5.

through pricing about their predecessors' experience of the event. It is highly pertinent that, unlike critics, speculators are paid directly by consumers. The demand for their services is linked directly to their reputation for getting it right, which encourages them to be genuinely, not just seemingly, efficient. Touts are thus selling their customers not only freedom to choose when they purchase, but also information about quality. This is not just the usual soft soap of sellers extolling their wares, but responsible predictions underwritten by the risk of being left with unsold tickets on their hands. Do consumers gain or lose from this? It depends on how they value their leisure time, and the alternative forms of payment available for various market segments. Less well-off people will be more willing to pay for access to culture by standing in queues.²⁰⁸ For them this form of labour may be better recompensed than what they do at their workplace. Rich people free up time by paying for the services of speculators, and simultaneously improve the likelihood that it will be transformed into quality time.

3.7.1.1 Ticket Speculation: The Cradle of Russian Big Business

Speculating in theatre tickets in the 1980s was to be the cradle of big business in Russia. Many well-known entrepreneurs graduated from it. Five or six prestigious Moscow higher education institutions effectively monopolised the distribution of tickets for the best theatres and individual productions in the capital. The mechanism by which they their dominance was simple but effective: detachments of students would besiege the theatre ticket offices before selling began and buy up all the available tickets. Since each group only had tickets for the theatre they controlled, they needed to be able to exchange them. Over time something like a stock market developed where tickets were exchanged at a rate reflecting the popularity of the various productions. The ratio could be 20:1, or even 50:1. If the quote for tickets for a particular production was 30 while those of another was 10, tickets were exchanged in a ratio of 3:1. A hierarchy of productions thus emerged, evident from their exchange rate and reflecting consumer preferences.

At that period in Russia the theatre was almost the only airhole in the ice where free-thinkers could assemble. The information cascade generated by those of like mind in political and aesthetic matters was a powerful factor in price formation. Quotes for particular productions on this informal stock exchange accurately reflected consumer quality and were highly informative. Customers learned from experience that the higher the cost of tickets the better, as a rule, they would like a production. The Veblen effect was probably also operative. If tickets were resold for money, the price reflected the stock market quote. More often tickets served as a kind of currency, converted into services remote from the world of the theatre.

This experiment, conducted by history itself, showed that, if professional players were interested in differentiating prices by consumer quality, this was entirely feasible. None of the real or imaginary difficulties traditionally raised, like demand

²⁰⁸This form of leisure activity may be of interest in itself.

uncertainty, proved a real obstacle. This tells us that if business has chosen to impose uniform prices, it has done so because it finds that profitable. The claim that it “doesn’t know how” to differentiate prices is just an excuse. The interests of consumers and of culture in general are pushed to one side.

The Moscow ticket exchange was able to reveal consumer quality because it was independent of the providers of culture, the theatres, and consequently free of all the obligations and considerations which would otherwise have bound it hand and foot.²⁰⁹ The student organisers did not need to worry about the sales of theatres outside their purview, they did not need to observe a balance between the price of admission and revenue from the buffet and, a factor of no small importance, their consumers were largely a like-minded public. For recommenders this is an ideal situation: not to be pretending to serve one master while receiving money from another. In the Moscow ticket oasis there was no duplicity. Income depended wholly on satisfying the customer, and that is why prices reflected the perceived quality of performances.

3.7.2 Should Touts Be Done Away With?

In order to appreciate the scale of the ‘problem’ of ticket speculation, let us look at the statistics of the secondary market. The generally accepted number of agents in the USA is between 800 and 1,000.²¹⁰ They usually service a particular region or a major city together with its suburbs. The agency business is mainly in the hands of small firms with a staff of up to a dozen and a half workers, and takings of \$3–4 million a year. None of these controls more than one per cent of the market. Tickets are acquired through all available channels: by queueing, for which people may be specially hired; through mass telephoning or emailing; through agreements with owners of season tickets; through sportsmen and actors; through infiltrating fan clubs; and through trading with other brokers. Between 25–40% of the tickets sold by agencies are on a “try to get” basis, not yet available elsewhere, and with no guarantee that they ever will be. (You can insure against this eventuality.)

Different sources give different estimates of the number of agents (brokers) in the USA. TicketAmerica, valuing the entire American ticket market in 1998 at \$7.2 billion, supposed that agents resold 10% of tickets at twice the price. This values the secondary market at \$1.4 billion. EventTixx believes that of a \$60 billion ticket market in 2000, agents accounted for up to \$3 billion. LiquidSeats believes 20–30% of the best seats go to brokers to be sold at a 150% markup on the face value, and considers that the secondary market brings in \$10–14 billion.

²⁰⁹Of course, the independence was relative. Informal contracts were concluded with theatre managements not to allocate tickets under the counter themselves.

²¹⁰According to EventTixx 2000 and LiquidSeats 2001, quoted in Happel and Jennings, “Creating a Futures Market for Major Event Tickets”.

Although the estimates are highly disparate, it is clear that many people have no qualms about resorting to the services of speculators, and accordingly put a premium on the freedom to obtain tickets and plan their leisure as it suits them. The state, and probably society, sees speculating in culture as an evil. Those who buy tickets from touts are in no danger of prosecution—they are not seen as part of the problem—but many would like to see resellers driven out of business.

3.7.2.1 Laws on Ticket Speculation (Scalping) in the USA

In the USA there are no federal restrictions on ticket speculation. In twenty states there is no legislative basis for this, in three there are minor location restrictions, and in five states the functions of regulation are delegated to local authorities. Of the remaining states, markups on ticket prices are limited in twelve, and in eight speculation is banned for particular events. In New York State there is one of the most severe anti-speculative schemes in the USA. In 2001 any resale at a premium exceeding \$5 or more than 20% of the face value was declared illegal. Ticket brokers were required to have a license. If prior to 2001 insider trading whereby ticket office employees channelled tickets to brokers for a fee (a so-called “ice” operation), was considered a misdemeanour, from 2001 it became a felony liable to criminal prosecution.²¹¹ Legislation on reselling was introduced in two stages. First generation laws tried to rein in touting, while the second generation laws distinguished between street speculators and ticket agencies or brokers.

The authorities intervened in order to protect the interests of society, but are these being interpreted correctly? Is it really necessary, in order to protect some consumers, to penalise others? How much harm are speculators doing to the market in particular and to culture in general? These questions raise the same issues as copyright and the battle against the pirates. In both cases it is a matter of finding a balance between universal access and the interests of private individuals, except that in one case the private individuals are the rights holders, and in the other speculators and their customers.

Who will provide the better balance, the state or the market? There was an amusing development which made ticket touts marginally more popular in Phoenix, Arizona when speculators were permitted to sell tickets at the entrance to the sports complex, without price restraint and without a license. The arrangement operated for the first time at the National Basketball Association All-Star Game in 1995, and has been functioning ever since. Fans are surprised and pleased to find that prices fall as the beginning of the game approaches,²¹² and see the system as operating in their own interests. Is this a special case from which we should not extrapolate?

²¹¹In June 2003 these laws were to be reviewed, and it was suggested that price restrictions could be dropped if the illegal supply of large batches of tickets could be stopped. Happel and Jennings, “Creating a Futures Market for Major Event Tickets”, p. 446.

²¹²Evidently the market is close to a state of perfect competition.

Before appealing to the state to clamp down on speculators, let us see what kind of regulation the market is capable of producing itself. Until recently organisers of events seem to have found this beyond their own abilities.

3.7.2.2 What Are Touts For?

Most official ticket sellers are in favour of controls on reselling, and restricting agencies' access to tickets. They lobby for an outright ban on resale.²¹³ At the same time there are other ticket sellers who are perfectly happy to allow dealers to resell tickets above their face value. Why do some object while others do not?

Why do show organisers allow any speculation in their tickets, thereby depriving themselves of a potential profit? If there is a profit to be made in the secondary market, why are not organisers trying to get their own hands on it? How do middlemen survive? In order to answer these questions, Pascal Courty modelled the strategy of a monopolist selling tickets.²¹⁴ As the day of an event approaches, consumers gain an increasing amount of information about it and can decide more exactly how much they can afford and how keen they are to attend. That is, they increasingly quantify their own demand.²¹⁵ The monopolist may sell tickets well in advance to less informed customers, and closer to the date of the event to customers who are better informed. He may also ration tickets and allow ticket holders to resell. Courty's main conclusions are:

1. if an organiser is not intending to sell tickets in the late market, staging sales is disadvantageous;
2. if tickets go on sale too early or too close to the date of the event, the results will not be optimal. Allowing the public a long, convenient period over which to buy tickets is disadvantageous;
3. the owner of a venue will obtain the same results by selling tickets early and allowing them to be resold, or by himself selling them immediately before the event. By permitting resale, he does not lose out, despite the fact that his customers would be willing to pay more for their tickets after becoming clearer about their own intentions. (Why this is the case we shall see below.)

In another article Courty gives an explanation of the phenomenon of speculation which can be understood without any calculations.²¹⁶ Some consumers ('fans') like

²¹³These include Californians Against Ticket Scalping, an association supported by the promoters of various events, which lobbies legislators to ban the resale of tickets by speculators. See Pascal Courty, "Some Economics of Ticket Resale"; Chuck Phillips, "Why Does a \$30 Ticket Become a \$600 Ticket?", *Los Angeles Times*, Calendar, 27 May 1990, p. 8.

²¹⁴Courty develops the models of de Graba, Lewis, and Sappington. Patrick de Graba, "Buying Frenzies and Seller-Induced Excess Demand", *RAND Journal of Economics*, vol. 26, No. 2, 1995, pp. 331–342; Tracy R. Lewis and David E.M. Sappington, "Supplying Information to Facilitate Price Discrimination", *International Economic Review*, vol. 35, 1994, pp. 309–327.

²¹⁵Pascal Courty, "Ticket Pricing Under Demand Uncertainty", *Journal of Law and Economics*, vol. 46, No. 2 (October 2003), pp. 627–652.

²¹⁶Pascal Courty, "Some Economics of Ticket Resale".

to plan their leisure in advance while others ('professionals') prefer to wait to the last minute. This differentiation explains the demand for speculators. The organiser cannot himself take their profit, because he cannot prevent their appearance in the market. He would like to sell tickets to 'professionals' at the last minute, but the agents have already bought them up. Sometimes theatres succeed in winning back part of the late market from speculators by holding back the best seats until the last minute. Thus, 50 of these retained seats for the Broadway show "The Producers" were sold at a price of \$480 instead of \$100.²¹⁷ This is not always possible, and in this case the organisers were so embarrassed by their extraordinary profit that they donated just over half of the premium (\$150) to the Twin Towers Fund. Perhaps they were afraid of being tarred with the same brush as ticket touts and spoiling their image.

Courty brings us to a conclusion we have already met: it is not always in the interests of an organiser to differentiate prices in culture. Admittedly, previously we were looking at the somewhat different situation of the paradox of uniform prices, with different products being sold at the same price. We find, however, that in the sphere of entertainment too, event organisers have little opportunity or incentive to manage pricing. The obvious explanation might seem to be that the monopoly distributor of tickets, even if he wanted to, cannot differentiate price because he cannot prevent resale. There are, however, a number of other reasons why arbitrage is best left to the touts. In the first place, they are more willing to take risks, and save the producer from uncertainty over whether the tickets will sell out or not.²¹⁸ In the second place, speculators have advantages in terms of transaction costs and the amount of tax they pay. And in the third place, they are better at discriminating because they know the consumers and local conditions better, and have built up a valuable asset through networking. Resale is in any case a time-consuming, highly mobile activity better suited to small, family teams than to bureaucratic organisations.

Different price management practices have evolved in different cultural sectors. Until recently, official ticket counters in sport and entertainment rarely gave discounts for buying early. They demonstrate insufficient price discrimination.²¹⁹ At the same time, the organisers of a classical music concert will operate with 20 or so different prices depending on the location of seats in the concert hall and the status of the event. Rock concerts have only two or three ticket prices. During the Rolling Stones' tour of the USA all seats were the same price. The main sports leagues often act in a similar way, setting the same price for all matches irrespective of the level of the opposing teams. How reminiscent this is of price formation in the digital sectors! Happel and Jennings offer four explanations for how this has developed.²²⁰ Firstly, the organisers of symphony concerts and opera performances have a better knowledge of their supporters and the specifics of their requirements than the main sports

²¹⁷Frederick Winship, "The Art World: \$480 Broadway Tickets?", United Press International, 6 December 2001.

²¹⁸Swofford, "Arbitrage, Speculation and Public Policy Toward Ticket Scalping", *Public Finance Review*, vol. 27, No. 5, September 1999, pp. 531–540.

²¹⁹Happel and Jennings, "Creating a Futures Market for Major Event Tickets".

²²⁰Some duplicate those we have already met when discussing uniform price.

leagues, or popular performers thronged by fans who number many thousands. In the second place, sports and music fans see the important thing as just being at an event rather than sitting in a particular seat. They view the tickets as a more or less homogeneous good.

In the third place, selling bundles which, in addition to the event, include a whole range of extras like beer or souvenirs, is far more profitable for major sporting events and popular concerts than for classical music concerts or opera. All the ordinary seats are underpriced in order to pull in the crowds, who will produce higher overall revenue through contingent spending. And fourthly, sports stars and popular performers are anxious not to give their fans the impression of being greedy.

3.7.2.3 More on the Advantages and Disadvantages of Touts

According to Courty, the current way the market is structured makes it impossible for the organisers of performances to combat the touts effectively. This brings us back to the question of whether they should be done away with using extra-market methods. To remove them and make everyone stand in a queue would seem to be a good way of making culture equally accessible to all, and to provide a level playing field for symbolic and monetary capital. How well advised is this approach? When the measure of equal access is equal payment, the implication is that discrimination denominated in time is less harmful. The purchasing power of time is declared to be higher than the purchasing power of money. The rich have in any case too much of the good things in life already, and it will do them no harm at all if just once in a great while they have to wait. But is discrimination directed against better-off citizens all that harmless? Do they really have so much free time, and is it so fulfilled, that their freedom to allocate it should be curtailed? “Kindly just be the same as everybody else!” the opponents of speculation insist. It is not that simple, however, to solve life’s problems with queues.

There will always be people willing to exchange their cheap time for someone else’s expensive time in return for a corresponding cash adjustment. In terms of economics, time is not generally more valuable than money but is equivalent to it, but if anybody finds that a particular market sets a higher value on time than their usual hourly earnings, they are entirely within their rights to sell profitably in that market. Likewise, high income groups have a right to acquire time at what for them is a relatively low price. The two sides exchange their consumer surpluses, only for some it is expressed in money and for others in time.²²¹

The process of changing time into money has no deleterious effects for culture, so one wonders why it should be thought necessary to intervene, and who might be in a better position than the individuals involved to dispose of their subjective

²²¹Since we are looking at both time and money costs of access to cultural events, it seems logical to complement the concept of monetary consumer surplus with temporal consumer surplus. This is the amount of time a person would be willing to spend above what is actually required under the conditions of a deal.

surpluses. Non-professional sellers in this market can be relatives, friends, business acquaintances, tour operators, concierges and others. Exchanges between them inevitably entail transaction costs, and speculators help to lower these.

Touts have one further effect: they improve the quality of choice. Business suffers from this, because thanks to the speculators consumers make fewer unfortunate purchases. Suppliers can, however, also benefit, as Williams has noted.²²² If clubs keep an eye on how tickets are reselling, they may find that they are underpricing. Williams concludes that if clubs are worried only about their return from tickets, they should oppose anti-speculation laws.

Courty thinks along similar lines. If resale is banned, the consumer surplus appropriated by agents will go either to organisers or remain with consumers. Society will not benefit, since on the whole the surplus will remain the same. If resale is permitted, part of the surplus is lost, since the activity of speculators has costs. Does this mean it should be banned? On the other hand, by making late market tickets more accessible agents help organisers sell tickets to consumers they themselves would miss. Speculators seek out new customers who otherwise might not go to the event at all, and provide them with tickets in accordance with their preferences. Moreover, by buying up seats at an early stage, speculators do the organisers a favour by confirming interest in the event. Courty does not come down unambiguously for or against, but I find his research compelling. The speculative business is viable, and that means that loss of part of the surplus is more than compensated for by an overall increase in turnover.

3.7.3 *On the Influence of Speculation on Social Welfare*

Would society benefit from the universalisation of queueing for tickets and a ban on speculation? What is the basis for the view that bartering tickets, rather than buying and selling them, is better for society? The worry seems to be that touts may buy up all the tickets and ratchet prices up so that the less well-off get nothing and culture ceases to be universally accessible (as if it were at present). Unfortunately, this is highly unlikely. ‘Unfortunately’ because, if it did happen, culture would flourish as never before. A large supply of solvent consumers could only be a good thing for culture. And ‘highly unlikely’ because there are not that many prosperous people around, and not enough of them have so much leisure time they would want to buy up all the available seats and take over the entire territory of culture which, like the galaxy, is rapidly expanding in every direction.

Let us suppose that some totally must-have book is published at an astronomically expensive price. Does this mean that rich people will buy up the whole edition? Probably. Will poor people thereby be prevented from purchasing it? No, because the next edition will be specifically targeted at their price bracket. Books, you may say, are issued in editions but what about performances? If the rich help themselves

²²² Andrew T. Williams, “Do Anti-scalping Laws Make a Difference?”, *Managerial and Decision Economics*, vol. 15, 1994, pp. 503–509.

to all the stars, what will be the lot of the poor? Nothing terrible will happen: new stars will appear. Actually, as analysts like Rosen and others tell us, they won't even need to appear because they are already there. Society hasn't got round to experiencing them, but if the need arises, the requisite work to discover new stars will undoubtedly be done. They may, indeed, already be idolised by select communities which have done part of the work. That is, those who in our rather far-fetched example lost their stars, will incur the necessary information costs to choose new luminaries. There are plenty of options: join some large community in order to lower the individual cost of quality consumption; adopt the principle of 'less but better'... In any case when business notices the unsatisfied demand it will be quick off the mark. In a word, less well-off strata will spend the necessary time to restore the cultural status quo, and after all, they are already spending it by standing in ticket queues. The exchanging of time for money and vice versa can be efficiently accomplished by purely market, economic methods, but this does not help us with the problem of adverse selection which restricts prospects for all consumer categories. When that is resolved the stars will shine in even greater numbers and there will no longer be a need for primitive speculation. This is a problem consumers themselves can solve by collaborating in the assessment of quality.

The conventions of the present day encourage consumers to spend more time and less money on aesthetic pleasures. Those whose resources are the reverse of this may give up on culture completely. Entry barriers into the sphere are already high and there is probably no point in artificially raising them higher. Perhaps the opposite would be healthier for culture: more money and less time. Or, better still, invest sufficient quantities of both time and money. Symbolic exchange cannot be regulated by the conventional tools of economics because the things most significant for it cannot be measured financially. This is tantamount to trying to change the level of liquid in communicating vessels by jiggling them up and down.

3.7.4 Online versus Offline Sales

It is by no means clear, then, that the welfare of society requires state intervention in the ticket market. In any case, the issue has largely gone away because the Internet has radically changed the rules. Those organising events can now arrange matters in whichever way suits them. If previously the touts were able to run rings round them in terms of efficiency and communicative effectiveness, now, thanks to the Internet, they can solve their distribution problems and are perfectly well able to cut off touts' oxygen supply. Online sales which enable buyers and sellers to interact directly make the middleman redundant.

Internet commerce is a rapidly growing institution for which most analysts predict a great future.²²³ Having paid for your tickets, you receive them there and then,

²²³In 1999 the Kelsey Group predicted that the proportion of online sales of tickets in the USA would increase from 2% in 1999 to 17.5% in 2004. In 2001 LiquidSeats anticipated that until 2006 online ticket sales would increase annually by 58%.

avoiding problems of delivery and forgery. In effect, a commission of 10% of the ticket's face value is returned to both the seller and the buyer, since this is the income which agents and speculators are losing. Global eTicket Exchange has suggested auctioning tickets in the primary market.

On 15 April 2005 the first batch of tickets for the 2006 World Football Championship in Germany was sold. The tickets were distributed through an electronic lottery in which 208,455 fans obtained 812,000 tickets for 64 matches. Each family was allowed to order up to four tickets for seven championship games. A limit of not more than two tickets for three matches operated for tickets in the cheapest categories, from €35 for an ordinary match to €120 for the final. The most expensive tickets were priced at €600. During the first of five phases of ticket selling, 900,000 people from 195 countries applied for 8.7 million tickets. Under the rules, everyone taking part in the lottery had to provide such personal details as name, address, and identification document number. This meant that virtually all the spectators were known by name, as was where they were sitting, and the organisers warned they would carry out spot checks of ID on entry to the stadia. For agents and speculators this was a lost cause. Such systems will undoubtedly hit the black market, where the price paid for tickets can be many times more than face value.²²⁴

If the organisers so wish, then, they can stop resale and market tickets without middlemen. The question is, do they want to? We are not going to get a straight answer from anybody, but the reactions of ticket speculators betray their intentions. The agency ticket market has always been extremely fragmented, and it seemed entirely logical when in 1998 Ticket America, exploiting the new electronic technologies, decided to try to bring agents into a national ticket exchange. Drawing on experience both in e-commerce and the ticket industry, Ticket America set out to link agents to an integrated portal for ticket re-sale. Anybody would be able buy the tickets he needed by clicking a button. In addition, Ticket America offered independent ticket agents an integrated site for conducting e-commerce. Even though only a few agents had their own suitable infrastructure, Ticket America got nowhere. An attempt by TickAuction.com to create an agent-to-agent network in the late 1990s also failed. Bringing independent agents into a group, one analyst commented, was like trying to shepherd cats into a flock.²²⁵

No matter how much small agencies try to resist, e-commerce and the ability to identify who bought a ticket will limit reselling and may drastically change the ticket market. As the purchaser may no longer be able to dispose of tickets as he sees fit, they will not be able to circulate without the knowledge and consent of the organiser of the event. Having gained this weapon against arbitrage, monopolist ticket suppliers will doubtless want to profit from price discrimination. When they start helping themselves to consumer surplus, the attractiveness of collaborative filtering will increase further. Consumers will have either to put their trust in a monopoly supplier's price formation, which is likely to be highly manipulative, or to turn to

²²⁴Itar-Tass Press Agency, 25 April 2005.

²²⁵Happel and Jennings, "Creating a Futures Market for Major Event Tickets".

accurate personalised predictions from a system of collaborative filtering. Competition will consist of rivalry between two methods of informing consumers about quality: the averaged price signals of the provider or the highly accurate recommendations of a collaborative service. The quality signal can be embedded in price, or it can exist independently both of the product's price and provider. The former is less transparent and more open to manipulation. The latter is free of these drawbacks.

3.7.4.1 A Futures Ticket Market as an Alternative to the Speculators

In Sect. 3.2 we mentioned in passing that a futures ticket market was unlikely to improve the quality of events or facilitate consumer choice because it would not be able to take tastes into account. With the aid of futures it is, however, possible to dispense with speculators and one can only wonder why a futures ticket market does not already exist.

Tickets possess several attributes of options (the right to buy and sell something in the future), and accordingly there is no reason why they could not circulate in a market. The lack of a futures exchange seems to have several causes,²²⁶ such as the inconsistency of legislation regulating resale; the relative ease with which one can manipulate prices for events in great demand; and the trend towards personalising tickets for important events. It is also possible that the market would not be deep enough, that it would lack the requisite volumes, so that daily trading would be possible for only a few tickets. Although all these reasons are pertinent, the main problem lies elsewhere: there is a broadly based coalition of sellers and resellers opposing it. Although a futures exchange would provide promoters with detailed information on prices and enable them to optimise ticket revenue, sales of contingent goods might have to be left out of an entertainment package. That delicate balance between the box-office takings and anticipated revenue from the buffet, souvenir sales and the like, which takes promoters so long to achieve, might be totally destroyed. Ticket agents and touts are also naturally opposed to a unified secondary market on the grounds that it would put them out of work. Finally, society does not look favourably on schemes which threaten a substantial price increase. The current channels for distributing tickets allow the average, non-wealthy person with no strings to pull to get into major events from time to time. Many people fear that a futures market would be a place where only those with deep pockets could afford to buy, and where, perhaps, they might buy up all the tickets. The fact that these fears are groundless, does not make them any less potent.

3.7.5 Signalling Quality as an External Effect of Piracy

If ticket speculators aid consumer navigation in the sports and entertainment markets, pirates perform the same service in the digital sector. This applies particularly

²²⁶The observations which follow are taken from Happel and Jennings, "Creating a Futures Market for Major Event Tickets".

to durable goods which are one-off purchases, such as computer software, computer games, and music recordings where the pirate copy often serves as a low-cost sample. Since copies are not perfect substitutes for the originals (in particular, they come without technical support), after obtaining an idea of the quality of a product by using them, informed consumers can decide to purchase a licensed version.

This is the view of Lisa N. Takeyama who sees unlicensed products as a means of combating asymmetric information.²²⁷ She suggests that pirate sampling, by making it possible to test products, can help to solve the problem of adverse selection. Without pirate copies, high quality products might not be produced at all since, if consumers are unable to distinguish high quality wares from low, the latter will predominate. Our own view is that on balance pirates reinforce rather than counteract a tendency to adverse selection. As we have seen in the case of fashion, pirates accelerate adverse selection and can disrupt the natural rhythm of a sector, which is normally set by the logic of the manufacturing process and customers' requirements. The information services of pirates, if they exist, come at a high price to the market as a whole. Moreover, for products like computer games, adverse selection is not a major problem. This durable product and the information cascade when consumers exchange their opinions are highly informative (customers are able to share their impressions of product quality with each other). The choice is not so great that users' attention becomes dissipated, and the sharing of individual assessments rapidly ascertains which really are the top products in each category.

And yet, despite the controversial nature of Takeyama's claims, they contain an element of truth and, even more importantly, they have the right approach. Most scholarly research on unlicensed copying takes no account of its information value.²²⁸ Takeyama sees such copying as providing a quality signal about products,²²⁹ which can save a reputable firm wasteful expenditure (i.e. advertising) on informing people about the competitiveness of its ware and free it of the need to devise special initial pricing strategies. This is supported by the fact that many top software developers release free giveaways of scaled down ('lite') versions of new products.

²²⁷Lisa N. Takeyama, "Asymmetric Information, and Product Quality Revelation" [online], Department of Economics, Amherst College, 2002. Cited 25 May 2004. Available from URL: <http://www.serici.org/2002/takeyama.pdf>; Lisa N. Takeyama, "The Advertising Value of Pirating Intellectual Property", unpublished manuscript, 1999.

²²⁸Takeyama instances: Stanley M. Besen and Sheila N. Kirby, "Private Copying, Appropriability, and Optimal Copyright Royalties", *Journal of Law and Economics*, vol. 32, 1989, pp. 255–280; Kathleen R. Conner and Richard P. Rumelt, "Software Piracy: An Analysis of Protection Strategies", *Management Science*, vol. 37, 1991, pp. 125–139; Stanley J. Liebowitz, "Copying and Indirect Appropriability: Photocopying of Journals", *Journal of Political Economy*, vol. 94, 1985, pp. 822–841.

²²⁹Takeyama points to the informational value of pirated products using a two-stage model in which the supplier is the sole rights owner. At first the consumer has no information about quality but, using a pirate copy, discovers the true situation. If quality is satisfactory and the copy is not a perfect substitute for the original, the next step may be that the consumer decides to buy a licensed version.

Takeyama believes the measures of the harm caused by unlicensed copying are usually overstated because they overlook the information value of such copies. "... even if without copying the high quality firm *is* able successfully to signal or guarantee its product quality, any measure of the relative harm from copying should also appropriately net out the additional costs that must be spent in the absence of copying to signal or guarantee product quality", for example, by giving away free discs with copies. Takeyama does not venture to say out loud that copyright should be abolished, but she believes it is more effective not to fight the pirates but to stimulate users to buy the licensed product after discovering its quality by using an unauthorised copy. Our own view is that the real alternative to copyright and the piracy it has engendered can be created through a public, consumer-based assessment of quality using monetary collaborative filtering.

Takeyama's analysis relates to digital durable products where the consumer really does have a motive to buy the licensed product. Here price and the frequency of updates are important. If a program is expensive, costing, say, several hundred dollars, and is rarely updated by the manufacturer, it is more beneficial to periodically buy up-to-date pirate copies than to spend a hundred times more on the legal product. In this case, pirates are taking the high-quality manufacturer's primary market, not extending it. Not only here but in every other situation, pirates are working against the manufacturer, not with him. Although they provide consumers with an immediate saving, if we accurately total the costs we shall see how questionable their utility is.

For primarily single-use products, like the cinema or books, the experiencing is identical to consumption, and a copy is close to a full replacement of the original. There may, of course, be subjective differences because of, for example, qualms of conscience or the fear of being caught infringing copyright law. By threatening consumers with legal proceedings, rights owners increase the imperfection of illegal copies. Consumers of such goods have little incentive to pay the legal supplier again for something they have already consumed behind his back. From the manufacturer's viewpoint piracy here has no redeeming features, and in the Napster case the court gave detailed grounds for rejecting sampling of this kind, which is tantamount to full consumption.²³⁰

At first sight, one-off unlicensed products seem a good deal for consumers. Pirates avoid a whole range of costs incurred by a reputable manufacturer,²³¹ and accordingly they can keep prices extremely low if they add only a moderate percentage of profit. This impression is, however, deceptive. By forcing down the price charged by legal manufacturers and depriving them of part of their revenue, pirates in fact provoke the release of an expanded range of cheap, low-quality products. Prices may be lower, but consumers end up buying far more wares. There is ultimately no monetary saving and information costs increase, which leads to degradation of the market. Among pirates one encounters 'noble' pirates whose product quality is no

²³⁰For further details, see Appendix 2, Sect. A2.1.1.

²³¹On piracy in the music market, see Appendix 1, Sect. A1.8.

worse than that of legitimate manufacturers, but there are fraudsters whose products ruin the works supposedly copied. It is not easy for a purchaser to distinguish between the two, so within the grey market too adverse selection is taking place.

3.8 Television as a Testbed for Attention Economics

Speculators are not the only people who are capable of making money by segmenting demand. Television executives also know who likes what, which is how they are able to obtain advertising revenue. The quantity and commercial value of the attention attracted by a particular programme is directly dependent on how many and what kind of people gather in front of the screen. This in turn depends on the nature and quality of the programme content and the time it is shown, which needs to be convenient for the advertisers' target audience. The content and timing of a programme are accordingly linked by the audience's tastes and lifestyles. Advertising revenue varies from one film to another, depending on the size of audience they attract (as determined by ratings), the total length of advertising breaks which a particular audience will tolerate, its cultural requirements, and social status. The common element underlying all these factors is the cost in free time which television viewers are willing to pay. Network programming consists of distributing programmes through the 24 hours in order to harvest the maximum amount of attention. The revenue-generating potential of advertising breaks varies throughout the 24 hours, and accordingly for advertising agencies paying for viewers' attention, the price of air time (and the value of films and the minutes they contain) also varies. This is the case for consumers too. If we include the cost of time spent watching advertisements, television programmes in prime time, generously larded with commercial breaks, cost consumers more. At least in Russia it is the case that highly rated programmes targeted at a mass audience are more generously basted with advertising than less popular ones.²³² This means that television viewers' time costs due to advertising correlate directly with their tastes and lifestyles, and indirectly with their financial status. The time at which programmes in the free broadcasting channels are aired, and the number of advertising minutes added to a film, is a reasonable guide to quality for television viewers.

By scheduling programmes in their own financial interests, television executives intentionally or unintentionally simultaneously provide consumers with a quality signal for the products they are offering. Lower income levels are more tolerant of commercial breaks and object less to an abundance of advertising in prime time; higher income groups tend to choose a different time, and hence different programmes, or switch to pay channels which have less advertising. Consumer costs of advertising vary, so television differentiates the time cost of access to content. This sort differentiation falls somewhere between second- and third-degree price discrimination, probably closer to third. If we recalculate time costs in monetary

²³²There are currently plans to regularise this situation legislatively.

terms, taking account of the value of minutes for groups at different income levels, we may well find that 'free' television is in fact costing the poor much the same as the rich pay for theirs. If this is so, television is evening out the price discrimination and all viewers are burdened with advertising to roughly the same extent. If we assume that, for manufacturers targeting viewer groups with different spending levels, all investments in advertising are equally profitable, then the consumer cost of advertising for well-off and less well-off citizens should correlate at first approximation in much the same way that their purchasing power does. For the rich, minutes free from advertising are just as valuable as minutes filled with advertising are for the suppliers of goods. Television programmers balance the supply of consumer attention with the demand for it. Accordingly, viewers' costs equal the amount charged to advertisers. Through advertising, television regulates the money-based symbolic exchange in just the same way that the fashion markets did, by allocating wares to counters with different status. Anybody who wants to save money is obliged to spend time searching for what he wants (or, in this case, waiting for broadcasting of content to resume after a commercial break).

Television has a precise price list for selling its viewers' time to advertisers. They buy it, so doubtless they too have calculated the value of people's minutes. Viewers are not privy to this information, although in theory they should be able to estimate it. By multiplying the length of the advertisements, the programme's rating, and the average rate paid for one minute's work, one can calculate the amount society is paying for 'free' broadcasting. We disregard for the moment the question of the utility of image advertising. An alternative way of calculating the social cost of advertising is to compare television watching with viewing recorded media free of advertising, like video cassettes, DVDs, or television on demand. It is possible to come up with an estimate based on the cost of videos and the amount of advertising in popular programmes. For Russians the cost of an hour of advertising, or more precisely of avoiding it, is around \$10, if we assume that the video cassette is watched by a single individual. Such is the price of avoiding advertising time for television viewers, and it divides them into those for whom watching television is or is not economically advantageous. By making a personal estimate, anyone can work out which particular method of consuming content is most appropriate for them.

It makes sense for a consumer to analyse the sources through which he is supplied with visual content from the standpoint of the payment he is being charged for being freed of the burden of advertising. For example, in Russia a person paid more than \$5 an hour who watches feature films more than twice a week should find it economically advantageous to subscribe to paid television (costing roughly \$40 a month), rather than to watch free television or buy films on DVD. Those who earn \$2.50 an hour would need to watch films twice as frequently for paid television to be more 'profitable'.

Such notions of time-money equivalents are basic to the pricing policy of media channels, which take account of the different time costs of different viewer groups. It would be good if consumers too learnt to take a rational approach to their cultural leisure. We suspect that if they analysed television provision through the lens of economics, many would switch from universally available 'free' broadcasting to such

less pricey sources as paid television (satellite and cable), television on demand, pay-per-view, video cassettes, DVDs, and web casting. Consumers who have discovered the merits of TiVo and VoD (Video-on-Demand) cannot imagine returning to ordinary television.

3.8.1 TiVo and VoD: Operators in the Leisure Time Market

VoD is a service which provides video-on-demand from a central depository. Subscribers receive content over cable networks from a special video server where it is stored.²³³ TiVo is a digital video recorder,²³⁴ a household appliance which enables its owners to record television programmes and watch them at a convenient time. TiVo devices resemble video recorders, but differ in having an integral hard disk and sophisticated software for recording programmes. The recording can be chosen by indicating when the programme is scheduled, the programme's title, or a combination of criteria like genre, actors, and directors. There is even an option for recording a particular show every time it is broadcast, without setting the time; moreover, repeats can be omitted. The bundle also includes collaborative filtering services (TiVo users can give ratings to programmes from -3 to +3 points). TiVo Series 2 devices are easily linked to a home network, which makes it possible to plan the recording of programmes through a web browser and exploits all the facilities of the net (like downloading recordings on to a computer).²³⁵ With TiVo it is possible to watch a programme stored in the memory whilst simultaneously recording another. It is also possible to watch a programme while it is being recorded. This is an extremely useful option which many people use in order to avoid advertisements. The television is turned on fifteen minutes after beginning to record and during commercial breaks the picture is fast forwarded.²³⁶ Despite its outstanding functionality, TiVo has not been conquering the markets very rapidly.²³⁷ This is due

²³³VoD was first introduced in 1994 by Time Warner Cable. Since then there have been many variations, including pay-per-view; subscription SVOD; downloaded VoD (store-and-forward); interactive VoD and BoD (broadcasting on demand). There is now also FoD (free for the consumer but financed by advertising).

²³⁴The word 'TiVo' is sometimes used to designate any digital recording of television programmes. TiVo Inc opposes the practice, fearing that its trademark will become a mere generic term, in the way that Hoover came to refer to any vacuum cleaner.

²³⁵In January 2005, TiVo Inc published a long-term strategy to support the recording of high-definition television (HDTV) with integrated tuning using CableCARD technology, the ability to download and view content from the Internet, and gave permission for other companies to develop plug-ins for the platform. The latest DirecTiVo devices can also record HDTV to a 215-gigabyte hard disk from satellite or over the airwaves using a standard UHF or VHF aerial. They have four tuners and, like the original DirecTiVo, can record two programmes simultaneously.

²³⁶In March 2005, TiVo experimented with pop-up advertising as an alternative source of revenue. Regular subscribers registered extreme displeasure.

²³⁷In early 2002 the manufacture of TiVo devices was discontinued, although TiVo services continued to be provided for customers who had already bought them. This is despite the fact that TiVo's

to the inertia of consumers, who are resistant to innovations and evidently do not recognise how meagrely their labour as viewers of advertisements is paid. Another reason is competition from VoD. Cable operators offer similar services, charge a low subscriber rate,²³⁸ and supply equipment on hire purchase.²³⁹ VoD subscribers can also view recorded programmes while avoiding the advertisements. Both TiVo and VoD, in defending consumers' right to their own attention, pose a threat to the television advertising industry.

In 2003 television networks obtained \$9.3 billion in advertising revenue, despite the fact that 10 million of the 80 million families in the United States have not only a television but also a digital video recorder and could, by fast forwarding the video, avoid 80% of advertising.²⁴⁰ It is predicted that by 2007 the television advertising spend will have fallen by 75%.²⁴¹ Owners of content need to learn how to move into new forms of financing, and advertising services need to find new advertising media, before it is too late.

3.9 Recommendation in Culture Without the Middleman

Concluding our analysis of the information institutions operating in the cultural sphere, it needs be admitted that we have not come to any clearcut judgements. That was not our aim. We were not seeking to provide specific practical recommendations for improving their performance. All the variants of recommendation we have examined, with the exception of collaborative filtering, are indirect. Information about perceived quality does not flow directly from users to producers but follows a complex trajectory. Institutions along its way select, sift, filter, re-evaluate,

devotees say they cannot imagine watching television without it. This is evidently true, since the price of secondhand devices in online auctions can exceed the original price by £400. TiVo services are currently available only in the USA and Great Britain, although enthusiasts have modified the system to make it work in Australia, New Zealand, Canada and the Netherlands.

²³⁸At the present time the pricing of VoD is still in its early stages. Typically, VoD services with a video server with 1,500–1,800 hour per server library costs roughly: new releases (shows, films): \$3.99; classics and recent favourites: \$1.99; adult films: \$7.99. Subscription VoD is being promoted either free, bundled with other services, or sold at \$3.99–\$12.99 a month (average \$6.99).

²³⁹A user's capital expenditure on VoD services amounts to around \$300, while the operating costs average around \$1.20 per month. Dom Serafini, "The Different Ways to Slice VoD", *Video Age International*, vol. 24, No. 2, March/April 2004.

²⁴⁰There are currently 4 million families in the USA with digital video recorders (DVRs), and 10 million use VoD. It is predicted that by 2007 this will be available to one-third of Americans. Two operators, Comcast and Time Warner, who between them provide cable services to more than one-third of US households, have already deployed VoD service to a majority of their digital cable customers. Both companies have made it possible for many of their clients to view HBO-on-demand (Home Box Office is the largest cable and satellite television network in the USA). Dom Serafini, "The Different Ways to Slice VoD".

²⁴¹Jonathon Barbato, "The Dawning of On-Demand", *Video Age International*, vol. 24, No. 2, March/April 2004.

underestimate, over-emphasise, and compromise the primary signal. But the problem is not only that the signal becomes distorted. What is most regrettable is that informative recommendation does not get passed on to the consumer. It is jammed out by a great plethora of non-informative signals, generated skilfully on behalf of vested interests. In order to interpret an advertisement and other market signals accurately and draw correct conclusions, an improbable amount of worldly wisdom is required. The consumer needs to be a professional if he is to separate out the wheat from the chaff. The fact that recommender mechanisms are of so little assistance is not so much their fault as a great misfortune caused by the fact that the economic rules of the cultural markets are faulty.

It is only too clear that no worthwhile progress is possible by tinkering with particular institutions: what is needed is radical change. By analysing from the viewpoint of information economics the phenomenon of stardom, ticket speculation, the role of pirates and so on, we have been able to gain an understanding of the information economics basis of cultural processes, to see the gaps and failings of the cultural markets. That, however, is about as far as economics can take us. It cannot transcend its limitations, and all that is most vital in culture flourishes outside them. I hope that I have succeeded in demonstrating that within the restricted framework of monetary economic logic there is no provision for cultural values or people's tastes.

In order to proceed further, we need to do more than oppose suggestions and theories to the computations of economists. We need representative facts. Box-office takings alone are not enough. We need a different assessment of the results of cultural consumption, other relevant indicators testifying to the real cultural experience of the individual. We do not have these today. Even conventional book-keeping has not been adapted to take account of the specifics of culture, and at this present moment in time the standard categories of stock-taking are incapable of distinguishing a designer shirt from a workman's padded jacket. What chance then that economics can talk coherently about a consumer's total assessment of cultural satisfaction? No institution exists for gathering the requisite data and adequately transforming it into a signal for the consumer. This is not something business needs. Indeed, it is dangerous for business. Institutions which appear as initiatives by amateurs do not survive, because devising new market rules is too labour-intensive and demanding. The institution proposed in this book, however, is viable as a commercial entity, independent of cultural producers and distributors, involving in its work a huge number of consumers of cultural wares and services who will pay for what they receive in return. It is a business making use of the mechanism of collaborative filtering and specialising in the collection, processing, production and sale of information about quality.

Implementing the business model described in Chap. 1 will serve many purposes. It is not, of course, a matter of mere stock-taking and calculation. The innovation we are proposing is capable of bringing about a radical modernisation of the cultural market and subsequently recasting it as a changed institution. To use the language of management theory, modernisation will primarily focus on the feedback rule. In economic terms, this could be described as an antidote to adverse selection by removing information asymmetry. A new level of conceptualisation of cultural

consumption will allow the cultural community to negotiate from strength in its dealings with business. Public consumer assessment of works is not a weak, isolated voice but an authoritative judgment. A judgement, moreover, which is not the imperious demand of some standardised and impersonal majority, but a truly democratic polyphony of the voices of different taste communities with equal facilities for making themselves heard.

Chapter 4

The Concept of Cultural Welfare

The long-established critical institutions have no option but to face up to reality now that their divided loyalties and ‘institutional sclerosis’¹ are only too obvious. Traditional culture is in such a state of confusion that consumers are on the verge of giving up on it. This is just the time to look more closely at the potential of a new recommender institution which exploits money-based collaborative filtering and promises to radically alter consumer navigation in culture. The consumer using a recommender system will have a powerful aid to rational choice which will enable him to occupy his rightful, dominant position in the market. Other players in the cultural process will have no option but to reorientate themselves towards his interests, and this will bring about a positive transformation of the entire sphere of the arts, a change in the mechanisms of price formation and distribution, a coming together of cultural communities, development of more refined taste, and an improvement in the material situation of the creative artist. The new service will make it possible to co-ordinate creative initiatives targeted at territorially dispersed groups of consumers with demand. It will help to expose cultural goods created solely in order to make money and which survive only by spreading disinformation. Their market share will plummet.

Collaborative filtering is not just a clever tool. It is a far-reaching idea which galvanises the central nerve of modern society: the monetary system. In order to substantiate this claim, let us return to the question of how, why, and under which circumstances money is able to perform its primary task of measuring.

4.1 Market Measurement of Cultural Value

4.1.1 *Correlating Price and Value*

Is there a correlation between price and value? Within a particular category of goods, more expensive items are usually better than cheap ones. In culture, however, this is not much in evidence or is simply not the case. Why should that be? Is money inherently incapable of measuring artistic quality, or is merely being used incorrectly? Everything we have discussed above has been hoping to show that the problem is not money as such, but the use to which it is put.

Economists identify a saving in transaction costs as one of the reasons for using money. One can barter goods but using money is a lot more convenient. As Klauer

¹Mansur Olson’s expression.

has shown, money simplifies exchange and, no less importantly, makes it possible to decouple the time of buying and selling. Instead of having to set up a chain of exchange to swap the goods you have for the goods you need, it is far simpler to use a medium with universal purchasing power: money. This special good is like an all-purpose transshipment terminal. Money also reduces the cognitive burden of exchange operations, which is why the nineteenth-century move by shops to fixed prices was so revolutionary. It enabled stately ladies and busy shopkeepers to delegate buying and selling to servants and sales assistants. The shopkeeper was able to move away from the counter, to which he had previously been tied by the need to negotiate every deal separately, and get on with expanding his business. Firm prices, which can be checked if there are any problems, solve the principal-agent problem.

For prices to be informative and to make it possible to judge the parity of an exchange, the selection of goods circulating in the market needs to be more or less unvarying. These are the ideal conditions for money to function as a means of measurement, and these were the circumstances in which it first appeared. Where there are repeat purchases and prices reflect a balance between supply and demand, there is no need to remember a huge number of barter equivalences and to negotiate exhaustingly every time. By and large, price serves the purchaser as a fair indication of quality.

What makes a price signal informative for the consumer? Quite clearly it depends on how accurately a sense of the utility of a good is conveyed. The conditions in which money is functioning nowadays are far from ideal. As items like household goods become more complicated, the message conveyed by price becomes less clear. The purchaser who relies on the monetary signal may not find the features he wants, and may instead obtain options he is not much interested in. Additional uncertainty is contributed by advertising which, as we have seen, can be a substitute for quality (Chap. 3, Sect. 3.4.4).

Ordinary, everyday goods are so diverse that, although each individual item can be fully inspected, there is no time to assess the whole range on offer. It is easier just to buy a product and try it out rather than research its specifications first, or simply to put your faith in the advertising. In this way, vast choice transmutes what economists classify as search goods into experience goods and credence goods. In the fashion and luxury sector, because of the unobservable nature of quality and the varied social games with signalling items, the situation is even more complicated.

Although the function of price is confusing, the monetary mechanism is reasonably informative: if a purchaser makes sufficient effort to decode them, prices can be relied on. The price, varieties and quantities of production are adjusted until supply and demand are indeed in equilibrium. The way this comes about, without the involvement of extraneous non-price information, is considered the most important single contribution classical economics has made to the understanding of social processes.²

²Kenneth J. Arrow, "The Potentials and Limits of the Market in Resource Allocation", in George R. Feiwel, ed., *Issues in Contemporary Microeconomics and Welfare*, London: Macmillan, 1985, pp. 107–124. Translated into Russian as "Vozmozhnosti i predely rynka kak mekhanizma raspredeleniia resursov", *Thesis*, Issue 2, 1993, pp. 53–68.

Usually prices regulate demand and demand regulates prices. Prices result from the joint pressure of supply and demand on all the players in the economic process. They are not just any old set of numbers, but the exact numbers which balance supply and demand. Prices are determined through the joint, if indirect, efforts of all the market agents. The information or messages contributed by individual participants are the amounts they are prepared to pay or accept for each good.³

Every now and again the cultural markets cause a collapse in quality. Until now, this has been explained in every conceivable way other than as a result of the inefficiency of money. Nobody has asked whether money is good or bad, and whether the way it is used is good or bad. For most people, including financial experts, money is a tool to which there is no alternative and which, by and large, can be used in one way only. The price system has, however, taken a knock and is now a poor guide for the consumer of culture. The problem is not only that in many instances pricing is uniform, but also that people have no very precise expectations of cultural goods and services. It would be highly surprising if, in this situation, consumers' willingness to pay arose, as economists conventionally claim, from expected utility generated on the basis of prior consumer experience. Wilfred Dolfsma has suggested that, since real art is by its very nature original, no market can exist for selling it.⁴

Jacob Viner is one of the few economists bold enough not to close his eyes to the fact that price measures desire, and is a measure of its satisfaction only to the extent that desire is fully satisfied.⁵ A coinciding of expectations and results is the norm in most market transactions, but for culture it is virtually the exception.

Prices usually gain informativeness as the result of repeat deals, or where the seller is able to adjust them in the light of the demand he has identified. Without repetition there is no feedback between buyer and seller, the very link which prices identify. Under these circumstances money loses its ability to measure; it cannot react in time. Metaphorically speaking, one should not pull the thermometer out of one's armpit the moment after it has been put there. If you do not allow time for stable measurement, you will get a new reading every time. The differences will indicate only that the measurement procedure is faulty.

³Arrow, "Vozmozhnosti i predely rynka", p. 54.

⁴Wilfred Dolfsma, "A Status Quo in the Economics of Art and Culture? A View of Some Recent Developments, *De Economist*, Amsterdam, vol. 145, No. 2, 1997, p. 245.

⁵Jacob Viner, "The Utility Concept in Value Theory and its Critics" ["Kontseptsiiia poleznosti v teorii tsennosti i ee kritiki"], *Landmarks of Economic Thought: The Theory of Consumer Behaviour and Demand [Vekhi ekonomicheskoi mysli: Teoriia potrebitel'skogo povedeniia i sprosa]*, 3 vols, ed. V.M. Galperin, vol. 1, St Petersburg: Ekonomicheskaiia shkola, 2000, p. 106.

4.1.2 Price, Value, and Scarcity

The market faces one further obstacle to assessing cultural value, and that is the matter of scarcity. Scarcity is by definition the correlation between the existing supply of a particular good and the quantity for which there is a demand. Value depends not only on the inherent characteristics of goods and their ability to satisfy needs, but also by how available the item is to consumers. Price reacts to a perceived shortage, and becomes a constraint regulating the amount of the good which would-be purchasers are able to buy.

Clearly, when we turn to a digitised product its ‘supply’ is limitless and, no matter how great the demand for it may be, the producer can easily satisfy the market. The utility of such a good may be extremely high, but since the supply is abundant there is no need for the consumer to tighten his belt in order to acquire something that is going to be readily available. The price accordingly tends to zero. The fact that useful goods like water have a low exchange value, or none at all, while substantially less useful goods like diamonds have a high exchange value,⁶ is known as the value paradox. As Joseph Schumpeter points out, Italian economists solved this riddle back in the sixteenth century and were the first to point to the importance of scarcity.⁷ Those unfortunate enough to lack an education in economics are often puzzled to find that market value is not determined by utility.

The economics of many kinds of art—representational, performing, or applied—is materially linked to scarcity, because the aesthetic value is inseparable from the individually produced medium. In reproduced art forms, the production of an edition involves labour and scarce materials, which limits the number of items produced and determines and justifies the price. Goods in short supply are valued not only because they may be expensive to produce, but also because a high price prevents them from losing value through over-consumption.⁸ Money regulates the frequency with which they are enjoyed and accordingly the intensity of the enjoyment.

In the digital sector, scarcity as a means of restricting access while simultaneously intensifying and stimulating desire is necessarily absent. Once they have been

⁶If our interest is in social utility, then diamonds are an unrewarding example, but for some reason when discussing this matter economists almost invariably come back to diamonds. See, for example, Joseph Schumpeter, *History of Economic Analysis [Istoriia ekonomicheskogo analiza]*, 3 vols, vol. 1, St Petersburg: Ekonomicheskaja shkola, 2004, p. 392.

⁷Schumpeter tells us that this matter was comprehensively considered in the eighteenth century by Ferdinando Galiani who elaborated the concept of relative scarcity and came very close to modern theory (Schumpeter, *History of Economic Analysis*, p. 394). Ferdinando Galiani, 1728–1789, was an Italian economist, philosopher, and statesman whose first work on economics was his *Treatise On Money* (1750) in which he expounded his concept of value. On the one hand Galiani tried to explain the value of goods through their utility, and the value of money through the particular nature of precious metals, for which he is considered a precursor of the Austrian School. On the other hand he claimed that only labour gave value to articles, and that wealth was a relationship between people.

⁸Possibly because of its rarity, black caviar seems to many people to taste better than red caviar, but if red caviar were the rarer, would it be preferred?

created, digital products are infinitely available and nobody needs to compete in order to consume them. They can be sold at as low a price as anyone sees fit, since at any level of consumption it costs the manufacturer almost nothing to service one extra customer. People know that their consumption is costing the producer very little and reason that he should be grateful for any additional takings, no matter how minute. This can make it difficult, no matter how great the consumer value of a work, to exact appropriate payment.

But how then are the costs of creating the good to be recouped if everyone has an economic incentive not to pay on the grounds that someone else will (the so-called ‘free rider’ problem)?⁹

The only way is to restrict access to those who are prepared to pay, and try to exclude the rest. This is really practicable only when the output of goods is limited and consumers have to compete with each other for the right to possess them. Where that is not the case, keeping out the free riders necessitates expensive measures, like resorting to legal sanctions or applying technical means of restricting access. In both these cases the price of the good will be determined, not by the relationship between scarcity and utility, but by the costs facing a would-be free rider intending to get round the artificial barriers. The interaction of supply and demand around the product has been replaced by the interplay of the costs of restricting access and the level of demand. Prices cease to be informative about the product’s quality.

To add to the difficulties, prices have little to tell a particular purchaser because aesthetic tastes differ. Even if in some way the price tag faithfully reflected a good’s average value, this would not be particularly helpful, since the consumer’s personal preferences might be far removed from the average.

4.1.3 *Economic Orthodoxy on Price*

In view of all this, complaining about how the price mechanism works in the cultural sphere might seem like trying to break down an open door. The defects in the link between price and consumer quality are so evident that there would seem to be little point in going on about them. However, it is not as simple as that. To economists, pointing out a systemic divergence between prices and value can either sound like a truism so banal as not to be worth mentioning, or suggest an irresponsible attempt to undermine tradition. Price, they will say, by definition results from the correlation of supply and demand and is nothing more than that. There is no implication

⁹The free rider problem is the burdening of some agents with production costs of social goods by others. (V. Radaev, *The Sociology of Markets: Towards the Formation of a New Trend* [*Sotsiologiia rynkov: k formirovaniu novogo napravleniia*], Moscow: Gosudarstvennyi universitet, Vysshiaia shkola ekonomiki, 2003). A fuller definition is: “Difficulty of implementing mutually beneficial collective actions because individual agents seek to derive advantage by failing to share in the common costs”. *Institutional Economics: New Institutional Economic Theory* [*Institutsional’naia ekonomika: novaia institutsional’naia ekonomicheskaiia teoriia*], ed. Aleksandr A. Auzan, Moscow: Infra-M, 2005.

of a link with actual value, so it cannot be attacked, let alone economic theory as a whole, on that basis. This, however, is the whole problem. Economics may seek to remain grandly aloof in respect of the relationship between price and value, but that is not much help to the markets. There is price as a theoretical concept, and there is price as an essential, practical tool of market agents. If for any reason the link between those two aspects is broken at any point, theory ceases to function and becomes a mere glass bead game. If economists have any ambitions at all to remain relevant in the cultural sphere, where a concept as fundamental as the role of scarcity in determining price is in the process of disappearing, it seems clear they will have to change their approach. What theory can you base on the role of scarcity in a sphere where, from an orthodox viewpoint, it is no longer to be found? One might as well develop an aerodynamic theory on the basis of a propeller rotating in a vacuum. Money makes the world go round precisely because the correlation of supply and demand, reflected in price, does indicate value. This in turn derives from a combination of desire and the degree of difficulty in satisfying it (scarcity). Market participants adjust and coordinate their requirements on the basis of price, and if you deprive money of its ability to inform customers about the value of their purchases, it will suffer a dramatic loss of utility. (This is already seen to be the case in sectors of culture with uniform prices.) It may be loudly proclaimed that the efficiency or otherwise of money in the cultural sphere is of no consequence, but behind this declarativeness we can sense a tactical manoeuvre aimed at defending doctrine from a dangerous heresy which, if it were to spread, would inevitably precipitate a schism in economic theory, which would put an end to claims of the discipline's universal applicability. Basically, economic theory is the theory of rational choice.¹⁰ Accordingly, if we undermine faith in the ability of the price of a work of art to serve as a guide to choice,¹¹ we abandon the claim that the approach of economics is universally applicable. Culture will be seen to be a sphere beyond the remit of economic analysis.

Concerned to protect the good reputation of economic theory, such authoritative figures as the Nobel prizewinners George Stigler and Gary Becker consider it a point of honour to demonstrate its applicability to every conceivable area, including the cultural sphere. Stigler and Becker proposed Z theory, which states that a change in the demand for a good can be explained by an increase in its ability to produce the sought-after Z state.¹² This hypothesis was introduced in order to rescue a fun-

¹⁰If only in the watered-down version of bounded rationality proposed by Simon. Herbert A. Simon, "Rationality as Process and as Product of Thought," Richard T. Ely Lecture, *American Economic Review*, vol. 68, No. 2, May 1978, pp. 1–16. Translated as "Ratsional'nost' kak protsess i produkt myshleniia", *Thesis*, issue 3, 1993, pp. 16–38.

¹¹Actually, the facility of relying on objective prices is the main competitive advantage of the economic approach. If we concede that price cannot be rationally analysed in a particular sphere, the advantage is lost.

¹²To make this possible, variations in taste and the ability to enjoy art are seen as changes in restrictions which (in the language of economists) accompany the extraction of utility from art. George J. Stigler and Gary S. Becker, "De gustibus non est disputandum", *American Economic Review*, vol. 67, 1977, pp. 76–90. In the opinion of the authors, Z theory is a comprehensive theory

damental postulate of economics regarding the uniformity of human preferences, despite the fact that aesthetic tastes manifestly differ. People are all striving to attain the same states, and the fact that they go about it in different ways and with the aid of different items is neither here nor there. According to this logic, a predilection for classical music is explained by the fact that, as more music is listened to, human capital (taste) increases, which makes it easier to attain the desired Z state. Consumption is an investment in the ability to enjoy.¹³ But how, in that case, would you explain a change in the demand for Z, Tyler Cohen wondered. He could find nothing new in Z theory.¹⁴

No matter how sceptically we may regard Z theory and similar conjectures, it has to be said that economics can prove an extremely fruitful approach in areas where it would appear to have no place. It is a basic dogma of economics that every element of an item's value, and cultural value is no exception, can be registered within the framework of utility theory. Each individual creates his personal scale of values and is guided by cultural criteria of his own choosing. If he considers the aesthetic, spiritual, or other value of a particular item is higher than that of another, then, other things being equal, he will be prepared to pay more for it. The difference in his willingness to pay, or consume in quantity, can provide a measure of the difference in cultural value. In the digital sector he may also be prepared to pay more for better quality but the market conditions do not require this of him, as there is no correlation there between price and his values. The individual is represented as being autonomous in his preferences, as if his tastes were not subject to conditioning.

Economists leave the nature of preferences to one side and make no attempt to establish how they develop, with the result that an important distinction between utilitarian and cultural needs is overlooked. Utilitarian needs recur automatically, while cultural needs do not. In order to understand, for example, the markets for food there is no need to go into the biochemistry of food products because we know that the consumer is simply unable to do without them. Demand for cultural products, on the other hand, does not arise automatically, and is not regular. If physiological needs vary a great deal depending on lifestyle, the non-essential demand for cultural products is even more variable. It is closely related to social and cultural standards.

of consumer choice. It gained considerable recognition, particularly among theoreticians of the Chicago School (of Economics).

¹³In the terminology of economists, there is a change in the production function, a function modelling the link between the production process and output.

¹⁴Tyler Cowen, "Are All Tastes Constant and Identical? A Critique of Stigler and Becker", *Journal of Economic Behavior and Organization*, vol. 11, 1989, pp. 127–135. Cowen considers changes in the production function in accordance with Z theory to be no less arbitrary than the hypothesis about changing preferences. To say that listening to music affects its ability to delight is tantamount to saying that listening changes musical tastes. David Throsby notes that the authors of many works on cultural economics have introduced a qualitative variable (in the performing arts—AD) into the production function, cost function or utility function and have tried to explain its role by going on to treat it as a constant or entirely removing it from the model. David Throsby, "Perception of Quality in Demand for the Theatre", in Ruth Towse, ed., *Cultural Economics: The Arts, the Heritage and the Media Industries*, vol. 1, 1997, Aldershot: Edward Elgar, p. 256.

Despite its schematic and simplistic tendencies, the economic approach is productive in a whole range of instances which at first glance seem unpromising. The tools of economics have been used to great effect to analyse the criminal world. Relations between the sexes can also be represented as a marriage contract market. This tendency of economics to expand into many areas traditionally regarded as the province of the humanities is known as 'economic imperialism'. There was little that its founder, Gary Becker, would not analyse in terms of economics, even matrimonial relations.¹⁵ Becker noted that a husband who reads before going to sleep and thereby keeps his wife from sleeping, does this not merely because he is inconsiderate, but because he has compared the utility of reading the book with the costs of not letting his other half get her beauty sleep. It is easy to mock such an approach, and Becker has assuredly been derided, but the husband probably is thinking along the lines Becker's model suggests.

Economic thinking (whether based on calculation or intuition) predominates in many apparently inappropriate situations. It may be implicit, but nonetheless decisive. No matter how difficult it may be to compute mood, intellect, or motivation, this is no reason not to view them in resource terms. In such spheres as crime or family planning, of course, where money is a primary consideration, a great deal of computing goes on, consciously or unconsciously.

It is not only professional economists who believe in the supremacy of economic principles. In recent times, market participants and, in their wake, non-market participants, are increasingly guided by these principles outside any market framework, bringing them over into private life and cultural activity.¹⁶ The strength and weakness of this is that money becomes the measure of all things. It may not be entirely appropriate, but the players adapt themselves to monetary rules. The economic perspective becomes predictive, and money does not so much measure cultural value as subjugate culture. Social and cultural processes have adapted themselves almost unnoticed to the monetary measuring system. We have seen that there is a market rationale behind uniform prices for cinema tickets, but the providers of films adapt to this fact. The economists are shown to have been correct: the admission price of films, adapted to suit the market, comes to reflect their value only too well, although it might be more accurate to say not that it reflects their value, but that it destroys it.

Does price, then, correspond to the expectations of consumers? The time comes, alas, when it undoubtedly does. A consensus is achieved between producers and consumers in respect of price and anticipated quality. Prices are levelled out and values are levelled down. The vicious circle is not the fault of the market's monetary mechanisms but of underinvestment in values. The tariffs of culture resemble the pedlars' trays of a hundred years ago where any item was to be had for 5 or 10 cents, although, needless to say, the selection was fairly limited. The situation as

¹⁵Becker's followers looked at such areas which are untraditional for economics as race discrimination and demographics. The first such foray was an economic analysis of crime.

¹⁶This is what is understood by the term 'homo oeconomicus'.

it has evolved today is seen as natural and unproblematical,¹⁷ but this is wrong. Society has been forced to adapt to the market rules.

The orthodox economic view of culture is not mere harmless theorising, but a poisonous self-fulfilling prophecy to which society is susceptible. Even if a human being is a million miles from the homo economicus portrayed by economists, if he is fed disinformation about himself for long enough he will come to resemble the caricature. If someone's ideas of utility are a million miles from those being drummed into him from all sides, his views will gradually fit the standard imposed by the market. As the resource approach gains acceptance, people begin to find it convenient to share each other's basic outlook, in just the same way that it is advantageous to swoon over the same film stars. The resource approach is not intrinsically evil, but it is inadequate when the resources which really matter are left out of the picture, which happens because money takes no account of personal resources. Economists do not go out to preach in the squares: they sow seeds in the minds of those predisposed to let them grow, the market players. The result is that theoretical postulates take on the status of market rules and, when transferred over into culture, are inadequate and harmful.

4.1.4 Consumption as Collecting: The Paradox of Non-decreasing Utility

In a recent discussion of the relationship between price and value an important point was succinctly made. We have seen how price is no indicator of the value of digital cultural products, and how in its wake the sector of material aesthetic goods, the industries of luxury and taste, are being inexorably sucked into similar pricing chaos. Marina Bianchi explains with elegant simplicity why this is happening, and proposes that consumption should be viewed as a form of collecting.¹⁸

She suggests that adding to his collection usually has an increasing value for a collector, although economic theory claims that, on the contrary, as a good is consumed the intensity of the desire for additional units of the same good (its so-called marginal utility),¹⁹ steadily tends to zero. We are talking of Gossen's law of satiation of wants which states that the continuance, increase or repetition of the same

¹⁷This is the view also of Boris Groys, one of the few theoreticians with a subtle understanding of the role money plays in art. Groys, however, is analysing these processes in painting, where prices are more or less informative. Boris Groys, "Money Talks" ["Yazyk deneg"], *Khudozhestvennyi zhurnal*, No. 47, 2002, pp. 11–15; Alexander Dolgin, "The Tied Tongue of Money: An Open Letter to Boris Groys" ["Zapletaiushchiisia yazyk deneg"], *Khudozhestvennyi zhurnal*, Nos. 51/52, 2003, pp. 78–82.

¹⁸Marina Bianchi, "Collecting as a Paradigm of Consumption", *Journal of Cultural Economics*, vol. 21, 1997, pp. 275–289.

¹⁹Irving Fisher uses the formulations 'the need for an additional unit of good' and 'wantability'; Wieser introduces the term 'marginal utility'; Jevons spoke of 'the final degree of utility'; Pareto of 'elementary desirability' ('*ophélimité élémentaire*'); J.B. Clark of 'specific utility'.

kind of consumption yields a continuously decreasing satisfaction or pleasure up to a point of satiety.²⁰ This postulate (which has similarities to the psychophysical Weber-Fechner law),²¹ is the cornerstone of the marginalist conception of price.²² Accordingly, in areas where it is untrue, prices cease to be subject to the theory.

Bianchi saw something more in the paradoxical price formation of luxury goods than a mere exception to the rule. She pointed out a parallel between collecting and consumption: for today's consumer, novelty, searching, completing an image are as important as they are for collectors: each successive purchase brings them nearer to perfection, so that utility rises rather than falls. Jacob Viner noted long before she did that collecting was an exception to the rule of decreasing marginal utility.²³ He explained that one could list obvious individual exceptions to the law, but claimed they could be readily explained in terms which did not contradict it. For example, a collector eager to have a complete collection of coins, stamps, or first editions usually desires the final item to complete his collection at least as powerfully, if not more so, than the first. A person selecting pearls for a necklace probably has an increasing desire to acquire the next pearl to match those he already has, until he has completed the whole string. The intensity of the desire to have the second of a pair of gloves may be greater than the desire to have the first on its own. In all these examples, however, the unit for which the law can be seen to be acting, according to Viner, is the collection, and the law of decreasing marginal utility may affect subsequent collections.²⁴ Viner gave other examples where utility increases, for instance, goods which are part of a network, like a telephone, or fashion goods.

For a collector, the last element in his collection is no less pleasing, and perhaps more pleasing, than the first, whereas for conventional goods the opposite applies. The second glass of a thirst-quenching drink is desired less than the first (unless, of course, it is Coca-Cola, which doubtless stands Gossen's law on its head). But what if we take as our unit not a glass of the beverage but a gulp, or a tiny sip? Perhaps the second or third gulp is more pleasing than the first? The topic awaits its researcher. As far as Viner is concerned, the challenge to fundamental economic postulates has been dealt with by taking the entire collection as the unit of measurement. The

²⁰ Alfred Marshall, *Principles of Economics*, 8th ed., New York: MacMillan, 1947, translated as *Printsiipy ekonomicheskoi nauki*, 3 vols, vol. 1, Moscow, 1993, p. 156.

²¹ Fechner's law: if y is the intensity of the sensation, x is the physically measurable external stimulus, and k is an experimentally determined constant, then the relationship between y and x can be expressed by the differential equation $dy = kdx/x$. The Weber-Fechner law states that the relationship between stimulus and perception is logarithmic. This relationship was deduced by the German psychologist and physiologist Gustav Theodor Fechner on the basis of Weber's law.

²² Marginalist theory is based on the idea of marginal utility. Economists who developed utility theory (Gossen, Jevons, Walras, Böhm-Bawerk et al.) needed the concept of marginal utility mainly in order to explain the mechanism of market price formation through the decline of demand with the growth of supply. Jacob T. Viner, "The Utility Concept in Value Theory and Its Critics", *Journal of Political Economy*, vol. 33, No. 4, 1925, pp. 369–387; No. 6, pp. 638–659. Translated as "Kontseptsiiia poleznosti v teorii tssenosti i ee kritiki", pp. 78–116.

²³ Viner, "Kontseptsiiia poleznosti".

²⁴ Viner, "Kontseptsiiia poleznosti", p. 86.

law of decreasing marginal utility again holds sway. Unless, of course, we find that people embark on assembling their second collection with no less excitement than the first.

Bianchi is having none of this. The incompleteness of the collection is not the exception but the rule, and a rule which applies not only to collecting but to consumption in general. The collector seeks items to complete his collection, while the consumer chooses items to complete himself. Both are constantly in a state of incompleteness. The concept of a collection can evolve, just as a person's ideas can, with the result that each new acquisition supplements the existing collection without completing it. The value which the new items adds to the whole may be out of all proportion to its value (and price) if viewed in isolation and, needless to say, the process is not subject to the law of decreasing marginal utility.

The same is true of the entire cultural baggage of a human being. As somebody appreciates music more deeply when listening to a piece for a second time, his pleasure does not decrease but increases (at least, up to a certain number of repetitions). Economists discuss this example so frequently (we recall Z theory) that we can see something is disturbing them. Why should they keep chipping away at this crack in the foundation of economic theory which they are unable to plaster over? Are they perhaps trying to foresee and forestall criticism, and to quietly take the rubbish out of their hut while pretending it is harmless and incidental?

They are not succeeding. The postulates which work so well in the economics of practical, everyday objects do not work for items with a substantial symbolic content, where the value of the next portion of consumption may well increase. In culture, divergence from the law of decreasing marginal utility is less the exception than the rule, and classical economic theory fails to account for this. In the utilitarian sphere the principle of marginal utility does, by and large, operate and exchange relationships between goods can be explained within the framework of economic theory.²⁵ Prices are fairly firm and informative. In culture, however, this is not the case, and market prices become detached from consumer value.

Bianchi is drawing a parallel between collecting and consumption in general, although her approach is far more illuminating when applied to the specific nature of non-utilitarian consumption. Here each successive act of consumption contributes (or fails to contribute) to the consumer's personal understanding of the world, leading to the building up of a different understanding of himself, rather as if collecting insights. Here again, the value of a building block which happily helps to complete the picture may be very different from its utility in isolation. On its own an item may, for all its merits, possess zero utility, for example, a fur coat acquired solely in order to complement a hairpin, which might seem to imply that the two items are of similar value.

For theoreticians of culture, the drawing of a parallel between consumption and collecting is not new, but Bianchi has helpfully emphasised its importance for cultural economics. The fact that cultural goods are not subject to the law of decreasing

²⁵Schumpeter, *History of Economic Analysis*, vol. 3, Appendix to Chap. 7, "A History of the Theory of Marginal Utility", pp. 1385–1412.

marginal utility shows up a glaring defect in economic theory. Until that defect has been rectified, applying the methods of economics to culture will yield only meagre results.

4.1.5 *A Utopian Approach to the Measurement of Value*

Despite all the stresses and strains bedeviling the economic approach to cultural value, specialists persist with it for want of anything better. There is, nevertheless, a noticeable intellectual ferment in the economists' camp. Thus, David Throsby, the venerable author of *Economics and Culture*,²⁶ calls for cultural values to be freed from the pall of prices. He sees price as at best an imperfect indicator of cultural value, and that indeed the two things are fundamentally incompatible. A readiness to pay cannot be considered a sufficient criterion of value, even if the latter is regarded solely on the basis of the individual's subjective perception. It is reckless to ignore the fickleness of taste and not to allow for the fact that a part of cultural value does not get reflected in current market prices.²⁷ Throsby boldly affirms that television serials are culturally of less value than atonal classical music, even though their economic value is plainly higher.²⁸

One may decry the market system of valuing culture, but in that case we need something to replace it with. Throsby proposes identifying different facets of cultural value²⁹—aesthetic, spiritual, social, historical, symbolic—and analysing them individually.³⁰ He surmises that in particular matters, for example, historical importance, it is possible to achieve a consensus within the professional community, although it would hardly be sensible to expect a summary conclusion in the form of a points system. It is more likely to be descriptive. This, however, is not the only snag. It is unclear how he proposes to correlate these disparate assessments to provide an overall valuation of an art work.

It is also unclear how the idea could be implemented in practice. It is not enough just to declare the independence of cultural value from economic value: a whole

²⁶David Throsby, *Economics and Culture*, New York: Cambridge University Press, 2001.

²⁷Even if market value did satisfactorily reflect all the quality perceived by consumers, it would still not be a satisfactorily exhaustive measure of cultural value. People sometimes fail to understand a work the first time and underrate it. Some values are not immediately apparent, and are recognised only by posterity.

²⁸This assertion is made only as an example and may be felt to lie outside Throsby's professional competence. It may, indeed, be mistaken, since arguments can be found in defence of serials. See, for example, Ia. Levchenko, "Notes of a Dead Government Inspector" ["Zapiski mertvogo revizora"], *Kriticheskaiia massa*, Nos. 3/4, 2005, pp. 83–87.

²⁹Throsby uses the term 'decomposition'.

³⁰Anna Della Valle tries to provide a scale of assessment based on the effects to which a work gives rise, such as innovation/surprise, socialising, educative cultural value, or the Guggenheim effect ("Have you seen the latest exhibition at the Guggenheim Museum?"). Anna P. Della Valle, "The Search vs. Experience Aspects of Cultural Goods: From Mass Media to the Performing Arts", *Materials of the ACEI Conference*, Chicago, Illinois, 2004.

mechanism for assessing it needs to be established. I fear that the proposal to divide the whole into separate parts will lead nowhere,³¹ and my doubts are shared by other admirers of Throsby, like Paul DiMaggio from Princeton University.³² Reviewing the above title, he writes that Professor Throsby is correct when he says that ‘willingness to pay’ is an inadequate indicator of the social value of a work of art. Throsby is, however, in DiMaggio’s opinion, excessively sceptical of the potential of economic analysis, and insufficiently wary of the difficulty of assessing cultural value without using the apparatus of economics.³³

4.1.6 Non-market Methods of Determining Cultural Value³⁴

Another technique for measuring value, not often used because it is time-consuming, is opinion polling. People are asked how much money they would be prepared to pay for something if they could afford to. This is known as the contingent valuation method³⁵ and is used to research social goods, particularly those relating to health and the environment. It is also used, more rarely, to assess the appropriate-

³¹In a number of recently introduced sports, for example, half-pipe snowboarding where competitors take a run and perform acrobatic jumps on a snowboard on an ice ramp) assessment takes in several parameters simultaneously. A judge cannot follow everything at the same time and, accordingly, the panel of judges agrees on a division of labour: one will observe the height of the jump, another will count the number of turns, etc. Each gives a decision only on his own parameter. How are the separate assessments to be totalled? They can be collated in a variety of ways to suit a particular competition, but the procedure is complex and agreeing a new system every time is costly. Cost is the weakness in Throsby’s proposed method.

³²Cultural analysts are also unlikely to agree with Throsby. Baudrillard, for example, is unenthusiastic: “In this way one may analyse the purchasing of a car in terms of motivations such as the biographical, technical, utilitarian, psycho-symbolic (over-compensation, aggressiveness), and sociological (group norms, aspirations to status, conformity or originality). The main problem is that all of them are equally ‘true’. It would be difficult to fault any of them, even though formally they may contradict each other: the need for safety, the need for risk; the need for similarity, the need for distinctiveness; etc. Which of them are crucial? How should they be structured or ranked? In their latest efforts our thinkers try to dialectalise their tautology with talk of a constant interaction between the individual and the group, one group and another, or one motivation and another. Economists, who at best are uneasy about dialectics of any kind, hastily retreat to their calculable units of utility”. Jean Baudrillard, *For a Critique of the Political Economy of the Sign [K kritike politicheskoi ekonomii znaka]*, 2nd rev. ed., Moscow: Biblion-Russkaia kniga, 2004, p. 74.

³³Paul DiMaggio, “David Throsby: 2001, Economics and Culture” (Book Review), *Journal of Cultural Economics*, vol. 27, 2003, p. 73. According to DiMaggio the problem is not that cultural value cannot be measured, but that it should be measured over a long period of time. The interest of the next generation is not reflected in today’s markets. DiMaggio is unconvinced that the voting systems Throsby proposes are any better for taking account of the interest of future generations than are the markets.

³⁴For a survey of this topic, see Stale Navrud and Richard C. Ready, eds., *Valuing Cultural Heritage: Applying Environmental Valuation Techniques to Historic Buildings, Monuments and Artefacts*, Cheltenham: Edward Elgar, 2002.

³⁵Abbreviated to ‘CVM’.

ness of state subsidies of culture, to find out how willing the population is for cultural projects to be given financial support, and to discover attitudes towards art in general.³⁶

This approach has been used to research issues relating to television broadcasting in Australia,³⁷ such projects as the Bosco di Capodimonte park³⁸ and “Open Museums” programme in Naples,³⁹ the cleaning of Lincoln Cathedral in the United Kingdom,⁴⁰ and subsidising the Royal Theatre in Copenhagen⁴¹ and museums in Quebec.⁴² Researchers invariably note the willingness of the population to finance culture and, moreover, more generously than the state. Should we believe such good news? It seems unlikely these protestations of support would fully stay the course through to actual payment, although some of the data which measures promises against cash realised supports findings of the contingent valuation method.⁴³ To be meaningful, willingness to pay needs to be based on sound knowledge of the good and of any alternatives. Critics claim that CVM cannot establish genuine preferences, particularly where use of a product, like the environment, is passive.⁴⁴ A further drawback is that a subtle change in the information provided about the proposed goods, the way questions are formulated, and the format of the questionnaire can have a significant influence on the results.

4.1.7 Techniques Using Revealed Preferences

There are techniques for assessing value on the basis of people’s reactions while consuming a cultural good, and also from the frequency with which people return to

³⁶Eric Thompson et al., “Valuing the Arts: A Contingent Valuation Approach”, *Journal of Cultural Economics*, vol. 26, 2002, pp. 87–113.

³⁷Franco Papandrea, “Willingness to Pay for Domestic Television Programming”, *Journal of Cultural Economics*, vol. 23, 1999, pp. 149–166.

³⁸Kenneth G. Willis, “Iterative Bid Design in Contingent Valuation and the Estimation of the Revenue Maximising Price for a Cultural Good”, *Journal of Cultural Economics*, vol. 26, 2002, pp. 307–324.

³⁹Walter Santagata and Giovanni Signorello, “Contingent Valuation of a Cultural Public Good and Policy Design: The Case of ‘Napoli Musei Aperti’”, *Journal of Cultural Economics*, vol. 24, No. 3, 2000, pp. 181–204.

⁴⁰Marilena Pollicino and David Maddison, “Valuing the Benefits of Cleaning Lincoln Cathedral”, *Journal of Cultural Economics*, vol. 25, 2001, pp. 131–148.

⁴¹Trine B. Hansen, “The Willingness-to-Pay for the Royal Theatre in Copenhagen as a Public Good”, *Journal of Cultural Economics*, vol. 21, 1997, pp. 1–18.

⁴²Fernand Martin, “Determining the Size of Museum Subsidies”, *Journal of Cultural Economics*, vol. 18, 1994, pp. 255–270.

⁴³Karen Blumenschein et al., “Experimental Results on Expressed Certainty and Hypothetical Bias in Contingent Valuation”, *Southern Economic Journal*, vol. 65, No. 1, 1998, pp. 169–177.

⁴⁴Nevertheless, a group of experts headed by the Nobel prizewinners Kenneth Arrow and Robert Solow spoke up in its defence. A commission was convened by the American National Oceanic and Atmospheric Administration (NOAA) which decided that CVM could be used to form a reliable assessment of loss which could be referred to in legal proceedings.

a particular product. For example, the value of a song for a particular consumer can be deduced from the number of times he listens to it, which can make non-monetary systems of collaborative filtering extremely effective. Texts are evaluated on the basis of how often they are viewed. Preferences elicited in this way provide the basis of commercial recommender systems like Amazon's, which we have already considered.

There has also been a unique piece of research which took visitors' travel costs as the basis for ranking museums.⁴⁵ If an out-of-the-way museum is visited more frequently than others, this testifies that consumers rate it highly. Obviously, preferences elicited by these indirect means are more trustworthy than mere verbal assertions.

4.2 Cultural Value in the Light of Welfare Theory

The market is failing to assess cultural values, and unless attention is paid to the problems to which this gives rise, market failure may lead to cultural decline. Recommender systems based on collaborative filtering are a means of compensating for market failure by providing for the exchange of information on individual utility, and the method is market-based. Until it is implemented in practice, however, the state and a number of other social forces are doing their best to compensate for the market failure. In order to take effective action, however, it is essential to be able to predict the consequences of decisions and to quantify the gains and losses of different groups of people. Efforts are made by specialists in 'happiness economics' to address these issues directly by asking people how they assess their own quality of life.

4.2.1 Happiness Economics

Andrew Oswald specialises in the economics of happiness and starts from the principle that economic indicators are of no interest in themselves.⁴⁶ They are significant

⁴⁵Jaap Boter et al., "Employing Travel Costs to Compare the Use Value of Competing Cultural Organizations", *Journal of Cultural Economics*, vol. 29, 2005, pp. 19–33. Information on the behaviour of visitors to Dutch museums during the period March 2000–January 2003 was obtained from the database of the Dutch Association of Museums (NMV). In the Netherlands a national museum card is in use for which an annual subscription is paid. Those aged over 25 pay €25, those under 25 pay €12.50. The card confers the right of free admission to 442 museums in the Netherlands. A system of electronically controlled access operates in 150 of the major museums in the scheme, with information about the number of visits being sent to a central server in order to recompense the museums' costs. A visit to a museum accordingly requires only the addition of transport costs.

⁴⁶Andrew J. Oswald, "Happiness and Economic Performance", *The Economic Journal*, vol. 107, issue 445, November 1997, pp. 1815–1831.

only to the extent that they make people happier. It seems reasonable to assume that, by increasing the volume of production, society lives better in economic terms, but, Oswald asks, are people happier as a result? The wealth of the United Kingdom has almost trebled since the Second World War, but what effect has this had on overall happiness which, after all, is not a matter of eating more roast beef or buying more television sets or seeing interest rates reduced, but of increasing people's sense of well-being (which in this context is treated as synonymous with happiness). How much well-being does economic progress bring? Unlike gross domestic product or inflation, happiness is not the kind of entity about which governments compile annual indexes.

Richard Easterlin was one of the first economists to analyse the data from questionnaires collected over many years about subjective well-being.⁴⁷ In a 1974 paper he showed the concept of individual happiness to be much the same in rich and poor countries, and that economic growth did not automatically cause an increase in well-being.⁴⁸ The French philosopher Destutt de Tracy (1754–1836) expressed the view that “It is in poor nations that people are comfortable, in rich nations they are ordinarily poor”, that is, not enjoying their nation's prosperity much.

Easterlin takes as his starting point the truism that happiness is not an independent condition. A sense of happiness results from comparison with those around one. Accordingly, happiness is relative and not all that closely linked to the overall growth of national income, since that improves the situation of almost everybody. Similar issues are dealt with in work by Hirsch, Scitovsky and Frank.⁴⁹ In 1995, Easterlin presented data for America which showed that the percentage of people describing themselves as ‘very happy’ did not increase between 1972 and 1991, although the proportion of those declaring themselves ‘unhappy’ decreased markedly.

Alternative calculations were based on data from the annual General Social Surveys of the United States, which asked people whether they were happy.⁵⁰ These de-

⁴⁷These are answers given by people to the question of how happy they were, and in particular how satisfied they were with their work. See Richard Easterlin, “Does Economic Growth Improve the Human Lot? Some Empirical Evidence”, Paul A. David and Melvin W. Reder, eds, *Nations and Households in Economic Growth: Essays in Honor of Moses Abramovitz*, New York and London: Academic Press, 1974; Richard A. Easterlin, “Will Raising the Incomes of All Increase the Happiness of All?”, *Journal of Economic Behavior and Organization*, vol. 27, 1995, pp. 35–48. See also Andrew E. Clark, “Job Satisfaction in Britain”, *British Journal of Industrial Relations*, vol. 34, 1996, pp. 189–217; Andrew E. Clark and Andrew J. Oswald, “Satisfaction and Comparison Income”, *Journal of Public Economics*, vol. 61, 1996, pp. 359–381.

⁴⁸After analysing Easterlin's data Oswald commented that his conclusions had been somewhat trimmed to fit his hypothesis.

⁴⁹Fred Hirsch, *The Social Limits of Growth*, Cambridge, Mass.: Harvard University Press, 1976; Tibor Scitovsky, *The Joyless Economy*, Oxford University Press, 1976; Robert H. Frank, *Choosing the Right Pond: Human Behavior and the Quest for Status*, New York and Oxford: Oxford University Press, 1985.

⁵⁰GSS data are available for virtually all the years from 1972 to 1990. The annual sample, whose composition changed, was around 1,500 interviewees.

Table 4.1 Satisfaction with life in European countries

Country	Average % 1973–1981	Average % 1981–1990	Increase in Well-being
Proportion of those who described their life as 'very satisfactory'			
Belgium	39.5	24.7	No
Denmark	51.7	62.8	Yes
France	12.4	13.7	Yes
West Germany	18.8	23.4	Yes
Ireland	38.8	31.1	No
Italy	9.0	13.2	Yes
Luxembourg	34.6	39.1	Yes
Netherlands	41.3	41.8	Yes
United Kingdom	31.7	30.9	No

Source: Calculations by Ronald Inglehart, based on data from the Eurobarometer Survey. (Ronald Inglehart, *Culture Shift in Advanced Industrial Society*, Princeton University Press, 1990.) The size of the sample in each country is approximately 1,000 respondents

tected a very weak positive trend. Oswald, following Andrews⁵¹ and Veenhoven,⁵² reached the same conclusion, namely, that satisfaction with life in the USA was gradually rising, but very slowly. An increase in income had a lamentably minor influence on happiness. A similar picture has been observed in Europe, where from the early 1970s to 1990 contentment with life, on people's admission, did not rise universally and, where it did, the increase was not marked. (See Table 4.1).⁵³

Another source for estimating well-being is the General Health Questionnaire,⁵⁴ or more precisely the part dealing with depression or negative utility.⁵⁵ On this basis,

⁵¹Frank M. Andrews, "Stability and Change in Levels and Structure of Subjective Well-Being: USA 1972 and 1988", *Social Indicators Research*, vol. 25, 1991, pp. 1–30.

⁵²Ruut Veenhoven, "Is Happiness Relative?", *Social Indicators Research*, vol. 24, 1991, pp. 1–34.

⁵³There is a strikingly large divergence between the results of the survey in different countries. For example, in Denmark more than half the population stated that they were 'very satisfied', whereas in Italy only about one-tenth of the population gave this answer.

⁵⁴The first British research project, the British Household Panel Study, provides information for 1991 which was collected on the basis of a questionnaire survey of a random sample of almost 6,000 British citizens in employment. The assessment was based on answers to questions like, "Have you recently:

- been able to concentrate on whatever you're doing?
- lost much sleep over worry?
- constantly felt under strain?
- been able to enjoy your normal day-to-day activities?
- been feeling unhappy or depressed?"

⁵⁵Michael Argyle, *The Psychology of Happiness*, London: Routledge, 1989.

Clark and Oswald were unable to find any statistically significant effect of income,⁵⁶ but they did identify a severe effect caused by unemployment.

Another resource for assessing quality of life is analysis of the suicide and attempted suicide statistics. Attempted suicide is 8–20 times more common than successful suicide.⁵⁷ From the 1970s until 1995 the number of suicides among men increased in almost all Western countries.⁵⁸ In rich countries the suicide rate is no lower than in poor countries. As regards work satisfaction, in the last quarter of the twentieth century it increased neither in Great Britain nor in the USA. Oswald comes to the conclusion that the following groups feel happier: those who are married; those with a high income; those with their own business; women; white people; highly educated people; retired people; and housewives. (Regrettably, he omits to mention efficient cultural navigation as a factor contributing to happiness.) In terms of age structure, the happiness graph has a U-shape, with its low point around the age of 30. Oswald does not claim that the state of the economy has little influence on life satisfaction, but he does see unemployment as the most important factor and, that being so, suggests that economic growth should not be a government's first priority.

The majority of economists have ignored these data, considering them insufficiently reliable and, indeed, the survey methods are not so irreproachable as to justify the drawing of far-reaching conclusions.⁵⁹ Our own view is that the sensation of happiness (satisfaction) is not directly dependent on current well-being but is also influenced by the rate of improvement of one's situation, a parameter which cannot be registered statically.

4.2.2 Welfare Economics and Social Choice Economics

Economists view attempts to find a formula for happiness rather coolly, not wishing to keep stepping on the same rake.⁶⁰ Generation after generation, they have

⁵⁶Andrew E. Clark and Andrew J. Oswald, "Unhappiness and Unemployment", *Economic Journal*, vol. 104, 1994, pp. 648–659.

⁵⁷Suicide data may be a poor or even useless indicator of social well-being since they indicate mental disorder rather than poor quality of life. Nevertheless, the fact remains that in the United Kingdom one in five patients is brought to hospital after a suicide attempt. Richard Smith, "I Can't Stand It Any More: Suicide and Unemployment", *British Medical Journal*, vol. 291, 1985, pp. 1563–1566.

⁵⁸Oswald, "Happiness and Economic Performance".

⁵⁹Respondents typically try to give socially acceptable answers and to appear optimistic in the presence of other people, so surveys may paint an unduly rosy picture. Against that, the present is usually being assessed by comparison with the past, which tends to be idealised, and this leads to a worsening of assessments.

⁶⁰A controversy in *The Economic Journal* in November 1997 on the link between economics and happiness nevertheless encouraged the professionals to recognise happiness as a legitimate category in economics.

addressed the problem of welfare, but the practical results have been unimpressive. At first it seemed that research would succeed in throwing light on the issue of welfare but it always came to grief on the monetary system. It would seem logical to suppose that the greater the sum of money paid, the greater the consumed utility, but utility theory yields no information on well-being.

The problem is that the utility of goods is not directly measurable. There is also a problem of variation between individuals. You cannot assert that a particular good gave the same amount of utility to one person as it did to another, since goods are individually perceived and the result depends on causes which include the level of consumption and accumulated wealth. In some cases utility can be assessed indirectly. Alfred Marshall noted that, although we cannot directly measure utility or motive, or the pleasant or unpleasant nature of sensations, we can do so indirectly. “An opening is made for the methods and the tests of science as soon as the force of a person’s motives—not the motives themselves—can be approximately measured by the sum of money, which he will just give up in order to secure a desired satisfaction.”⁶¹ But still, attempts to find a direct link between financial indicators and well-being do not bear scrutiny.

Viner gave the following explanations for this⁶²:

1. The monetary unit is itself not constant over time.
2. Prices characterise the relative marginal utility of various goods for purchasers, while well-being is determined by overall satisfaction and not by the satisfaction induced by the latter (marginal) portion of the good.
3. People may revise their attitude towards material prosperity and rate free time more highly. Well-being expressed in monetary terms fails to reflect these changes.
4. Changes in the distribution of income between people will bring about changes in the amount of welfare, even if the total income of society remains the same. Viner quotes Henry Sidgwick to the effect that one cannot know what the wealth of a country is before knowing how it is distributed among its population.⁶³
5. Finance is an unsuitable measure of welfare if ‘free goods’ become ‘economic goods’, and vice versa. An example of the former is clean water and air, which are disappearing as we watch, and an instance of the latter is network communications which are becoming increasingly important. In calculating welfare one should also take account of goods which used to be, but are no longer, free, and goods which did not previously exist. This cannot be done through calculation in financial terms.
6. The same applies to social goods: if we estimate them from tax revenues the picture will be severely distorted in terms of actual market value.

⁶¹Marshall, *Principles of Economics*, Book 1, Chap. 2, paragraph 2.

⁶²Viner, “Kontseptsiiia poleznosti”.

⁶³Henry Sidgwick, *Principles of Political Economy*, London, 1883, p. 76. Quoted in Viner, “Kontseptsiiia poleznosti”, p. 108.

7. If we calculate welfare solely on the basis of consumption, we shall overlook such factors as satisfaction and the negative utility associated with work. An increase in income bought at the price of a lengthened working day leads to a reduction of welfare.
8. Even if price or real income could be used for measurement, they would be reflecting the desire to have goods, not the satisfaction obtained from consuming them. It would be possible to estimate satisfaction from desire only if the two things were equivalent, which is doubtful.

The last explanation is what we have been saying all along: measuring satisfaction in monetary terms may in fact be possible, but different kinds of goods will require different techniques. The more clearly a person knows what he is paying for, the more accurately the payment reflects the utility he expects to obtain. Today's financial calculations in culture do not allow for even an approximate correlation between the two. According to Viner, the main contribution utility theory has to offer welfare economics is that it shows that price, and other indicators expressed through price, are inappropriate for measuring welfare.⁶⁴ In certain cases, prices mask the very problems they are supposed to be solving.

There have been a number of attempts to bolster welfare theory. These have included the Pareto optimality,⁶⁵ the Kaldor-Hicks compensation principle,⁶⁶ and the Bergson-Samuelson social welfare functions.⁶⁷ There is no point in dwelling on them here since welfare theory, having failed by and large to solve the problems which prompted its appearance, was transformed into social choice theory.⁶⁸ The emphasis moved from attempting to devise economic indicators of social good to working out optimal procedures for decision taking. An important contribution to the research was made by Kenneth Arrow, who showed that totalling individual preferences, which is an essential operation when assessing welfare, would not provide an optimal solution because it is impossible to reduce the personal ideas of utility of a number of individuals to an overall formula of utility for the group. According to

⁶⁴As Viner points out, theoreticians of utility have often concentrated their attention on the single aspect of inequality of the distribution of wealth, and have neglected other factors which undermine the idea that price is an appropriate measure of welfare.

⁶⁵The optimal state of an economy is where the position of certain members of society can only be improved by worsening that of others. Any change in economic conditions which creates benefits for a particular group without causing loss to anyone else increases social welfare. In real life, however, almost any change of circumstances benefits one group and disadvantages another. In these cases the Pareto criterion fails.

⁶⁶Under Kaldor-Hicks efficiency, an act or decision increases welfare if those benefiting from it could in theory compensate those disadvantaged for their loss and lead to a Pareto optimal outcome. This criterion leaves two problems unresolved—intransitivity and reversibility (the Scitovsky paradox).

⁶⁷See Rustem M. Nureev, *Social Choice Theory: A Course of Lectures [Teoriia obshchestvennogo vybora: Kurs lektsii]*, Moscow, GU VShE, 2005.

⁶⁸This area of economics relates to the study of political processes: theory of state, balloting rules, voters' behaviour, etc.

Arrow's impossibility theorem, social choice cannot be simultaneously both rational and democratic.⁶⁹

Nevertheless, for many of the purposes of political economy, financial calculation is essential and, despite its failings, widely used. Specifically, the prosperity of a country, the national standard of living, and the pace of economic growth are judged in terms of gross national product per head of the population. However, nobody has any illusions about the informativeness of GNP. It is generally acknowledged that it reflects such aspects of life as social opportunities and quality of education only very indirectly, if at all.⁷⁰ The result has been the devising of complex systems of indexes of quality of life.⁷¹ Amartya Sen⁷² and Martha Nussbaum developed this topic by introducing two basic concepts of 'functioning' and 'capability'.⁷³ In the 1980s the United Nations in its development programme proposed the introduction of a human development index as a generalising indicator of the quality of life of a population.⁷⁴

⁶⁹Any collective choice which satisfies the requirements of ordering, transitivity, universality, Pareto compatibility and independence from external alternatives turns one of these individuals into a dictator. Kenneth J. Arrow, *Collective Choice and Individual Values [Kollektivnyi vybor i individual'nye tsennosti]*, Moscow: GU VShE, 2004.

⁷⁰Amartya K. Sen, "The Concept of Development", Hollis Chenery and T.N. Srinivasan, eds, *Handbook of Development Economics*, vol. 1, Elsevier Science Publishers, 1988; Amartya Sen, "The Economics of Life and Death", *Scientific American*, May 1993.

⁷¹A variant of this system elaborated at the United Nations has 12 basic groups of indicators:

1. demographic attributes of a population (birthrate, mortality, illness, longevity, etc.);
2. sanitary and hygienic living conditions;
3. consumption of foodstuffs;
4. accommodation conditions, and provision of consumer durable goods;
5. education and culture;
6. employment and working conditions;
7. population's income and expenditure;
8. relationship between the cost of living and prices;
9. transport;
10. organisation of rest, physical culture and sport;
11. social welfare;
12. personal freedom.

⁷²Amartya Sen's achievements were recognised by the award of the Nobel Prize for Economics in 1998.

⁷³Functioning is what a person manages to obtain from society (education, income, health, kinds of leisure), while capability is the multitude of alternatives of functioning from which he may choose. This indicator reflects freedom of choice. See Martha Nussbaum, "Aristotelian Social Democracy", R. Bruce Douglass et al., eds, *Liberalism and the Good*, New York: Routledge, 1990; Amartya Sen, "Well-being, Agency, and Freedom: the Dewey Lectures, 1984", *Journal of Philosophy*, No. 82, 1985; Amartya Sen, *Commodities and Capabilities*, Amsterdam: North-Holland, 1985; Amartya Sen, "The Concept of Development"; Martha Nussbaum and Amartya Sen, eds., *The Quality of Life*, Oxford: Clarendon Press, 1995.

⁷⁴The Human Development Index is based on four paradigms:

- Effective activity aimed at enhancing income and economic growth;

4.3 Assessing Welfare Through Culture

No matter what systems of indicators of social reality are proposed, they yield meagre results in the cultural sphere. No matter how many quantitative indicators you bring together—on box-office takings, the number of seats, the number of cultural establishments, the variety of goods and services on offer, and so on, the longed-for clarity remains elusive. There are not and cannot be indexes making it possible to judge the dynamic development of culture. They do not exist because the data they could be based on is nowhere to be found within the existing methodology of accounting. Neither this nor any other kind of audit captures the reality of symbolic communication. It is difficult to be systematic in the cultural sphere, but if we could be, it would not take us much further forward. That being the case, what of the situation in culture which has little in the way of a material component? There is no summarising indicator of the literary process, and it is difficult to imagine what one would be like. Financial indicators of cultural business give no indication of overall cultural utility. Purely on the basis of revenue, the rapid growth of cosmetic surgery, which can be included in the category of aesthetic cultural activity, might seem to be splendid, but in the civilised world the practice is not generally encouraged.

Nevertheless, when decisions have to be taken, for want of anything better, culture is measured using the tools of economics. So it was during the Napster trial, where what was foregrounded was the existing economic interests of manufacturers. The claim that the pirates were causing financial loss to the manufacturers—which the defence disputed, insisting that pirate sampling had a positive influence on demand—was fundamental to the rationale of the verdict. The possibility that their activity was providing utility to music lovers was ignored.⁷⁵

No matter how hard one tries to throw light on the social sphere using numerical indicators, they give us no real idea of the existential pulse, how and by what values people live when they are not engaged in their increasingly frequent purchasing and consuming operations which do get registered in the accounts. How would the quality of life be assessed if we looked at it as a kind of work of art? The physical trappings, which the accountants add up so tidily, would certainly have some significance, but no more than the scenery has for a stage production. The symbolic component of the action remains beyond the purview of statistics, and all that matters most, all that gives rise to a sense of happiness (including the imperative to in fact be happy) is associated precisely with that symbolic component.

A number of moral teachings are based on learning to live without desires which cannot be fulfilled. This is believed to be more likely to lead to happiness than the

-
- Equality of opportunity in realising abilities and using goods;
 - Access to the benefits of civilisation not only for today's but also for future generations;
 - Expansion of opportunities which presupposes that development is implemented not only for the benefit of people but through their own efforts.

Among the indicators for calculating the HDI are: expected longevity, educational level, real per capita GDP.

⁷⁵See Appendix 2, Sect. A2.1.

pursuit of pleasures which lead only to satiation and disappointment. In the more economically developed societies this approach may be disparaged, but all parties are coming to see that the growth of material culture is accompanied by spiritual decline and that overall little changes for the better. To say the least, progress in this area is less obvious than one would expect from the economic indicators.

Social philosophers have written passionately on the topic, and economists too have had something to say in such works as Fred Hirsch's *Social Limits to Growth*⁷⁶ and Tibor Scitovsky's *The Joyless Economy*.⁷⁷ Scitovsky, arming himself with Maslow's concept of a demand pyramid, feels that when people have satisfied their material needs they should move on to more elevated concerns. Why do they not do so? Unfortunately, he observes, under capitalism the ability to appreciate symbolic goods atrophies. His proposed solution is to inoculate people with the art of 'creative consumption', but the effectiveness of such educational initiatives seems highly dubious.

4.4 Material Enrichment vs. Personal Cost

Economists write about culture in a down-to-earth, cogent and boring manner, as probably they should in order not to be ambivalent. The materially well-off social strata on whom their deliberations primarily focus are already well aware that they should be devoting more time to culture, but when the chips are down, sententious declarations of the importance of culture get pushed to one side. The race for money and status takes up most of their energy and little is left for culture. To make matters worse, culture is fenced in behind extremely high entry barriers. Its destinations are not clear and the sea lanes have no markers.

Scitovsky analyses this predicament, which is understandable enough in terms of practical, day-to-day living. He asks why the art of consumption is so neglected,⁷⁸ and suggests a number of reasons. One is the puritan scale of values. The idea that culture should give pleasure, or even that its sole purpose is to give pleasure, strikes many people as false and shocking.⁷⁹ Another important factor is practical common sense. Training for a profession or training to consume culture more effectively, irrespective of whether it is a pleasure, is an investment in the future. The former may be expected to bring extra income from a job qualification, the latter greater

⁷⁶Fred Hirsch, *Social Limits to Growth*, Cambridge, Mass.: Harvard University Press, 1976. This book considers the ecological costs of industrial development, and also problems related to the consumption of symbolic goods in developed countries.

⁷⁷Tibor Scitovsky, *The Joyless Economy: The Psychology of Human Satisfaction*, New York: Oxford University Press, 1976.

⁷⁸Tibor Scitovsky, "Our Disdain for Culture", Towse, ed., *Cultural Economics: The Arts, the Heritage and the Media Industries*, vol. 1, Edward Elgar, 1997.

⁷⁹Scitovsky, "Our Disdain for Culture", p. 90.

enjoyment of life as the result of developing consumer skills.⁸⁰ In the first case, however, the rewards are countable, while in the second they are ephemeral and unquantifiable. It is impossible to convert the ability to enjoy ballet into dollars. It is impossible to put a price on the effort needed before a novice can become a fully fledged balletomane. Given this vagueness, it is more than likely that the average person will sacrifice hedonistic cultural considerations and concentrate instead on raising his professional qualifications, with their promise of tangible results and rewards. The attitude is rooted in modern society's orientation towards quantifying everything and everyone. Such, in Scitovsky's view, are the sources of a rationalist prejudice against culture. People prefer leisure activities which demand no special consumption skills, trying everything out once or twice, or signing up for three easy lessons at most, but often remaining dilettantes and rarely aspiring to a more agreeable and sophisticated consumer experience.⁸¹

Priority is given not to the quality of life here and now, but to applying material resources to growth. Wealth is not spent, but saved to promote further growth. Aristotle called such an attitude to value, not for happiness but for self-advancement, 'chrematistic'. Of course, it is not true that people abstain totally from purely personal spending, but overwhelmingly their expenditure seems to be seen as an investment, or it is for display.⁸² An unbiased observer must surely be dismayed by this chronic overinvestment in potential capabilities, with its accompanying inability to actually put them to use. George Soros once said that he spent 5% of his time earning money, and the other 95% disposing of it skilfully. The chrematistic attitudes which predominate among capitalists, however, bring endless new recruits into the race behind the banner of consumption.

The logic of 'instrumental rationality', to which Scitovsky subscribes, makes understandable this bias towards display at the expense of the personally valuable. Given the increase in social mobility, the individual feels a need to position himself quickly and correctly in new surroundings and communities and to establish new contacts efficiently. The tokens which identify birds of a feather are the things people surround themselves with, in particular clothing, their living space, and their means of transportation. These provide a coded system which operates in the social status game, helping one to home in on potential partners. As the codes become more widely known, imitative strategies appear which aim to create a more flattering image. The language of things is increasingly used as a screen by individuals, which makes it ever more difficult to identify accurately who belongs to which particular cultural stratum.

An individual's cultural baggage, his preferences in the cinema, literature, and the theatre, is far more informative but takes longer to discover. Being less amenable

⁸⁰Scitovsky defines culture as the knowledge of the upper class of society, which they develop and need in order to enhance the effectiveness of their leisure.

⁸¹Scitovsky, "Our Disdain for Culture", p. 92.

⁸²Baudrillard considers that consumption has little to do with personal enjoyment. It is an obligatory social institution which programs behaviour on a subconscious level. Baudrillard, *For a Critique*.

to speed reading, it is relatively little used in the status game. The appearance of success is valued more highly than the reality. In a society based on networking, values are skewed towards information gleaned from status symbols, which in turn are tied in to the system of prices. People underestimate or overestimate what is underpriced or overpriced. In other words, they appreciate not what really is of most value, but what the market's price system gives prominence to. As Erich Fromm might have put it, it has become more important to seem than to be.⁸³

But if this deviation is associated with the mindset of instrumental (calculable) rationality which is how most people now think, why not rationalise the mindset itself? Is it not more rational to stop mindlessly accumulating for tomorrow and deepen one's skill in the art of spending? How can investments be re-channelled in this direction? The change will not come about of its own accord. The institutions which have brought about this stereotypical behaviour are only too firmly established. Lifestyles which appear to derive from instrumental rationality are widespread, but in reality they are far from satisfactory. We would do well to switch to a non-financial criterion of success, no less universal and easily comparable, which would enable us to break free from meretricious practices which are no longer functional. If we adopt this, investors in symbolic culture will become role models. In economics, efficiency is measured in terms of the growth of capitalisation, but this measure is uninformative for culture. We need a different but no less universal indicator.

4.5 Quality Personal Time: The Universal Indicator and Goal of Culture

There are a number of possible approaches to assessing cultural welfare. Of course, examining the state of its infrastructure will give some sense of its present state. One can and should also measure the time and money spent on consuming cultural goods and services. The clearest picture, however, will be obtained by considering the results of perception of works. The need is to set up a system for monitoring this both at a personal level and on a scale which can encompass the whole of society.

As we have already remarked, economists associate welfare with utility, but come to a dead-end because they measure utility, if with many reservations, through price. Culture's contribution to well-being is not efficiently reflected by price. The market is blind to the effect of what culture produces,⁸⁴ but it is utopian to imagine that an effective system of measurement can be established outside the market. All we need is for the market to register not the expected utility, as at present, but the resultant utility. Switching the emphasis to total utility, which only the consumer can

⁸³Erich Fromm, *To Have or To Be? [Imet' ili byt' ?]*, Moscow: AST, 2000.

⁸⁴As we have stressed, the specific nature of works of art as market products means that it is more difficult for a purchaser to assess their potential than is the case with conventional, frequently purchased goods and services. The consumer of culture pays up front, and the price paid tells us his expectations but not whether they are met. This apparently minor detail, "You pays your money and you takes your choice", is actually crucial.

identify, will allow us to move forward the issue of assessing cultural welfare. This ceases to appear utopian if we take account of the breakthrough which enables us to gauge the perceived quality of works. It is just one step from the monetary measurements obtained through collaborative filtering to a new and accurate understanding of welfare which takes into account the utility of art to the individual.

In the course of user-to-user collaborative filtering, consumers award points to works which reflect their personal assessment of the overall value of the cultural communication for themselves. In the system of collaborative filtering which we are proposing, and which is compatible with market mechanisms, this assessment will be expressed in monetary terms. The result will be to generate invaluable data, subjective assessments of utility which are so damagingly absent at present from welfare theory.

People long for happiness, whatever they associate it with and however they understand it. To a significant extent, it is realised through emotional and creative activity. We can judge well-being from the strength of that activity, and consumers can give expression to it by post-consumption monetary signals. Their payments will indicate the realised utility of a work, that is, its perceived quality, or the quality of the symbolic communication, and indeed the level of quality personal time. The latter formulation is perhaps the most accurate. Quality time is time which a person would himself define as having been well spent. Ideally, it is time which has been optimally used in accordance with the priorities, capabilities and criteria of a particular individual.

At first view, the term ‘quality time’ adds nothing new to what people mean by quality of life, but this is not so. The crucial feature of the innovation is in moving over to a subjective system of coordinates which allows us to objectify the experiencing of time. To make empirically measurable such a personal and elusive attribute is revolutionary.

The subjective nature of time and the mechanism by which a person experiences it has long been the subject of intense speculation, but the problem was not succinctly formulated and the conclusions did not become widely known. Although it will come as no surprise to many people to be told that the subjective perception of time does not flow regularly or coincide with the movement of the hands of a clock,⁸⁵ this does not appear to have any far-reaching consequences. At all events, individual approaches to managing personal time, the subjective sensation that it is passing slowly or swiftly, the emotions that accompany it, are not ‘capitalised’ into social experience, unless we view Eastern practices in that light. The difficulty of understanding the phenomenon of time was first described by St Augustine in the eleventh chapter of his *Confession*, and many outstanding philosophers since then have sought to give an answer.⁸⁶ Despite this, the concept of personal subjective time has not found expression in popular speech, and nowhere are there classes in personal time management. One wonders why something so important to the living

⁸⁵K. Abulkhanova and T. Berezina, *Time of the Personality and Time of Life [Vremia lichnosti i vremia zhizni]*, St Petersburg: Aleteia, 2001.

⁸⁶Kant, Husserl, Bergson, Heidegger, et al.

of life has been so neglected, when understanding it promises to open up many new opportunities and could lead to a radical rethinking of numerous aspects of life.

It is well known that the perception of time is radically altered in artificial conditions of sensory deprivation where the subject is immersed in special experimental baths, when living in caves,⁸⁷ or when under the influence of narcotics. There are, however, any number of obstacles to measuring the individual sense of time passing. The most fundamental is that what is being assessed is subjective, and making it objective removes the subject under investigation.⁸⁸ A statistical approach might solve the problem, but it is difficult to conflate the introspection of different individuals. The fact that no means has been found of quantifying the quality of personal time has ensured that it has been relegated to the attic of philosophical thought. It would be interesting to establish a link, which one is intuitively certain must exist, between the quality of time and its subjectively perceived duration.

Our attitude towards time is a priori subjective. It can only be characterised objectively through the payment of a certain amount of money post factum, indicating how the quality of the consumed work was perceived. Such a procedure will be valid, providing that those paying understand the nature and purpose of their action. The object of assessment may be segments of life devoted to the appreciation of a work of art, or any other intervals of time. The total of such assessments, together with their distribution over time, can provide highly accurate information about well-being. No one is pretending that life consists exclusively of ingesting symbolic goods, but the subjective sensation of happiness is largely dependent on it.

4.5.1 Art as a Means of Creating Quality Time

At the hands of an expert consumer, art can become a tool for managing the quality of his interior time. If it is 'real' art, it draws the reader/viewer/listener into its world, into its narrative. By immersing himself in this, a person leads, as it were, a different life, or the life of another person, and makes it his own, extending his own life. Accordingly art is a means of existential prolongation. One of its most important functions is psycho-emotional regulation.⁸⁹

For any individual, there is an optimal, consistent configuration of psycho-emotional states which, by analogy with encephalograms and cardiograms, should

⁸⁷Sensory deprivation refers to a situation where an individual is subjected to a prolonged, more-or-less total deprivation of sensory impressions, which triggers a heightening of imaginative processes.

⁸⁸It is also necessary to find a way of evening out distortions introduced by the experiment itself, for example, to adjust for differing individual assessments of the sensation of time passing outside the laboratory. A further problem is how to ensure that all those being tested are in the same subjective state at the beginning of the experiment, so that variations in that should not affect the result.

⁸⁹Along with creating significance, language formation and other functions.

perhaps be called an ‘emotiogram’. At particular times, whether he knows it or not, a person needs certain emotions, or rather, mental states. There is probably a variable emotional profile which would be ideal for each individual.⁹⁰

A person’s emotional side is receptive to events in the external world which, to a greater or lesser degree, are outside his control. If there is a consistent lack of certain experiences, the emotional make-up becomes distorted and there is an urge to remedy the situation. A person feels a need for the emotions missing from his personal palette, and this influences his actions and the situations he creates. If the emotiogram diverges from an individual’s personal norm,⁹¹ the situation can be remedied by turning to art, which is a treasure-house where, if you like, a supply of ready-made emotions is kept. A great virtue of this repository is the latitude it allows for choosing the moment of consumption, which allows the individual to restore his disturbed emotiogram. The mission of creative artists is to provide a bank of symbolic value on which the public can draw when they need a loan.⁹²

A particular work may be right, or not, for restoring the emotional equilibrium of a particular individual. Recommender systems facilitate not only the choice, by helping to identify the object required, but also take account of the moment of consumption. The latest versions attempt to take account of the consumer’s mood, social context, the weather, time of year, and even whether he has just had an argument with his nearest and dearest. In the near future, these technologies promise to give us the benefit of fundamentally new capabilities for putting leisure time to good use.

What the cultural markets are offering is nothing less than time for the soul or, to be rather dramatic, immortality. Such quality personal time can be used as a basic indicator of well-being, in that increasing it is tantamount to providing more abundant life as subjectively perceived by the individual. This enables us to view the very nature of culture in a new light.

As we said, an approach to culture through economics requires that all the relevant costs are taken into account, and also that the aims of the expenditure are properly formulated. We can view life as a process of turning monetary and personal resources such as time, taste, and resources of cognition and motivation, into quality time. If we come at the task from this direction, there is no reason to doubt that the methods of economics are entirely applicable.⁹³

⁹⁰Although no scholarly research into the play of the emotions has been discovered, services like MoodLogic use the latest software to suggest playlists selected on the basis of mood. www.moodlogic.com. See also Appendix 1, Sects. A1.11.1 and A1.11.2.

⁹¹The ideal is for experiences to be present in a successful configuration and to succeed each other no less happily. The extent to which the actual emotional situation diverges from the ideal quantifies the quality of life.

⁹²Many goods exist because of the way they draw people into the process of shopping, which modulates cognitive and emotional states. The consumer is paying less for the good itself than for the process of buying it. Z theory suggests that the consumer has less need of articles in themselves than of the mental states they evoke.

⁹³From a practical point of view what matters is that individual and collective resources and goals are defined in the same terms, so that the motivational vector of individuals and the overall cultural vector are compatible.

4.5.2 Collaborative Filtering: A Means of Indicating Quality Time

We have already mentioned how we propose to collect assessments of individual quality time which different works generate, or fail to generate: we shall resort to collaborative filtering. If previously economists lacked any indicators of utility other than market prices,⁹⁴ with the invention of collaborative filtering they gained new opportunities. What yesterday appeared to be a mere pipe dream, the aspiration to collect data on the subjective utility of a whole range of acts of consumption by a large number of people, may soon become a matter of routine.

Collaborative filtering was initially intended solely as a means of facilitating consumer choice, but it was found that it could be used to identify the perceived quality of works of art or, to put it more technically, to provide empirical evidence of the quality of personal time.⁹⁵

Happiness economics seeks to discover whether people are happy by conducting surveys. This is an expensive procedure, and measures are taken only periodically. Collaborative filtering can answer this vitally important question more simply by recognising it as an intrinsic element in user signals. The mechanism is precisely the same as the mechanism by which transparency in market dealings is ensured, with money acting as both the medium of exchange and the instrument of measurement. This new approach to collecting data relies neither on expensive monitoring institutions nor on the national census. Information is derived solely from automated monitoring of private market initiatives.

Something of fundamental importance is that those taking part in this kind of cultural communication have a direct interest in the summarising and publication of their experiences. It is only by taking the trouble to make their user profile accurate and complete that they can become effective consumers. This overcomes the difficulty, which Arrow predicted, that you cannot compel a person to reveal his utility functions; if he knows the information is to be used in a process of distribution, he will edit it so as to skew the distribution in his favour.⁹⁶ Happily, the collaborative mechanism is so designed that it is in users' own interests to publish their true assessments.

It might seem surprising to claim that what at first sight seems a highly technical procedure, applying mathematical calculations to consumer preference profiles, is

⁹⁴Kenneth Arrow remarked that the precise utility function of each individual is known only to himself and can be described only on the basis of observed behaviour. (Arrow, "The Potentials and Limits of the Market" ["Vozmozhnosti i predely rynka kak mekhanizma raspredeleniia resursov."] In 1985, when he made this observation, nobody imagined that there could be systematic and large-scale collection of data on subjective utility. Today that is an entirely real possibility.

⁹⁵Since we are talking about a summary indicator, we need to bear in mind the problem of the commensurability of comments by a number of different individuals, which has given economists many headaches and which they have been unable to resolve. Fortunately, we do not face this problem. In mutual consumer filtering the scale of assessment can be chosen to ensure that monetary signals of quality will be entirely affordable by everybody. Accordingly, the effect of money having different value for recommenders with different incomes is an obstacle which can be overcome.

⁹⁶Arrow, "Vozmozhnosti i predely rynka kak mekhanizma raspredeleniia resursov", p. 54.

capable of radically changing the world. Such things have happened on more than one occasion in history, however, from the invention of gunpowder to the establishment of a stock exchange. These were devised to address particular problems, but became a lever for transforming the future of mankind. Consumer navigation has rapidly developed beyond being the solution to a specific problem and is now seen to have a global applicability.⁹⁷

4.6 The Ultimate Goal of Culture: Increasing Symbolic Capital

4.6.1 *What Is Symbolic Capital?*

We have introduced the concept of quality time and a method for indicating it, so let us now introduce one further concept: 'symbolic capital'. We suggest that this is the ability to produce quality time. Pierre Bourdieu was one of the first to propose the concept, but its significance was only partly revealed then, as was the case also with the related concepts of cultural, social, human, and knowledge capital.

The crucial quality of capital is its productive capacity. Economic capital operates within a financial context and is valued for its ability to generate profit, but what of social or human capital? What do they produce? If we view them from a corporate standpoint, within the context of a firm, they are constituents of conventional capital. In principle one can assess their contribution to the financial results and hence to the capital of the company (which is an increasingly common procedure). If we use these concepts outside corporate economics, we shall have to specify the kind of potentials we have in mind and to measure, if only approximately, the extent of immaterial capital. There is a danger otherwise that the terms will be too insubstantial to be of practical use.

4.6.2 *Assessing Symbolic Capital*

Symbolic capital can be narrowly defined as the ability to generate quality time. If, in a particular context, quality time is measurable, then so is symbolic capital. The concepts correlate in just the same way as conventional capital and profit. On the basis of the latter we can pass judgement on the amount of capital which generated

⁹⁷Although our focus is on the sphere of culture, it is clear that collaborative techniques could radically alter procedures of collective choice, including the logic and technology of the electoral process. If in the past each voter has related to a particular group (cluster) on the basis of very meagre information, this service makes possible far greater contact between the electorate and candidates. Politicians will have to compete in order to represent the real preferences of groups of electors. If this should happen, then Churchill's maxim that democracy is the worst form of government, except for all those other forms which have been tried from time to time, may seem unduly harsh.

it. The markets can do the same in respect of so-called immaterial assets, which sometimes seem to be as elusive as ‘time for the soul’. Nevertheless, assessing the value of brands, an operation without which today’s advertising markets are inconceivable, as are today’s mergers and takeovers, is closely similar in its complexity to the task of assessing symbolic capital. The assessment of brand value is based on calculating the cash flows generated by brands.⁹⁸ When we have collected user ratings of culture it will be possible, following the same logic, to assess symbolic capital.

Symbolic capital is invested, and quality time results. To stay with our present terminology, art is the embodiment of symbolic capital. The creative artist, the bearer of symbolic capital (like any private individual), is capable of being a source, a provider to all and sundry, of quality time. Something, a work of art or someone’s act of communication, provides or fails to engender quality time in its recipients. Their responses can be collected and the symbolic capital is proportional to the total response. Its size depends not only on the number and nature of recipients’ assessments, but also on the size of their own capital. We may take Coulomb’s law as a metaphor: The magnitude of the electrostatic force between two point charges is directly proportional to the magnitudes of each charge and inversely proportional to the square of the distance between the charges.

Roughly the same thing can be said of symbolic capital: it is proportional to the capital of the parties and the symbolic distance between them. One work may gather a small group of sophisticated admirers who will award it a very high rating indeed, while another will receive modest encouragement but on a massive scale. In terms of symbolic capitalisation, they may be close to one another.

Operating with the concept of symbolic capital will help us to resolve a whole raft of important issues. To take just one example, it is obvious that assessment of cultural welfare should take account of the distribution of symbolic capital between people and communities. We are back to the issue of the optimal distribution of wealth, which is such a thorny subject even if a vast amount of information is available about material resources. If we had information about the distribution of symbolic capital and flows of quality time, we would finally obtain a coherent picture, and the correlation between material and symbolic capital would become evident.

4.6.3 The ‘Decile Coefficient’ of Symbolic Capital

Sociologists make use of the so-called decile coefficient, the ratio of the income of the most prosperous 10% of citizens and the poorest 10%, as an index of class tensions in a society. Something of the sort would be very useful for culture, although the decile coefficient of symbolic capital would on its own be insufficient. We need as much information as possible about the distribution of quality time flows.

⁹⁸This recognised method of brand assessment belongs to the Interbrand Corporation.

If post factum monetary signalling of impressions becomes established, an amazingly informative database will result. Let us mention here just one possible use. Any policymaker should be in favour of an optimal distribution of symbolic capital. The problem is that nobody knows what that really means, or knows what the overall reserves of symbolic wealth are. Debate about, for example, globalisation versus localisation generates more heat than light. If we had reliable information at our disposal, its importance for cultural policy and for politics in general would very soon be recognised.

Almost all the problem issues in the cultural sphere can be revisited in terms of quality time and symbolic capital. ‘Cultural progress’ itself can be defined as the increase in the total quality time of members of a community. A national elite will be able to see itself as those in a position to enable others to enjoy quality time. Consumer signals of perceived quality will be instrumental in reviving all areas of culture. By ensuring effective navigation and allowing individuals’ quality time to be maximised, the symbolic economic approach can be fruitful in vastly important areas like social and individual well-being and analysis of the distribution of symbolic capital. We can now see how these and many related questions should be approached. Having comparative data available about the quality and trends of communication in different cultural sectors will make it possible to formulate cultural policy more coherently and rationally.

What is actually taking place? Is cultural capitalisation increasing or decreasing? Is the distribution of symbolic capital tending to even out or is inequality growing? What is the balance between ‘low’ and ‘high’ culture? The revolutionary sailor-poets who rejected Khodasevich, Afro-American ‘rapping’ recitative, and all the ‘Star Factory’ television series have something in common. ‘Affordable luxury’ will find itself in the same category. From the viewpoint of a refined public, of course, it is all nonsense, but if we reject everything in this category on the grounds of its vulgarity, are we not highhandedly denying those lower down the cultural pyramid their own version of quality time? Scitovsky wonders whether the growing banality of culture is positive or negative from the standpoint of the individual.⁹⁹ There is no way we can answer this question without knowing the views of particular individuals themselves.¹⁰⁰

As regards the future of culture, predictions tend to be pessimistic. One hears endless complaints that maintaining symbolic inequality is in the interests of the powers that be, but is it only in their interests? The masters of life do not need intelligent dishwashers and petrol pump attendants, or an overly creative office proletariat. They need an adequate supply of zombie-like drudges to work in such labour-intensive areas as massage, bed-making, brushing crumbs off tables, and not to be

⁹⁹Tibor Scitovsky, “What’s Wrong with Mass Production?”, in Ruth Towse, ed., *Cultural Economics: The Arts, the Heritage and the Media Industries*, vol. 1, Aldershot: Edward Elgar, 1997.

¹⁰⁰Scitovsky’s own answer was that the frequency with which the public are bombarded with bad reproductions and music compositions evidently results in the works losing their novelty faster than they otherwise might, without producing any greater satisfaction. Scitovsky, “What’s Wrong with Mass Production?”, p. 109.

unduly oppressed by the monotony of their occupations. For those working in such jobs, developed aesthetic taste is a mere burden. But what of the proletariat itself? Perhaps for those with limited creative potential and ambitions it is kinder not to rock the boat, to let them carry on living in their blinkered world of delusory happiness? Should the philistine plebs really be exposed to the perplexing challenges of ambiguity?

In other words, perhaps adverse selection in culture is an admirable mechanism for reconciling the interests of the influential and the economically powerful with those of an undemanding majority. That adverse selection is occurring is beyond doubt, but are its consequences as negative as the term suggests? A clear majority of those affected are not complaining about the dumbing down of culture, perhaps because anaesthetising the ability to think critically is one of the consequences of adverse selection in culture. Until the ideas of quality time and symbolic capital are able to play a fitting role in social practice, those practices themselves are hardly likely to change for the better.¹⁰¹

4.7 A Modified Relational Contract in Culture

Monetary collaborative filtering is not a partial or a random solution which just happens to have presented itself. It follows on logically from a particular kind of contract which is essential in cultural exchange. In terms of economics, the problem of indicating quality can be resolved only within the framework of a relational contract. Such a contract is appropriate for regulating agreements where the future development of mutual relations is unpredictable and the likely outcomes are not apparent. It enables the parties to limit their obligations and intentions within an 'if... then' operator. The interaction between a creative artist and the recipients of his art is clearly of this kind and, since the consumer effect is uncertain, it needs to be constructed along these lines. Relational agreements are, however, expensive to prepare and service, and are not customary in the cultural sphere. In practice, a different extreme is usual, a very elementary agreement to pay by cheque as appropriate. The simplest form of a relational contract might provide for payment in two stages: the first, for the right of access to content; and the second after its consumption. Since the consumer's assessment of the result is of a credence kind, the second part of the payment is best made on a wholly voluntary basis, in the manner of an *ex gratia* payment.

For payment of a gratuity of this kind it may prove appropriate to resort to a special instrument, a kind of meta-currency which would circulate solely within the bounds of the symbolic realm but which would, like any hard currency, be convertible into conventional money. From the two autonomous kinds of money something like a Cartesian dual coordinate system would be constructed to reflect reality:

¹⁰¹The idea of increasing quality time does not imply that everybody should have the same values imposed on them. Rather, it would have to fit the subjective system of an individual's taste and would adopt a policy of equal opportunities towards the classics and post-modernism.

the primary monetary axis would register costs in the material sphere, and the secondary monetary axis the value of the symbolic sphere. We have put forward the secondary money idea elsewhere.¹⁰² Unfortunately, no matter how attractive and desirable such a parallel monetary institution might be for culture, it is not feasible, or too expensive in practice, at least for now. We can save the expense of setting it up by using existing money in a way it is not often used: for voluntary donations.

4.8 Money and Donation

Different ways of giving money are widespread today and a lot has been written about them.¹⁰³ The giving of gifts is altogether a very common form of interpersonal transaction. It is regulated by social norms which have evolved at this point where calculation and openheartedness meet. The permissible value of gifts is a function of the social distance between the parties to the exchange. It would be naive to overlook the fact that gifts are made with a degree of calculation, sometimes of an economic nature, but great efforts are traditionally made to conceal this. On the other hand, a gift invariably involves financial and time costs, which can be considerable, and it is usually given in such a way that the recipient has a fair idea of their magnitude.

An article given as a gift is a reminder of the giver, ties the recipient to him, advertises him, has the force of a charm, and proclaims a reciprocal obligation. Maoris call the spirit of a gift its ‘Hau’ and believe it has great power.¹⁰⁴ The gift thus balances altruistic concern for the other party with a selfish expectation of reciprocity.

Friends make gifts, the saying goes, and gifts make friends. A gift of money, however, is impersonal and lays no claim to friendly relations. Paradoxically, it imposes

¹⁰²Alexander Dolgin, “A Second Universe” [“Vtoroi universum”], *Logos*, Nos. 5/6, 2002, pp. 243–291.

¹⁰³On the proliferation of money and money in the function of donation see Viviana A. Zelizer, *The Social Meaning of Money* [*Sotsial’noe znachenie deneg*], Moscow: Dom intellektual’noi knigi, 2004, p. 284.

¹⁰⁴Mauss wonders what the power contained in a gift is which obliges the recipient to make a gift in return. He believes this power is Hau—the spirit of the person making the present. Until the gift has been redeemed, the giver has a dangerous mystical power over the recipient. (Claude M. Mauss, “An Essay on Giving” [“Ocherk o dare”], in *Societies, Exchange, Individuality: Papers on Social Anthropology* [*Obshchestva. Obmen. Lichnost’: Trudy po sotsial’noi antropologii*], Moscow: Vostochnaia literatura, Russian Academy of Sciences, 1996, pp. 134–155, 169. Quoted by Marshall Sahlins, *Economics of the Stone Age* [*Ekonomika kamennogo veka*], Moscow: OGI, 1999, p. 142. Fers does not agree with Mauss and claims he is confusing types of Hau which are completely distinct for the Maori people: the Hau of a person, the Hau of the Earth and the woods, and the Hau of Taonga. Fers believes that on the whole Mauss’s idea that an exchange of presents is an exchange of personal essences is mistaken. He prefers a secular logic of reciprocity to mystical explanations. The basic impulse to carry out obligations, as Mauss himself hypothesises, is social: a wish to continue to enjoy economically useful relations and to maintain power and status. There is no need to resort to hypothetical interpretations of an unclear belief system. Fers is, however, inclined to agree with Mauss that, in the sense of a psychological expansion of the giver’s ego, a gift is part of the giver. Sahlins, *Economics of the Stone Age*, p. 142.)

fewer obligations than an ordinary present. The latter, also contrary to appearances, is highly pragmatic.

Why is it invidious to offer money directly? Why should a lady of the night be only too willing to accept diamonds (which on a rainy day she can cash in for half their true value), but take exception to being offered a wad of banknotes? Is it because money exposes what ought to be concealed: the self-interest behind the gift? Or is it considered improper to save yourself the time and trouble of thinking about a gift and simply buy your way out of the obligation? There is also that danger that, if you get it wrong, you may humiliate the other party by giving too little or too much.

The giving of money certainly risks emphasising the unequal status of the giver and the receiver. A gift of money will normally be accepted only from someone very close or very powerful, a patron, in which case it will be expected to be a substantial sum. Accordingly, it works out cheaper to offer something specific than to give money, and a modest present may say and do more than a large cheque. A present is money plus the time and emotion invested, while money is just money. Some experts in these matters consider money the worst possible symbolic present.¹⁰⁵ In order to overcome this defect, the sum needs to be increased by the amount of the symbolic deficit, and then some. This may, of course, put other gift givers in an awkward position for having saved money by making a present other than cash.

Despite the restrictions and prejudice, money has wormed its way into the realm of gifts. There are norms which prescribe the situations and ways in which it should be handed over, how much is appropriate, and who may receive it. Viviana Zelizer deduces from this a ‘proliferation’ of money. She means by this that, while all that can be said objectively about money is restricted to its quantity, subjectively it is ‘earmarked’ and gains supplementary attributes from the purposes and means for which it is intended to be used.¹⁰⁶ In the many examples of psychological nuancing of money which Zelizer presents, we detect pride in the human race for courageously standing up against the money Moloch. It is not clear why something as natural as the humanising of money should be seen as such an innovation. We are, after all, only talking about different ways of treating a universal tool. The proliferation of different kinds of time might prove a much more rewarding topic.

The fundamental objection to a gift of money is that it gives poor expression to the symbolic balance between individuals, replacing it with a statement of eco-

¹⁰⁵For example, David Cheal. See Zelizer, *The Social Meaning of Money*, p. 129.

¹⁰⁶According to Zelizer, the proliferation of money is embodied in three processes: the issuing of different monetary units; the use of surrogates of money; and the earmarking of money for specific purposes. The latter, most important of these points, differentiates money by types of social interaction. (Zelizer, *The Social Meaning of Money*.) Money proliferates because, although objectively it is homogeneous (that is, it does not matter which particular banknotes a sum is represented by or where they are physically located), people give it differing significance by earmarking resources and use it for different purposes. Depending on how money has been obtained (earned, won in the lottery, through inheritance, savings, etc.), it may be spent for particular purposes (basic living expenses, education, entertainment, or gifts). There is no need to see this as a tendency to make money sacred, but rather as an instinctive and entirely sound urge not to put all your eggs in one basket.

conomic status. Georg Simmel, a most impressive thinker who has devoted himself to studying the metaphysics of money, considered it an indifferent present.¹⁰⁷ In at least one relationship, however, the universality of money proves an advantage. Giving money works admirably between patron and artist. The universality of money makes it possible for the balance of symbolic economic exchange to be regulated very precisely. Money is exchanged for high-quality interpersonal communication in a symbiosis of equal partners mutually sharing what each has a surplus of. Money here is not a donation, let alone a giving of alms, but a voluntary investment, a form of complicity in the work of the individual receiving the gift.

In the cultural sphere, money has not always functioned the way it does today. Europe has known times when the system of exchange in the material sphere was not applied to culture. In the Middle Ages a relatively independent cultural world existed within which something quite separate from the mundane was created. If an artist was invited to the court of a powerful lord he would enjoy renown and a privileged existence. Relations between the person commissioning and the person creating the art were based on a model outside of economics. Of course, even then money was important to the masters of art, but its role was secondary and it did not determine how artists behaved. It was paid to artists primarily to honour their work (which is the origin of the word ‘honorarium’).¹⁰⁸

Another situation where money is readily acceptable is where it expresses social acclamation. Modern communications make possible the delivery of largesse in a remote, depersonalised manner which radically alters the situation. A gift depersonalised immediately sheds the embarrassment attached to giving cash. A gift of money which has been specially collected is untainted because the recipient does not know who contributed how much, what subjective value any particular donor had in mind, and has no grounds for trying to interpret the ethics behind the gift. A gift of money which has undergone this kind of transmutation is perfectly straightforward and tactful.

In Bronislaw Malinowski’s terms, this is a ‘pure’ gift, a gift without the least implied expectation of a reciprocal gift.¹⁰⁹ Collaborative filtering brings us very close to this, although the monetary transfers within its framework are not a gift. The process of compiling recommendations may depend on voluntary payments, but these are an economically justified operation. In the first place, they pay for themselves through the information on quality which is received in return; in the

¹⁰⁷Georg Simmel, “The Philosophy of Money” [“Filosofia deneg”], in *Theory of Society [Teoriia obshchestva]*, Moscow: Canon Press Center, 1999.

¹⁰⁸Honorarium comes from the Latin ‘honor’. Ekaterina Men’, “Regeneration of the Experts” [“Pererozhdenie ekspertov”], interview with Aleksandr L. Dobrokhoto, Globalrus.ru, 6 December 2005, Komp’uterra, online, No. 28, 10 August 2004. Cited 28 February 2006. Available from URL: <http://www.globalrus.ru/pragmatics/779763/>.

¹⁰⁹Bronislaw Malinowski, *A Scientific Theory of Culture [Nauchnaia teoriia kul'tury]*, Moscow, 1944. Reprinted Moscow: OGI, 2005; also Malinowski, *Selected Works: The Cultural Process [Izbrannoe: Dinamika kul'tury]*, Moscow: Rossiiskaia politicheskaia entsiklopediia, 2004; also *Magic, Science and Religion [Magiia. Nauka. Religiia]*, Moscow: Raffle-Book, 1998.

second place, the resources spent on sending the signals may be returned a hundredfold to the person paying, rather like online gambling. The cashflows within a recommender system are partly recycled, and this process is integral to the business plan.

Some form of direct communication between a performer and his admirers without the intervention of middlemen would be very germane to recommender systems. It seems entirely probable that people will happily transfer their bonus payments if they know these go directly to the creative artist. Talented people will thus have the opportunity of enjoying collective patronage from their admirers and deliverance from the snares of the business world.

Having purified the act of giving of its implied reciprocal advantages, consumers will discover that money is the freest, most selfless and beneficent form of giving. Their contributions will be neither surreptitious commercialism, nor emotional vampirism, nor importunacy, nor bragging. Well, perhaps bragging, just a bit. The spirit of Hau will be exorcised from their gifts. Collaborative filtering can facilitate communication not only between consumers, but also between consumers and producers. The second, voluntary payment to the artist will contain two recently recognised functions of money: the altruistic, and the function of personal quantification.

4.8.1 Money and Micro-Patronage

No matter how utopian it may at first sight seem to attempt to embed money in a system of depersonalised giving, this is an aspect that analysts have been focusing on recently. Wanting to give instead of take might seem contrary to consumer psychology, but such practices as tipping¹¹⁰ and giving money to buskers afford grounds for optimism. The problems business has encountered with digital products, which are not used up in the process of consumption and can be copied very cheaply, have prompted a search for new ways of settling up with customers. Everybody is concerned about how to get users to pay for content when it is uncertain whether free riders can be kept out.

On a commercial level, information products invite two fundamentally different approaches. The first is to restrict access in order to take the good out of the category of social goods and block attempts to use it without paying. This is the approach, for example, of the Digital Rights Management scheme.¹¹¹ The second method attempts to make money out of a social good by relying on ethical standards and contracts based on trust.

¹¹⁰For a fresh survey of research into the issue of tipping, see Ofer H. Azar, “The Implications of Tipping for Economics and Management”, *International Journal of Social Economics*, vol. 30, No. 10, 2003, pp. 1084–1094; Azar, “The Social Norm of Tipping: A Review”, *Journal of Applied Social Psychology*, vol. 37, issue 2, 2006, pp. 380–402.

¹¹¹See Appendix 1, Sect. A1.10.1.

4.8.2 Voluntary Payment Systems

There has been increasing discussion in the literature on digital content of the last two or three years of voluntary schemes where payment is taken not as a condition of access but after consumption or as an investment contribution. Many of the ideas go back to the development of peering networks.¹¹² It is difficult to prevent free rider access to products which get on to the Internet, or which might.

One approach is the Street Performer Protocol (SPP) business model,¹¹³ which is based on not insisting on fairness or getting everybody to pay, but just invites subscription from those genuinely interested in the product.¹¹⁴ The provider announces a fixed total price for his good and the date by which it needs to be collected. Each potential user decides the extent to which he wishes to take part in the collective investment. As soon as total contributions exceed the price indicated, the product becomes freely available on the Internet. Subscribers reconcile themselves to the fact that some people will obtain it without payment. If the requisite sum is not raised, the product remains inaccessible and contributions are returned.¹¹⁵ The model is not suitable for all goods by any means. It could hardly be used for news products.

Needless to say, both parties to a contract of this kind need to have a fair idea of the overall willingness of other users to pay for the product, and this information is not readily obtainable. It is easier to follow the traditional pattern of charging a fixed price for single-use access. For music or films the approach seems unlikely to work because nobody can guarantee in advance that the result will be a masterpiece. There have, nevertheless, been occasions when the SPP model acquitted itself well. When Blender, which had devised a free 3D program, went bankrupt, a subscription to raise €100,000 was launched, and when this was achieved the firm went on to fulfil all its outstanding obligations.¹¹⁶

Among the problems with SPP are that insufficient money may be collected, or the producer may not live up to expectations and come up with work of the necessary quality. Moreover, if the full sum is not collected but the product is in the process of being created, or has already been created, it has to be artificially held back. The

¹¹²See Appendix 1, Sect. A1.9.

¹¹³The reference to street performers in the title alludes to a similarity between the scheme and the way buskers receive their income.

¹¹⁴The model is proposed in John Kelsey and Bruce Schneier, "The Street Performer Protocol", Third USENIX Workshop on Electronic Commerce Proceedings, online, USENIX Press, November 1998. Cited August 2003. Available from URL: http://www.counterpane.com/street_performer.html; See also John Kelsey and Barry Schneier, "The Street Performer Protocol and Digital Copyrights", *First Monday*, vol. 4, No. 6, 7 June 1999.

¹¹⁵Jens L. Hougaard et al., "Selling Digital Goods on the Internet", online, University of Copenhagen, October 2002. Cited August 2003. Available from URL: ideas.repec.org/p/kud/kuiedp/0209.html.

¹¹⁶Andreas Neus, "Blender and the Street Performer Protocol: Freak Success or First of a Trend?", online, 2002. Cited August 2003. Available from URL: <http://www.blender.org/modules/bc2002/Neus-Blender-SPP.pdf>.

threat that it will not be made generally available needs to be convincing, since otherwise subscribers, instead of paying, could simply wait for the initiator's patience to run out. A creator who for any reason is unwilling to wait, is in a vulnerable position. In order to overcome the problem, the SPP model is being further developed. Contributions are being broken down into tranches,¹¹⁷ which enables investors to gain a sense of other people's readiness to pay, while themselves putting at risk only a smaller initial investment. The originator of the product, a writer, say, can issue his work in instalments, giving readers the opportunity of deciding whether they wish to sponsor it as a whole.

DeFigueiredo suggests artists could be encouraged by adopting an approach similar to the appeals for cash which accompany 'free' software.¹¹⁸ The software is openly accessible but users are invited to make voluntary donations. Usually a file is attached to the program with the address to which a cheque can be sent. Those who send donations may be doing so because they want to hear about updates, or simply out of the goodness of their hearts. DeFigueiredo looks at ways of linking payments to consumers' rating of songs, and to that extent his ideas are developing along the same lines as ours, but he then follows the usual notion of totalling up contributions and arriving at ratings.¹¹⁹ He suggests that information about the total payments attracted by a particular artist or work will provide a good indication of quality for those in the loop. This, as we know, is fairly wide of the mark. An additional consideration is that publishing the total amount raised might cool the ardour of anyone suspecting the artist is getting indecently rich. It is not clear how the running of the service would be financed.

Robert Woodhead suggests making content freely available with subsequent payment in the form of gratuities.¹²⁰ He is satisfied that, if the ethic of tipping can be extended to intellectual property, the problems of Internet distribution will disappear. On the basis of his own experience, Woodhead declares that demanding payment for intellectual property is a non-starter. During the two and a half years before his article appeared, in August 2000, Woodhead had a site offering (and continuing to offer) guidance and software for advertising on the Internet. Some of the content is free, and he suggests a price for a number of other options. Users are free to decide whether they wish to pay more or less than that. The results have been that 1 in 10 paid above the level indicated, 4 out of 10 paid less (often apologising by e-mail

¹¹⁷Paul Harrison, "The Rational Street Performer Protocol", online. Cited August 2003. Available from URL: <http://www.logarithmic.net/pfh?action=random>.

¹¹⁸Dimitri do B. DeFigueiredo, "Unleashing the Power of Digital Goods: Enabling New Business Models for the Music Industry", University of California, Davis, August 2003. Available from URL: www.cs.ucdavis.edu/~defigued/index_files/unleash.ps.

¹¹⁹Dimitri DeFigueiredo pays attention primarily to the technology of micropayments. For money-based collaborative filtering systems this problem simply does not exist. Monitoring of operations is conducted on special customer accounts and actual monetary transfers are performed only occasionally when significant sums have accrued.

¹²⁰Robert Woodhead, "Tipping—a Method for Optimizing Compensation for Intellectual Property", online, 15 August 2000. Cited 24 November 2005. Available from URL: <http://tipping.selfpromotion.com>.

and promising more generous remuneration in better times), and the overall total of ‘tips’ was twice what he expected.

Thus, instead of stating a price but leaving it to his users to judge, the owner of this website doubled his income. Contributions are received both from people who would not have paid anything if they had felt he was asking too much, and from people who would have been prepared to pay more. If he had set a fixed price, he would have drawn only on the latter category. Woodhead puts the honesty of his customers down to the fact that it is a personal website. Users are in contact not with an impersonal corporation but a particular individual.¹²¹ This is thought to be why the model of tipping can work for intellectual property, since its creator is invariably known. Recalling Stephen King’s experiment of publishing *The Plant* on the Internet in episodes using a system of post factum payment (King asked his readers to pay \$1 if they liked the chapter),¹²² Woodhead considers that King’s mistake was in fixing the price. If he had allowed readers to decide for themselves how much to pay, many would probably have contributed more, which would have compensated for the shortfall.

4.9 The Future of Copyright

I would like finally to attempt to clarify the issues surrounding the matter we raised at the very beginning of this book: copyright. Copyright is the mainstay of modern commercial culture and a real Ishmael of controversy for analysts. It makes sense to examine its prospects from the standpoint of cultural welfare theory, and also in the light of two major innovations: e-commerce in works of art; and monetary collaborative filtering. We have already mentioned the main reason copyright appeared: the artist needed a business partner to market his work, and the latter needed reassurance that the fruits of his labours would not slip through his fingers. The question is whether copyright, which originated as a tool to serve commercial interests, is serving culture satisfactorily today.

4.9.1 Copyright as a Bridge between Art and Commerce

Before focusing on the present state of play, let us take a look at the origins of copyright and some kindred institutions regulating the commercial circulation of information. What is meant by “establishing a person’s right of property over an

¹²¹In our experiments with payment for cinema and theatre (the Cinema and Theatron Projects, Appendix 4) the audience paid voluntarily. If this was only due to a special motivation in the context of the experiment and the participants felt obliged to act in accordance with a local norm, the whole question would be how to get such behaviour generally accepted as normal.

¹²²King’s experiment is described in Chap 1, Sect. 1.3.6.1.

immaterial object”? Let us begin by stating what is evident from the semantics of the word ‘copyright’: one may not copy without permission an information product belonging to another person (whether for commercial purposes or not) to the detriment of the owner.

In a world based on the circulation of information, the legislation on this issue is crucial. Regulation which champions the interests of commerce is bound to impinge on the interests of other participants. An institution is a rule, backed up by sanctions if it is broken.¹²³ Rules and sanctions and the monitoring of how they are implemented can have negative consequences extending beyond the immediate issues being resolved. Interpersonal communication, in particular creative communication, presupposes certain rights and freedoms. If for economic reasons copyright is essential for the flourishing of the arts but simultaneously restricts freedoms, the harm may outweigh the benefits. The social system will resist and reconfigure itself in order to minimise the damage. An exaptation may follow, an unforeseen reaction against the disturbance caused. An apparently unimportant over-application of the principle may cause a breakdown in the cultural process. Copyright was intended to support culture through commercial incentivisation, but as can be seen from the history of state subsidy, positively influencing creative motivation with money demands the precision of a jeweller. Copyright is not that subtle. On the contrary, as the evolution of the sound recording industry has shown, copyright has come to dominate the area so completely that it is arguably now more of a hindrance than a help.

In order to gain an overview of why copyright is necessary and how it functions today, let us look at a mature market full of artistic works. At the moment when the author types his last fullstop, he has monopoly control of his work in the market (unless he is bound by prior contractual obligations). Quite how useful and valuable this monopoly is, is a moot point. He has no private publicity organisation, so the market is virtually closed to him. Moreover, he is surrounded on all sides by other monopolists just like himself. Each is aspiring to break through to his public. Professional middlemen of the arts market regulate the competition between authors and filter out those who are less commercially promising. Authors who make it through the filter and get a good reception from the public gain a reputation which gives them a competitive advantage over other writers, who may be just as good but are unknown. Attention focuses on the most successful creative artists, the ‘stars’. Newcomers stand little chance of breaking into the market on their own. Writers must either try to go it alone or engage the services of a middleman. Almost certainly they need help with the organising of production and distribution, and in other areas where investment is needed and special, non-artistic competence.

A creative artist, then (be he a director, writer, or painter) and a businessman (a producer, publisher, or agent) enter into a partnership which matters to both of them. They need some way of agreeing how the responsibilities and the proceeds are to be shared. The institution which guarantees their agreement is copyright. The primary

¹²³This is how institutional economics looks at institutions, and more specifically Douglass C. North, one of the founders of the discipline.

right in a work belongs to its creator. Nobody else even knows of its existence or, if he so decides, ever will. In order for this right to be of practical value, however, the originator needs to share it with a business partner who will take on the technical costs and shoulder the financial risks. In return he needs a guarantee that he will get a share of the revenues, and this is underwritten by his legally binding right to copy. If the work is a commercial failure, the investor will lose money. Conversely, if it is a success he is entitled to a portion of the profit. He naturally needs protection against the possibility of an outsider appearing after all the hard work has been done, and finding that the primary rights holder has transferred his loyalty to him instead. By the time it is clear that the work is a success, the project's risks have been greatly reduced. If the originator were not under contract, he might well be able to strike a deal more advantageous to himself with a more amenable and generous publisher, denying the original investor the full return due from his investments.

Copyright is a bridge from the creative realm to the business world. It is a bridge which creative artists themselves are glad to make use of in order to keep ahead of their fellow artists. It is the competition rather than the businessman who are the main threat to an artist. By contractually cementing his alliance with the businessman, our artist comes out into the big, wide world and it is at this point, since a debt is blessed only in the payment, that he should show respect for his ally's financial interests. Commercial success has to be nurtured, fuel needs to be thrown on the fire of popularity if it is not to go out, and by helping his work to be a commercial success he is also looking after his own interests.

The critics of all this side of things demand that the creator should be liberated from his demeaning dependence on business, as earlier they sought to free him from his tyrannical patron. In the process they overlook the fact that, without the contribution of the business world, the artist would never gain broad recognition. The zealots of creative freedom are dead set against this life-saving bridge. Determined to rescue the artist from what they see as his misalliance with business, what do they offer in its place? What secret weapon do they have for the artist to mount his assault on the frontiers of popularity? If they demolish the bridge, how is the artist to cross the abyss between creative art and the market in order to become known to his public? Their answers are fairly incoherent. How is management to be provided and by whom, how are incentivisation, navigation, distribution and all the other vitally important practical aspects to be taken care of if nobody is to be paid? How are the non-creative players to be incentivised without a proportion of the property rights ensuring them a legitimate share of the income? Is it really better to give nobody rights or profits? Perhaps there is a secret assumption that creative and administrative activity will become the prerogative only of people who are already wealthy? But then, what about opportunities for all the others? Do the zealots believe that progress in communications will eventually bring everybody and everything together? What about those members of the public who need the services of selectors and mediators? Copyright is a logical development of the professionalisation of creative work, and if we accept that professionals in the creative arts achieve better results than amateurs, we need to accept that there is a place for copyright.

4.9.1.1 The Birth of Copyright

In the Middle Ages a literary work was not distinguished from the material on which it was written. Property relations were regulated by common law, and the law made no distinction between possession of a manuscript and possession of land. With the invention of the printing press, the owner of a text began to need protection. Regulation began in the reign of the Tudors with a system of royal patents which afforded a monopoly right to print particular books or types of books.¹²⁴ In the main, patents were used by the monarch as rewards for loyalty and service or as gifts to a favourite. Patents were of two sorts: general, which related to an entire class of literature, for example, almanachs or works on the law, and particular, which gave the right to publish a particular book.

In England, the homeland of copyright, official recognition of the rights of publishers goes back to 1557 when Mary Tudor awarded a charter of incorporation to the Stationers' Company, which had brought together the old fraternities of 'scriveners, limners, bookbinders, and stationers'. Now a 97-man strong association of printers, booksellers and bookbinders, it was entrusted with control, or in other words censorship, over all publications.¹²⁵ Any member of the company (and they were mainly printers) who had possession of a manuscript had the right to register it for publication, after which nobody else could print the work without his permission. He also had the right not to publish it at all.

Literary piracy was already widespread in those times,¹²⁶ and many of the activities familiar to us today promptly appeared in book publishing. Disreputable publishers hired hacks to introduce slight changes to the text of existing works, and then published them under new titles. But "whenever exceptional profits attracted interlopers, the case against unregulated competition was argued by the Company with a skill which our present-day trade associations hardly excel".¹²⁷

It is largely thanks to the Company that copyright acquired its present contours. Although the law provided privileged publishers with a measure of protection from troublesome outsiders, those who denied the legitimacy of the established order sought to find ways round it. The battle for the literary market was based on the ties binding the author and publisher, and those in turn depended on how one understood the author's claims. There were two competing approaches. One was rooted in the common law view that the purchaser of an object had a right to dispose of it as he

¹²⁴Arnold Plant, "The Economic Aspects of Copyright in Books", *Economica*, New Series, vol. 1, Issue 2, May 1934, pp. 167–195.

¹²⁵At first the printers were dominant in the Company, since in the mid-sixteenth century they were the main owners of manuscripts and hence of the right to reproduce them. Gradually booksellers became predominant. They did not need to spend money on acquiring printing presses, paper, etc., and accordingly had greater opportunities to accumulate capital. See L. Aliab'eva, *The Literary Profession in England in the XVI–XIX Centuries [Literaturnaia professia v Anglii v XVI–XIX vekakh]*, Moscow: Novoe literaturnoe obozrenie, 2004.

¹²⁶The usual punishment for a pirate was a fine, half of which went to the offended party and half to the Exchequer.

¹²⁷Arnold Plant, "The Economic Aspects of Copyright in Books", pp. 174–175.

saw fit, including making as many copies as he wished.¹²⁸ A different viewpoint, which finally came to predominate, argued that the author's property was not the material, paper embodiment of his idea, but the idea itself. And before that idea could be distributed it was necessary to obtain its creator's consent.

For a very long time, what was regarded as of primary importance was the right of the publisher to reproduce a manuscript, and by no means the rights of the author. The process was driven by people with business nous, but authors too did not want to miss out. In 1704, Daniel Defoe published *An Essay on the Regulation of the Press*, describing all the injustice and humiliations which an author faced. Under the existing law he could be held criminally liable for the content of the work, but had no means of defending his property rights.¹²⁹

The first law on the rights of the author (the *Statute of Anne*) came into force in England on 10 April 1710, and gradually spread to other countries.¹³⁰ In the USA the principle of protecting an author's rights was included in the 1776 Constitution, and the first Federal Copyright Act was passed in 1790. It made it possible to prohibit the copying of an author's work without his permission, which gave writers some degree of power in negotiating with publishers. Although the 1710 law enabled authors to be published without surrendering all their rights, they preferred on the whole to sell their manuscripts outright to publishers.

4.9.2 An Economic Analysis of Copyright

4.9.2.1 What Is Copyright?

The popular conception of copyright is that it gives an author the right to stop other people from making and distributing copies of his works. From an economic viewpoint, copyright is an institution,¹³¹ a system of formal rules to regulate relations associated with the creation, use and defence of rights in products of intellectual

¹²⁸This view was defended in an English court in the early days of copyright. It was argued that an author had an exclusive right to the fruits of his intellectual labour, but only until it was published. Before that he could do anything he liked with it: keep it in an attic, give it away, sell it to a publisher. . . . Afterwards he lost all rights in his work, which by dint of publication was transferred to the public domain. The ideas which an author expressed in a work become public property in the same way that "land allocated for a highway becomes a gift to society". It was argued that, by analogy with rights to material objects, the main property rights should pass to the purchaser of a good after the deal was done. Aliab'eva, *Literaturnaia professia v Anglii*.

¹²⁹Aliab'eva, *Literaturnaia professia v Anglii*.

¹³⁰Its first mention in the parliamentary record is on 12 December 1709. The motion was presented by Edward Wortley MP, and in the preamble piracy was described as a serious obstacle to the development of science and letters. Aliab'eva, *Literaturnaia professia v Anglii*.

¹³¹On the concept of an 'institution' in institutional economic theory, see A.E. Shastitko, *Neo-institutional economic theory [Neoinstitutsional'naia ekonomicheskaiia teoriia]*, Moscow: TEIS, 1999.

and creative labour.¹³² The conventional understanding of copyright is an author's rights and the related rights of others involved with a work.¹³³

Copyright protects two different groups of rights. The first derives from the natural claims an author has to the product he has created, and society's obligations towards him.¹³⁴ These are so-called non-property rights, which are divided into three major subgroups:

- The right of paternity, that is the right to be recognised as the creator of one's works and to be protected from plagiarism;
- The right to integrity, that is the right to be protected from alterations or distortions of one's work and the right to make changes to it oneself;
- The right to publish one's work (or not to do so).¹³⁵

These rights are a priori accorded to an author, and they are inalienable and perpetual. The author may sell or transfer his rights to an agent on specific conditions.

The second group consists of property rights, based on the promotion of the general well-being of society. They focus on:

¹³²Article 7, Law of the Russian Federation "On Author's Rights and Related Rights" lists classes of works subject to copyright.

¹³³In continental Europe the term used is 'author's rights', while in Anglo-Saxon law copyright, literally the right to make copies, is used. This is not quite the same thing, but in most cases the system of copyright is referred to without special qualification, and refers to both author's and related rights.

¹³⁴As Robert Hurt points out, a person has a natural property right to the fruits of his creation. If a person has invented a particular product, then the person who uses it without informing the author of the fact is guilty of theft. This theory of property right is rooted in scholastic jurisprudence and is most fully presented in John Locke's *Second Treatise*. Immanuel Kant defended copyright, seeing the works of authors not as objects which should bring them gain, but rather as an extension of their personality. These views played an important part both in the theoretical justification of the existence of copyright, and also in the evolution of the French, German, and Swedish systems of copyright. In Article 6 of the French Act of 1957 there is mention of the practical application of the doctrine of moral rights: "The author shall enjoy the right to respect for his name, his authorship and his work. This right shall be inseparable from his person. It shall be perpetual and inalienable". French laws protect authors more on emotional rather than strictly economic grounds. Robert M. Hurt and Robert M. Schuchman, "The Economic Rationale of Copyright", *American Economic Review*, vol. 56, issue 1/2, 1966, pp. 421-432.

¹³⁵The disclosure of a work with the author's consent is an act which for the first time makes the work widely available through publication, public exhibition or performance, broadcast transmission, or by any other means. Publication (public issuance) is circulation of a number of copies of the work sufficient for satisfying the needs of the public. The two similar terms 'disclosure' and 'publication' have different meanings and different spheres of application. An invariable feature of publication is the manufacture of a number of physical copies of the work, whereas disclosure of the work may not involve the production of any copies. The work becomes widely known thanks to performance, broadcast transmission, or public exhibition. For an object to be considered disclosed or published, there is no need for a large number of people to actually become familiar with it or for it to be brought to general notice. It is sufficient for that possibility to be present. E.P. Gavrilov, *Commentary on the Law of the Russian Federation "On Author's Rights and Related Rights" (With Notes on Court Implementation)* [Kommentarii k zakonu RF "Ob avtorskom prave i smezhnykh pravakh" (s sudebnoi praktikoi)], Moscow: Eksamen, 2005.

- Reproduction (copying) of works;
- Adaptation of works (creation of derivative works);
- Distribution of copies;
- Public performance;
- Disclosure.¹³⁶

In the current system of copyright, the main rights belong from the outset to the creator. If the purchaser of a copy had the right to do as he pleased with the work, by analogy with the way in which he may dispose as he pleases of a material object which has been purchased, that would invite unrestricted copying. Whereas, when a material good is sold, all the important associated rights are automatically transferred to the new owner, in the case of creative products they remain with the creator. This is done to provide an economic incentive for creative work. Were it not the case, a writer would be deprived of his livelihood, since after the first disclosure of a work he would lose control of its distribution.

If free riders are not kept out (people who make copies without a contract with the rights owner), they would threaten to choke the supply of original works because their creators would obtain no remuneration. By according monopoly rights to creators, copyright makes it possible for them to set prices which will at least make it possible to recoup the costs of producing the original. Otherwise prices would settle at a level determined by the costs of copiers, and the creator of the original would be ruined. Copyright accordingly corrects a market failure, which would result in underproduction of a social good.¹³⁷

4.9.2.2 Testing the Underlying Rationale of Copyright

From what has been said it might seem that, without the legal protection of copyright, some works would never appear and mankind would be that much the poorer. After all, if there was no way of keeping the competition at bay, nobody might have sufficient incentive to be the first to invest in a cultural product.

This sounds convincing, but what would actually happen if the state decided there was no need, or at some future date found itself unable, to enforce the operation of this institution? Would culture go into decline? Why should production relations be any concern of the state anyway, rather than being decided by market agents between themselves?

More specifically¹³⁸:

¹³⁶In Point 2, Article 16 of the Law of the Russian Federation “On Author’s Rights and Related Rights” there is a list of actions which an author has the right to take.

¹³⁷Tyler Cowen suggests that in an ideal world a government, which should concern itself with the production of social goods, would subsidise idea suppliers directly and reward the best ideas. From this standpoint, “Copyright can be seen as a response to the government’s inability to pick winners”. “Copyright and the Symbolic Nature of Art” (2002), Tyler Cowen, *Symbolic Goods: The Liberal State in Pursuit of Art and Beauty*, unpublished manuscript, Chap. 5, online. Cited September 2003. Available from URL: <http://www.serici.org/2002/cowen.pdf>.

¹³⁸As formulated by Robert Hurt. Hurt and Schuchman, “The Economic Rationale of Copyright”.

1. Does the copyright system encourage the creation of new goods which would otherwise not be created?
2. Does the existence of copyright result in the appearance of products more valued by consumers than those which might appear in its absence? Is social welfare enhanced?
3. If there are indeed benefits from the institution of copyright, are they negated in whole or in part by such administrative costs as enforcement through lawsuits and criminal prosecution of offenders?¹³⁹

These are not idle questions, but they have been debated over the centuries without any clear conclusions being reached. The question “To be or not to be?” still hangs over copyright, and indeed is heard ever more clamorously: is it beneficial to society as a whole to continue to allow some of its members to make money out of culture through the exploitation of copyright? Might not the same, or greater, benefits result if society got rid of an institution which has proved so problematical lately?

Arnold Plant, the author of a ground-breaking work on the economics of copyright, put the question as follows: “Would books be written in such circumstances [of free copying—AD], and would they be published? Would firstly authors, and secondly publishers, find it possible to make arrangements of a sufficiently remunerative kind to induce them to continue in the business of book production?”¹⁴⁰ Plant firmly separates the interests of authors and publishers.

Does every creative artist need financial recompense for his works, Plant wonders. Does he need a business partner and copyright? Numerous works have seen the light of day without the aim of obtaining any kind of material remuneration. For example, Franz Kafka requested in his will that his works should be destroyed after his death. “There are authors—scholars as well as poets—who are prepared to pay good money to have their books published.” Of course they will be happy to receive some recompense for their work, but this is not the main thing for them. Even without it they are happy to see their ideas being spread. Put more simply, these authors find it more important to be read than paid, and for them controlling copying is not important. Plant identifies a second significant group of authors who desire no more than not to have to pay to be published. “They may welcome, but they certainly do not live in expectation of, direct monetary reward. Some of the most valuable literature that we possess has seen the light in this way,” he notes.¹⁴¹

If this is the case, does society actually need writers for whom money is the primary consideration? Do people write better or worse for money? If you stop paying for writing altogether, will literature disappear? Poets somehow get by, and they get paid practically nothing. They write after hours and for their own pleasure.

¹³⁹Copyright costs result from the fact that, as a result of the monopoly it has established, some products for which there is a demand do not get marketed because their price is too high. There is an inefficiency in the allocation of resources. We see here also a technical inefficiency, known as the X-inefficiency, which consists of unjustifiably high expenditure of resources in producing a good. Both these things, as we have seen, are particularly evident in the sound recording industry.

¹⁴⁰Plant, “The Economic Aspects of Copyright in Books”, pp. 167–195.

¹⁴¹Plant, “The Economic Aspects of Copyright in Books”, p. 169.

Prose writers, as far as one can tell, are a different breed. The longer genres evidently mature better in conditions where the author is less burdened with anxiety about where his next meal is coming from.

Be that as it may, most works today are created with the intention that they should turn a profit, and that turns the ethic of symbolic relations upside down. The communist ideal of “from each according to his abilities, to each according to his needs” gives in to the capitalist idea of how relationships should be. The symbolic partnership between the creative artist and his admirers becomes unbalanced, the money paid to the author transforming him from someone working for his own delight into an employee with obligations. His public in turn ceases to be a valued, if junior, spiritually kindred partner, communing with the author to the extent of its powers and abilities, and becomes a customer with corresponding rights and privileges.

In his efforts to become rich, the author panders to the public both morally and financially in the hope that it will love him and pay him regularly enough to ensure a good standard of living. To be successful on either of these fronts demands great skill, and to achieve both at the same time requires a double virtuosity. Even so, not all an author’s spiritual progeny can be equally beautiful or appeal equally to the public. As Henry Fielding observed in this connection, “An author ought to consider himself, not as a gentleman who gives a private or eleemosynary treat, but rather as one who keeps a public ordinary, at which all persons are welcome for their money. In the former case, it is well known that the entertainer provides what fare he pleases; and though this should be very indifferent, and utterly disagreeable to the taste of his company, they must not find any fault; nay, on the contrary, good breeding forces them outwardly to approve and to commend whatever is set before them. Now the contrary of this happens to the master of an ordinary. Men who pay for what they eat will insist on gratifying their palates, however nice and whimsical these may prove; and if everything is not agreeable to their taste, will challenge a right to censure, to abuse, and to d—n their dinner without controul.”¹⁴²

A number of arts are inconceivable without a business element, like the cinema, which requires large initial investments, but also the theatre, classical music concerts, television, and any cultural event which involves a lot of people, equipment and publicity. The more complex the technical underpinning, the greater the risk and investment of money. Where no way can be found of guaranteeing the return of stake money, works with high production costs may not appear at all. “However, it does not necessarily follow that the grant of a copyright monopoly is the only such device possible, nor that it is the most desirable device.”¹⁴³

Does every businessman need copyright? Seemingly only those who are trying to conduct cultural business in a particular manner after having acquired particular assets. Thus, although the production cost of sound media has always been extremely low, the music corporations have grown thanks to the fact that copyright did not allow other companies to hang on to the coat-tails of their business. The result is that the market has moved towards becoming an oligopoly based on the accumulation

¹⁴²Henry Fielding, *Tom Jones, A Foundling*, Chap. 1.

¹⁴³Hurt and Schuchman, “The Economic Rationale of Copyright”, p. 425.

of copyright.¹⁴⁴ Four companies¹⁴⁵ share 80 per cent of the music recording industry and control the channels for publicising and distributing music recordings. Until recently they appeared to be functioning efficiently,¹⁴⁶ but the advent of peering technologies fundamentally changed the picture, both from the viewpoint of potential competitors and of consumers. The Internet promises both these latter parties the advantage of being able to communicate without relying on the middlemen.¹⁴⁷

Is this not cause to look again at the functioning of copyright?

4.9.3 *Copyright and the Progress of Digital Technologies*

4.9.3.1 The Moral Deterioration of Copyright

Previously copyright was a relatively simple and entirely effective law which extended to a relatively modest proportion of creative activity. However, the field it regulates is changing radically, and is being shaken to the foundations by technological innovations. Peering networks and copying equipment create the preconditions for violations of copyright on a massive scale. At the same time, the technical measures for restricting access are able to protect the owners of certain kinds of content even without copyright. The first innovation (peering) subverts copyright, the second (DRM) makes it unnecessary in a number of cases. As Cowen remarks, “Copyright has not been easily enforced throughout much of Western history, and it is only a matter of time before enforcement problems reemerge in one form or another [...] Much of musical copyright law, for instance, was written for technologies of player pianos and sheet music, and hardly seems appropriate for a world with digital reproduction [...] Effective copyright enforcement depends on a delicate balance of technologies—protection abilities must outpace copying abilities—that is unlikely to reign continually during rapid technological change, as we are now experiencing.”¹⁴⁸

The root of the problem is that copyright is being extended and made more rigorous in response to the increasing number of devious means of getting hold of a product. The simpler and more accessible the copying of an original or legitimately

¹⁴⁴Ruth Towse, “Copyright and Cultural Policy for the Creative Industries” (2002), *Economics, Law and Intellectual Property*, vol. 20, pp. 419–438. Online. Cited 18 November 2003. Available from URL: <http://www.serci.org/2002/towse.pdf>.

¹⁴⁵Discussed in Chap. 1, Sect. 1.1.1. Further information on the major labels will be found in Appendix 1, Sect. A1.4.1.

¹⁴⁶Tobias Regner, “Innovation of Music”, *The Economics of Copyright: Developments in Research and Analysis*, ed. Richard Watt, online, Cheltenham: Edward Elgar, 2002, pp. 99–111. Cited Aug., 2003. Available from URL: <http://www.berlecon.de/output/events/files-bite5/Regner2.pdf>.

¹⁴⁷Peering technology reduces the cost of distribution and simultaneously raises the cost of defending copyright, thereby encouraging a change in the business model and the appearance of new market participants.

¹⁴⁸Tyler Cowen, “Copyright and the Symbolic Nature of Art”, 2002.

acquired copy becomes, the wider the number of cultural practices where business needs to control it, and the more rigorously it seeks to regulate the right of copying. For purely technical reasons, working with digital information invariably involves copying it and a user finds his actions, quite irrespective of any intention to use digital content legally or illegally, coming under the scrutiny of the rights owner. The result is that copyright becomes more than a law for regulating the competition of market agents and turns into a tool for interfering in the private lives of millions of people.¹⁴⁹

The virulence of this interference derives from the scope of copyright, the broad rights granted under it, and also from the extensive, and sometimes secret, technical means used to enforce the strictures of the institution. In 1790 when the US passed its first legislation on the subject, copyright applied to a relatively small area. Today it is huge. If previously copyright applied to the republication of complete works, today the owner has the right to control any derivative item.

4.9.3.2 The Problem of Derivative Creative Products

As Lessig has said, “If you write a book, no one can make a movie out of your book without permission.¹⁵⁰ No one can translate it without permission. [. . .] The copyright, in other words, is now not just an exclusive right to your writings, but an exclusive right to your writings and a large proportion of the writings inspired by them.”¹⁵¹

Initially the extension of copyright to derivative items was part of a battle against manifest violations of a narrower copyright. “If I write a book, can you change one word and then claim a copyright in a new and different book? Obviously that would make a joke of the copyright, so the law was properly expanded to include those slight modifications as well as the verbatim original work.”¹⁵²

¹⁴⁹This was confirmed by the much publicised saga of the XCP anti-piracy technology used by Sony. When a compact disc coded using XCP was played on a computer, a program was secretly downloaded which gave Sony full access to the computer, as if the company were its owner or the system administrator. One day after this became public knowledge, the issuing of CDs with XCP was halted. To justify its conduct the company stated that it had intended only to limit the number of copies made by a user.

¹⁵⁰There was a famous spat between the Marx Brothers and Warner Brothers. The Marx Brothers intended to make a parody of “Casablanca” but the rights owners, Warner Brothers, refused permission and threatened to sue. In response the Marx Brothers pointed out that they had been brothers long before the Warner Brothers and accordingly had exclusive rights to use of the word ‘Brothers’. This was a fairly despairing joke, but the situation recurred for real when a Russian court heard a case concerning the right to the title ‘Children’s Encyclopaedia’. The plaintiff, who published a volume under that title, sought an injunction to stop the defendant from publishing a book titled ‘Children’s and Young Person’s Encyclopedia’. Gavrilov, *Commentary on the Law of the Russian Federation “On Author’s Rights and Related Rights”*.

¹⁵¹Lawrence Lessig, *Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity*, Penguin Press, 2004, p. 138. Available from URL: <http://www.free-culture.cc/freeculture.pdf>.

¹⁵²Lessig, *Free Culture*, p. 138.

If there were no protection of rights in respect of derivative works, film-makers could enrich themselves without cutting in the author of the literary source on which a film was based. Toy manufacturers could exploit images, which the public had come to love from films and books, without paying for them. That might not be bad for culture, but business sets its face against such altruism. By extending its grip to derivative works, copyright is pursuing the same goal as brand protection. Its mission is to protect a product from parasites, after the rights owner has put money into promoting it. Only very rarely can borrowings be justified on the basis of creative necessity. It is, after all, not that difficult to camouflage an original source in order to circumvent copyright. What the pirates are after is mainly the brand constituent, the work's renown. Protection is, however, automatically extended to works as a whole, not merely to their brand component, since the lawyers find it impossible to make such subtle distinctions.

Extending the reach of copyright to take in derivative works has dangerous and unpredictable consequences. How do you distinguish the significant parts from the insignificant, plagiarism from reminiscence, and imitation from parody? You would need an objective measure of aesthetic and semantic distance, and also to take account of interpretation and the context of perception, otherwise any manufacturer may face litigious and absurd prosecutions. By dealing with one extreme, the law has opened the door to another—legal wrangling on every conceivable matter. This plays into the hands of the large corporations, which find it easier to keep the creative process under their control when everybody and everything is drawn into the area where copyright operates.

Now, wherever he looks in search of inspiration, the creative artist is confronted by people who own texts and symbols, with whom he has to enter into rental arrangements.¹⁵³ The commercial warehouse of culture is full to the gunwales of tons of raw material which, at first sight, appears to be freely available but, before you know it, the argumentative proprietor of some utterance you have taken a shine to will pop up. There is no certainty that something you have independently arrived at has not already had a flag hoisted over it by somebody else. Any word, image, or combination of letters, almost any flourish of the pen can be registered as someone's property. Obtaining protection under the law requires no effort on the part of a creative artist, or even any action.¹⁵⁴ In a number of countries, like the USA and Russia, all creative work is automatically protected.¹⁵⁵ Even if the author has not

¹⁵³The heir of a writer can prevent another writer from publishing a sequel to an earlier book, as was shown in the case of Victor Hugo's novel, *Les Misérables*. Françoise Benhamou, [Review of Ruth Towse, *Creativity, Incentive and Reward: An Economic Analysis of Copyright and Culture in the Information Age* (2001)], *Journal of Cultural Economics*, vol. 28, 2004, pp. 157–163.

¹⁵⁴Under Article 9 of the Russian Federation law "On Author's Rights and Related Rights", copyright in a work of science, literature or art arises upon its creation. No registration of a work, no special form or the observance of any other formalities is required for copyright to arise and be enforceable.

¹⁵⁵There is now no requirement to register a work for copyright. It arises irrespective of whether the work bears the copyright symbol, and irrespective of whether any copy has been registered and preserved. When copyright expired, having a copy in official keeping would enable the work to be transferred into the public domain, where others could use it without consulting the author.

attached a copyright symbol, even if he had no intention of restricting the use of his works, he can find his wishes thwarted by legal obstacles. Anywhere else, a person, even if he has no expectation of gain, can copyright a work he creates, just in case. Copyright, like any social good, is exploited. Great herds of ‘copyrighters’ are grazing the open spaces of culture, spattering it with their copyright symbols, with the result that attempting to cross those areas is as dangerous as negotiating a minefield.

4.9.3.3 The Blurred Contours of Copyright

An author may not only not know of potential claimants to co-authorship, he may even be unsure where exactly he needs to show caution. As Lessig says, “While the contours of copyright today are extremely hard to describe simply, in general terms, the right covers practically any creative work that is reduced to a tangible form. It covers music as well as architecture, drama as well as computer programs.”¹⁵⁶ As a result, it can be difficult to know what, in theory, an author is allowed to do and what he is not.

Thus, William Bright altruistically created a website, iPodSubwayMaps.com, which enabled anyone to download a map of the subway to their telephone without payment.¹⁵⁷ It transpired that this content was copyright, although a subway map might not seem a particularly creative product. The transport authorities of New York and San Francisco threatened to sue.¹⁵⁸ Bright dug his heels in and, in order to escape liability, made his own diagrams. That was not enough. The colours of the subway lines in his maps repeated the official colour scheme, which meant he was still liable.¹⁵⁹ Of course, he could have used a different colour scheme, but the consumer value of the maps would have been vastly reduced. What would happen if, following the example of the subway authorities, somebody should decide to patent the numerous maps showing the routes of overground transport?

Geographical maps were protected primarily on the grounds of military security, but copyright on sketch maps is fairly recent, and numerous public acronyms and signs have been turned into somebody’s property. Thus, Google set up a successful email service, Gmail, without taking the time to discover that a British company, Independent International Investment Research, had been using the name for two

¹⁵⁶Somewhat exaggerating, he claims that “every e-mail, every note to your spouse, every doodle, every creative act that’s reduced to a tangible form—all of this is automatically copyrighted.” Lessig, *Free Culture*, p. 138.

¹⁵⁷Information from *Wired* magazine.

¹⁵⁸The site has several dozen subway maps, not only of American cities but also of Tokyo, Paris, London, Seoul, Toronto and others. From 9 August 2005 when his service started, maps were downloaded by more than 9,000 people. However, already on 14 September Bright was officially notified by the New York Metropolitan Transit Authority that he had violated the authority’s copyright by distributing maps without authorisation.

¹⁵⁹The *New York Times* reports that in July the New York Transit Authority patented the colours and map of the subway system with the intention of obtaining royalties from souvenirs which make use of the subway’s symbols.

years and had applied to have it registered as a trademark. Now the owners are insisting that Google should buy from them the magic word which brings business success. A combination of five letters, which has become a brand thanks to Google, has been priced at £25–35 million. Although the investments were made by Google, the owners of that combination of letters are suing. By legal criteria, they appear to have a strong case. Although they have barely used the name, it seems likely the defendant will have to pay compensation.¹⁶⁰ Although this is not strictly an example from copyright but from trademark legislation, the consequences are the same. It will soon be impossible to take a step in the semiosphere without trespassing on a private zone to which somebody has managed to stake a claim, which can be done merely by hanging up a signboard at the entrance. All this makes the law protecting the rights of creative artists rather two-edged for culture. By erecting barriers against would-be free riders, copyright is supposedly providing economic incentives for creative work. But it also erects obstacles which force authors to negotiate with sometimes unidentified owners of something that can be claimed to be a source of their work.

This fetishising of the economic side of creativity through use of the law on copyright manifests itself not only in the protection of existing signboards, but also in the banning of distribution of information about signboards which are in disfavour. A ruling, not easy to square with common sense, was handed down by the Peking District Court, which found the major Chinese search engine, Baidu.com, guilty of violating the copyright of the Shanghai Push Sound Recording Company. The court forbade the defendant to provide references to sites with pirated MP3-files, and ordered it to pay the plaintiff almost \$9,000, \$247 for each of 36 compositions, which had been downloaded free “at the instigation” of the defendant. This, so far unique, verdict forbids the supplying of references to pirated materials, despite the fact that a search engine has no link to the sites which its database registers and does not provide a facility for downloading files.¹⁶¹

The search engine was fined for owning a bulletin board which had enabled pirates to publicise their whereabouts on the net. The court’s decision appears to suggest that the mass media are responsible for the conduct of an advertiser, irrespective of whether they know anything about the reality behind his advertisement. Why then not fine those carrying advertisements for sleazy nightclubs, disreputable Internet casinos, manufacturers of counterfeit medicines and bio-active supplements, esoteric therapists, and practitioners of black magic? The advertising of harmful or not particularly harmful products inevitably makes them more attractive, so those carrying the advertisements are benefiting from a plan to mislead and should be charged with fraud. Publications giving house room to advertisements indicating where such services can be obtained are clearly in cahoots with fraudsters and should be punished accordingly. And what of the mass media which provide information about markets and supermarkets which are bursting at the seams with counterfeit goods

¹⁶⁰Reported in *The Guardian*, September 2005.

¹⁶¹Natalia Portiakova, “Search Engine Fined for References to Pirate Sites” [“Poiskovik zasudili za ssylki na piratskie saity”], *Kommersant*, 26 September 2005.

which originate in a country where everybody, it seems, is law-abiding with the exception of a single Internet search engine? Was *Kommersant* perhaps sailing close to the wind by publishing the news about Baidu.com? We must, after all, assume that this venerable publication was aware of its place in the chain of those marketing pirated goods. Before that report, readers did not know the place where they could find out about the place where an artist's property was up for grabs. Is, perhaps, the author of the present book also complicit in this malefaction by having told the tale?

If previously many things were beyond the reach of justice, now an apparently harmless act can land you in the dock. The logic is irreproachable. Let us suppose that a certain offence has been proven in case N . As soon the same offence has been identified in case $N + 1$, guilt is automatically established for all subsequent cases, $N + 2$, $N + 3$, and so on to infinity. This is none other than the recurrent formula we learnt about at school, where N represents the person who revealed information about a source of information. Developing the logic, we can only assume that the court itself, by publishing its verdict in which the defendants are named, is also complicit in the chain of criminality. It should clearly have held the hearing behind closed doors. There is a non sequitur here. Information about the whereabouts of information cannot be the object of a lawsuit if the entire legal system is not to be discredited.

As we see, you need to be a genius to know what is lawful and what is not, the more so because the boundary of the permissible is constantly shifting. Textiles or cuisine appear not to be subject to copyright, and the suppliers of goods in these areas must surely be suffering loss as a result. Should they not appeal to the authorities to extend copyright to fabric patterns and give aid and comfort to a monopoly in the making up of clothing? (Perhaps this has already occurred and we just haven't heard about it.)

Since summer 2005 the penalties for piracy have been made more severe in Italy, and now even purchasing fakes with the logo of well-known firms is a criminal act. The law extends to foreigners, and plainclothes policemen have been instructed to patrol tourist-rich areas. It is assumed that everyone knows perfectly well that real designer handbags, shoes, scarves and the like are not sold by street vendors, and anyone who doesn't faces a fine of between €3,333 and €10,000.¹⁶² A 60-year old Danish woman was caught buying sunglasses allegedly made by Dior. She was fined the maximum sum. A Filipino woman who bought "Prada" spectacles in Florence for €10 was fined €3,333. Another holidaymaker was fined for purchasing a fake "Louis Vuitton" handbag.¹⁶³ In each case, the police failed to apprehend the sellers.¹⁶⁴

¹⁶²For well-behaved citizens the authorities relent slightly. If a delinquent pays the fine within 60 days it is reduced to €3,333. Otherwise interest begins to accrue with no upward limit.

¹⁶³"A Fine Will Be Payable for Buying Cheap Fakes in Italy" ["Za pokupku deshevykh poddelok v Italii pridetsia platit' shtraf"], Travel.ru, online, 27 June 2005. Cited 16 August 2006. Available from URL: <http://www.travel.ru/news/2005/06/27/74150.html>. Travel.ru refers to the British newspaper *The Telegraph* of 25 June 2005.

¹⁶⁴France goes even further in protecting its brands. Seven out of ten of the most frequently counterfeited global firms are French. Those buying 'grey market' bags, perfume, jewellery, or clothing,

Ignorance of the law is no defence and, as we now see, neither is ignorance of the going price. One foresees the day when prices, which after all are entirely creative, will also be subject to protection by copyright. One can only wonder that the producers of luxury goods have not already added this to their arsenal.

4.9.3.4 The Two-Edged Effect of New Technologies

In parallel with new copying technologies, others are being developed to enable market players to detect infringement of their copyright. Rights owners are patrolling every inch of the semiosphere to detect unauthorised borrowings. The results can be unexpected. An entrepreneur in the Urals used a man's portrait to advertise his product and promptly received a writ from overseas alleging unauthorised use of the image of Bruce Willis, which belongs to an international corporation. The case collapsed when the image in the advertisement proved to be a photograph of the entrepreneur himself, who happens to be a Bruce Willis look-alike.

Digital technologies for distributing content make it possible to introduce restrictions additional to those created by copyright proper. It would seem natural to treat digitised material in the same way as a book, but electronic versions of novels on which the copyright has expired can, if the distributor sees fit, have a restriction placed on the number of times they can be read.¹⁶⁵

If we add to this the technical blocking of copying on to a hard disk (which is the main innovation in the European Union's directive "On the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society" of 22 May 2001), the picture becomes alarming. Copyright is advancing in all directions, in terms of the period of its validity, the class and number of items protected, and also the kind of consumer actions it regulates. The detection and control of abuse is increasingly straightforward. All this merely accelerates the processes of consolidation in the mass media market. Firms which can be counted on the fingers of two hands control the production of content, the means of publicising it, and the channels of physical distribution.¹⁶⁶ Only in exceptional circumstances does an outsider manage to break in to the charmed circle.¹⁶⁷ A market distortion results which leads

face a fine of up to €300,000 and imprisonment up to three years. Possession of a counterfeit item is considered a serious infringement of the law and is subject to confiscation of the item, a fine levied by Customs, and even legal prosecution.

¹⁶⁵As Lessig points out, a book in electronic format comes under different rules from the same book printed on paper. From now on, if the rights owner permits you to read the book only once, or not more frequently than once a month, copyright will assist in enforcing the condition and will treat such use as copying. If you read the book ten times and the license allows only five readings, any reading over the limit will be regarded as illegal copying. Thereby free enjoyment of works of art is restricted. This was an inalienable right of free culture before the Internet. Lessig, *Free Culture*.

¹⁶⁶In 1994 the US Federal Communications Commission abolished the requirement that these should be owned separately.

¹⁶⁷Oligopoly has one further inconspicuous drawback. When there are many players, each with only a small number of projects, any particular project matters a great deal because the risks are

to a flattening out of culture.¹⁶⁸ In this connection one can only sympathise with Michael Brown's view that history has shown that attempts to regulate culture by law are at best sterile and at worst create new opportunities for manipulation by the powerful.¹⁶⁹

4.9.3.5 Copyright: Does It Do Authors Any Favours?

The increasing consolidation of the market gives sceptics a powerful, and possibly devastating, argument against copyright. Among the economists, Ruth Towse has reminded us of the half-forgotten paradox that, despite its name, the institution of 'author's rights' does little for authors. It didn't when copyright was first instituted, and never has. In the early versions of the law there is not a single mention of authors,¹⁷⁰ and Towse suggests that copyright really does not provide sufficient economic stimulus for creative activity.¹⁷¹ No matter what the lawyers say, copyright does not guarantee that authors will be paid. Fees are determined in the course of negotiations by the market, and who gets how much income from the possession of copyright depends on the correlation of the market power of commercial firms versus creative artists. With the exception of superstars, artists are in the weaker position because the supply of creative work is constantly in surplus. If a creative artist starts making waves, others can always be found who are willing to replace him. The income of the vast majority of artists, other than superstars, is modest and does not allow them to 'rest' for long. Apart from those few cultural business corporations they have no one to turn to. Moreover, the author is not sure of the demand for his product, while the entrepreneur knows much more about that. As a result, deals are concluded on an unequal basis.¹⁷² Business benefits, without paying, from the willingness of artists to engage in creative activity,¹⁷³ while authors remain underpaid.¹⁷⁴ Thus, under the present oligopoly the institution of copyright does not serve

higher. Small firms are vitally interested in the success of any author they back. When there are fewer players and rights are bundled, the techniques of portfolio investment operate and make it possible to minimise risk. This also reduces a publishing house's usefulness as a critical institution which filters works since it is not so much at risk, and can be fairly sure of selling off anything it prints given the low level of competition.

¹⁶⁸Joëlle Farchy, *Internet et le droit d'auteur: La culture Napster*, Paris: CNRS Éditions, 2003, p. 164.

¹⁶⁹Michael F. Brown, *Who Owns Native Culture?* Harvard University Press, 2003, p. 252.

¹⁷⁰See Aliab'eva, *Literaturnaia professia v Anglii*.

¹⁷¹Towse, "Copyright and Cultural Policy for the Creative Industries".

¹⁷²For further detail, see Richard E. Caves, *Creative Industries: Contracts Between Art and Commerce*, Cambridge, Mass.: Harvard University Press, 2000.

¹⁷³Ruth Towse, "Partly for the Money: Rewards and Incentives to Artists", *Kyklos*, vol. 54, Nos. 2/3, 2001, pp. 473–490.

¹⁷⁴Issues relating to the defence of copyright, the market for authors, and also the incentivising and rewarding of authors are examined in Towse, *Creativity, Incentive and Reward*.

authors well, other than the superstars. Creators and performers will only be able to appreciate the situation, however, when they see real alternatives to copyright.

4.9.4 *Regulating the Scope of Copyright*

Ideally the costs associated with copyright should be felicitously recouped by gains in stimulating artistic creativity. This is difficult to quantify, however, because neither the costs nor the gains are readily measurable, and the balance between them is in flux as information technology develops. To be effective, the law needs to reflect these changes. Is such sensitivity possible? The supporters of copyright believe it is precisely the flexibility and responsiveness of copyright that ensures its effectiveness.

Firstly, they point out, it is not an idea that is protected but its objective expression,¹⁷⁵ since otherwise all innovation would be blocked. This gives authors a degree of freedom, because it is difficult to register the borrowing of artistic concepts as a result of boundary problems.¹⁷⁶ In practice, courts vary in their assessment of how the extent to which the ‘objective expressions’ of a particular idea are identical.¹⁷⁷

Secondly, they argue, the protection afforded by copyright is, in most cases, limited to seventy years after the death of the author, although non-property rights continue in perpetuity. (The term of copyright is, however, constantly being extended, as we shall see below.)

Thirdly, although the creation of derivative works without permission is prohibited, the courts vary in their assessment of the blurred boundaries of derivative products.

And finally, in cases of ‘fair use’, free and unpaid use is permitted without the author’s consent, for example when quoting a work for scholarly, informational or educational purposes, or using it for illustration.¹⁷⁸ The general principle is that fair use applies when it is associated with significant social benefits and causes no significant financial loss to the work’s creator.

¹⁷⁵Copyright does not extend to ideas, methods, processes, systems, techniques, conceptions, principles, discoveries, or facts. Neither does it extend to any creative work which might be created in parallel, by individuals working independently of each other.

¹⁷⁶See, for example, William M. Landes and Richard A. Posner, “An Economic Analysis of Copyright Law”, *Journal of Legal Studies*, vol. 18, 1989, pp. 325–363.

¹⁷⁷If in the technical sphere key elements are read out of designs, matters are considerably more complicated in respect of the component parts of artistic form. How is one to distinguish a substantial element of a work from one which is not substantial? How is one to assess the contribution to the final image of a particular constituent, possibly slightly altered, and the contribution of the particular way in which the constituents are composed? What set of features makes a work original?

¹⁷⁸The doctrine of fair use is based on the notion that new works are to some extent based on existing creative materials.

The main problem in the legislation is finding a balance between allowing access and ensuring appropriate payment to the artist.¹⁷⁹ In practice there is scope for negotiation here, since the courts vary in their interpretation of freedom of access and in their assessment of the costs and benefits of applying copyright.

4.9.4.1 Is the Law an Ass?

The flexibility of copyright is supposed to give judges a fair degree of discretion in ruling on newly arising situations. The latitude may sometimes seem excessive in terms of, for example, rights, fair use, and the treatment of derivative products. Whom does it actually benefit? We can see who it is who constantly lobbies for the period of copyright to be extended, so it is not difficult to guess.

In the first US Copyright Law of 1790, the period of protection of author's rights was set at 14 years, with the option of extending it by a further 14 years. The two-stage system allowed rights to lapse if there was no benefit in them for the rights owner and in order not to weigh the system down needlessly. In 1831 the initial period was extended to 28 years; in 1909 to this could be extended by a further 28 years, and in 1962 for a further 47 years. The Copyright Act of 1976 did away with the extension for a second period, but lengthened the term of copyright to 50 years after the death of the author. This meant that items which no longer needed protection continued to receive it and could not be transferred into the public domain. For companies, the period of validity was 75 years from the moment of publication of a creative product, or 100 years after its creation (depending on which period expired first). Corporations were constantly lobbying Congress and in the last 40 years have succeeded in having the period of validity of existing rights increased on 11 occasions. Twice in this period Congress has extended the term of copyright for newly created works. The last amendment was the (Sonny Bono) Copyright Term Extension Act of 1998, which increased the period to 70 years after the death of the author. Companies' rights were also extended by 20 years and now amount to 95 years from the date of publication. As a result the transition of works into the public domain has been moved into the distant future.

The campaign to extend the term of copyright was headed by the Disney Corporation. Not only new works came under the prolongation of rights but also, vitally important for Disney, such earlier works as the image of Mickey Mouse, whose rights were about to expire. This image itself derives from old European fairy-tales and American folklore, so Disney itself is under no obligation to pay anybody.¹⁸⁰

The reaction of economists was divided. In 2002 a group of 17 outstanding scholars appealed to the US Supreme Court, protesting against the extension of the term

¹⁷⁹Landes and Posner, "An Economic Analysis of Copyright Law".

¹⁸⁰In other cases, however, where earlier influences are known, why not dig deeper for their benefit? Some of Bob Dylan's songs are reminiscent of the works of Woody Guthrie. We believe Dylan would lose in court if Guthrie were able to claim copyright today, although Guthrie in turn borrowed extensively from his own predecessors. This does not deter Dylan from actively campaigning for extension of the term of copyright.

of copyright.¹⁸¹ Among the protesters were the greatest authorities on institutional arrangements in the world, the Nobel prizewinners Ronald Coase, Milton Friedman, Kenneth Arrow, James Buchanan, and George Akerlof. Their arguments were:

- For creative artists the positive impact of extending the term of copyright was wholly insignificant;¹⁸²
- There was no benefit from the proposal in respect of already existing works;
- Extending the period would increase social costs, primarily borrowing costs.

Economists specialising in copyright matters disagreed. Liebowitz and Margolis tried to show that the positive impact on new works had been underestimated, that in respect of already created works it had been overlooked, and that social costs had been exaggerated.¹⁸³ Landes and Posner spoke out in favour of an unlimited term of copyright by analogy with trademarks.¹⁸⁴

Thus economists who, by intellectual inclination and the nature of their work, are accustomed to pronouncing from *au-dessus de la mêlée* failed to speak with one voice even on the one, clearly delimited question of the term of copyright. There are, of course, quite a few less obvious and more controversial issues in copyright, but it is crystal clear that in practice there is no means for ascertaining whether the present level is too high, too low, or just right.¹⁸⁵ Moreover, specifying property rights¹⁸⁶

¹⁸¹Brief of George A. Akerlof et al., as Amici Curiae in Support of Petitioners in *Eldred v. Ashcroft*, U.S. Sup. Ct. No. 01-618, 20 May 2002.

¹⁸²It was shown that, with the US discount rate at 7%, extending the term of copyright by 20 years would increase creative artists' annual income by 0.33%.

¹⁸³Stan J. Liebowitz and Stephen E. Margolis, "Seventeen Famous Economists Weigh in on Copyright", Working Paper, December 2003.

¹⁸⁴William M. Landes and Richard A. Posner, "Indefinitely Renewable Copyright", University of Chicago Law and Economics, Olin Working Paper, No. 154.

¹⁸⁵See, for example, *Economic Perspectives on Copyright Law*, Centre for Copyright Studies Ltd., Canberra, 2003.

¹⁸⁶Economists generally use the classification of property rights proposed in 1961 by A.M. Honoré. It includes 11 points or 'leading incidents'. Among these are the rights:

- to possess, by which is understood the legal exercise of physical control over the property;
- to use the qualities of the property;
- to manage, that is, to take decisions about who may have access to the property and under what conditions;
- to the income of the property;
- to the capital value, that is, to the disposal, consumption or destruction with impunity of the property;
- to security of the property, that is, immunity from expropriation, invasion, etc.

Two further 'incidents' characterise the temporal limits of these rights (the lack of a time limitation on the ownership of property) and the possibility of bequeathing the rights to one's descendants. Three of the eleven points include the right (or lack of a right) to use the property in a way which might cause loss to other persons, rights (and corresponding obligations) relating to the payment of debts and compensation for loss, and finally, 'residual' rights which regulate the use of property in the event of termination of all or any of the rights listed. A.M. Honoré, "Ownership", A.G. Guest, ed., *Oxford Essays in Jurisprudence*, Oxford University Press, 1961. L. Iakobson, *Economics of the*

(what a rights owner may or may not do) is becoming increasingly complicated and even if copyright were ideal at a particular moment, it would require constant readjustment.¹⁸⁷ This, however, cannot be done frequently.¹⁸⁸

Copyright protects creative work through economic interests, but when the economists were unable to reach consensus, the problem was handed over to politicians and lawyers. This opened up a whole new ball game for them, which held out the prospect of continuous, highly paid employment for the foreseeable future.

This suits the major corporations very well. The wide scope for interpreting copyright has made it an ideal tool for predatory behaviour and extortion. Litigation and lawyers' fees become a significant cost and are used as a weapon in the competitive battle. The less evidence there is, the more expensive it becomes to seek the truth and, if you have enough money, the law can be bent in different directions. This is a situation beneficial to those who are rich, and also to lawyers, as was shown by the lawsuit against Napster. When the matter at issue was the utility or harmfulness of sampling (providing specimens of products),¹⁸⁹ both sides presented the conclusions of expert witnesses. While some received an attentive hearing from the court, others were almost accused of charlatanism. This should not have been the most difficult issue to clarify, but to this day it remains obscure.

4.9.5 *The Economic Philosophy of Copyright*

Copyright provides opportunities for playing games. The institution whose function is to regulate productive relations in culture has become a weapon in a battle which has little to do with its professed aims. Copyright does not protect ideas but establishes a monopoly on their material expression. In order to express something new, you need to use vocabulary already in common use, but words have been privatised and before you can use any sign which is a part of everyday life you have to negotiate for somebody's permission. The rights of the players who have taken the lead are protected, while those of all the others are disregarded. It is a situation favouring the imposition on society of rules which favour the vested interests of narrow groups.

Social Sector, [*Ekonomika obshchestvennogo sektora*], ed. E. Zhil'tsov and J.-D. Lafei, Moscow: Ekonomicheskii fakul'tet MGU, TEIS, 1998.

¹⁸⁷The law on intellectual property has evolved during the resolution of disputes, with new and similar problems being decided on the basis of precedent. When technologies change, however, existing laws and precedents can prove less helpful. The European Union's directive "On the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society" was passed in order to enable the legal rules to adapt to new realities and the frequent market changes resulting from the development of communication and information technologies. Robin Cowan and Elad Harrison, "Mobilizing Digital Sounds: Appropriation and Dispute of Music Recordings", Paper for the SERCIAC Conference, Madrid, June 2002.

¹⁸⁸In late 1998, the US Congress passed the "Digital Millennium Copyright Act". Although the legislation gives detailed consideration to illegal copying using the Internet, most of its proposals are already technologically obsolete.

¹⁸⁹See Appendix 2, Sect. A2.1.2.

Anybody who wants to listen to music must pay a price set by the monopolists. If you can't pay, you can't listen to it. Is this fair? And what about those who would prefer not to listen to that particular music but have no option, since all the major channels are full of it? Whether he likes it or not, the consumer is permanently in a media showroom. When he has heard or watched enough of what he is supposed to, he obeys the laws of merchandising and is directed like a zombie to the supermarket where he buys whatever has been implanted in his mind under the veil of cultural enrichment. Even music, an art seemingly immune to advertising, is pressed into the service of product placement, the casual mentioning of goods by weaving their names into song lyrics. This innovation will surely appeal to firms eager to promote their products in the wake of McDonald's, who have declared their readiness to pay rappers who use the right words. Pirates are no obstacle here, because they cannot expunge the words from the songs, so their activities are all to the good of the advertiser. Rights owners may well already have received full recompense from the related markets, and the tribute they have collected from the environs of culture is probably much greater than the trifling sums they can hope to squeeze out of Internet punters, having first scared the living daylights out of them.

The issue is particularly sensitive in poor countries, where the flourishing campaigns of prosecution of piracy reek of hypocrisy and increasingly look like a smokescreen for hegemony of a different kind. A country which imports media products is ordered to give the green light for implementation of the media corporations' unpublicised aims, since otherwise it will not be admitted to the community of respectable nations. The rulers of countries catching up with the West might do well to think long and carefully over whether they are being tricked into scourging their own people, with or without good legal cause.

Why, when exporting their products to countries where the population have low purchasing power, do the major labels keep prices at the same level as for rich countries? Why do they not introduce discriminatory pricing? For an averagely prosperous West European, \$15 for a DVD is a small percentage of his disposable income, while for a Ukrainian, for example, it is his entire monthly budget for cultural items. A disc costs \$1 to produce at most, and could be profitably sold in several regions for \$3–\$4, thereby squeezing out the pirates. Price discrimination under these circumstances would be entirely appropriate, but instead the corporations shrilly demand that people should be sent to prison. Is this not shocking barbarity, compelling those with little money to shell out for art if they don't want to end up in court? Perhaps the far-sighted publicity strategy is to keep people seeking after what, if it were readily accessible, they might find less attractive.

The cultural community has a response to this. One has only to popularise automated recommender systems and almost all the overpriced trash will become unsaleable. What song will the corporations sing then?

A real battle is developing in terms of symbolic expansionism, leading to economic domination. This is why admission to the World Trade Organisation is conditional upon the introduction of draconian measures against piracy. There is something more here than merely the economic interests of certain cultural industries. We might well ask who should be paying whom: is it those using media products who

should pay the producers, or is it the other way round? Perhaps the exporters should be grateful that the Trojan horse of ideology is being allowed on to the territory of the nation's broadcasting. Those governments may prove to have been wise which are in no hurry to collaborate with the culture police of a foreign state, blaming their dilatoriness on the moral and legal ambiguity of copyright. It is impossible to eliminate piracy completely (especially on the Internet), and God grant that in the near future the need to do so will fall away of its own accord.

The governments of well-off countries would do well not to buy in to the economic rationalisations of the audio-visual corporations, and to moderate their ardour for tightening the screws of copyright. That is, by all means tighten them, but in moderation and bearing in mind that piracy is like unofficial aid to less developed regions. Illegal channels are emergency valves which allow surplus tension to escape in the global system of symbolic economics. To close them completely will cost more in the end if the boilers overheat and explode.

4.9.5.1 Copyright and Folklore

The issue of copyright has also yet to be properly discussed from a moral viewpoint. Everybody knows it would be dangerous to dig too deeply into the topic and they limit themselves to facile moralising. Closer inspection would make it clear that copyright is not a matter of fairness but a means of cynically pumping wealth out of one nation and into another. The giveaway is the attitude towards folk art. Why is there no protection for creative artists there? Why does copyright kick in only when it is advantageous to the corporations? Is it really because of the difficulty of determining the ownership of a product? Numerous Disney shareholders are making money out of the image of Mickey Mouse. Or is it because the forms of folklore have rarely crystallised definitively? Michael Brown ponders these and other no less thorny questions where culture and property collide, in his book *Who Owns Native Culture?*¹⁹⁰ The overarching question it asks is whether the modern concept of cultural property merely panders to Western interests by imposing a Western view of what culture actually is.

But even if the property rights in folklore were entirely clear, which court would enforce them? What if the courts in poor countries took to deciding whether a corporation like Disney had taken too much from the local oral tradition and ought to be fined?¹⁹¹ There was a case where three Maori tribes received compensation from

¹⁹⁰Michael F. Brown, *Who Owns Native Culture?*.

¹⁹¹As Tyler Cowen observes in his very positive review of Michael Brown's book, Unesco and the World Intellectual Property Organisation have called for copyright to apply to folklore and oral creativity. In other words, if the Disney Corporation took certain ideas from the legends of a native tribe, it should pay royalties or face legal sanctions. Although US copyright as a rule covers the expression of an idea and not the idea itself, folk tales and folklore are also a kind of expression, if not a kind which has customarily enjoyed protection in Western countries. Tyler Cowen, [Review of Michael F. Brown, *Who Owns Native Culture?*, Cambridge, Mass.: Harvard University Press, 2003], *Journal of Cultural Economics*, vol. 28, Issue 4, 2004, pp. 317–323.

the Lego company for the use of Maori and Polynesian words in a computer game. Perhaps Cuba will claim back some of its national music rhythms and sue the record labels for cultural piracy. Some state may decide to demand compensation for a film set on its territory. And so on.

By asserting copyright over folklore, poor countries could play the card of the underlying moral uncertainty of copyright law. They feel they have a right to compensation, and none of the prospective defendants have worthwhile moral arguments with which to deflect their unwelcome claims. The prosperous countries, of course, are in no hurry to show magnanimity in a contentious matter or to bear the white man's burden before they have to. They defend the convenient position that copyright protects their own cultural products, but not those of outsider states.¹⁹² As the Russian fabulist, who knew how to put a borrowed artistic concept to good use, says, "The strong are always right; it's the poor who get the blame".

4.9.5.2 Example: Leeches in the Village Pond

Let us suppose that somebody who breeds leeches has persuaded a community of the utility of these creatures, has created a good deal of hype around them, and is using a public pond for plying his trade. Although not all the bathers are persuaded of the merits of leech therapy, and some are so hostile to the bloodsuckers that they refuse to go bathing at all, the leeches attach themselves to all without distinction. On these grounds, the providers of the service levy a payment, setting up special units to monitor use. In retaliation, those opposed to leeches might wish to claim compensation for the blood taken from them, but the modus operandi of leeches is such that one might not detect the loss. The question of who owes whom relates to the value of the pond with leeches and without. (The example is not entirely fair, since many people cannot stand leeches, while most are fairly tolerant of even very bad music.)

The moral of this tale is that if you acknowledge somebody's right to speak, you cannot deny a countervailing right not to listen to them. For as long as the law regulates some rights and disregards others, it will be at cross-purposes with the interests of society and will run into resistance. Many people feel instinctively that in its present form the law of copyright is unfair and, in part, petty, and accordingly have no qualms about transgressing it. Their attitude is in harmony with the views of practitioners of cultural studies who increasingly see the creation of a work as extending beyond the actual act of its creator and representing a process of selection. The consumer is an active participant in this process. He fulfils the role of a selector but is not receiving his due. This may be a further reason for the low esteem in

¹⁹²Brown's proposal is for compulsory licensing. It would permit the use of protected materials without permission, but would oblige commercial users to pay a modest fee to the copyright holder. This compromise has appeared because the copyright system can function only if transaction costs are low. If radio stations had to obtain permission to broadcast every song, the negotiation costs would be unreasonable.

which copyright is held. Having found something worthwhile, the consumer shares the fruits of his labour with his friends. Thereby he is not doing anything bad, but merely establishing that he has laboured to some purpose. Should he be sued for this? Piracy would not have spread the way it did if it was not receiving massive support from consumers.

If the law continues to listen only to the self-interested reasoning of the corporations and fails to take account of other interests, culture must expect ructions.

4.9.6 Is a Market Without Copyright Possible?

When all is said and done, most of the experts on copyright agree that if it is an evil, then it is probably a lesser evil. Until someone comes up with a better method of reconciling the various interests, the existence of this institution with all its associated costs has to be tolerated. Surely no one can disagree with that, can they?

In several areas the tasks copyright is supposed to deal with can be resolved without it: through the market, including the use of technical measures to limit access; through social norms of good behaviour; and with the aid of state support and patronage. Market mechanisms can protect copyright holders without bringing in the law. Thus the online music service iTunes trades almost at a loss, but the Apple Corporation makes money on the sale of iPods and is overall in profit. The distribution of pirated discs harms legal sales but nevertheless increases the takings from live concerts.¹⁹³ Musicians who are losing out in one area simply switch their emphasis to the other.¹⁹⁴ The playing of recordings promotes tours which, in the opinion of Cowen, increases the number of good live concerts.¹⁹⁵

In some circumstances it may be to the advantage of manufacturers to decrease the level of protection against copying.¹⁹⁶ Even if the legal owner's market share decreases, the market itself and/or a related market may grow, and with it overall revenue. There has been widespread discussion of many instances where copying stimulated demand in new markets. The 1959 appearance of the photocopier, its ready

¹⁹³Starting in 1997, the price of concert tickets has soared because artists are experiencing a major reduction of income from the sale of compact discs and cassettes. Between 1996 and 2003 the average price of a concert ticket rose by 82 per cent. Alan B. Krueger, "The Economics of Real Superstars: The Market for Rock Concerts in the Material World", Working Paper, Princeton University, April 2004. Krueger called his account of what was occurring, the Bowie theory. See next footnote.

¹⁹⁴This was foreseen by David Bowie who advised performers: "You'd better be prepared for doing a lot of touring because that's really the only unique situation that's going to be left". Jon Pareles, "David Bowie, 21st-Century Entrepreneur", *New York Times*, 9 June 2002, p. 30.

¹⁹⁵Tyler Cowen, "Copyright and the Symbolic Nature of Art" (2002), Tyler Cowen, *Symbolic Goods: The Liberal State in Pursuit of Art and Beauty*, unpublished manuscript, Chap. 5.

¹⁹⁶Stanley M. Besen and Sheila N. Kirby, "Private Copying, Appropriability, and Optimal Copyright Royalties", *Journal of Law and Economics*, vol. 32, 1989, pp. 225–280.

availability from the mid-1970s and widespread use in public libraries, faced journal publishers with the same problem which faces the sound recording companies today. In fact, the gloomy predictions proved mistaken, and the number of magazine subscribers increased. In such cases there is no point in restricting access rather than stimulating demand, especially since price discrimination is an option.¹⁹⁷ The subscription price of journals for libraries is higher than the retail price,¹⁹⁸ just like the price of video cassettes intended for rental.¹⁹⁹ Moreover, digital technology makes it possible to completely block non-paying users from highly topical content.

Another option is to take full advantage of being able to make the first move by garnering most of the revenue before copiers can make it to market. This is how the leading fashion houses operate, although a breakneck race results. As Plant reminds us, in the days of manuscripts “there was never, so far as we know, any thought of author’s copyright. Manuscripts were sold outright, the author knowing that the buyer might have copies made for sale; and the first buyer knew that every copy he sold was a potential source of additional competing copies. In selling copies, he would therefore exploit with all his skill the advantage he possessed in the initial time-lag in making competing copies. Moreover, copies of copies naturally fetched lower prices, for errors in transcription are cumulative.”²⁰⁰

In the nineteenth-century the rights of American companies which published foreign books were not protected. Despite this, “to secure priority American publishers regularly paid lump sums to English authors for ‘advance sheets’”,²⁰¹ which often exceeded the payments they received from English publishing houses. Today’s clothing manufacturers similarly remunerate designers. The creative artist’s permission gives a certain cachet to the supplier. J.R. Tolkien had it printed at the beginning of his trilogy *The Lord of the Rings* in order to combat unauthorised versions.²⁰²

As we see, the market can get by without copyright if, for example:

- the original is in some way better than the copies;
- the cost of producing copies is high;

¹⁹⁷Harold Demsetz, “The Private Production of Public Goods”, *Journal of Law and Economics*, vol. 13, 1970, pp. 293–306.

¹⁹⁸Stanley J. Liebowitz, “Copying and Indirect Appropriability: Photocopying of Journals”, *Journal of Political Economy*, vol. 93, No. 5, 1985, pp. 945–957; Stanley J. Liebowitz, “Back to the Future: Can Copyright Owners Appropriate Revenues in the Face of New Technologies?”, Wendy Gordon and Richard Watt, eds., *The Economics of Copyright: Recent Developments and Analysis*, Cheltenham: Edward Elgar, 2003.

¹⁹⁹The original publisher can resort to punitive price-cutting. This tactic was used by American publishers against copiers in the nineteenth century, although they were not protected by copyright. If a pirate product appeared, the publisher retaliated by issuing a ‘fighting’ edition. These were extremely cheap publications printed in order to take the selling price lower than the copier’s costs. Plant, “The Economic Aspects of Copyright in Books”, p. 172.

²⁰⁰Plant, “The Economic Aspects of Copyright in Books”, p. 170.

²⁰¹Plant, “The Economic Aspects of Copyright in Books”, p. 171.

²⁰²The permission reads: A Statement from the Author “This paperback edition, and no other, has been published with my consent and co-operation. Those who approve of courtesy (at least) to living authors will purchase it, and no other.” (Signed) J.R.R. Tolkien).

- there is a marked superiority of the original work, which is the first to appear in the market;
- price discrimination can be brought to bear against copiers.

Unfortunately these circumstances are relatively rare, and do not apply to Internet business. Another alternative to copyright is state subsidies, grants, prize, and the like. Compulsory licensing when works become publicly available can also be effective, with a levy payable by third parties whose actions are considered to be reducing the author's income. The losses suffered by composers and musicians from private copying of audio-visual recordings are compensated for by a charge paid by the manufacturers of players and cassettes. When the possible introduction of similar measures for the Internet was being discussed, the proposal was to introduce a 'global licence' costing in the region of €10 which would give users the right to copy freely. At present it is unclear whether this levy will apply only to music or also to films. In France the proposal was ultimately rejected. As we have seen, however, this is not very efficient because, frankly, the state does not know who to give the money to. The best it can do is assist those who are knowledgeable and conscientious, like sponsors. Tax concessions can be introduced for them and, indeed, for creative artists.

4.9.7 Copyright from the Viewpoint of Symbolic Economics

Even though copyright has led over time to a situation which contradicts its initial purpose, it is by now very entrenched in the ways of the world. It has a 300-year old tradition behind it, and it would be naive to suppose that any individual, or the passion generated by any debate, is going to do away with it. In any case, the criticisms which have been directed at copyright are less than devastating. The approach generally adopted by economists is to seek a compromise between efficient consumption (maximising the quantity of consumed cultural product) and efficient production (support for the intention of creating the particular product).²⁰³ Optimal correlations of these are described in terms of welfare, which economists define as the sum of consumer surpluses (the difference between the price paid and the value acquired), and the gross profit of the producer. To put it more simply, is it better to give a million dollars to Sony or to distribute \$1 to a million consumers? As of now consumer surpluses cannot be quantified, which means that only a qualitative analysis is possible. For establishing optimum correlations, however, and it only makes sense to approach the question in that way, calculations are needed and, given the

²⁰³Paul Belleflamme, "Pricing Information Goods in the Presence of Copying", online, Department of Economics, Queen Mary College, University of London, August 2002. Cited August 2003. Available from URL: http://www.econ.qmul.ac.uk/papers/wp/WP463_FR.HTM; Jens L. Hougaard et al., "Selling Digital Goods on the Internet", online, University of Copenhagen, October 2002. Cited August 2003. Available from URL: <http://www.econ.ku.dk/Research/Publications/pink/2002/0209.pdf>.

present state of economics, the effects of culture are not only difficult to calculate, but even to identify.

Accordingly, instead of pushing an anti-copyright line as is currently in vogue, it will be more effective to concentrate on drawing the public's attention to the symbolic economic approach, which will make it possible to obtain a comprehensive overview of the problem. We need, firstly, to change attitudes to information, transaction and other costs accompanying cultural consumption, and, secondly, to reach agreement about a different understanding of the value of time. The whole purpose of art is to fill life with quality personal time. Only if we view it from this standpoint can we see the present institutions which regulate culture in their true light. Until the approach of symbolic economics is generally recognised by society, legislators will simply not attempt to update copyright. There are currently too many observable and unobservable, calculable and incalculable pros and cons in play. For the time being, symbolic exchange economics does not enable anything to be "added up", but the approach it suggests will make calculation possible, providing valuable information on consumer surpluses.

4.9.8 Cultural Communism is Copyleft Plus Collaboration of the Whole Realm of Culture

In the not too distant future creative artists may find themselves less dependent on copyright. Somewhere along the way it has been forgotten that it is the prerogative of the artist to sanction, or not, the functioning of this institution. Without his consent nothing can be done, but until now it has been possible to take that consent for granted. The artist in search of recognition needed someone to guide him and to beat a path to the hearts and minds of consumers, and indeed to their purses. As soon as a critical mass of artists had been enslaved by businessmen with capital and better knowledge of the market, the latter had it all their own way.

As means of direct communication between artists and their public develop, however, the need for middlemen, and hence for copyright, will become much less. The main justification of copyright is producer risks, but as the recommendations of the consumer community take care of this, the creative artist may well find himself in a stronger situation, able to renounce copyright and turn instead to its antithesis—copyleft.

4.9.8.1 What Is Copyleft?

Publication under copyleft means that a work by an artist may be copied, published, and even altered as anyone thinks fit, providing a number of license conditions are observed. First among these is that the original author and source must be indicated. The simplest way of making a work freely available might seem to be to put it in the public domain, but here there is a risk that somebody may come along, make a

few changes, and start distributing the product with his own name after the copyright symbol.²⁰⁴ Accordingly, one of the main principles of copyleft ensures that the condition of free use is passed on. Nobody can circumvent the expressed wishes of the original author and introduce restrictions when re-distributing or amending his work. Under no circumstances can a secondary user register a derivative product as a copyright item. Copyleft relies on the defences of copyright, but is a means not of privatising a work but of ensuring its continued free distribution.²⁰⁵

The idea of copyleft has been around for more than 20 years. In the 1980s Richard Stallman from the Massachusetts Institute of Technology was struck by the absurdity of a situation where computer software that worked badly could not be improved because its source code was secret. He advocated open code and proposed an instrument for regulating the use of it, the GNU General Public License.²⁰⁶ This license for free software created within the GNU project in 1988 is now known as GNU GPL, or simply GPL.²⁰⁷

“In order to apply copyleft to the program,” Stallman writes, “we first protect it with copyright; then we add conditions in respect of distribution which serve as a legal tool to give everybody the right to use it, alter it and redistribute the program code, but only if the distribution conditions are not changed.”²⁰⁸

At first it was thought that GNU GPL would only be used for computer programs, but it was later extended to other products, both digital and non-digital: scientific work, works of art, and so on.²⁰⁹

A series of copyleft class licenses was devised by the Creative Commons non-profit organisation, founded in 2001 by Lawrence Lessig, a professor at Stanford Law Academy. The Creative Commons license makes it possible to retain authorship and protect certain rights (“some rights reserved”).²¹⁰ More generally, it allows

²⁰⁴If a program is free, but does not bear the copyleft symbol, some copies or modified versions of it may be taken out of free circulation. For example, a software firm could compile a program with changes or without, and then distribute the resultant product commercially.

²⁰⁵This account is taken from information published by Richard Stallman about the GNU project from the site of the GNU Russian translation team, online. Cited 13 December 2005. Available from URL: <http://gnu.stu.cn.ua/gnuweb>.

²⁰⁶From information by Richard Stallman about the GNU project.

²⁰⁷For the Ethymonics Free Music License, see www.ethymonics.co.uk; there is a Free Art License; the EFF Open Audio License was devised in 2001 on the basis of GNU GPL by the Electronic Frontier Foundation (EFF), online. Cited 13 December 2005. Available from URL www.eff.org. For other kinds of free licenses see Appendix 3.

²⁰⁸Richard Stallman, see Footnote 205.

²⁰⁹Some creative products are inadvertently distributed on copyleft conditions. For example, any musician has the right, and is, indeed, even obliged to interpret the ‘source code’ when performing a composer’s music. Cookery recipes are also distributed freely and modified at will.

²¹⁰The Creative Commons website has been operational since December 2002 (creativecommons.org) and, as an aid to authors, provides templates for a variety of free licenses without charge. If the standard documents are unsuitable, you can synthesise your own license, including only those points which accord with your personal understanding of how your work should be used. One can, for example, permit only non-commercial use. Such a license is called a Creative Commons Custom License.

free copying, distribution, exhibition and performance of copyright items—music, videos, drawings, photographs, books (even for commercial purposes), and also the creation of derivative items subject to copyright. In order to use the license a third party has only to acknowledge the author of the initial work and the fact that it is being distributed under the terms of Creative Commons.

Free distribution does not need to be unpaid. Stallman not only does not object to payment, but on the contrary “invites those who are distributing free PO to charge as much for it as they wish or are able”.²¹¹ Although people are not obliged to pay for free products, peer pressure, and also savings on search costs and testing, are a powerful incentive to do so. Everything relies on the artists, composers, scholars, independent directors, and users who are able to contribute personally to realising the ideal of free creative exchange.²¹²

This is the principle we are relying on in the project of our new recommender institution: not compulsion, but free will. If something cannot be protected, it is sensible instead to rely on trust. We need to move from the principle of “Do not give to those who do not pay” to a principle of “Let those who are willing to pay, do so”. If a reader has enjoyed a work, then whether or not it is published by its first publisher by agreement with the author, or whether it is being distributed by somebody else, a payment in gratitude can nevertheless be sent to the author. He will become the more powerful party in his alliance with the publisher, and will be able to determine remuneration of the latter on the basis of consumer contributions which, in the new scheme of things, will depend on the quality of the product itself and not on market manipulation. Amazing as it may sound, the creative artist and the manufacturer will exchange roles: it is not the publisher who will pay royalties to the author, but the author who allocates a portion of his revenues to the person he has contracted to service his creative idea.

We need nevertheless to make one important reservation. Even if the work itself, distributed on copyleft terms, is free and paid for on a voluntary basis, information about its quality will need to be paid for. No matter how attractive the idea of copyleft is, in its present form it can provide the daily bread mainly of stars who are already well known, by enabling them to convert their popularity into earnings in related markets.²¹³ Moreover, copyleft is dogged by the problem of ‘noise pollution’, a surfeit of low-quality products clogging the market. This ailment is something that

²¹¹Stallman comments that GNU GPL does not lay down how much you can charge for distributing free software. You may ask nothing, or a few cents, a dollar or a billion dollars. “That is entirely your business and the market’s business, so do not complain to us if nobody wants to pay a billion dollars for a copy”. Richard Stallman, “Selling free programs” [“Prodazha svobodnykh programm”], online. Cited 13 December 2005. Available from URL: <http://gnu.stu.cn.ua/gnuweb>.

²¹²According to *The Independent*, the BBC made Beethoven’s nine symphonies freely available on its site. More than a million copies were downloaded, which angered the top management of labels which pay large sums of money to record classical music performed by major orchestras. They accused the BBC of devaluing classical music and of unfair competition. The BBC halted the experiment, which was in fact entirely legal since Beethoven’s symphonies are in the public domain and had been recorded by its own symphony orchestra.

²¹³On the entrepreneurial activity of stars, see Appendix 1, Sect. A1.4.4.4.

peering networks suffer from, and it may cool the ardour of supporters of the ‘Long Tail’ concept.

4.9.9 The Anatomy of the Long Tail

The Long Tail concept expounded by Chris Anderson sees the future of the cultural industry as lying in niche markets.²¹⁴ Anderson believes the problems of culture are rooted in an unsatisfactory meshing of supply and demand, in other words, in inefficient distribution: “An average movie theater will not show a film unless it can attract at least 1,500 people over a two-week run; that’s essentially the rent for a screen. An average record store needs to sell at least two copies of a CD per year to make it worth carrying; that’s the rent for a half inch of shelf space. And so on for DVD rental shops, videogame stores, booksellers, and newsstands.”²¹⁵ As a result of the geographical dispersal of the public, many works with a large total demand are unable to overcome this barrier. For example, “The Triplets of Belleville”, nominated for the best animated feature Oscar in 2003 and awarded 16 prizes at other festivals, was screened in only six US cinemas. The currently prevailing economy relies on bigtime hits and leads to a situation where there is neither enough space nor enough channels of communication to tell everybody about everything. Figure 4.1 is the basic premise of the Long Tail concept.

Anderson believes it will be possible to solve this problem because of the virtually limitless nature of digital storage, which online services can provide. This means that accommodating a huge selection of items incurs no additional costs and it can be made available to a dispersed public. The Rhapsody music service, for example, is able to offer 19 times more titles than Wal-Mart with its almost 40,000 retail outlets. It is the demand for less well-known tunes which falls into the niche

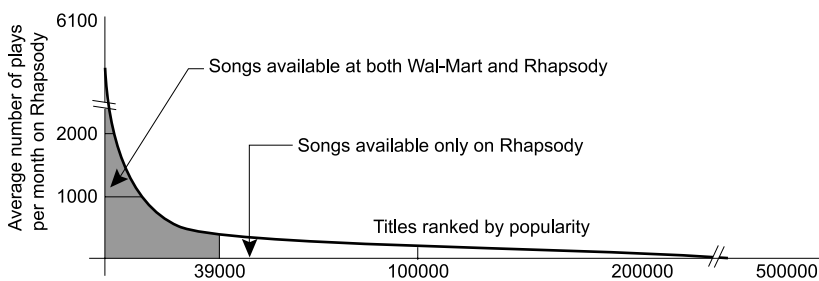


Fig. 4.1 Illustration of the Long Tail (Taken from Chris Anderson’s article “The Long Tail”)

²¹⁴Chris Anderson, *The Long Tail: Why The Future of Business is Selling Less of More*, online, 14 December 2004. Cited 29 November 2005. Available from URL: <http://changethis.com/10.LongTail>.

²¹⁵Anderson, *The Long Tail*.

of the Long Tail. Beyond the boundary of the 40,000 top titles, shops like Wal-Mart find zero demand for the simple reason that they do not display anything that is not going to sell 100,000 copies. The situation is different for online stores which their drip-feed sales.²¹⁶ These are the future. In the Long Tail, Anderson suggests, you will be able to find absolutely everything: an old catalogue, forgotten tunes which somebody still loves, and so forth. There will, of course, be endless junk in there, the author comments benignly, but no more than seeps out of the radio between hits. Will it really be possible to find all the heart desires in the Long Tail, or is Anderson being over-optimistic?

Chris Anderson is very taken with the idea of the Long Tail, but he seems to be underestimating one important aspect, which he touches on only in passing: the limitations of the consumer's time. One might imagine there were no consumer selection and experiencing costs, and that removing the entry barriers to publication did not simultaneously erect new obstacles to navigation. He suggests that, instead of investigating demand for non-hit works, it is easier "to simply dump huge chunks of the archive onto bare-bones DVDs, without any extras or marketing [one must suppose, whatever old way it turns out—AD] . . . the publishers of computer games can issue games as 99 cents downloadable files three years after their first issue—without support, guarantees or packaging [this is clearly going too far—AD] . . . The same is true for the music industry. It should be securing the rights to release all the titles in all the back catalogs as quickly as it can—*thoughtlessly, automatically, and at industrial scale*" (my italics—AD).²¹⁷

If we act on Anderson's idea, the reality will be nightmarish. A vast majority of homo sapiens currently alive and well will rent personal memory cells in which to store a plethora of digitised manifestations of its individuality. The result will be an almost infinite cyberspace clogged up with adolescent lyric poetry, childish scribbles and photographs, and with snapshots of interesting personal possessions and what have you. All this creative micro-production will patiently await its moment of glory when an appreciative customer comes along and is willing to part with a modest sum to enjoy it.

This is an extreme vision from which no amount of collaborative filtering could save us, although Anderson puts his trust in just that in, apparently, its Amazon redaction. He is evidently overlooking the problem that testing works of art within a system of filtering entails either costs or a loss of accuracy. He also ignores the problem of sparsity of assessments. He plans to drag the consumer to the far end of the Tail with the lure of low prices, but the economics behind this vision is far from obvious. If there is no initial filtering of any kind, and it is difficult to imagine what kind there could be other than an expensive manual assessment, the venture is doomed to fail spectacularly.

Peer-to-peer networks are good, as we have said, for distributing content, but promotion over the Internet is a problem, and most probably will remain so until

²¹⁶One quarter of Amazon book sales are titles which do not make it into the list of 130,000 top titles. Anderson, "The Long Tail".

²¹⁷Anderson, "The Long Tail".

monetary collaborative filtering is widely adopted. As the cost of communications reduces, their intensity increases, but the problem of differing aesthetic tastes does not disappear. Accordingly, popularising content will remain the prerogative of other channels. This is why peer-to-peer networks tend to adopt a traditional model of sponsorship through advertising, or find themselves at loggerheads with the law of copyright. In order to avoid these unsatisfactory situations, both the filtering and the exclusion of free riders need to be achieved through the efforts of users themselves. To date the best and only method of doing this is collaborative filtering.

Conclusion

What Culture Most Lacks: A Metalanguage

It is generally believed that money is the root of all culture's ills, but if we dig deeper, we shall find that the real villain is not money but the rules governing the way it is used. This is a case where it takes a wedge to dislodge a wedge. The shape of this saving wedge and how to use it have been becoming apparent only recently, before which culture had no immunity to money and came off worst in operations involving it. No matter how allergic culture may be to financial calculations, without them it will be unable to break free of the suffocating embrace of business. Business practice is based on financial calculation and co-ordination, and the practical aspects of culture can rely on them too.

It is traditionally held that there can be no valid links between money and emotion, numbers and aesthetic taste. Nevertheless, when skilfully used, numbers make it possible to hone, codify, and publish a judgment of taste. Boris Groys is almost alone in having formulated this clearly: "Without recourse to the code of money, aesthetic evaluation would be little more than a choice between 'yes/no', 'good/bad', like/dislike' . . . between these two bald choices there would be no room for a differentiated assessment based on one's own aesthetic sensibility. Naming a price for a work of art gives us the opportunity of a far more accurate judgement of art and [. . .] does not at all mean that we are repudiating aesthetic sensibility and experience and going over to cold calculation [. . .] naming the price you are prepared to pay out of your own pocket for a work of art is the only valid critical assessment of art".¹ Groys was talking of the buying and selling of paintings, while we are talking about payment for the quality personal time engendered by art. It is this payment which is the optimal method of registering, measuring, signalling, and ultimately increasing that desirable time which, we suggest, is the meaning of life and the mission of culture.

Money can unite or divide people, depending on the rules under which it is used. The integrating/differentiating function of money can be brought to bear in the area of symbolic assessment without anyone in the process imposing his own tastes on anybody else. Discreetly supporting thoughtful evaluation of cultural quality, money will be able to serve culture. In the new symbolically orientated relations of business

¹Boris Groys, *Commentaries on Art [Kommentarii k iskusstvu]*, Moscow: Khudozhestvennyi zhurnal, 2003, p. 211. Groys illustrates his thesis with the following example: "A whole life is summarised in the assessment that 'This picture is worth \$2,000'. Accordingly, in its presence we feel the way we would in possession of \$2,000—not a cent more, not a cent less." *Commentaries on Art*, p. 213. One wonders how he would apply this idea to a masterpiece of the cinema for which a ticket costs only a few dollars. Would we feel the way we feel with a few dollars in our pocket during the showing, or a few cents better off?

and culture, the arbitrating function of money will allow both parties to get on with their jobs. Business will be able to produce as much variety as anyone could wish for, while the cultural community will identify the quality clusters which interest it with the aid of post factum payments.

The main advantage of the new approach is that it has the potential to use money as a means of subtle differentiation of aesthetic quality and of providing data on the development of cultural processes. Monetary values embodying subjective ratings will move assessment forward from the endless crude binary opposition of yes or no, high or low which really tells us nothing. A major drawback of thinking within the humanities is its chronic sterility when attempts are made to analyse multi-polar areas populated by diverse motives and communal interests.² No matter how meticulously states are described and distinctions registered, when there is a need to choose between alternatives, the lack of a metalanguage is insurmountable.³ The same is true of situations where multi-directional forces are operating, and it is a disaster if matters are decided merely by the relative dynamism of the different players,⁴ as is only too often the case. Equally problematical is the situation where a system has developed to a stage beyond which it threatens to degenerate. "At such tipping points those supporting different views may find themselves on different sides of the watershed and hence evaluate the situation differently. Often they are unaware of these differences and find themselves unable to think within a single system of coordinates." The reason they cannot move beyond endless wrangling over 'high' and 'low' culture, over the definition of 'welfare', and the influence of the right to make copies is that the language they are using is incapable of reconciling their different logics. It can register them, but not balance or reconcile them.

The reader will hopefully be persuaded by now that the time is ripe for the idea of putting money to the service of culture in a novel way. For the mechanism to function efficiently, however, several elements need to be co-ordinated very precisely. In its conventional role, money is effective because it fulfils several functions simultaneously: measurement, circulation, payment, accumulation. The same applies to collaborative patronage schemes based on monetary signals. They will become popular only if several functions can be combined. The most important of these is signalling; the second most important is patronage in the form of contributions paid to the author and rights owner or owners; and the third is monitoring, self-management of the individual consumer who accurately records his personal aesthetic reactions.

Various inventors and practitioners have individually discovered important constituents and parts of the scheme we are proposing, namely, file exchange technologies, voluntary post factum payments, and collaborative filtering. On their own

²Kurt Lewin, who clearly understood this difficulty, proposed field theory. However for its practical application it requires quantitative measures, and our understanding is that the technique for these has yet to be worked on. Kurt Lewin, "Field Theory and Experiment in Social Psychology: Concepts and Methods", *American Journal of Sociology*, vol. 44, No. 6, 1939, pp. 868–897.

³These questions come within the remit of economic psychology, but the model of the decision-making process is considerably over-simplified.

⁴It is difficult to prove that Achilles would catch the tortoise without using the word 'speed'.

these do not add up to a robust autonomous system and their sphere of application is limited. Only when the whole complex of ideas is brought together and implemented in a manner wholly compatible with market mechanisms will a desperately needed innovation become possible: the institution of independent user-certification of culture.

The acquisition of a critical mass of supporters is vital for the social goods promised by voluntary payment for cultural products. Any such code of behaviour has attributes of a network good, in that the more people practising it, the more valuable and reliable it becomes. If a large number of people are to be persuaded to adopt the practice of post factum payments, the concept needs first to be understood and accepted, and this will come mainly through practical experiencing of its benefits. The difficulty is in the simultaneity and parallel nature of all these processes, but the reform should be no more difficult to introduce than any other. Given that people are less responsive to arguments which do not benefit them financially, the idea of making payments signalling the quality of a product or service should be publicised less as a form of patronage than as a way of enabling users to obtain valuable information. Conventional economics is unable to explain why anything more should be needed than the traditional mechanism of price formation. The need can be shown only by a discipline able to operate with the value of quality personal time.

For societies based on respect for individual values and freedoms, the invention of mutually beneficial monetary filtering is a cornucopia of opportunities, comparable to the discovery of a new form of energy. The similarity is that people have the prospect of mastering a new information resource, releasing it from the nucleus of the atoms that are the elementary particles comprising a society, namely its individual members. The uses to which this resource can be put are innumerable: from the most basic, but by no means trivial, task of consumer navigation through the abundance of goods on offer, to fundamental change in cultural processes.

Appendix 1

The Marketing of Music Recordings

A1.1 Introduction

The first part of this book was based on a specially undertaken market investigation whose results are given here, in Appendix 1. The information is structured within the economic logic of supply and demand. The following aspects are considered:

Supply:

- General structure of the sector;
- Description of products and manufacturing technologies;
- Characteristics of key market participants of the music industry;
- Contracts in the music sphere;
- Macro-economic indicators of the music market;
- Marketing channels;
- Marketing methods;
- Added value and price formation.

Demand:

- Size of the market;
- Characterisation of consumer groups;
- Demand for products by type and distribution channel.

Additionally, the sector's main trends, problems, and current issues are identified and information is provided which provides an understanding of various aspects of the music industry, including:

- The impact of technological innovation (broadband Internet, peer-to-peer networks);
- Competing standards of music file compression;
- Piracy and the struggle waged against it (technical and legal measures against illegal distribution).

A1.2 Overview of Trends in the Sound Recording Industry

The music industry was born about a century ago when innovations allowed the capture, storage and replaying of sound. Ever since, the industry has confronted and adapted to many technological advances. Sound technologies evolved from mono audio to Dolby® surround sound. Vinyl records yielded to compact discs, and gramophones evolved into large stereo systems and portable audio devices. Industry players either adapted to these changes or vanished from the scene. Today,

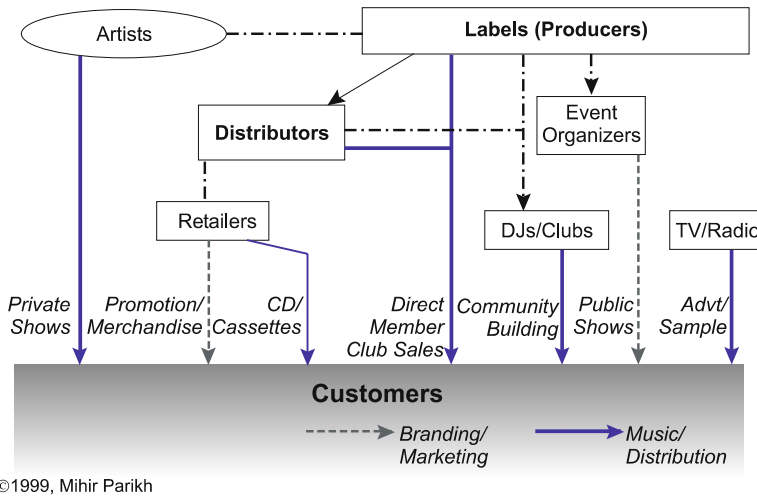


Fig. A.1 Structure of the traditional recording industry

the evolution of the Internet and the merging of audio and computing technologies is again radically altering the structure of the sector.

The traditional music industry is built around three major processes (Fig. A.1):¹

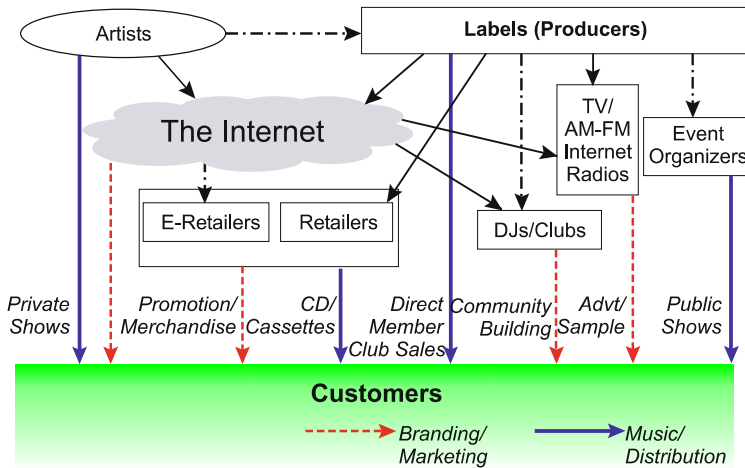
1. Creation of music: performers, composers, poets and others create music;
2. Marketing of music: branding and promotion is the sphere of professional promoters, DJs, dance clubs, television and radio stations, and also of retailers selling music and related goods.
3. Distribution of music: music stored on physical media such as CDs and audio-cassettes is supplied to consumers through a retail sales network and, to a lesser degree, through other channels.

A major role in all three processes was played by the major labels (Sony Music, Bertelsmann Music Group, EMI Recorded Music, Warner Music Group and Universal Music Group) who, by providing the initial capital and know-how to create, market and distribute music, gained enormous market power, consolidated by long-term contracts with musicians and songwriters. Young performers had limited access to marketing and distribution channels, and accordingly had a major interest in signing contracts with a label since otherwise they could expect only a modest market toehold.

There were three levels of intermediaries between the creators of music and its consumers, and this system existed for decades until a first wave of changes arrived in the mid-1990s. It was caused by the appearance of the Internet which enabled

¹This account is based on Mihir Parikh, "The Music Industry in the Digital World: Waves of Changes", Institute for Technology and Enterprise, August 1999, online. Cited 12 October 2004. Available from URL: <http://ite.poly.edu/musicwave01.htm>.

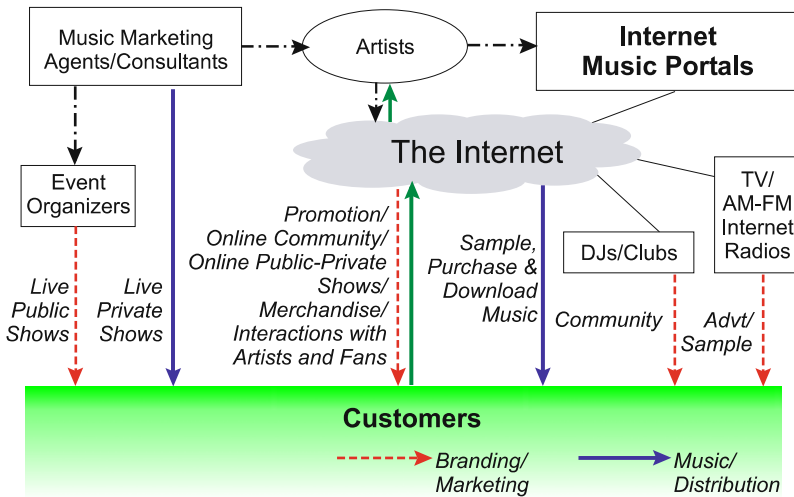
The First Wave



©1999, Mihir Parikh

Fig. A.2 The first wave of changes

The Next Wave



©1999, Mihir Parikh

Fig. A.3 The second wave of changes

sellers and buyers to contact each other directly. At this stage, the impact was mainly on retailing. (See Fig. A.2.)

Several e-retailers, such as CDNow, BuyMusic.com, and Amazon.com, emerged to sell CDs and audiocassettes over the Internet. Their success prompted several physical retailers to go online. In addition, a new type of information propagator, the Internet radio station, also appeared, using streaming audio technology to broadcast music from a website. This allowed users to listen to music but prevented them from storing it on the hard disk of their computer. Many Internet radio stations directed listeners to affiliated e-retailers.

The next wave of changes came about by the interplay of such factors as a new generation of communications technologies, like xDSL and cable modems which ushered in high-speed broadband channels which made it possible to expand the online distribution of music in a major way. As a result, geographical boundaries and distance ceased to be an important consideration in the distribution of music.

Music became a digital product. Audio technologies like MP3, RealAudio, Microsoft Media Player, LiquidAudio compressed music files to a size which made it practical to transfer them over the Internet. With the old digital audio technology a 4-minute song which took up some 40 megabytes of space on a CD was reduced to just 4 megabytes without any perceptible loss of sound quality when compressed to MP3 format.

These sound compression technologies were followed by portable audio players which made it possible to download music and listen to it on the go.

All this impacted on how the product was delivered, and hence on the structure of the music industry. (See Fig. A.3.)

Distributors, physical retailers and e-retailers of compact discs were gradually marginalised by online services offering digital music. The artists found they had new channels for promotion, not least setting up a website of their own. The overall result of the innovations in the music industry was reduced reliance on certain intermediaries and a new reliance on others.

A1.2.1 Some Overall Indicators of the Music Recording Market

Table A.1 Global share of the main music markets

Country	% of world population	Share of global music market, %
USA	5.7	37
Japan	2.7	17.7
United Kingdom	1.2	10
Germany	1.8	6.6
France	1.2	4.6
Other countries	87.4	24.1

Source: IFPI, US Census, Screen Digest

Table A.2 Sales of music recordings in various genres (%)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Rock	35.1	33.5	32.6	32.5	25.7	25.2	24.8	24.4	24.7	25.2
Rap/ Hip-hop	7.9	6.7	8.9	10.1	9.7	10.8	12.9	11.4	13.8	13.3
R&B/ Urban	9.6	11.3	12.1	11.2	12.8	10.5	9.7	10.6	11.2	10.6
Country	16.3	16.7	14.7	14.4	14.1	10.8	10.7	10.5	10.7	10.4
Pop	10.3	10.1	9.3	9.4	10.0	10.3	11.0	12.1	9.0	8.9§
Religious	3.3	3.1	4.3	4.5	6.3	5.1	4.8	6.7	6.7	5.8
Classical	3.7	2.9	3.4	2.8	3.3	3.8	2.7	3.2	3.1	3.0§
Jazz	3.0	3.0	3.3	2.8	1.9	3.0	2.9	3.4	3.2	2.9
Soundtracks	1.0	0.9	0.8	1.2	1.7	0.8	0.7	1.4	1.1	1.4
Retro	0.8	1.0	0.8	0.8	0.7	0.7	0.9	0.8	0.9	1.3
New Age	1.0	0.7	0.7	0.8	0.6	0.5	0.5	1.0	0.5	0.5
Children's	0.4	0.5	0.7	0.9	0.4	0.4	0.6	0.5	0.4	0.6
Other	5.3	7.0	5.2	5.7	7.9	9.1	8.3	7.9	8.1	7.6

Source: RIAA

Table A.3 Sales of music recordings in various genres (\$ million)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Rock	4.236	4.127	4.086	3.977	3.527	3.675	3.552	3.495	3.538	3.609
Rap/Hip-hop	953	825	1.116	1.236	1.331	1.575	1.848	1.633	1.977	1.905
R&B/Urban	1.159	1.392	1.517	1.371	1.757	1.531	1.389	1.518	1.604	1.518
Country	1.967	2.057	1.842	1.762	1.935	1.575	1.533	1.504	1.533	1.490
Pop	1.243	1.244	1.166	1.150	1.372	1.502	1.576	1.733	1.289	1.275
Religious	398	382	539	551	865	744	688	960	960	831
Classical	447	357	426	343	453	510	387	458	444	430
Jazz	362	370	414	343	261	438	415	487	458	415
Sound-tracks	121	111	100	147	233	117	100	201	158	201
Retro	97	123	100	98	96	102	129	115	129	186
New Age	121	86	88	98	82	73	72	143	72	72
Children's	48	62	88	110	55	58	86	72	57	86
Other	640	862	652	697	1.084	1.327	1.189	1.132	1.160	1.089

Source: RIAA

Table A.4 Size of the music market

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Sales	12.068	12.3203	12.5338	12.368	13.7235	14.5845	11.43230	13.74089	12.61421	11.8544

Source: RIAA

Figures are in \$ billions at factory gate prices (i.e., excluding distribution costs). Calculated on shipments.

A1.3 Types of Sound Recording and Manufacturing Technology

A1.3.1 Types of Music Products

The following are the recognised formats of sound recordings:

Phonogram: a recording of a musical composition lasting not more than three minutes, in any medium;

Album: a long-playing medium comprising a selection of tracks; the minimum number of tracks in an album, including remixes, is 10; for an album to sell well it should include 2 hits;

Single: depending on the medium this may be:

- a. a two-track CD (maximum playing time 10 minutes);
- b. a maxi-CD/DVD (maximum playing time 20 minutes; not more than 3 tracks, plus remixes of the same tracks);
- c. a 7-inch record (maximum playing time 20 minutes; not more than 3 tracks);
- d. a 12-inch record (maximum playing time 20 minutes; not more than 3 tracks, plus remixes of the same tracks);
- e. a cassette (maximum playing time 20 minutes; not more than 3 tracks).

Ringtone: a tune for mobile phones.

A1.3.2 Stages in Creating an Audio Album²

The initiative for creating an album may come from the performer or from the record company.

The first stage is for the two parties to sign an agreement to issue one or several albums. This stipulates the term of the agreement, financial aspects, payment obligations of the parties, an outline of their functions and powers, including delivery by the producer or artist of a master tape for the album:

- creation and recording of the album;
- an advertising campaign (presentations, television and radio announcements, radio broadcasting of songs from the album, creation of a video clip and promoting it on television, organisation of promotional events).

²Account based on E. Zhdanova et al., *Management and Economics in Show Business [Upravlenie i ekonomika v shou-biznese]*, Moscow: Finansy i statistika, 2003.

The contract confirms the granting of property rights to produce the album in all media and distribute it subsequently. In addition, publisher's rights are detailed in respect of:

- copying the master tape;
- distributing the product through all channels;
- importing the product;
- public performance;
- using tracks in the compilation of collections;
- broadcasting the original.

The artist or performer must confirm to the publisher that he will not give the original work to another publisher and will not infringe any third party's copyright.

The second stage is developing the concept of the album and preparing the musical material.

The third stage is working in the studio: musical arrangement, multi-channel recording, recording of vocals, mastering of the separate components. A master tape results which must meet the accepted standards of audio product manufacturers. The artist delivers this original to the publisher to create a master disk and work on the design.

The fourth stage is copying of the recording.

The fifth is an advertising campaign and release of the album. Copies of the album are forwarded to distributors.

In addition to studio costs and fee payments the budget will provide for vocals coaching, scene-shifters, a choreographer, a psychologist, an image-maker, and other specialists.

Photographic sessions also have to be paid for, a video, press conferences, presentations and tours, liaison with radio stations. Tours also involve companies renting staging, lighting and sound equipment.

Additional specialist firms include:

- studios to produce the master tape;
- companies which manufacture and copy the physical media bearing the music;
- printing companies;
- advertising agencies promoting the album on radio, television, and the press;
- wholesale distribution companies;
- retail companies.

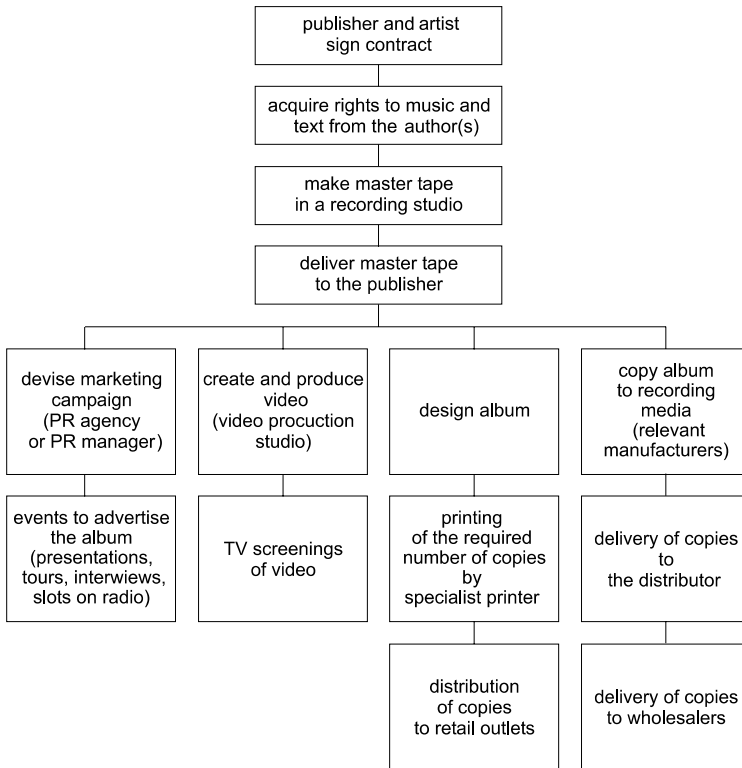


Fig. A.4 Chart illustrating the creation of an audio album

A1.3.3 Encoding (Digitisation) Technology³

In audio equipment, sound is represented by a continuous electrical signal or by a set of digits (zeros and ones). Equipment reproducing sound on the basis of a continuous electrical signal, for example, a radio receiver or oscilloscope, is known as analogue equipment.

Analogue-digital conversion (encoding) of a signal involves two processes: the amplitude of the signal is measured at particular time intervals, and the values obtained are stored digitally.

The signal amplitude values cannot be written with total accuracy and have to be rounded. Analogue-digital conversion stores signal amplitude, sampled at particular intervals of time, as rounded digital values. Clearly, the more frequently measure-

³Account based on “Encoding Sound” [“O kodirovanii zvuka”], published on the allofmp3.com website, online. Cited 4 July 2006. Available from URL: <http://music.allofmp3.com/help/help.shtml?prm=legal&rnd=77974#top>.

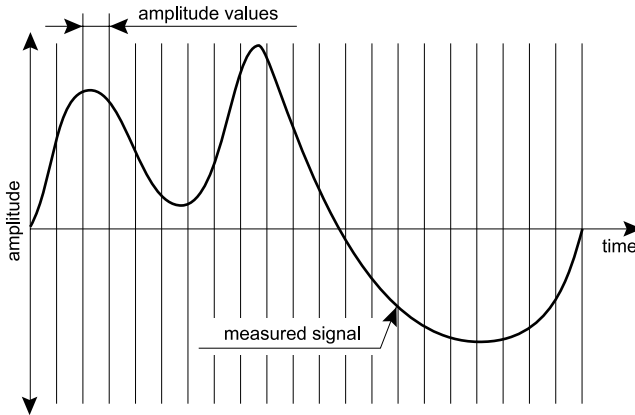


Fig. A.5

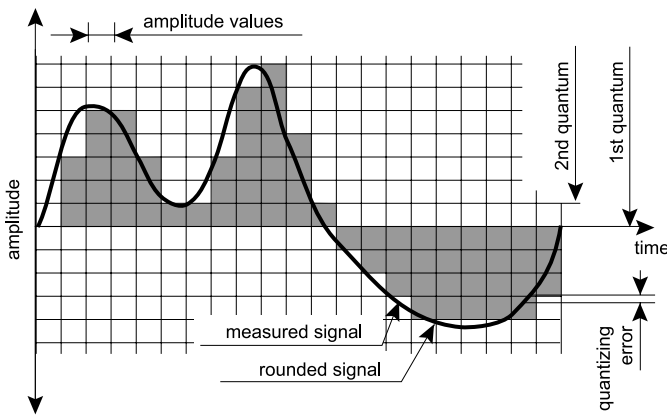


Fig. A.6

ments are taken and the less the initial data is rounded, the more accurate the digital representation of the original signal.

The size of the resulting digital file can be reduced by compressing it, using a variety of algorithms, but if this is not to detract from the original sound quality high conversion values are needed. Unfortunately, the higher these are, the greater the amount of memory the digital data takes up. For example, a standard 650 Mb audio CD can store about one hour of music. The standard file type for storing digital audio today is a WAV file, a universal container which allows storage of digital audio with different digitisation parameters.

A1.3.4 Principles and Formats for Digital Sound Compression

There are two prevalent ways of coding audio data (besides simple storage in pure digital form “as is”).

1. Lossless data compression is a way of encoding audio data which allows 100% accurate data restoration from the compressed form back to the original stream. Modern compression methods make it possible to reduce data size by 20–50%. Such coders⁴ are a kind of data archiver (like ZIP, RAR and others), but are designed specifically for the compression of audio data. Lossless data compression is ideal in respect of maintaining the integrity of source data, but cannot provide high compression.
2. The other means of audio compression accepts loss of quality: so-called “lossy coding”. The aim is to achieve sound similar to the original while minimising file size. This is done by “simplifying” the original audio signal. The coder analyses it, identifies elements which are inaudible or almost inaudible to the human ear, shortlived and barely noticeable fluctuations of frequency, and removes them. After lossy coding, the decoded signal sounds similar to the original but is in reality no longer identical to it.

As we can see in Figs. A.7–A.8, if we represent the sound wave in the form of a signal spectrum, it contains peaks on certain frequencies and “silence” at other points. It is these silences which are cut out during compression.

The most commonly used compression methods are MPEG-1 Layer 3 (MP3), AAC, Ogg Vorbis (OGG), Windows Media Audio (WMA), and MusePack (MPC). They make it possible to compress data 7–14 times with barely noticeable loss of quality. If a song in the form of a WAV file takes up about 50 Mb of storage, after compression by MP3 it will ‘weigh’ only 3–7 Mb or so.

Particularly high compression is achieved by “aggressive simplification”, where the coder discards many nuances as insignificant. Too aggressive compression, naturally, results in serious degradation of quality, because many audible details may

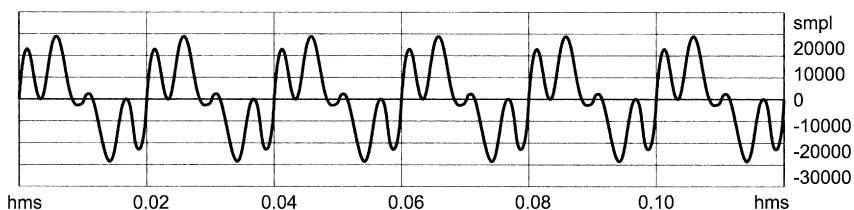


Fig. A.7

⁴A coder is a program (or hardware device) implementing certain algorithms of data coding (for example, the ZIP archiver or MP3 encoder). A decoder is a program (or hardware device) which in reverse decodes the encoded data. A codec (coder/decoder) is a program/software driver/hardware device for data coding and decoding.

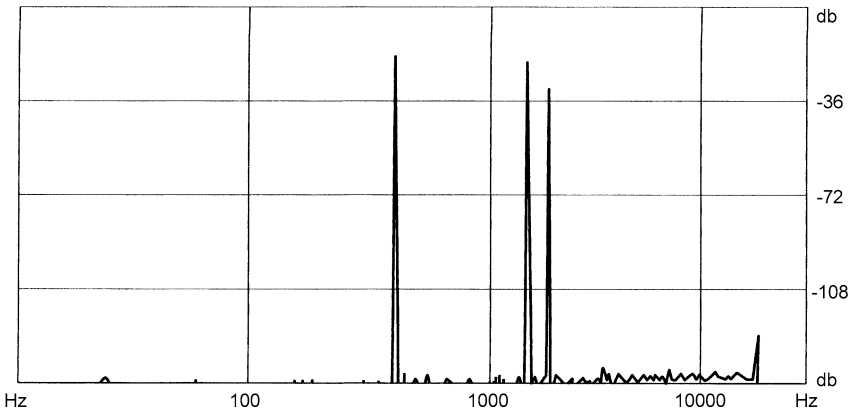


Fig. A.8

be considered insignificant and be discarded by the coder. All modern lossy-coders allow fine adjustment, which makes it possible to achieve high data compression rates with imperceptible loss of original quality.

*A1.3.5 Properties of Digital Sound Recording Formats*⁵

MP3 (MPEG-1 Audio Layer 3)

This format was devised some twenty years ago and is currently the most popular and widespread. It is inferior to more perfected formats, but is widely distributed, which obliges us to accept its shortcomings. MP3 files are reproduced on the computer, modern music centres, DVD players and mobile phones. When encoding MP3 files the sound quality can be very variable, depending on the state of the initial material and the parameters of the encoder. Modern MP3 codecs make it possible to achieve sound quality indistinguishable from the original at bitrates above 192 kbit/second.⁶ A drawback of MP3 is a sharp deterioration of sound quality at bitrates below 128 kbit/second. At 64 kbit/s the sound of MP3 files is seriously distorted, and at lower bitrates it becomes unintelligible.

⁵The following account is based on T. Brizitskii, “Auditory Illusion” [“Obman slukha”], *Chip Special*, No. 6, 2004, pp. 48–53; and on information from the Help Center of MP3sparks.com Available from URL: <http://www.MP3sparks.com/help/help.shtml?prm=legal&rnd=77974#top>.

⁶The bitrate is the number of bits used for storing one second of audio. When using MP3 and many other compression formats, a user can specify the preferred bitrate or range of bitrates, as well as other parameters, before compression. The lower the bitrate, the fewer bits the coder is allowed to allocate for storing one second of audio and, accordingly, the greater the simplification of the signal during compression. The most common average bitrate value for MP3 files downloaded from the Internet varies within the range of 128–192 kbit/s.

MPEG-2/4 AAC (Advanced Audio Coding)/MP4

This format, introduced some 5 years ago, is considered the successor of MP3. It results from the joint efforts of a number of companies, including the Fraunhofer Institute, which created MP3, and Sony; NEC, and Dolby. When compared with MP3, AAC has markedly higher compression efficiency. The sound quality of an AAC file at a bitrate of 128 kbit/s is comparable with the quality of an MP3 file at 192 kbit/s. In addition, AAC enables the creation of multi-channel files, which makes it suitable for storing film soundtracks. When encoding at low bitrates it is possible to create AAC HE (High Efficiency) files using SBR (Spectral Band Replication) technology.

The main coding device used in AAC is similar to MP3 and is based on psychoacoustic analysis of the signal, but with a number of extensions which improve the output sound quality. In addition, AAC makes it possible to store “watermarks” in the output stream,⁷ containing copyright information. These cannot be deleted without destroying the integrity of the audio data. This technology makes it possible to exercise control over the distribution of audio material, but its inclusion in AAC has proved a serious obstacle to acceptance of the algorithm and files created by it. Apple uses the AAC format in its iTunes service. The Apple iPod plays AAC files. AAC HE (or aacPlus) can be read by most modern audio equipment.

WMA (Windows Media Audio)

The WMA format was created by Microsoft as an alternative to MP3 for users of the Windows Operating System. The developers claim that it makes it possible to achieve comparable quality to MP3 at half the bitrate, but users’ comments suggest that files of the most widespread WMA 8, even at 128 kbit/s, are noticeably inferior in sound quality not only to CDs but also to MP3 files.

The WMA format makes it possible to instal Digital Rights Management protection against unauthorised use of the audiofile.⁸ A considerable advantage of WMA is its popularity with Windows users and it consequently has considerable support from producers of portable equipment. Many modern MP3 players are capable of reproducing WMA 7/8 files no worse than MP3.

OGG Vorbis

The Vorbis codec for expanding OGG files was developed by Xiph.org, a non-commercial organisation, in 2000 as a fully valid alternative to pay formats. Producers of codecs or players had to pay the patent holders for the right to create and reproduce MP3, AAC and WMA files. The OGG Vorbis codec emerged from the

⁷See Appendix 1, Paragraph A1.10.1.1.

⁸See Appendix 1, Sect. A1.10.1.

Ogg Squish project to create a fully open multimedia system, as a result of which the project itself and the new software based on it, and Ogg Vorbis are available for free distribution. The same ideas underlie Ogg Vorbis as underly MPEG-1 Layer II. At the same time, OGG uses an original mathematical algorithm and its own psychoacoustic model, which exempts it from having to pay license fees to other manufacturers of audioformats. The format can be used even in commercial applications. The music of a considerable proportion of computer games is recorded in OGG Vorbis precisely because it is free.

Not surprisingly, Vorbis immediately attracted attention. Nevertheless, its repudiation of patented technologies means that the format will be unable to occupy a leading position, although neither is it an outsider. The latest versions of the codec make it possible to create files whose quality is comparable to AAC over a wide range of bitrates, and support from devices is appearing, if somewhat belatedly. Its chances of displacing AAC or MP3 are, however, currently close to zero. On the other hand, the codec is fully adequate to the task it initially set itself, providing developers and users with an unpaid format for music storage whose facilities exceed those of MP3. The Ogg Vorbis algorithm is intended to compress data at all possible bitrates, that is, from 8 Kbit/s to 512 Kbit/s.

Musepack (MPEG plus)

Experienced music-lovers consider Musepack the best of the existing lossy-codecs. It was forced to change its previous name of MPEGplus because of the similarity to MPEG. Its psychoacoustic model is superior to the majority of similar applications. Despite the fact that its closest relative is MP2, the predecessor of MP3, the format not only functions well with music at middle and high bitrates, but can hold its own against Vorbis and AAC at 128 kbit/s. Nevertheless, development of Musepack is making slow progress and it is neglected by developers of software and hardware.

Real Audio

Until recently RealNetworks used its own music coding format for online transfers. Its particular merit was that files of acceptable quality could be created at bitrates as low as 20 kbit/s, which made it possible to make Internet transfers even over dial-up connections, and allowed owners of audio shops to offer brief fragments of music which could be sampled before ordering a disc.

Because the RA format is firmly attached to RealOne Player, most music lovers have little reason to use it. One can obtain acceptable playing quality at very low bitrates using any modern codec, like AACplus, Vorbis, or WMA.

A1.3.5.1 Moving between Formats

Music-lovers using files in different formats may need to convert one format into another, for example to download a multi-gigabyte music archive to blank discs or

to fit more music into an MP3 player. There are currently many programs enabling them to do so, but one has to remember that different codecs use their own psychoacoustic models, and each of these cuts out different parts of the sound signal. Accordingly, the sound quality transferred, for example, from MP3 to OGG or vice versa will be significantly impaired.

A1.3.6 Types of Media

- CD (Compact Disc): an optical laser digital system of sound reproduction;
- DAT (Digital Audio Tape): a digital tape for recording and reproducing sound;
- MD (MiniDisc): an optical laser system for recording and reproducing sound;
- Audio DVD: an optical laser system containing sound and video channels;
- SACD (Super Audio Compact Disc): an optical laser system containing a sound channel;
- LP: a vinyl record;
- MC: a music cassette.

A1.3.6.1 Music Sales Trends by Media Type⁹

The changes in the music industry are evident from a comparison of sales of music recordings on different media types (Table A.5, data from 1991–2003).

From 1991 to 1999 the market overall was stable. CD sales rose, and this was balanced by a fall in music sales on other media, but from 2000 a sharp decline is observed both in unit and monetary terms. This negative trend is evident in many different media types, especially singles.

The fall in sales is seen as due to the influence of online and offline piracy, and also because of competition from other entertainment industry products. It is noticeable that the fall in sales coincides with the creation of Napster in the second half of 1999 and the appearance of filing-sharing technologies in the latter half of 2001.

We can see from these charts how outmoded such media as music cassettes and vinyl records (LPs) became.

2000 saw the final displacement of music cassettes by compact discs. The end of such a changeover results in loss of revenues for manufacturers.

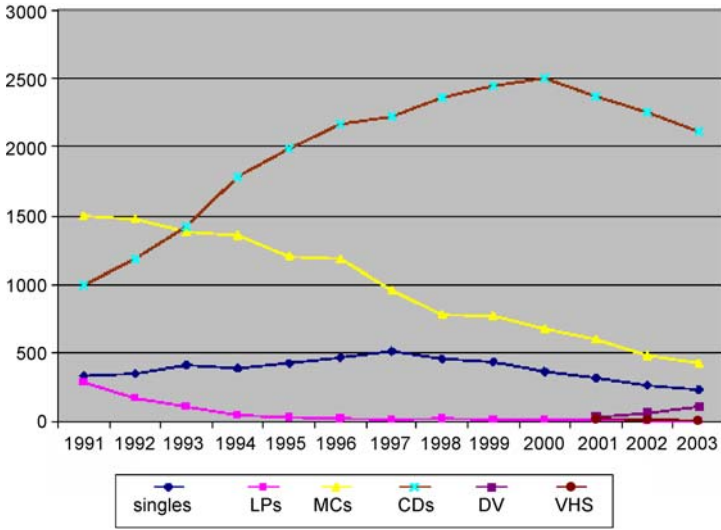
The sale of DVDs is picking up, and the music industry is placing great hopes on Super Audio CD (SACD), which gives better quality sound than ordinary CDs, and offers surround sound. Sales of music DVDs are a small but growing segment of the DVD market: 7.1% in 2003 against 6.3% in 2002. In 2003 DVD sales accounted for 5.7% of sales against 3.1% in 2002.

⁹Account based on Martin Peitz and Patrick Waelbroeck, “An Economist’s Guide to Digital Music”, *Cesifo Working Paper No. 1333*, November 2004. Cited 30 July 2007. Available from URL: <http://cesifo.oxfordjournals.org/cgi/reprint/51/2-3/359>; IFPI, “Global Music Sales Fall by 7.6% in 2003—Some Positive Signs in 2004”, International Federation of the Phonographic Industry, 7 April 2004, online. Cited 20 September 2004. Available from <http://www.ifpi.org/site-content/statistics/worldsales.html>.

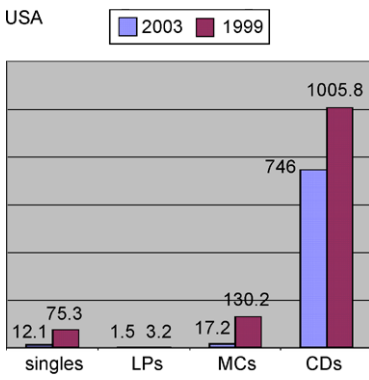
Table A.5 Sales by media type in units sold (millions) and monetary terms (\$ millions)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	
CDs	pcs	662.1	722.9	778.9	753.1	847.0	938.9	942.5	881.9	803.3	745.9
	\$	8,464.5	9,377.4	9,934.7	9,915.1	11,416.0	12,816.3	13,214.5	12,909.4	12,044.1	11,232.9
CDs (singles)	pcs	9.3	21.5	43.2	66.7	56.0	55.9	34.2	17.3	4.5	8.3
	\$	56.1	110.9	184.1	272.7	213.2	222.4	142.7	79.4	19.6	35.9
Cassettes	pcs	345.4	272.6	225.3	172.6	158.5	123.6	76.0	45.0	31.1	17.2
	\$	2,976.4	2,303.6	1,905.3	1,522.7	1,419.9	1,061.6	626	363.4	209.8	108.1
Cassettes (singles)	pcs	81.1	70.7	59.9	42.2	26.4	14.2	1.3	-1.5	-0.5	-
	\$	274.9	236.3	189.3	133.5	94.4	48.0	4.6	-5.3	-1.6	-
Records	pcs	1.9	2.2	2.9	2.7	3.4	2.9	2.2	2.3	1.7	1.5
	\$	17.8	25.1	36.8	33.3	34.0	31.8	27.7	27.4	20.5	21.7
Vinyl (singles)	pcs	11.7	10.2	10.1	7.5	5.4	5.3	4.8	5.5	4.4	3.8
	\$	47.2	46.7	47.5	35.6	25.7	27.9	26.3	31.4	24.9	21.5
Music video	pcs	11.2	12.6	16.9	18.6	27.2	19.8	18.2	17.7	14.7	19.9
	\$	231.1	220.3	236.1	323.9	508.0	376.7	281.9	329.2	288.4	399.9
DVD audio	pcs								0.3	0.4	0.4
	\$								6.0	8.5	8.0
SACD	pcs										1.3
	\$										26.3
DVD video	pcs					0.5	2.5	3.3	7.9	10.7	17.5
	\$					12.2	66.3	80.3	190.7	236.3	369.6
Total	pcs	1,122.7	1,112.7	1,137.2	1,063.4	1,123.9	1,160.6	1,079.2	968.5	859.6	798.3
	\$	12,068.0	1,2320.3	12,533.8	12,236.8	13,711.2	14,584.7	14,323.7	13,740.9	12,614.2	11,854.4

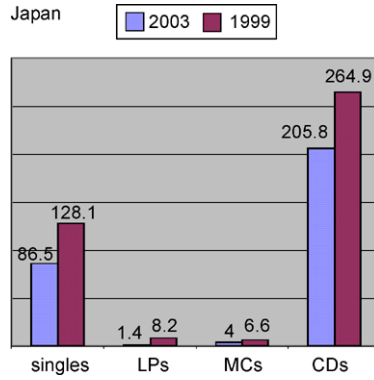
Source: RIAA 2003 Yearend Statistics



(a)



(b)



(c)

Fig. A.9 Trends of world sales (in millions of units) for various media types (CDs, DVDs, cassettes, records) in 1991–2003. Source: (a) IFPI; (b) IFPI, *The Recording Industry in Numbers 2003*, cited in Peitz and Waelbroeck; (c) IFPI, *The Recording Industry in Numbers 2003*, cited in Peitz and Waelbroeck; (d) IFPI, *The Recording Industry in Numbers 2003*, cited in Peitz and Waelbroeck; (e) IFPI, *The Recording Industry in Numbers 2003*, cited in Peitz and Waelbroeck; (f) IFPI, *The Recording Industry in Numbers 2003*, cited in Peitz and Waelbroeck

Overall sales of music videos in 2003 totalled \$2 billion, of which \$1.8 billion were music videos in DVD format. Overall the music video sector grew by 46.6% over the year, while DVD sales increased by 67%. Thanks to the popularity of DVDs the share of music video in worldwide music sales has doubled in 3 years and currently stands at 6.3%.

Sales of music in audio format, however, have fallen by 9.9% (in monetary terms), and of singles by 18.7%.

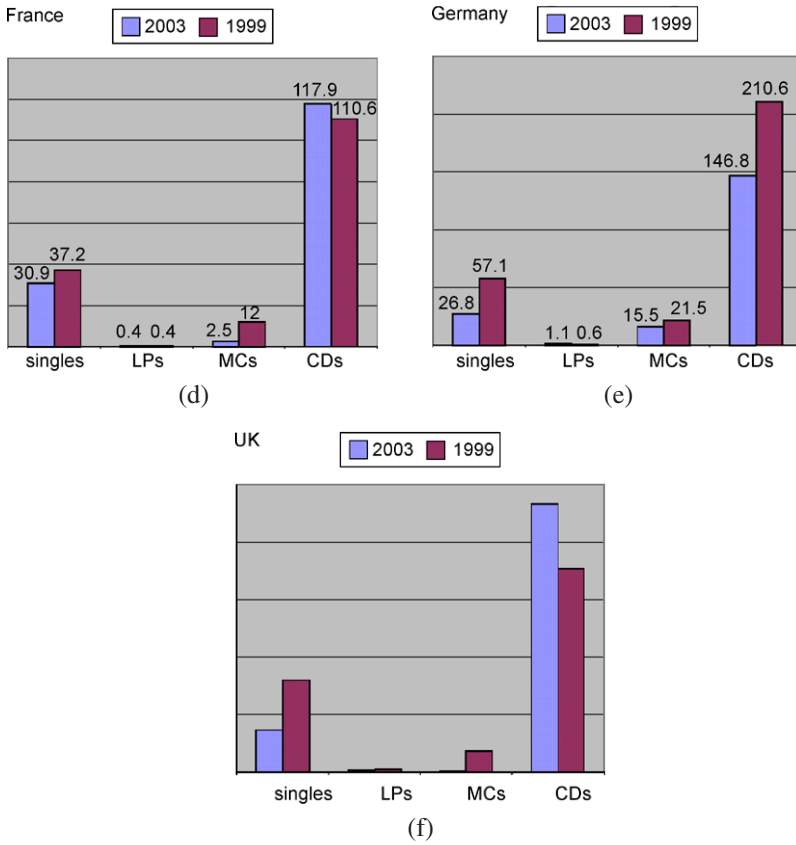


Fig. A.9 (continued)

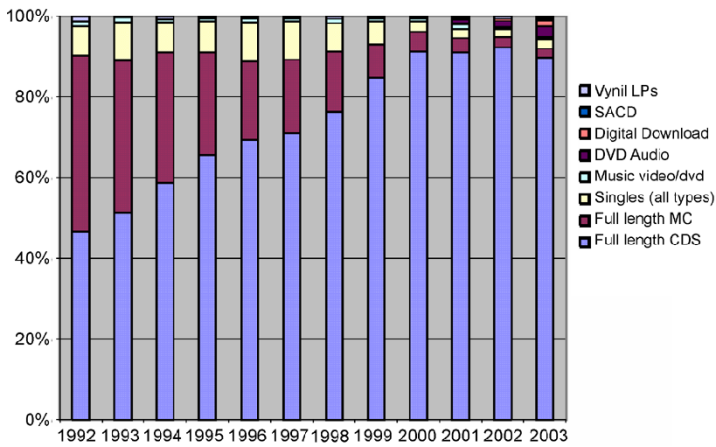


Fig. A.10 Substitution of different types of media in the USA, 1992–2003. Source: RIAA and calculations by Peitz and Waelbroeck

Despite the fact that sales of music DVDs in the main regional markets are picking up, this is not compensating for the downturn in sales of compact discs.

A1.3.7 Compact Disc Manufacturing Technology

The manufacture of compact discs involves the following stages (omitting initial creation of the master tape):

- Mastering: two basic operations of preparation the master disc and matrix;
- Copying: producing the requisite quantity of compact discs from the master disc;
- Design: applying graphics to the compact disc;
- Packaging of the product in plastic “jewel cases”.

Data is recorded on the compact disc in the form of a sequence of pits of varying length placed in a spiral from the centre to the edge of the disc. The width of each pit varies from 0.6 to 0.8 μm , and it is from 0.1 to 0.13 μm deep. The track spacing is 1.6 μm and must be maintained to within a tolerance of 0.1 μm . Photolithography is used to produce such precision. In order to prepare the original (the master disc) an extremely flat, meticulously polished glass substrate is used. A layer of photoresist or negative photoresist material is then applied to it. The thickness of this layer determines the depth of the future pits, which can vary from 0.1–0.13 μm . Where the pits are to be placed, a laser beam recorder exposes the photoresist with a deep blue or ultraviolet laser. The area is then soaked in a developer solution, causing the exposed areas of positive photoresist, or unexposed negative photoresist, to dissolve. The glass master is then metallised using the technique of nickel vapour deposition. The metallised layer is needed so that it can be used for preparing a second, wholly metallic, original of the disc by galvanoplasticism. Intermediate copies are made from this original, and from these the working matrices are then manufactured. Under the classical method of mastering, up to 50,000 copies can be made from a single matrix.

The compact disc is manufactured using a technique of injection moulding of optical polycarbonate. The matrix is placed in the press mould of a thermoplast machine to which molten polycarbonate is introduced under pressure. After cooling, a base is obtained with depressions (pits) and eminences (lands) which are counted as ones and zeroes, and this is covered with a reflective layer of aluminium and protective varnish. A label is affixed to the disc, and it is sent for packaging.

A1.3.8 The Evolution of Digital Data Media¹⁰

In 1980 Sony and Philips presented a joint application, the first CD-DA (Compact Disc-Digital Audio) standard in the family of modern CD formats. This brought

¹⁰Account based on M. Mikhin, “Edison’s Legacy” [“Nasledie Edisona”], *Chip Special*, No. 6, 2004; I. Pyzhov and A. Shepelev, “Music in Numbers” [“Muzyka v tsifrakh”] *Chip Special*, No. 6, 2004.

to an end the almost century-old era of gramophone records. The CD-DA digital medium proved more reliable, more durable, and in many respects more convenient than vinyl records and magnetic tape. It was not affected by water, and was resistant to electromagnetic fields. Among its advantages were low cost of production and copying and the small size of the discs (120 or 80 mm in diameter).

A few years after introduction of the CD-DA standard, with the appearance of other players in the market and of personal computers equipped with CD disc drives, users defected en masse to compact discs. Before the 1990s CD recording had been used only for industrial purposes. Recorders and blank discs then appeared which made it possible for discs to be recorded at home.

The standard CD is 120 mm in diameter. The minimum playing time for a track is 4 seconds, and the maximum number of tracks is 99. Initially a CD's capacity was 74 minutes, and a little later 80 minutes became standard.

After CD-DA Sony devised and released a new digital format, DAT (Digital Audio Tape) with improved technical characteristics. Magnetic tape made it possible to record and even edit sound at home. Special players are required and, as they cost appreciably more than CD players, this has been an obstacle to widespread acceptance of DAT technology, although the equipment is still in use in professional studios.

In early 1993 Sony and Philips almost simultaneously issued new media for storing digital sound. After a fiasco with its attempt to mass distribute magnetic DAT tapes, Sony came up with the Mini Disc or MD. Philips instead put its money on magnetic tape, offering users a digital compact cassette, the DCC. Both systems used audio data compression, but neither the MD nor the DCC became popular and the CD, constantly evolving, remains the most popular medium.

In the late 1990s there was a battle between two alternative formats for storage of digital data: SACD (Super Audio Compact Disc) and DVD. Both these media used variants of the DVD concept, with modifications. SACD discs using a hybrid system have reverse compatibility with ordinary CD players.

A DVD disc consists of two layers: the CD and SACD, both of which have different reflective capacity. The SACD layer is visible only to reading devices with a laser whose wavelength is 650 nanometres. If a hybrid disc is reproduced on an ordinary player whose laser wavelength is 780 nanometres, then only the CD layer will be played. In addition to music data, this layer can contain text, graphics and video.

The DVD format, which has more robust anti-copying protection, has dominated the film market since 2001. SACD gives higher sound quality than ordinary CDs, and can deliver surround sound.

A1.4 Key Players in the Music Recording Market

The professional participants in the music recording market are:

- the major labels;
- independent sound recording companies, the 'indie' labels;

- music publishers;
- legal wholesale and retail sellers of music on physical media;
- online operators;
- artists;
- pirates
 - using physical media;
 - on the Internet;
- television and radio stations;
- Internet radio stations;
- fan clubs and dance clubs.

A1.4.1 The Major Labels

Over the past ten years the music industry has become highly centralised. Five companies (since July 2004, when Sony Music merged with BMG, four companies) have concentrated vertical and horizontal control of the sector in their hands. At the present time four sound recording conglomerates¹¹ control more than 80% of production and sales in the USA, and approximately the same percentage worldwide. These are Warner Music, EMI Group, Universal Music Group (UMG), and Sony BMG Music Entertainment (Sony BMG). These four giants own practically all the well-known sound recording labels,¹² including some founded in the Victorian era like RCA Victor and Parlophone, and also the rights to a large proportion of all music.

Universal Music Group is the music division of the transnational media corporation Vivendi Universal. This is a major sound recording company with one of the most comprehensive music catalogues in the world. It is distributed by Universal Music Enterprises in the USA and Strategic Marketing and Commercial Affairs outside the USA. Universal Music Group includes an electronic commerce division, Universal eLabs.

Sony BMG Music Entertainment is a joint enterprise of the American division of the Japanese company Sony Music Entertainment and Bertelsmann Music Group, the music division of Bertelsmann AG media holding. When they merged in August 2004, the two partners divided the equity equally between themselves. The result was the second largest sound recording company in the world, with a global market share of 21.5%. The parent firms' divisions for music publishing, physical distribution and production were not incorporated into the company. The profit target for 2006 was €269 million.

EMI (Electrical and Musical Industries) is the only major music company which is not part of a media conglomerate. This makes it more sensitive than the

¹¹They are also known as 'record labels' or 'majors'.

¹²The term 'labels' has been retained since the era of vinyl records, which had a paper label glued in their centre to indicate the contents.

Table A.6 The major music labels

Company	Vivendi Universal www.umusic.com	Sony BMG www.sonybmg.com	EMI www.emigroup.com	WMG www.wmg.com
Sound recording group	Universal Music Group (UMG)	Sony BMG Music Entertainment (50% Sony Corp. of America, 50% BMG)	EMI	Warner Music Group (WMG)
Market share (2004)	25.5%	21.5%	13.4%	11.3%
Sound recording companies in the group (largest)	MCA, Geffen, DGC, Mercury, Polydor, London, Vertigo, Verve, Wing, A&M, Island, Motown, Decca, Interscope, Deutsche Grammophon, Philips, DefJam	Arista Records, Columbia Records, Epic Records, J Records, Jive Records, LaFace Records, Legacy Recordings, Provident Music Group, RCA Records, RCA Victor Group, RLG-Nashville, Sony BMG Masterworks, Sony Music Nashville, Sony Urban Music, Sony Wonder, So So Def Records, Verity Records	Capitol, EMI, Blue Note, Parlophone, Angel, Chrysalis, Virgin	Atlantic, Atco, Elektra, Asylum, Reprise, Maverick, Rhino, Sire, Warner Brothers
Publishing division	Universal Music Publishing Group	BMG Music Publishing	Capitol EMI Music Publishing	Warner/Chappell Music
Distribution division	Polygram Distribution	Sony BMG Distribution	EMD	WEA
Retail		BMG Direct		Ryko Distribution

others to a fall in sales. Nevertheless, EMI has the world’s largest publishing division with rights to more than 1 million songs.

Warner Music Group (WMG) is a conglomerate of the Atlantic Group, Elektra Entertainment Group, Rhino Entertainment, London-Sire Records, and Warner Brothers and owns the rights to the creative output of more than 1,000 artists from 65 countries. The label’s union catalogue includes a total of 50,000 titles. Warner Music Group includes the Warner/Chappell Publishing Corporation and WEA Corporation, the largest distribution company in the USA.

Table A.6 (continued)

Company	Vivendi Universal www.umusic.com	Sony BMG www.sonybmg.com	EMI www.emigroup.com	WMG www.wmg.com
Artists under contract (incomplete list)	Andrea Bocelli, Warren G., Nelly, Willie Nelson, Shania Twain	Aerosmith, Whitney Houston, Bruce Springsteen, Britney Spears, Justin Timberlake, Maroon 5, Rod Stewart, Avril Lavigne, Michael Jackson, Eros Ramazzotti, Placido Domingo, Ricky Martin, Pearl Jam, Elvis Presley, Celine Dion, Jennifer Lopez, Patricia Kaas, Joe Dassin, Barbra Streisand	Sarah Brightman, Garth Brooks, Janet Jackson, Liz Phair, Rolling Stones	Faith Hill, Linkin Park, Madonna, Red Hot Chili Peppers, Seal, Eric Clapton
Other major media holdings in the group	Universal Studios (film), Canal Plus, USA Networks (television)		WEMI Television	Warner Brothers (film), WB Network, Time Warner Cable (television), Time-Life (magazines), Warner Books.

Table A.7

	Universal Music Group	2001	2002	2003	2004
Revenues (€ millions)		6,560	6,276	4,974	4,993
Earnings (€ millions)		719	556	70	338
^a Earnings before interest, taxes, depreciation, and amortisation	EBITDA ^a (€ millions)	1,158	1,000		
Source: Company's annual accounts on its website	Market share	23.7%	25.4%	23.5%	25.5%

In 2003 Warner Music's market share was 12.7%, falling in 2004 to 11.3%. In May 2005 WMG was planning a stock market flotation to raise \$750 million, but then decided to postpone it because of problems in the music market. Analysts believe that if the decline continues, EMI and Warner Music are likely to consider merging.

Table A.8

Sony BMG	2003	2004
Revenues (€ millions)	2,712	2,547
EBITDA (€ millions)	54	163
Market share		21.5%

Source: Company’s annual accounts on the BMG website

Table A.9

EMI ^a	2000	2001	2002	2003	2004
Revenues (€ millions)	3,729	4,381	3,945	3,399	3,030
EBITDA (€ millions)	544	639	390	465	406
Market share	12.5%	14.1%	13.4%	12.7%	13.4%

^aFinancial year ending 31 March

Source: Company’s annual accounts from its website. GB Pounds converted into Euros at the average exchange rate for the year

Table A.10

Warner Music Group ^a	2001	2002	2003	2004
Revenues (€ millions)	3,226	3,290	3,376	3,437
OIBDA ^b (€ millions)			75	219
Market share			12.7%	11.3%

^aFinancial year ending 30 November until 2004, from 2004, 30 September

^bOperating income before depreciation and amortisation

Source: Company’s annual accounts from its website

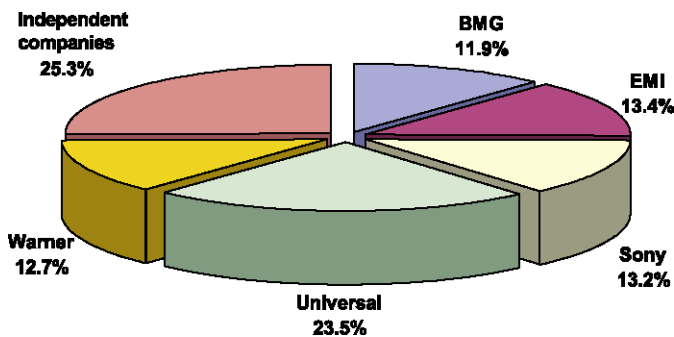


Fig. A.11 Market share of the majors and independent companies, 2003 (“Global Music Sales Fall by 7.6% in 2003—Some Positive Signs in 2004”)

In 2004 the four major labels accounted for 72% of all music sales. The big four expanded horizontally, swallowing music labels in all markets, and vertically, appropriating the processes of value creation and distribution. For example, Sony has for many years been the largest manufacturer of compact discs, while BMG has

the music club with the largest number of members in Europe, and EMI, as already mentioned, is the largest publisher in the world.

A1.4.1.1 Recent Mergers and Takeovers in the Sound Recording Industry

As already mentioned, by the late 1990s the music market was shared between five companies, which together controlled more than 70% of sales: the American Warner Music, the Franco-Canadian Universal Music, the Japanese Sony, the German BMG, and the British EMI. These had all been formed as a result of a lengthy process of mergers.¹³ Enlargement made possible considerable savings in marketing and sales. A major amalgamation occurred in 1998 when PolyGram¹⁴ signed a contract with Universal.

In 2000, Time Warner and EMI announced their intention to merge, but the European Commission objected and the plan was shelved. If the restructuring had taken place, a joint company called Warner EMI Music would have resulted, with an estimated value of \$20 billion. The Commission was concerned that this would have been a monopoly able to dictate prices. In an attempt to salvage the deal, EMI announced it would sell one of its main sound recording companies, Virgin Records. This was insufficient to placate the European Commission. The merger plan was withdrawn for further consideration.

Rumours began circulating in late 2002 about a merger between EMI and BMG. Since EMI was the only free-standing company, it had long been considered a potential takeover target. To general surprise, however, EMI itself took the initiative and began negotiations with AOL Time Warner to acquire a controlling share in Warner Music. The firms could have complemented each other well because EMI is strong in Europe but weak in America, while the reverse applies to Warner. Potential economies from the merger were put at approximately \$240 million by Merrill Lynch. Bringing the assets of Warner Music and EMI together would have created a company controlling about 22% of the American sound recording market, compared to the market leader, Universal, which, according to data from the ratings agency Nielsen SoundScan, controls about 30%.

A number of factors stopped the deal from going through. AOL Time Warner needed cash to pay down its debt, and EMI was itself carrying major debt. There were also difficulties in respect of the future management of the company.

In July 2003 it became evident that negotiations were taking place between AOL Time Warner and BMG, possibly in order to put pressure on EMI. The combined

¹³Sony Music was formed on the basis of CBS Records, Epic and Columbia. BMG annexed Zomba, Jive and Arista. EMI, which was founded in 1900 when the HMV trademark was registered, subsequently added such companies as Capitol Records, Liberty Records, United Artists Records, Chrysalis, SBK, Virgin Records and Priority Records.

¹⁴PolyGram had been formed through a merger of Polydor and Phonogram, and further back in the family tree of the organisation we come across such names as Motown Records, MCA, Geffen, A&M, Chess, and Decca.

market share of Warner and BMG in Europe would have been 20%, but the negotiations fell through. In November 2003 preliminary agreement was announced for a merger of Sony Music¹⁵ with BMG (respectively the second and fifth largest companies in the world).

In parallel, negotiations continued between Time Warner and EMI, the latter offering \$1.6–1.7 billion for the Warner Music division.

Games were being played: if BMG and Sony Music succeeded in being the first to come to terms, EMI and Warner would be in difficulties. The European Commission would hardly give approval for two major amalgamations to go through at the same time. The BMG/Sony alliance would control 25% of the world sound recording industry. Roughly the same proportion would be controlled by EMI/Warner if they were to unite.

Initially the European Union objected to the Sony/BMG merger on the same grounds as in 2000 when it had blocked the EMI/Time Warner merger: the new corporation would have too much market share; but in July 2004, the Commission gave its blessing to the union. A week later the US Federal Trade Commission, charged with ensuring observance of anti-trust legislation, also gave its approval and the deal finally went through.

Experts anticipate annual revenues of \$5–6 billion for Sony/BMG, and the new giant will be in a position to compete with market leader, Universal.

Although EMI had already lined up finance for acquiring Warner Music with a group of leading world banks, its chances of pulling off the deal were sharply reduced. Time Warner had debts to repay, and as a result accepted a different offer from a consortium of private investors which included Edgar Bronfman, the former CEO of Seagram, the billionaire Haim Saban, and the Thomas Lee investment firm. In March 2004 Time Warner sold its music business for \$2.6 billion, and Warner Music became the largest private music company in the world.

A1.4.2 Independent Sound Recording Companies (the Indie Labels)

An independent sound recording company is a firm operating without financial support from any of the major labels. The boundary between the majors and indie labels is blurred, with some independents, especially those working with successful performers, receiving financial support from the major labels, and many of them dependent in their work on international licence and distribution agreements concluded with the giants. According to the IFPI, the independent labels have approximately 25% of the world sound recording market but the figures vary significantly from one region to another. Thus, in Japan and Southeast Asia they have 40% of the market, but in Western Europe less than 10%. During the past five years the market share of the independent labels has been slowly but steadily decreasing.

¹⁵The merger did not involve the Japanese division, Sony Music.

Their main problems are:

- increasingly expensive marketing campaigns for performers;
- heavy expenditure on devising an Internet strategy;
- insufficiently influential organisations, for example, the Association of Independent Music Companies, AIM, representing their interests in the world markets;
- consolidation of the major labels increasingly restricts openings for the indie labels in retail sales and on the airwaves.

There are, however, other factors which work in favour of the indie labels. If previously they were obliged to negotiate with an area's regional distributors, they can now conclude a contract with a single distributor controlling a country. In the USA this enables them to service up to 90% of music purchasers.

The indie labels have one further, long established method of reaching their niche customers: mail order. In the USA this channel accounts for 10% of sales for the major labels, but 50% for the independent companies.

Because it is difficult for the indie labels to compete with the majors in the same market segment, they are forced into niches where the majors have a minimal presence or are absent: smaller markets and performers unable to achieve substantial sales.

The independent labels are particularly good at bringing new performers and music styles to market. The majors are not particularly agile, and find it difficult to discover and nurture talents. Usually the indie labels have a more flexible approach to contracts concluded with artists, although larger independent companies like Zomba differ little in this respect from the majors. New music trends usually appear through the efforts of the independent companies.

The major labels keep a close eye on the success of independent companies and artists. When the companies become sufficiently large, or their performers become popular, the major labels usually seize the company or artist, thus minimising competition.

A1.4.3 Music Publishers

The music publishing business is built on the acquisition and exploitation of rights to music works. Music publishing houses manage copyright in compositions and collect royalties from the use of works on radio, in films, television programmes, restaurants, advertising, and other places and sources on behalf of the rights owners, who are usually the authors.

There are three main kinds of royalties:

- mechanical: royalties received on every album sold;
- performance: royalties paid for the broadcasting of a song on television or radio, or for a public performance;

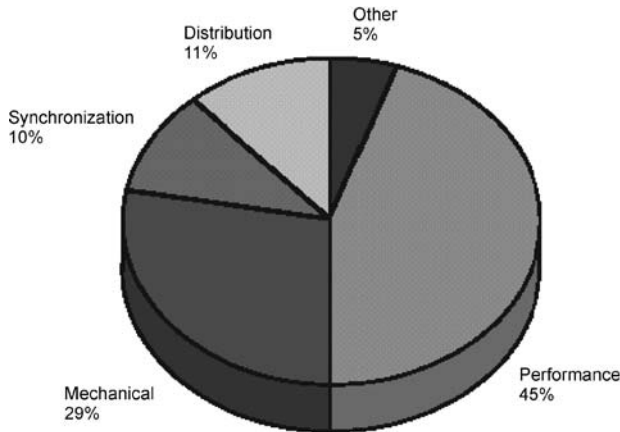


Fig. A.12 The sources of music publishers' earnings (Merrill Lynch, *The National Music Publishers Association*)

- synchronised: royalties paid for the synchronisation of music with visual images in films, advertisements or computer games.

The publishing houses are also reaping a harvest from the growing sector of legal online music.

The music publishing business is more profitable than sound recording, with a 30% profit margin against 10%. It also enjoys more stable income. Meryll Lynch estimates its global turnover at \$6.6 billion. The sector is less centralised than the sound recording industry, with the major labels controlling only about one-third of the market.

There are three main players in music publishing: authors/composers, publishers, and authors' societies. The latter collect and pay mechanical royalties to music publishers, who then usually pass on 50–75% to authors. For work in outlying regions, the largest publishers conclude agreements with local publishing companies, authorising them to collect the author's revenues for the use of works whether on mechanical media or in public performance. With the publisher's agreement, whose interests they represent, they can grant permission for the use of works in films, commercials, mobile phone ringtones, sheet music and text.

The purpose of the music publishing houses is not merely to collect money and distribute it among authors, which can be done perfectly well by an authors' society, but to promote the portfolio of the authors entrusted to their management.

The largest publishing house in the world is EMI Music Publishing which has divisions throughout the world from America to Hong Kong, from South Africa to Scandinavia. It includes a large number of publishers who may represent only a single, well known, artist. Among the most famous artists are Sting, Steven Tyler (Aerosmith), Kurt Cobain (Nirvana), Queen, Per Gessle (Roxette), Diane Warren, Pink, and Jack White.

A1.4.4 Artists

A1.4.4.1 The Artistic Career Ladder¹⁶

There are several grades of performers:

- the superstar, the creation of whom requires considerable financial investment;
- the star, a performer in the range from middling to very well known who is expected to have a long stage career;
- the middle-ranking performer, an artist temporarily enjoying the limelight.

The actual vocal attributes of a performer may sometimes not be all that important. What is important for the fans is the performer's image, created by image-makers and accompanying the artist throughout his stage career. Competent management of stars is crucially important. It includes scouting for new artists, organising their creative work, selecting their repertoire, finding a sponsor, creating a stage image, and planning their career.

To start with, an artist may have an agent who represents his interests on a commission basis. The staff of a star or superstar may include a producer, a personal manager or director of a group, an administrator, business manager, PR manager, lawyer, production manager or technical director, make-up artist, sound producer, lighting artist, choreographer, dresser, and others.¹⁷

The producer¹⁸ directs the creative process and secures the finance. He selects the performers, studio, sound producers and arrangers; selects and edits the musical material; oversees the rehearsal; monitors work in the studio; works on the style of the performance; organises the sound mixing; and finally presents the product to a publisher who pays him a percentage of the revenue from disc sales.¹⁹ The producer

¹⁶This account is based on E. Zhdanova et al., *Management and Economics in Show Business [Upravlenie i ekonomika v shou-biznese]*; I. Prigozhin, *Politics is the Pinnacle of Show Business [Politika – vershina shou-biznesa]*, M.: ACT, Alkigamma, 2001.

¹⁷In Russian show business, functions and duties are less strictly defined. The artist is often working with a director who simultaneously performs the functions of business manager and producer, contrary to international practice.

¹⁸The term 'producer' has been adopted from the American film industry. In the music industry it is used in different ways: sometimes more narrowly to refer to the producer of the vocals who works with the performer and musical material, editing the song or music; sometimes more broadly to refer to the sound producer, a professional who has oversight not only of stylistic aspects of the music and text but also of the process of sound recording and activity of the musicians in the studio. He also manages the final sound mix.

¹⁹In Russian show business the producer is the boss, entirely controlling both the creative and production process. He decides on the hiring and firing of creative and technical personnel, controls the implementation of the project, and intervenes at all stages. In addition to his involvement in creating the product, the producer acts as the artist's personal manager, supervising his career and sometimes also his personal life, as a business manager controlling the financing of the project, as press spokesman, sponsor, and sometimes even lawyer when concluding deals, etc. Producers quite commonly take no part in production of the music, but engage mainly in promotion, taking entire responsibility only for financial resourcing, creating the artist's image and developing his commercial success.

is usually a permanent member of the team, but in a one-off project may work on contract. The Beatles owed much of their success to the work of their producer, George Martin.

The personal manager is the producer's right-hand man. His usual duties are to select an agent for the artist, a lawyer, a sound recording company; to supervise the work of the staff; to liaise with key individuals; to coordinate the advertising campaign; to devise the company's image; to conclude business deals; to prepare tours; to arrange pyrotechnics, tickets for transport, etc.

The business manager is responsible for finance, paying taxes, etc.

The agent finds work for the artist and organises his concert appearances.

The production manager organises the stage production side, and is responsible for apparatus and equipment.

The promoter or impresario organises concerts and tours for various performers and, as a rule, has his own business.

Until recently, the most important aspect of a star's work was seen as issuing an album, while concerts and tours were regarded as part of the marketing campaign, but today the balance is changing.

A1.4.4.2 The Contract Between the Performer and the Company: Ideology and Key Elements²⁰

If the performer is unknown to the wider public, the music company signs a contract with him to produce three albums. Upon receiving the studio recording, the label has the right to release the album or not to do so. If the decision is positive, the countdown begins for getting out the next album which will earn the artist a bigger advance and higher royalties. These decisions are taken album by album. If even once the revenues received by the company fail to cover the musician's advance, the musician is put on ice—he remains in debt to the label and the deficit must be redeemed by revenue from subsequent recordings. The deal is one-sided, and the artist is not allowed to record albums for a different firm until the term of the contract expires.

The contract provides for the advance paid to be spent on recording the album, which encourages musicians to use their studio time sensibly. The recording company is entitled to take decisions on matters of distribution and promotion. From an economic point of view, the apparently enslaving terms of the agreement are entirely justified. The long-term nature of the contract enables the label to recoup losses incurred in the early stages of its collaboration with the performer. Part of the profit from successful projects goes to cover the cost of loss-making recordings, and these are 80–90% of a company's total output.

²⁰Account based on R.E. Caves, "Contracts Between Art and Commerce", *Journal of Economic Perspectives*, vol. 17, No. 2, spring 2003; V. Mikhailov, "A Music Career: The Repulsive, Vile, Cold Truth About Contracts in the Record Industry". "Muzykal'naia kar'era: protivnaia, merzkaia i kholodnaia . . . pravda o kontraktakh v rekord-industrii", *Zvuki.ru*, 21 September 2004, online. Cited 5 October 2004. Available from URL: <http://new.zvuki.ru/R/P/12033>.

Less than 1% of albums manage to sell more than 1 million copies. Of 32,000 recorded each year, only 250 sell more than 10,000 copies, and fewer than 30 sell a million or more. In the United States in 2001, of 6,455 CD albums promoted by the major labels only 112, less than 2%, even returned the resources invested in them. According to RIAA data, less than 10% of compact discs make a profit.

The labels/distributors act as agents for other artists, promoting them to record shops in a bundle with stars because it is on newcomers who make good that they make the real money. They sell them the opportunity of having a song included on the album of a star, for which the star gets a handsome fee. The influence of stars is used to advance the career of newcomers, at a price.²¹

A1.4.4.3 Performers Income and Outgoings²²

In accordance with the standard contract, a music company pays the musician an advance for recording his first album, plus a negotiated royalty.

In the USA the following approximate rates predominate:

1. Contract of a beginning artist with an independent company: 9–13% of the catalogue retail price;
2. Contract of a beginning artist with a major company: 11–13% of the catalogue retail price;
3. Middle-ranking (good) performer: 14–16% of the catalogue retail price;
4. Superstar: 16–20%.

As sales increase, the rate may be increased by 0.5–1%.

The royalties specified in the contract do not all end up with the performers. If the group invites a famous producer to record an album, his fee of approximately 2% is paid for by the musicians. A condition commonly inserted in contracts stipulates that royalties only become payable when at least 85% of the album's initial edition has been sold. 10% of the value of the edition is written off at the artists' expense as "rejects". This condition was imposed in the days when about 10% of vinyl records were commonly damaged during transportation but, although the situation is different with CDs, the clause remains in force. The labels also include two extra discs with every 10 delivered to distributors "for PR and advertising". The distributor receives 12 CDs, but the label pays the musicians a royalty only on 10. The label effectively deprives the musicians of a fifth of the amount due.

For packaging (the box, a brochure) and the disc itself the label helps itself to a further 25–30% of the album's retail price, although the actual costs are much lower.

When signing a contract, the group receives a number of advances from the music company, to record the music, for making the video, organising concert tours, and

²¹Kevin Laws, "Music Industry Structure: Why Madonna Never Complains", September 2003, online. Cited 4 January 2005. Available from URL: <http://www.pacificafund.com/blog/2003/09/29.html>.

²²This account is based on V. Mikhailov, "A Music Career"; I. Prigozhin, *Politics is the Pinnacle of Show Business*.

so on. These are subsequently deducted from the initial 13–14% royalties. Until the label has recouped its investment, the performers receive no more money.

One further item which can be paid for from the performers' share is the cost of organising tours. For example, Fastball was paid around \$100,000 by its label, Hollywood Records, for the tour to promote their debut album, "Make Your Mamma Proud". After paying for the recording and promotional tours of their first two albums the group owed their label some \$500,000.

In addition to performers' royalties, payments are made to the songwriter.²³ In the USA this amounts to about 7 cents per song on each CD sold.

A1.4.4.4 Private Enterprise by the Stars²⁴

With increasing popularity comes an increase in an artist's fees and tax bill. In order to reduce these deductions, businesses are set up, sometimes overseas. The practice became widespread in the United Kingdom, for example, in the late 1970s when progressive rates of taxation could be as high as 90%.

Thus, Elton John is the director of a company he set up called "Happenstance/J. Bondi Ltd", Andrew Lloyd Webber owns "The Really Useful Company/Escaway", and Paul McCartney is the director of "MPL Communications". Brian Epstein's firm "Nems Enterprises", created for managing the Beatles, went on to specialise not only in the promotion of other performers (in particular, Cilla Black and Gerry and the Pacemakers), but also invested in property, owning, for example, the Saville Theatre. Thus, in a number of cases stars are able to promote their own businesses.

A1.4.4.5 Artists' Sales Ratings

When they achieve a particular level of sales, performers are awarded silver, gold, or platinum discs. In different countries, depending on the size of the population, a different level of sales has to be achieved to attain a particular status. In the United Kingdom, for example, platinum is awarded for sales of 300,000 discs. In the USA there is also a diamond nomination after an album has sold 10 million copies.²⁵

The award system extends also to video, and annual awards are made within the framework of the world's most authoritative hit parade, compiled by "Billboard".

²³Artists who do not write their own songs collaborate with songwriters. Such collaborations are usual after a group has had an album which achieved substantial sales.

²⁴Account based on E. Zhdanova et al., *Management and Economics in Show Business*.

²⁵Such record-breakers can be counted on the fingers of one hand: Madonna, Michael Jackson, Led Zeppelin and The Beatles. In no other country has a single disc sold so many copies.

Table A.11 European platinum awards²⁶

Year	Total albums receiving awards	New albums receiving awards	Number of artists receiving awards
2003	70	21	57
2002	92	32	77
2001	87	30	69
2000	80	35	73
1999	81	39	68

Source: IFPI

A1.4.4.6 The Life-Cycle of a Music Product²⁷

The life cycle of birth-growth-levelling off-(decline)-demise is something both artists and their songs pass through. The changing position of songs in the charts is assessed on a number of criteria:

1. entry position (during the first week the song is in the chart);
2. number of weeks from first appearance in the chart to peaking;
3. highest position reached in the charts;
4. total number of weeks in the charts;
5. dropping out, or rating during its last week (chart position before finally dropping out).

The rule is that most songs which make the charts enter and leave at a very low position. Ten to 15% of songs peak in their first week. The majority have a brief and unremarkable life in terms of the number of weeks they stay in the charts, the position at which they peak, and how quickly they do so.

A1.5 Commercial Outlets and Channels for Promotion

Music is sold both on physical media and over the Internet. In both cases, legal markets are under great pressure from unlicensed sales. In these appendices “pirate” business is seen on the one hand as a major factor influencing the legal industry and its sales, and on the other as one of the segments of the music market. As far as online distribution of music is concerned, pirate business preceded legal distribution, and largely facilitated its development. Despite this, it is primarily the situation in the legal markets which is usually considered.

²⁶Awarded to albums which have sold more than 1 million copies.

²⁷Account based on Eric T. Bradlow and Peter S. Fader, “A Bayesian Lifetime Model for the ‘Hot 100’ Billboard Songs”, *Journal of the American Statistical Association*, vol. 96, No. 454, 2001, pp. 368–381.

Table A.12 Best-selling artists (data from RIAA for 20 June 2005)

Artist/Group	No. of discs sold (millions)
The Beatles	168.5
Elvis Presley	116.5
Led Zeppelin	107.5
Garth Brooks	105.0
Eagles	89.0
Billy Joel	78.5
Pink Floyd	73.5
Barbra Streisand	70.5
Elton John	69.0
AC/DC	66.0
Aerosmith	65.5
The Rolling Stones	64.5
Springsteen, Bruce	61.5
Madonna	60.0
George Strait	60.0
Michael Jackson	59.5
Mariah Carey	57.5
Metallica	57.0
Van Halen	56.5
Whitney Houston	54.0
U2	50.5
Kenny Rogers	50.0
Fleetwood Mac	48.5
Kenny G	48.0
Neil Diamond	47.5
Celine Dion	47.0
Shania Twain	47.0
Alabama	46.0
Santana	42.0
Journey	41.0
Alan Jackson	39.5
Eric Clapton	39.0
Prince	39.0
Simon & Garfunkel	38.5
Bob Seger and the Silver Bullet Band	38.0
Chicago	38.0
Reba McEntire	36.5

Table A.12 (continued)

Artist/Group	No. of discs sold (millions)
Guns 'n' Roses	36.5
2 Pac	36.5
Foreigner	36.5
Backstreet Boys	36.0
Bob Dylan	35.0
Rod Stewart	34.5
Willie Nelson	34.0
Def Leppard	33.0
Phil Collins	33.0
John Denver	32.5
James Taylor	32.0
Bon Jovi	32.0

*A1.5.1 Mass Media Channels for Promoting Music*²⁸

The channels for promoting music are radio (including Internet-radio), television, cinema, the press, computer games, mobile phones, clubs, ringtones,²⁹ etc.

Radio The American classification of music broadcasting has been widely adopted:

- CHR (Contemporary Hit Radio): a station playing current hits. Target audience, aged 15–28 years;
- AC (Adults Contemporary): contemporary music for listeners aged 25–35 years;
- Dance: electronic dance music for age 14–24 years;
- Oldies: retro music, for age 35 and above.

Narrowly focused radio stations also exist, mostly broadcasting special interest music like jazz, rock, folk, rap, and country.

Programme producers classify music as New Releases; Hot Hits; Cooling Hits; and Golden Oldies (favourites of earlier years).

Television An important role in promoting music is played by such specialised music channels as MTV and MUZ-TV (Russia).

The Internet Internet-radio stations work on much the same principles as ordinary radio. Music is transferred from the websites using audio streaming technology which permits listening but not storing the music on a computer hard disk.

²⁸See, for example, E. Zhdanova et al., *Management and Economics in Show Business*.

²⁹For information on ringtones see below, Sect. A1.11.2.

Cinema³⁰ Film music is divided into three categories: the musical accompaniment of a film; an existing song appropriate to a film; a song written specially for a film.

A film which pulls in a large audience advertises music with variable effectiveness, depending on:

- how the song is used (performed by an actor in front of the camera, or as a background accompaniment, instrumental or vocal);
- the type of film (whether made by a major studio, an independent studio or an experimental workshop);
- the status of the song or tune (a new song, a classic, a hit);
- extent of playtime during the screening (1 minute, 4 minutes, 10 seconds, played once or several times);
- whether the song/composition is included in the soundtrack album of the film;
- whether the song develops into the main musical theme of the film;
- whether it is heard in trailers for the film;
- extent of exhibition of the film.

Computer and Video Games In the past the record labels took little interest in the games industry but the situation is changing as a result of convergence of different media and the transformation of games consoles into multi-purpose entertainment systems. Manufacturers have begun including facilities for recording on to CD and DVD, providing them with USB ports which enable them to be connected to a computer's hard disk, giving extra memory, and Dolby digital sound systems. The sound quality of video games is rapidly improving, along with the capacity for storing information, including a musical accompaniment.

A1.5.1.1 The Impact of Different Media on American Consumers

A1.5.2 Legal Distribution of Albums on Physical Media

A1.5.2.1 Retail Distribution of Compact Discs

Retailers obtain about 60% of compact discs sold from authorised distributors of the record companies and 28% through wholesalers. The remaining 12% come from mail-order suppliers.

Retail outlets offer much the same repertoire as each other and compete mainly on price and quality of service. The major labels prefer to do business with the main retail networks, as these have a better knowledge of the market and do not need guidance. They also have among their customers many blockbuster fans who bring

³⁰Based on Jeffrey and Todd Brabec, *Music, Money and Success*, Schirmer Trade Books/Music Sales, 2001.

Table A.13 Media which have influenced American consumers' decision to buy their last CD

Radio	75%
Friends/relatives	46%
Music TV channel	45%
Seen in shop	42%
Heard film soundtrack	37%
Concert visit	29%
TV advertising	24%
Used in TV show	23%
Downloaded MP3 file	19%
Internet	17%
Magazine/newspaper	17%
Internet-radio	15%
Music club	15%
Videogame	5%

Source: Edison Media Research, June 2003 (percentage of purchasers of a music CD over the previous 12 months)

Table A.14 Share of distribution channels, %

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Music shops	53.3	52.0	49.9	51.8	50.8	44.5	42.4	42.5	36.8	33.2
Other shops	26.7	28.2	31.5	31.9	34.4	38.3	40.8	42.4	50.7	52.8
Music clubs	15.1	14.3	14.3	11.6	9.0	7.9	7.6	6.1	4.0	4.1
Internet				0.3	1.1	2.4	3.2	2.9	3.4	5.0
Other	3.4	4.0	2.9	2.7	2.9	2.5	2.4	3.0	2.0	1.5

Source: RIAA, 2003, 10-year Music Consumer Trends Chart

the record companies substantial profits. Working with independent shops involves higher overhead costs and the tastes of their customers are less predictable.

The main retail networks control about one-third of CD sales and are accordingly offered special promotions and discounts on the wholesale price of discs. In an effort to increase sales, Universal Music Group dropped its wholesale price by approximately \$3 (from \$12.12 to \$9.09).³¹ As a result the retail price fell to \$11–12, and in shops serving the mass customer it fell below \$10.

All this favours the big retailers like Wal-Mart and Best Buy whose great priority is to increase sales volumes, and is bad news for independent shops and medium-sized music chains, many of which are closing down.

³¹The promotion was offered to shops on condition that they devoted 25% of their usable space and 33% of their best sales space to Universal products.

A1.5.2.2 The Role of the Main Store Operators Like Wal-Mart³²

Wal-Mart only stocks albums from the top 200, and offers neither hits from the past nor music by young artists. Even for payment the company will not display their CDs in prominent shop space. The public knows that discs in Wal-Mart are cheaper than in other legal outlets and accordingly chooses to buy them there. As a result Wal-Mart takes the bread-and-butter, the highly saleable top hits, from other retailers who are left with products which sell more slowly.

Specialised music shops like Tower Records, Sam Goody and others have tried to resist Wal-Mart, but have finally resorted to exactly the same tactics, concentrating on a fast selling catalogue and excluding beginning artists from their offerings. Not even this is always enough to save them: Tower Records was put up for sale in order to avoid bankruptcy.

Quite a few people believe the expansion of Wal-Mart has altered the structure of the music industry almost more radically than the Internet and peer-to-peer networks. Wal-Mart's agreement to sign a contract with a music company is something the latter is proud of. Exploiting its negotiating clout, Wal-Mart squeezes a lower price out of the producer than any other retailer. As a result, the turnover of the latter falls and the music industry as a whole loses a channel of information about consumer preferences.

A1.5.2.3 Distribution of Compact Discs Through Record Clubs

One further distribution channel is record clubs, which were popular in the West even before retail chains appeared. For outlying regions they were the only way of buying sound recordings. For the consumer, belonging to a club often proves the least costly way of acquiring discs. Two of the largest record clubs, Columbia House and BMG, legally copy and distribute CDs among their members. The clubs have the right to supply on the basis of "buy one, get one free". Since artists receive no royalties if discs are distributed free, they sometimes try to include a clause in their contract banning the licensing of their music to record clubs.

A newly initiated club member starts receiving collections chosen by experts. As a rule this is 6–8 new albums, plus several other CDs chosen at random (e.g., exclusive offers, rare recordings, imported discs, or music issued in a limited edition). The buyer can make his mind up about the knowledgeable ability of the club's experts by subscribing for one collection. The discs are delivered to his home or office, saving him the trouble of going to get them from a shop. Deliveries are made not more than once a month, and usually every 8–10 weeks. On average such a selection costs \$60 within the USA, or \$80 abroad.

³²855 After Kevin Laws, "Music Industry Structure: RIAA Enemy No. 1 – Wal-Mart, Not Kazaa", October 2003, online. Cited 4 January 2005. Available from URL: <http://www.pacificavc.com>.

A1.5.3 Online Distribution of Music

The Internet reduces trading costs because e-retailers do not need warehousing or retail accommodation, to hire sales staff, build and maintain shops. If they organise things properly, e-retailers act as information middlemen and can deliver goods (compact discs and audio cassettes) directly from the depositories of manufacturers, which not only economises resources, but makes the distribution system more flexible and reduces the risks of overstocking associated with changes in consumer tastes. E-retailers do not need to expend resources on setting up the logistics for shops in different towns. The Internet has opened a global market to them, allowing them to serve purchasers in any part of the world, accept orders round the clock, and deliver goods using the FedEx and UPS delivery services.

Using the Internet reduces the costs of sellers and buyers searching for each other. The buyer can compare prices of several key retailers. In addition he can listen to music using audiostreaming technology before deciding to buy. For their part, sellers can track the music preferences of customers and optimise sales.

Online retailers can be divided into four groups:

- those who mainly conduct their business in real commercial premises, but additionally trade through a website;

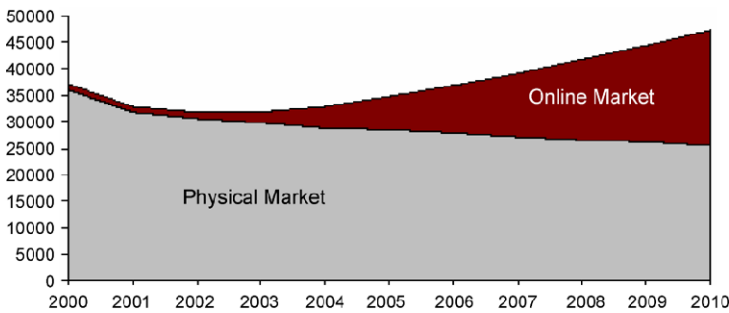


Fig. A.13 Retail sales of music (\$ millions). Source: Merrill Lynch, Arthur Andersen

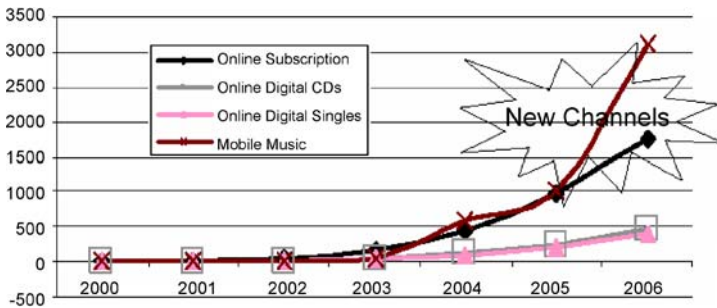


Fig. A.14 Distribution channels of digital music (\$ millions). Source: Merrill Lynch, Arthur Andersen

- those who sell through catalogues;
- e-retailers working exclusively over the Internet;
- producers of music (record labels or artists), using the Internet to reach their end-users and avoid intermediaries.

A1.5.3.1 Formation of a Legal Online Music Market³³

A breakthrough in legal online music selling³⁴ occurred in 2003. Record companies at that time licensed an enormous number of EU retailers, and the major sound recording companies began giving licenses for their catalogues, reducing the gap between the music becoming available in the off-line and online markets, and offering users different ways of working with music content.

Development of the Online Music Market in the United States in 2003:

April 2003 iTunes launched for owners of AppleMac computers;

May 2003 Roxio acquires the PressPlay music service from Sony and Universal, having already bought Napster in November 2002;

August 2003 BuyMusic.com website opens;

October 2003 Musicmatch offers downloading of tracks, and markets a portable player (in collaboration with Dell);

- iTunes comes to the market;
- Launch of the legal Napster service;³⁵

By the end of the third quarter the number of subscribers to RealNetworks had reached 250,000;

November 2003 MusicNet announces it has 185,000 subscribers;
BestBuy website launched.

The growth of legal online services in the USA at this time was encouraged by the success of Apple's iTunes Music Store (www.apple.com/itunes/). According to Apple, in its first six months iTunes sold an average of 500,000 tracks a week.

³³Account based on IFPI, *Online Music Report 2004*, International Federation of the Phonographic Industry, 2004. Cited 20 September 2004. Available from URL: <http://www.ifpi.org/site-content/library/online-music-report-2004.pdf>.

³⁴The legal online music business began in 1998 in the USA when eMusic.com began selling singles and albums in MP3 format from its website. In 1999 Streamwaves was the first to offer the facility of listening to music on subscription. In 2001, OD2, Peter Gabriel's company, marketed the WebAudioNet platform for a legal service. In late 2001 the MusicNet, Rhapsody and PressPlay online music services were launched in the USA, operating on a subscription basis which permitted users to listen to music on their own computers, but not otherwise. The high subscription cost and restricted choice of tunes discouraged potential customers, most of whom preferred the illegal services.

³⁵Napster 2.0 was a music service which took over the name of its predecessor which had been shut down by court order. It offers tunes and a number of other paid services. For more detail see Sect. A1.5.3.3 later in this Appendix.

By mid-October the number of downloads had reached 13 million, and by mid-December 25 million.³⁶ At the time of opening its online store, 200,000 works were being offered.³⁷

From the second half of 2003 the conquest of online space in the USA accelerated. In January 2004 Wal-Mart began testing a digital service, and RealNetworks opened the RealPlayer Music Store with more than 300,000 tracks. In April 2004 Sony announced the launch of its Connect online service offering 500,000 tracks.

In the second half of 2003 the total volume of legal online music downloads in the USA reached 19.2 million.³⁸ At this time sales of digital music exceeded the turnover of singles on physical media by 3:1. During the first half of 2003 the number of Americans paying to download music doubled from 8% to 16%.

Development of the Online Music Market in Europe

In 2003 some 30 legal online services were in existence in Europe. Over half a million customers had access to between 275,000 and 300,000 tracks. The majority of online services were operating on the OD2 platform. The MyCokeMusic.com service, for example, was launched by Coca-Cola in a number of European countries.³⁹ Many services using the OD2 driver offered a combination of listening (streaming) and downloading of works.

Independent services also began to appear in Europe, like the German T-Online's Musicload.

Table A.15 Overall data for the European online market

	End of 3rd quarter 2003	End of 4th quarter 2003
Number of registered users	380,000	450,000
Number of available tracks (various types of use)	210,000	275,000
Number of downloaded tracks (average per month)	220,000	300,000

Source: OD2

³⁶Statistics from April to mid-December 2003. What ensured the success of iTunes was the ease of use and variety of ways of working with content, and also integration with the iPod, a portable digital player.

³⁷Apple signed deals with five major companies: Vivendi Universal, EMI Group, Sony, AOL Time Warner, and BMG. The number of recordings could have been higher but for restrictions imposed by artists, composers, authors and publishers.

³⁸As estimated by Nielsen SoundScan.

³⁹The retail partners of OD2 included MSN Music Club, Virgin Downloads, Tiscali Music Club, HMV Digital Downloads, Fnac, TDC Musik (Denmark), Karstadt and MTV DE.

Legal Online Services Outside the USA and Europe

The situation developed along similar lines in many other regions. The first Canadian legal online service, Puretracks, appeared in October 2003. In the course of a year its catalogue increased from 175,000 to 300,000 tracks. In the Asia-Pacific region the service providers Soundbuzz, mylisten.com, PlanetMG, ilikepop.com, and clickbox.co.tw offered their services. In Taiwan the first legal online service was imusic.com.tw based on the iBiz platform projected to offer 500,000 songs. Two services appeared in Australia: Destra gave access to more than 500,000 tracks, Telstra Big Pond offered 200,000. The pioneering online music business in Latin America was the Brazilian provider, iMusica.

It took something like five years to establish a legal model of online business. Such a lengthy, in Internet terms, period is due to the fact that a legal scheme is much more complicated than the pirates’ distribution models.

A1.5.3.2 Problems of Creating a Legal Online Business

The development of the digital music market was delayed by two factors:

- Internet piracy;
- relatively low availability of broadband Internet.
- The development of the digital music market was favoured by:
 - stable demand for music. Music consumption (including all legal physical formats and the whole range of legal and illegal downloading) increased by 30% between 1997 and 2002.⁴⁰ Online consumption of music (mostly pirated) in

Table A.16

Conversion of content into digital format	Libraries of music works have to be created from scratch, necessitating high-quality digitisation of hundreds of thousands of tracks.
Agreeing legal matters and licensing sound recordings	Clearing rights for online distribution involves time-consuming agreement of legal matters with numerous parties. Distribution rights for sound recordings have to be obtained from the record companies; rights to songs from music publishers or authors’ societies. Different licenses may be needed for distribution in different territories.
Technical upgrading	Legal services are responsible for the quality of what they offer.
A user-friendly Digital Rights Management system	The user needs to be able to store and use the downloaded track without infringing copyright.
Anti-virus protection	Both content and operating systems need to be protected from viruses, which requires specialist support technology.
Secure payment systems	

⁴⁰IFPI research covering Australia, Germany, the UK, USA, and Canada.

Australia, Germany, the UK, the USA, and Canada alone amounted to approximately 8 billion tracks, or about one third of all music content;

- a growing number of people using or willing to use paid music services. 36% of customers of peer-to-peer networks in Germany, France, Sweden, Spain and Italy declared their willingness to pay for music.⁴¹ An MTV survey in summer 2003, conducted among visitors to European music websites, also showed that one-third of fans (most respondents were under 25 years of age) would like to buy music.

A1.5.3.3 Options for Buying Music on the Internet

A la carte downloading to computer disc or player by a user who pays for each song;

- “tied” downloading, where tracks are rented for a fixed period. Music files remain on the computer’s hard disk until the subscription expires. The music cannot be downloaded to a player;

Table A.17 Service options for customers

Service	Main Options	Payment Method	Special Features
iTunes	À la carte downloading	Payment per song. Account facility	Audiobooks, emailing of music samples, exclusive tracks and video on demand, personal playlists, transfer of music to iPod portable player
Napster 2.0	Track streaming, customised streaming, à la carte downloading	Monthly subscription to Napster Premium, pay per song, payment by Napster Card available from 14,000 retailers	Recommendations for creating playlists, shared use of playlists, video on demand, free access to online music magazine, studio performance, transfer of music to player
Rhapsody	Track streaming, customised streaming	Monthly subscription with supplementary charge for burning music to CD	Music accessible from any computer
MusicMatch	Track streaming, customised streaming, à la carte downloading	One-off payment for customer software MusicMatch Jukebox Plus, then payment per song	Transfer of music to player, burn personal CDs with customer’s playlist, recommendation of new music based on customer’s preferences
OD2	Track streaming, à la carte downloading	Prepayment for downloading and streaming (different tariffs), payment per song, subscription	Transfer of music to player, news and special video materials about artists

⁴¹Independent research by Jupiter Research, *Online Music in Europe*, 2002.

- downloading a complete album. A standard charge is paid for the album;
- downloading a bundled playlist, compiled by other users or the artist. The bundle may include video or photographic content;
- streaming audio, where music can be listened to but is not stored on the hard disk. The data is transferred to the computer, not as a physical file but in the buffer of the sound reproduction program, which is subsequently cleared. The service is very cheap, and widely used for listening to a song before deciding whether or not to buy it;
- customised streaming, enabling the user to compile his own playlist according to taste.

A1.6 Price Formation and Price in the Music Industry

Unsystematic and often contradictory information about the contribution of the various constituents of added value to the final product price is dispersed over a variety of sources. This is partly due to the fact that the success of albums is highly variable. Some features of price can nevertheless be ascertained, subject, of course, to scale of production.

An album’s budget covers: payment for the services of a producer; studio rental; payment for musical arrangement; fees to the songwriter and composer; and payment of the sound producer.

There are also such extras as paying technicians, consumables, etc.

Steve Albini in his article “The Contract of Your Dreams”⁴² offers the following:

Table A.18 Recording budget table

Recording Budget	US\$ 150,000
Producer’s advance	50,000
Studio fee	52,500
Drums, amplifiers, microphones, phase “doctors”	3,000
Recording tape	8,000
Equipment rental	5,000
Cartage and transportation	5,000
Lodgings while in studio	10,000
Service	3,000
Mastering	10,000
Miscellaneous expenses	6,500

Source: Adapted from Steve Albini. Prices in US dollars

⁴²Steve Albini, “The Contract of Your Dreams”, *Maximum Rock ‘n’ Roll*, No. 133, 1993, online. Cited 5 October 2004. Available from: <http://indie.chat.ru/Albini.html>.

A1.6.1 Typical Production Costs of a CD

Other companies⁴⁴ may have slightly higher or lower prices for different quantities.

In Russia the lowest price is offered by CDmax (www.cdmax.ru). The price includes production of a matrix, copying, label for the disc, packaging in a jewel box (in a plastic case this firm charges \$0.20), printing (insert for the front and back sides of the case).

From the data it can be seen that for any reasonable quantity production of compact discs cost around 50 cents. Including sound recording, the manufacturing cost of a CD is less than \$1. It also varies greatly depending on the quantity produced, which in turn depends on the marketing budget.

In addition to recording and copying costs, the labels include in the manufacturing price the cost of making a video, getting the product broadcast on television and

Table A.19

	Type of expenditure	Edition 250,000	Cost per CD US\$
Sound recording	Fixed	100,000	0.40
Studio hire		52,500	0.21
Drums, amplifiers, microphones, sound producer		3,000	0.01
Recording tape		8,000	0.03
Equipment rental		5,000	0.02
Cartage and transportation		5,000	0.02
Lodgings while in studio		10,000	0.04
Service		3,000	0.01
Preparing the master disc		10,000	0.04
Miscellaneous expenses		6,500	0.01
Manufacturing costs (preparing matrix discs from master disc, copying, design, packaging, printing)	Variable	550,000	2.20
Total		650,000	2.60

Source: Steve Albini. Prices in US\$⁴³

⁴³Steve Albini, "The Contract of Your Dreams".

⁴⁴See, for example, online: <http://www.12zcd.com/pricing.htm>, http://www.snjcd.com/cd_replication.html. Cited 5 June 2005.

Table A.20 Sample rates for manufacturing a CD, US\$

Product	Manufacturer	Quantity										
		500	1,000	2,000	2,500	5,000	7,500	10,000	20,000	50,000	100,000	200,000+
CD with full-colour printing	Sun Plastics and Dynamic LP Stereo	0.96	0.91	-	0.86	0.81	0.76	0.71	-	-	-	-
	Record Pressing Co	-	0.40	0.38	-	0.35	-	0.31	0.25	0.21	0.17	Contract
CD with full-colour printing, packaged in jewel-box, cellophane-wrapping, printing	Manufacturing, Inc	-	0.98	0.90	-	0.70	-	0.63	0.53	0.44	-	-
	Digital Quality 3 Manufacturing, Inc	-	0.98	0.90	-	0.70	-	0.63	0.53	0.44	-	-

Source: Websites of the manufacturing companies

Table A.21

Quantity	1,000	2,000	3,000	5,000	10,000	20,000
Price	0.43	0.38	0.35	0.30	0.28	0.26

Table A.22 Price breakdown of a CD album (\$)

	Amount, \$	Share, %
Retail price of a CD album	14.64	100
Retail margin	2.93	20
Wholesale price	11.71	80.00
Returns	0.44	3.00
Net price	11.27	77.00
Manufacture and distribution	2.34	16.00
Artists' royalties	1.76	12.00
Mechanical royalties (paid to publishers and composers)	0.73	5.00
Marketing	2.34	16.00
Operating income	1.76	12.00
Overhead costs	2.34	16.00

radio, press advertising, posters, stickers, promotional samples, creation of a website, accompanying tours, etc. Market participants claim that “it costs \$2 to produce and distribute a CD, but the marketing costs can be over \$3 (for a hit CD) to \$10 or more (for projects which flop)”.⁴⁵ The amounts given by different sources vary widely. In particular, the cost of making a video is put at anything from \$30,000 to \$150,000.

A List of the Most Expensive Videos⁴⁶:

- Michael Jackson, “Scream”—\$7 million
- Puff Daddy, “Victory”—\$2,700,000
- Mariah Carey, “Heartbreaker”—\$2,500,000

⁴⁵Chuck Philips, “Record Label Chorus: High Risk, Low Margin”, *Los Angeles Times*, 31 May 2001.

⁴⁶Vadim Mikhailov, “A Music Career”.

Table A.23 Price breakdown of a CD album (€)

	Amount, €	Share, %
Retail price of a CD album	13–24.5	100
Retail margin	2–2.5	10–15
Taxes	3.5	14–27
Wholesale price	7.5–18.5	58–75
Record company's profit	2.5–4	16–19
Net price	5–14.5	38–59
Recording	2.25	9–17
Manufacture	0.25–5	2–20
Pressing of CD	1	4–8
Artists'/ Rights' owners' royalties	1.25	5–10
Marketing	0.25–5	2–20

- Busta Rhymes, “What’s It Gonna Be?”—\$2,400,000
- Backstreet Boys, “Larger Than Life”—\$2,100,000
- Will Smith, “Miami”—\$2 million
- Missy Elliott, “She’s a Bitch”—\$2 million
- N Sync, “Pop”—\$1,800,000
- TLC, “Unpretty”—\$1,600,000
- Guns ’n’ Roses, “November Rain”—\$1,500,000.

To the price of the compact disc must be added the creators’ royalties, the label’s profits, the retailer’s margin, and taxes.

(Tables A.22 and A.23 are taken from a variety of sources.)⁴⁷

A1.6.2 The Retail Price of Music on CD and Online

The prices of music products in the US- and European-based Internet stores have been established by monitoring. In US stores, discs (for example, Madonna’s album, “American life” or Britney Spears “Baby, One More Time”) are sold at \$13.05–\$15.50; in German stores at \$12–\$19 (converted from Euros); in British stores at \$25

⁴⁷Charles R. Wolf, “Surprise! The Price Is Right!”, Needham & Company, 16 July 2003, online. Cited 23 December 2004. Available from URL: http://www.needhamco.com/Research/Documents/20030716_Wolf_Bytes_39.pdf; Peitz and Waelbroeck, “An Economist’s Guide to Digital Music”.

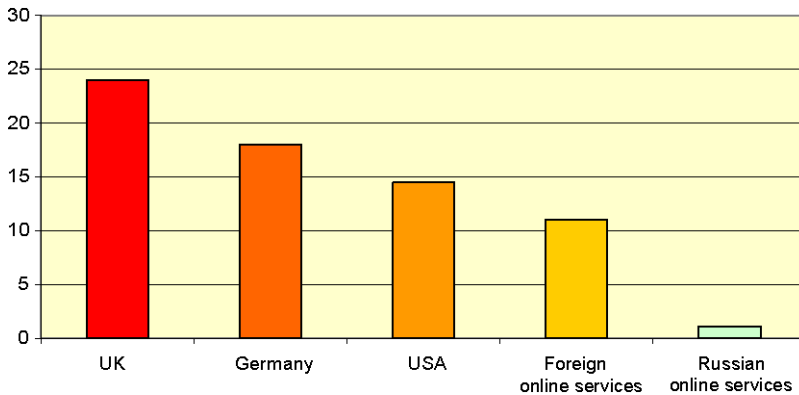


Fig. A.15 Price of music albums (US\$)

(converted from Pounds Sterling). CDs with singles are uncommon, but in British stores they cost \$3.05–\$7.05 (converted from Pounds Sterling).

In Russia, a song downloaded from a legal foreign online music service is \$0.99 (iTunes, Napster, BuyMusic.com, connect.com).⁴⁸ On the Internet in Russia, paid music services offer songs at \$0.10 each. Some, for example, www.MP3search.ru, target foreign users. No information is provided on the legality or otherwise of the content offered.⁴⁹

A1.6.2.1 Economic Indicators of Online Stores⁵⁰

Of the \$0.99 received by the iTunes Music Store⁵¹ for a single, the record company receives approximately \$0.65. From the remainder the Store has to pay for the In-

⁴⁸Certain paid music services only accept orders from US territory.

⁴⁹In February 2005 the Moscow office of IFPI complained to the Public Prosecutor's Office about copyright infringement by the owners of the AllofMP3.com website, which was offering a large number of music products for downloading in a variety of digital formats (MP3, OGG, WMA, etc.) at a price of \$0.02 per Megabyte. An investigation showed that the owner of AllofMP3 had no authorisation from the rights holders, but despite this, because of gaps in Russian legislation, the request to institute criminal proceedings was refused on the grounds that no crime was being committed.

The website's owners claim they are operating under license from ROMS (the Russian Association for Collective Management of Rights of Authors and Other Rights Holders in the Spheres of Multimedia, Digital Networks and Visual Art). Despite this, there is a statement on the website itself to the effect that they do not consider themselves bound by foreign legislation. Representatives of Western labels and international societies for the protection of the rights of music publishers claim that AllofMP3.com's license is invalid and that its operation is illegal. Blocking the AllofMP3.com service was one of the conditions for Russia to be admitted to the World Trade Organisation.

⁵⁰Account based on Wolf, "Surprise! The Price Is Right".

⁵¹www.apple.com/itunes.

ternet channel and the services of credit card companies. The companies take \$0.25 for each transaction, plus a further 2–3% of the amount paid (even though Apple receives a discounted rate from the card companies). Singles are generally purchased 5 or 6 at a time, and in order to save on fees Apple combines them into a single transaction. A large part of the online store’s residue of \$0.35 is thus swallowed up by distribution costs. Apple probably earns 5 or 10 cents per song. Given something like 500,000 downloads a week, this produces gross annual revenues of \$25 million, which is very modest in comparison with the company’s overall annual revenues of \$6 billion.

A1.6.3 The Price Trend⁵²

When compact discs first appeared, their retail price averaged \$21.50 in the USA, but by 2001 this was down by one-third to \$14.64. From 1983 to 1990 prices fell inexorably, then rose insignificantly, and by 1996 had reached their lowest level by comparison with 1990. From 1997 to 2001 prices rose at an average of 2.8% a year. (See the Chart below.)

In 1983–2001 the US Consumer Price Index rose 77.8%. If CD prices had kept pace with inflation, a compact disc would have cost \$38.23 in 2001 instead of \$14.64. Adjusting for inflation, the price of a CD fell by more than 60%.

At the same time the average number of tunes which can be recorded on a single compact disc increased from 9.9 in 1983 to 14.6 in 2001. The average listening time rose from 41.6 minutes to 55, that is by 32%. Accordingly, in 1983, 1 minute of

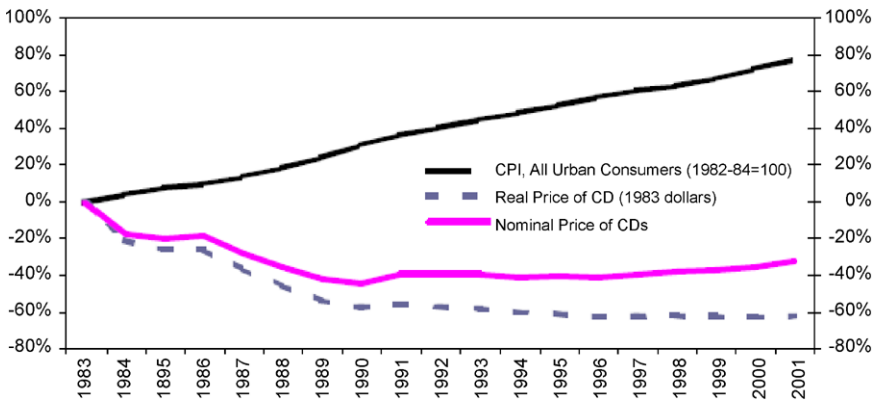


Fig. A.16 Cumulative percentage change in the consumer price index and real and nominal price of a CD

⁵²Account based on Andrew R. Wechsler and George R. Schink, *CDs: A Better Value Than Ever*, LECCG, 21 May 2002, online. Cited 25 July 2005. Available from URL: http://banners.noticiasdot.com/termometro/boletines/docs/consultoras/riaa/2002/riaa_CDValueStudy2002.pdf.

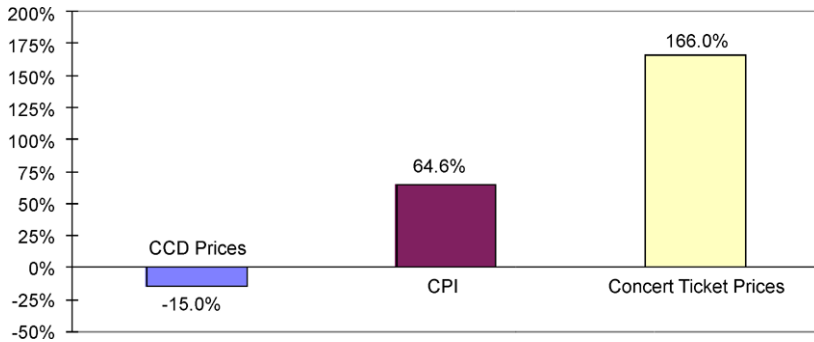


Fig. A.17 Percentage change in CD prices, the CPI, and concert ticket prices, 1985–2001

music on a CD cost 51.7 cents, while by 2001 its price had fallen to 15 cents (at 1983 prices).

Over the same period the average cost of attending a popular music concert, on the contrary, rose from \$14.79 in 1985 to \$39.34 in 2001.

Prices for entertainment events other than music, including cinema, theatre, and sporting events, increased between 1983 and 2001 by 142.4%.

A1.6.4 Consumer Costs of Obtaining Music Through Various Channels

In this Section we present the results of an investigation⁵³ to establish the overall cost to a resident of Moscow of acquiring music recordings through various channels. These costs include both money spent directly on purchasing the music, such overheads as travel costs, and also the time costs of shopping.

Channels for Acquiring Music Recordings:

1. *Peer-to-peer networks*. The user of a peer-to-peer network spends less than 15 minutes (on average 14.0 minutes) searching for and downloading the tune he wants, and less than \$0.24 in monetary terms;
2. *Markets* (Gorbushka Market, Mitinsky Market). Both markets are located far from the city centre, so travelling there takes one to one-and-a-half hours. Finding the music you want takes about half an hour. Total time costs can be as high as 3.5 hours. The return fare is about 55 roubles. Discs cost 80–200 roubles. There is a large selection of recordings and both licensed and pirate discs. The average disc price is 100–120 roubles;
3. *Specialist music shops* (Soyuz, Purpurnyi Legion). These stores are located in central Moscow, so a single journey can take up to 1 hour. A further 20 minutes

⁵³This research was carried out by the Pragmatics of Culture Foundation in December 2004.

is required to select and buy the music. Overall time costs are estimated at 2 hours 20 minutes. Fares on public transport are 26 roubles and the music costs from \$5 for Russian recordings to \$45 for foreign discs (because of the import tariff). All the music is licensed. Some stores have facilities for recording specially listed MP3 files to disc, facilities for listening to music and advice can be obtained from the sales staff;

4. *Music departments of retail chain stores* (Carrefour, Ramstor). All discs are licensed. The average price is 100 roubles. Limited selection with only the most popular CDs on sale. Time cost, 1 hour;
5. *The music department in hypermarkets on the Moscow Ring Road*. Most customers arrive in their own transport, spending not less than 30 minutes one-way travel time, and not less than 1 hour walking round the shop. The products are licensed and bought in the course of a shopping expedition, so that it is not possible to isolate time costs. A disc costs 120 roubles. Restricted selection, with only hits on sale;
6. *Kiosks in subways, at railway stations, in the Metro*. Discs are bought in passing. The goods are mostly pirated, although some are licensed. Discs cost 50–150 roubles. No guarantee of quality;
7. *Borrow a disc from friends and copy it*. It is possible to copy favourite songs selectively but there is no guarantee of finding the tunes wanted. The cost is the price of a blank CD (if you do not copy to a hard disk), 15–30 roubles;
8. *Internet stores*. Disc prices from 100–900 roubles. Delivery by motorcycle courier within Moscow from 50 roubles. Delivery time at least two days;
9. *Paid Russian music services on the Internet*. The MP3search.ru service offers a vast choice of Russian and foreign music in MP3 format at 10 cents per song. There is no information about who owns the service or the legality of sales on the website. The AllofMP3.com service offers legal music, the price per song varying from 11 to 18 cents depending on the sound quality, which can be selected when downloading. The MP3Spy.ru service offers music at 5 cents per song, but so far the selection is limited. If you do not have a credit card, you can top up your account at a branch of Sberbank savings bank or by buying special cards, which is a hassle;
10. *Paid foreign Internet music services*. Enormous record libraries. The price of a song averages 99 cents, but many services are available only to residents of a particular country. Payment by credit card. Searching for and downloading a song using a cable connection takes around five minutes;
11. *Internet record libraries bundled with other services*. Internet service on the Stream tariff allows unlimited access to the AllofMP3.com and MP3Spy.ru services for \$24 per month;
12. *Free music on the Internet*. Servers providing free downloads on the Internet are more difficult to find in Russia than previously, but do exist. For example, rmp.ru. Search time, depending on the particular tune, can take from five-and-a-half minutes to a fairly long time;
13. *Ask friends to send a file reference or the file itself by e-mail*. The same costs as using peer-to-peer networks, but the source is more reliable.

Table A.24 Rating of channels for acquiring music (in rising order of inclusive costs)

No.	Channel	Constituents of monetary costs	Average time costs in minutes	Time in hours	Total costs in roubles ^a	Total costs in dollars ^b	Advantages and disadvantages
1	Peer-to-peer networks	Less than \$0.25 (search time/traffic). Total 7.5 roubles.	15	0.25	26.25	0.88	+ can download individual songs; – virtually no Russian-language songs; – risk of infecting computer with viruses and parasitic programs. + can download individual songs; + music (legal!) effectively free.
2	Internet record libraries as addition to other services	\$0 for song + \$0.25 for search time/traffic. Total 7.5 roubles.	15	0.25	26.25	0.88	
3	Ask friends to send reference or MP3 file	Less than \$0.25 (traffic). Total 7.5 roubles.	15	0.25	26.25	0.88	– risk of infecting computer with viruses; + can trust source sending the content.
4	Paid Russian music services on Internet, e.g., MP3search.ru, allofMP3.com	\$0.05–0.18 for song, depending on service, + \$0.25 for search time/ traffic. Total 12–15 roubles.	15	0.25	33.75	1.13	+ vast choice; + no need to travel; + ability to choose what you want in comfort; + can download individual songs; – if no credit card, need to top up personal account with vouchers or paying through Sberbank.

Table A.24 (continued)

No.	Channel	Constituents of monetary costs	Average time costs in minutes	Time in hours	Total costs in roubles ^a	Total costs in dollars ^b	Advantages and disadvantages
5	Paid foreign music services on Internet, e.g. iTunes.com	\$0.99 for song + \$0.25 for search time/traffic. Total 37 roubles.	15	0.25	55.75	1.86	+ vast choice of foreign music; + no need to travel; + ability to choose what you want in comfort; + can download individual songs; - no Russian music, payment only by credit card; - many services available only to residents of a particular country.
6	Free music on Internet	\$0.25-\$1.00 for search time/traffic. Total up to 30 roubles.	30	0.50	67.50	2.25	+ can download individual songs; - may not find what you want; - risk of infecting computer with viruses and parasitic programs while searching.
7	Borrow disc from friends and copy	15-30 roubles for blank CD. Total 15-30 roubles, average 20 roubles.	60	1.00	95.00	3.17	+ ability to copy only works you like, not the whole disc; - may not find what you want.
8	Kiosks in subways	50-150 roubles for disc, average 100 roubles.	15	0.25	118.75	3.96	+ disc is bought in passing, on impulse; - products mainly pirated, and no guarantee of quality.

Table A.24 (continued)

No.	Channel	Constituents of monetary costs	Average time costs in minutes	Time in hours	Total costs in roubles ^a	Total costs in dollars ^b	Advantages and disadvantages
9	Internet stores like Ozon	From 150 roubles for disc. Total from 150 roubles.	5	0.08	156.25	5.21	+ no need to travel; + ability to choose what you want in comfort; – at least two days from order to delivery.
10	Music department in retail chain stores like Carrefour or Ramstor	100 roubles for disc.	60	1.00	175.00	5.83	+ ability to buy along with other goods, and see what you are getting; + all discs licensed; – limited choice; – only hit discs on offer, and no cheaper than usual.
11	Music department on hypermarkets on Moscow Ring Road, like Ashan and Mega	120–200 roubles for disc, average 160 roubles.	120	2.00	310.00	10.33	+ licensed products; – limited selection; – only popular discs on offer, and no cheaper than usual.

Table A.24 (continued)

No.	Channel	Constituents of monetary costs	Average time costs in minutes	Time in hours	Total costs in roubles ^a	Total costs in dollars ^b	Advantages and disadvantages
12	Specialist music stores like Soyuz and Purpurnyi legion	Russian music from 150 roubles for disc; most foreign discs more than \$15 + 26 roubles for travel. Total from 176 roubles.	140	2.33	350.75	11.69	+ all music licensed; + in some stores of the chain you can copy to MP3 disc (but only files from a limited selection); + ability to seek advice from qualified sales staff; + ability to listen to music being considered; – virtually no MP3 discs.
13	Gorbushka and Mitinsky Markets	52 roubles for travel, 100–120 roubles for disc. Total 172 roubles.	210	3.50	434.50	14.48	+ large selection of recordings; – availability of both licensed and pirated discs. No guarantee of the quality of the latter.

^aThe monetary assessment of costs was calculated as the sum of monetary and time costs, the monetary equivalent of the latter being assessed at \$5/hour. Costs of acquiring music were also calculated as half the time actually spent, since for half the time the purchaser is otherwise occupied. Accordingly, when calculating total (full) costs the following formula was used: total costs = monetary costs + time (hours)/ 2 × \$5 Assumptions: The number of tunes acquired was disregarded

^b1\$ = 30 roubles

Source: Pragmatics of Culture Foundation, 2004

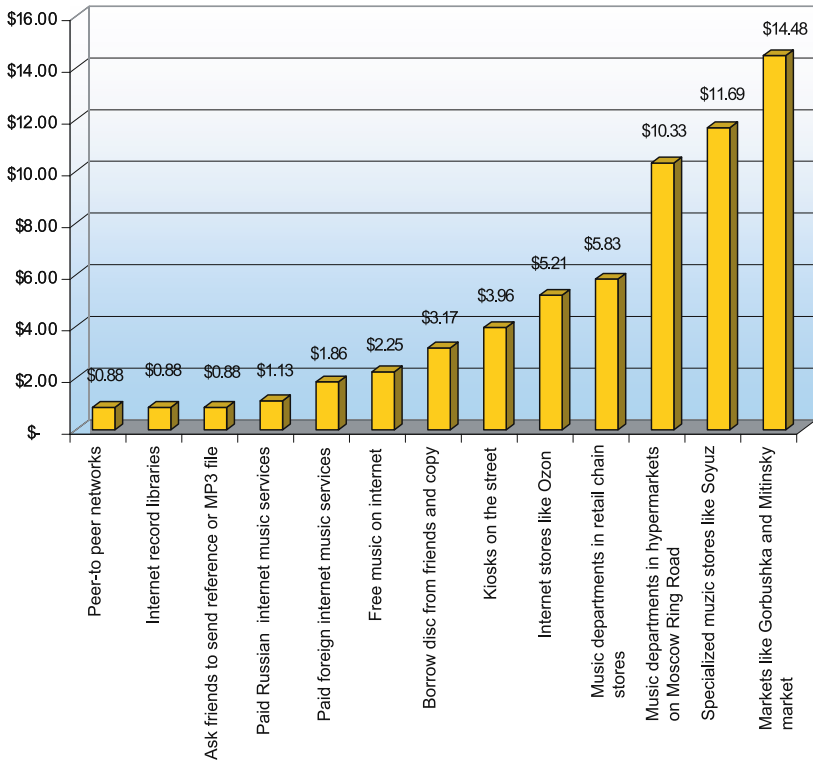


Fig. A.18

A1.7 Description of Demand/Consumption

There are two models of media usage:

- active, when a person is focusing all his attention on the media (for example, when listening to and sorting hundreds of thousands of songs to compose playlists);
- passive, when music is being listened to while doing something else, as a background, for no particular reason.

Research by Ball State University's Centre for Media and Design has shown that the average American spends around 11.7 hours a day on media use. The most passive media users⁵⁴ spend on average 5.25 hours per day, and the most active 17 hours.

A1.7.1 Average per Capita Media Usage

In one day a person can listen to at most:

483 3-minute songs (if he does not sleep but listens 24 hours a day);

⁵⁴By media use is understood watching television, videocassettes or DVDs; listening to the radio, CDs, cassettes or an MP3player; time spent at the computer, on the Internet; telephone calls; reading books, magazines or newspapers.

Table A.25 Average per Capita Media Usage (hours per person per year, in the USA)

Media	1999	2000	2001	2002	2003 ^a	Trend of Consumption, %	
						2002–2003	1999–2003
Cable and Satellite TV	720	774	844	914	949	3.8	31.8
Television	867	865	828	786	778	(0.6) ^b	(8.4)
Internet	80	107	136	154	169	9.7	111.3
Home video (watched on videocassette or DVD)	55	57	60	58	67	15.5	21.8
Film rental	13	12	13	14	13	(7.1)	0.0
Interactive TV (Video on demand)	1	2	2	2	2	0.00	100.0
Radio	939	945	953	994	1,013	1.9	7.9
Music (recorded)	281	258	229	201	188	(4.2)	(19.4)
Newspapers	183	180	177	176	173	(1.1)	(5.4)
Popular magazines	134	135	128	125	123	(1.7)	(6.4)
Fiction	119	109	106	109	110	(1.8)	(10.8)
Videogames	53	59	60	67	75	11.9	41.5
Total	3,445	3,503	3,536	3,600	3,660	1.7	6.2

Source: Veronis Suhler Stevenson, 2003

^aInformation for 2003 is given from preliminary calculations by Veronis Suhler Stevenson

^bBrackets indicate a negative quantity. Thus people spent 0.6% less time watching TV (786 hours in 2002 against 778 in 2003)

- 360 4-minute songs (ditto);
- 288 5-minute songs (ditto);
- 285 4-minute songs (if he sleeps 5 hours and listens to music for the remaining 19 hours);
- 228 5-minute songs (ditto);
- 165 4-minute songs (if he sleeps five hours, has an 8-hour working day, and listens to music for the remaining 11 hours);
- 132 5-minute songs (ditto).

As can be seen from Table A.25, the average American spends 3,660 hours per year on media use. This is just over 9 hours a day. Two-thirds of this time is spent listening to music on radio or listening to recorded music, in total about 900 hours a year or slightly less than 3 hours a day (values from the boxes “Radio” plus “Recorded Music” divided between 365 days in the year), which is about one-third of the total attention market.

In 3 hours one can listen to: 60 3-minute, or 45 4-minute, or 36 5-minute songs.

Top hits can be repeated on radio up to 14 times in the course of a day, so that within his daily 3-hour quota of music a person may listen to a hit 3 times over. In the course of the several weeks the tune stays in the playlist, it might be broadcast

up to 50 times. The aim of performers and labels is to occupy as many music slots on the airwaves each day as possible.

A buyer coming into a store for a tune he has liked will, if the sales and promotions are well organised and the staff competent, depart with 5 discs rather than one. According to NPD Group, subscribers to legal music online services who download music for temporary use in 2003 bought an average of 11 compact discs; those downloading music from sites like iTunes bought 10; and users of peer-to-peer file-sharing networks bought 8. Those who do not use the Internet for acquiring music bought an average of 6 CDs.

A1.7.2 Consumer Profiles

A1.7.2.1 Buyers of Music Products by Age, %

Table A.26

Age group	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
10–14 years	7.9	8.0	7.9	8.9	9.1	8.5	8.9	8.5	8.9	8.6
15–19 years	16.8	17.1	17.2	16.8	15.8	12.6	12.9	13.0	13.3	11.4
20–24 years	15.4	15.3	15.0	13.8	12.2	12.6	12.5	12.2	11.5	10.0
25–29 years	12.6	12.3	12.5	11.7	11.4	10.5	10.6	10.9	9.4	10.9
30–34 years	11.8	12.1	11.4	11.0	11.4	10.1	9.8	10.3	10.8	10.1
35–39 years	11.5	10.8	11.1	11.6	12.6	10.4	10.6	10.2	9.8	11.2
40–44 years	7.9	7.5	9.1	8.8	8.3	9.3	9.6	10.3	9.9	10.0
45 years +	15.4	16.1	15.1	16.5	18.1	24.7	23.8	23.7	25.5	26.6

Source: RIAA, 2003, 10-year Music Consumer Trends Chart

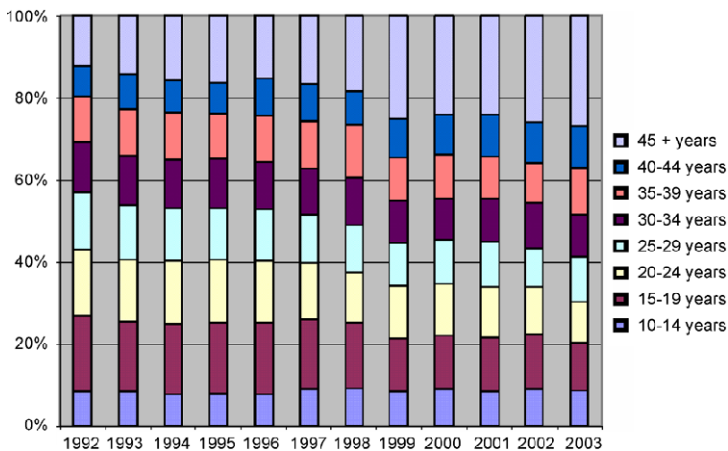


Fig. A.19 Source: RIAA

A1.7.2.2 Buyers of Music Products by Gender, %

Table A.27

Sex	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Women	47.3	47	49.1	51.4	51.3	49.7	49.4	51.2	50.6	50.9
Men	52.7	53.0	50.9	48.6	48.7	50.3	50.6	48.8	49.4	49.1

A1.7.2.3 Distribution by Buying Activity

Table A.28

Consumer type	Number of recordings acquired annually	Percentage	
		of total of buyers	of sales
Inactive buyers	1–3	45	15
Moderate buyers	4–9	35	30
Active buyers	10–19	15	30
Hyperactive buyers	20+	5	25

Source: Screen Digest

A small proportion of listeners have a particularly high demand for music products: 20 or more recordings a year are acquired by 4–10% of buyers. This group accounts for only 15–35% of the overall market. Active buyers are mainly men aged 20 to 39.

A1.7.2.4 Distribution of Demand by Country

The percentage of people buying music recordings remains relatively constant over time, although this indicator varies between countries. There is also a correlation with the level of economic development. In the most developed countries the proportion of people acquiring music is not more than 60% of the population.

Table A.29

Proportion of country's population acquiring music	Country
45–55%	France, Germany, Japan, Netherlands, Sweden, UK, USA
30–40%	Italy, Poland, Spain, Taiwan
15–25%	Brazil, Mexico

Source: IFPI, Screen Digest

Table A.30 Demand for music recordings by country (%)

Country	% of population	Share of global music market	Country	% of population	Share of global music market
Argentina	0.7	0.5	Lebanon	0.1	0.0
Australia	0.4	1.5	Lithuania	0.1	0.0
Austria	0.2	0.8	Malaysia	0.4	0.1
Belgium	0.2	0.7	Mexico	1.9	1.8
Brazil	3.4	2.0	Netherlands	0.3	1.2
Bulgaria	0.2	0.0	New Zealand	0.1	0.2
Canada	0.7	2.2	Norway	0.1	0.6
Chile	0.3	0.2	Pakistan	2.4	0.0
China/Hong Kong	30.3	0.5	Paraguay	0.1	0.0
Columbia	0.7	0.3	Peru	0.5	0.0
Croatia	0.1	0.0	Philippines	1.4	0.1
Cyprus	0.0	0.0	Poland	0.8	0.4
Czech Republic	0.2	0.1	Portugal	0.2	0.4
Denmark	0.1	0.6	Russia	3.2	0.5
Ecuador	0.2	0.0	Saudi Arabia	3.7	0.2
Egypt	1.3	0.1	Singapore	0.1	0.1
Estonia	0.0	0.0	Slovakia	0.1	0.0
Finland	0.1	0.3	Slovenia	0.0	0.0
France	1.2	4.6	South Africa	0.8	0.4
Germany	1.8	6.6	Spain	0.9	1.5
Greece	0.2	0.2	Sweden	0.2	0.9
Hungary	0.2	0.2	Switzerland	0.2	0.7
Iceland	0.0	0.0	Taiwan	0.5	0.7
India	18.8	0.6	Thailand	1.2	0.3
Indonesia	4.3	0.3	Turkey	1.3	0.3
Ireland	0.1	0.4	United Kingdom	1.2	7.7
Israel	0.1	0.1	Ukraine	1.1	0.0
Italy	1.3	1.4	Uruguay	0.1	0.0
Japan	2.7	17.7	USA	5.7	38.2
Korea	1.0	0.8	Venezuela	0.4	0.1
Latvia	0.1	0.0	Zimbabwe	0.2	0.0

Source: IFPI, US Census, Screen Digest

A1.8 Piracy in the Music Market

Along with the enlargement and consolidation of the principal music industry players,⁵⁵ a defining feature of the music market is piracy. This applies both to recordings on physical media and to music over the Internet.

A1.8.1 *Pirate Products on Physical Media*

A1.8.1.1 The Scale of Pirate Markets

⁵⁵See Sect. A1.4.1.1 of the present Appendix.

Table A.31 Losses from piracy (\$ millions) and piracy levels in different sectors by country, 2003

	Film Industry		Sound Recording Industry		Business Computer Software		Entertainment Computer Software		Books		Total losses
	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	
Priority Foreign Countries											
Ukraine	45	90%	125	75%	59	91%	n/d	85%	n/d	n/d	229
Monitoring											
Paraguay	2	80%	154.6	99%	5	83%	n/d	n/d	2	n/d	163.6
China	178	95%	286	90%	1787	92%	568.2	96%	40	n/d	2,859.2
List of priority surveillance											
Argentina	30	45%	30.6	53%	44	71%	n/d	n/d	4	n/d	108.6
Bahamas	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d
Brazil	120	30%	338.7	52%	309	61%	125.7	56%	14	n/d	907.4
Egypt	n/d	n/d	8	45%	34	69%	n/d	90%	25	n/d	67
European Union	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d
India	77	60%	6	40%	187	73%	113.3	84%	36.5	n/d	418.8
Indonesia	29	92%	44.5	87%	94	88%	n/d	n/d	30	n/d	197.5
Kuwait	12	95%	3	55%	24	68%	n/d	95%	2.5	n/d	41.5
Lebanon	10	80%	2.5	70%	14	74%	n/d	80%	2	n/d	28.5
Pakistan	12	95%	70	100%	9	83%	n/d	n/d	44	n/d	135

Table A.31 (continued)

	Film Industry		Sound Recording Industry		Business Computer Software		Entertainment Computer Software		Books	Total losses
	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy		
Philippines	33	89%	22.2	40%	33	72%	n/d	95%	45	133.2
Russia	275	75%	405	64%	704	87%	n/d	80%	40	1424
South Korea	40	20%	3.5	20%	275	48%	248.4	36%	38	604.9
Taiwan	42	44%	58	42%	83	43%	261.8	42%	20	464.8
Turkey	50	45%	15	75%	81	66%	n/d	n/d	25	171
Surveillance										
Azerbaijan	n/d	n/d	12.2	83%	n/d	n/d	n/d	n/d	n/d	12.2
Belarus	n/d	n/d	22	74%	n/d	n/d	n/d	n/d	n/d	22
Belize	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d
Bolivia	2	100%	16	90%	7	78%	n/d	n/d	n/d	25
Bulgaria	4	25%	7	80%	16	71%	n/d	n/d	0.3	27.3
Canada	120	n/d	n/d	n/d	500	35%	n/d	n/d	n/d	620
Chile	2	40%	21.1	40%	42	63%	n/d	n/d	1.1	66.2
Columbia	40	75%	49.4	70%	37	53%	n/d	n/d	5.4	131.8
Costa Rica	2	35%	7.2	56%	10	68%	n/d	n/d	n/d	19.2
Croatia	2.5	27%	n/d	n/d	26	59%	n/d	n/d	n/d	28.5
Dominican Republic	2	20%	9.9	65%	3	76%	n/d	n/d	1	15.9

Table A.31 (continued)

	Film Industry		Sound Recording Industry		Business Computer Software		Entertainment Computer Software		Books		Total losses
	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	
Ecuador		95%	19	95%	7	68%	n/d	n/d	2.3	n/d	28.3
Guatemala	2	60%	5	60%	6	77%	n/d	n/d	2.5	n/d	15.5
Hungary	20	30%	8	30%	55	42%	n/d	n/d	4	n/d	87
Israel	30	50%	40	63%	35	35%	n/d	n/d	1	75%	106
Italy	140	20%	42	22%	642	49%	168.5	47%	23	47%	1,015.5
Jamaica	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d	n/d
Kazakhstan	n/d	n/d	22.7	70%	n/d	n/d	n/d	n/d	n/d	n/d	22.7
Latvia	n/d	85%	10	80%	10	57%	n/d	95%	n/d	n/d	20
Lithuania	n/d	n/d	13.5	85%	10	58%	n/d	90%	n/d	n/d	23.5
Malaysia	38	50%	40	45%	77	63%	n/d	90%	9	90%	164
Mexico	50	45%	360	61%	220	63%	136.9	66%	40	66%	806.9
Peru	4	45%	87	98%	19	68%	n/d	n/d	8.5	n/d	118.5
Poland	30	30%	34	45%	171	58%	n/d	n/d	5	n/d	240
Romania	8	35%	18	80%	28	73%	n/d	n/d	2	n/d	56
Saudi Arabia	20	40%	16	40%	76	54%	64	83%	14	83%	190
Slovakia	2	25%	n/d	n/d	24	50%	n/d	n/d	n/d	n/d	26

Table A.31 (continued)

	Film Industry		Sound Recording Industry		Business Computer Software		Entertainment Computer Software		Books		Total losses
	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	Losses	Level of piracy	
Tadjikistan	n/d	n/d	5.2	82%	n/d	n/d	n/d	n/d	n/d	n/d	5.2
Thailand	28	60%	26.8	41%	84	80%	n/d	n/d	28	82%	166.8
Turkmenistan	n/d	n/d	7	89%	n/d	n/d	n/d	n/d	n/d	n/d	7
Uruguay	2	35%	1.4	60%	6	67%	n/d	n/d	1.5	n/d	10.9
Uzbekistan	n/d	n/d	30.5	81%	n/d	n/d	n/d	n/d	n/d	n/d	30.5
Venezuela	25	50%	n/d	n/d	33	72%	n/d	n/d	n/d	n/d	58
Vietnam	7	100%	n/d	n/d	24	92%	n/d	n/d	12	n/d	43
Total:	1,535.5		2,503.5		5,910.0		1,686.8		528.6		12,164.4

Source: World Intellectual Property Organization

A1.8.1.2 The Extent of Piracy on Physical Media⁵⁶

In 2004 the pirated music market amounted to 1.5 billion manufactured units, worth \$4.6 billion.⁵⁷ The quantity of pirate discs rose by 2% over 2003, reaching 1.2 million units. Sales of pirate discs almost doubled by comparison with 2000. One-third of all discs sold in 2004 were pirated.

According to Interpol, the profit made by criminal organisations counterfeiting all types of goods in 2004 was over €500 billion. A link can be found between piracy and organised crime (distribution of drugs, illegal arms dealing, money-laundering, and massive tax evasion, as well as a link to terrorism).

In Asia and Russia pirated output is primarily pressed discs, while in Latin America, North America and Europe it is CD-R.

Sample rates for manufacturing a CD, US\$

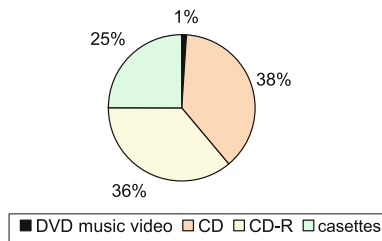


Fig. A.20

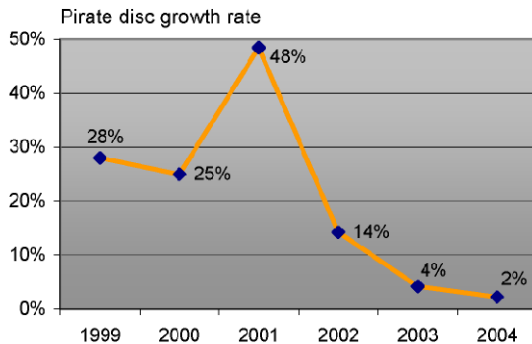


Fig. A.21

⁵⁶IFPI, *The Recording Industry Commercial Piracy Report 2004*, International Federation of the Phonographic Industry, 2004, online. Cited 25 September 2004. Available from URL: <http://www.ifpi.org/site-content/library/piracy2004.pdf>.

⁵⁷This figure includes pressed discs manufactured on factory lines, CD-R discs, and also pirated cassettes.

A1.8.1.3 Levels of Music Piracy by Country, 2004

Table A.32

Country	> 50% ^a	25–50%	10–24%	<10%
North America				Canada, USA
Europe	Bulgaria Czech Republic Estonia Greece Latvia Lithuania Montenegro Romania Russia Serbia Turkey Ukraine	Croatia Cyprus Hungary Italy Poland Portugal Slovakia	Belgium Finland Netherlands Slovenia Spain	Austria Denmark France Germany Iceland Ireland Norway
Asia	China India Indonesia Malaysia Pakistan	Philippines Taiwan	Hong Kong South Korea Thailand	Japan Singapore
Latin America	Argentina Brazil Colombia Mexico Paraguay Peru Uruguay Venezuela Central America Chile Ecuador			
Middle East	Egypt Kuwait Lebanon	Israel Oman Saudi Arabia	Bahrein Qatar UAR	
Australasia				Australia New Zealand
Africa	Morocco	Nigeria South Africa Zimbabwe		

^aPercentages indicate the market share of pirates

A1.8.1.4 Compact Disc Manufacturing Capacities

A key factor in the spread of pirated discs is increased manufacturing capacity. Production is moved to countries like Vietnam where copyright law is weak. CD-R piracy grows in parallel. According to IFPA estimates, there are some 1,040 disc manufacturing factories worldwide.

Between 2000 and 2004 approximately 300 new factories were built, with the result that the supply of discs is considerably in excess of legal demand. In some countries the supply exceeds legal local demand by anything from a factor of 9 to over 30.

Table A.33 Estimated manufacturing capacity in 2000 (all formats)⁵⁸

Country	Estimated capacity (millions)	Demand (millions)	Excess capacity (millions)
Taiwan	10,700	300	10,400
China	5,800	1,100	4,700
Hong Kong	2,700	90	2,610
Malaysia	2,500	60	2,440
Mexico	1,600	110	1,490
Singapore	700	60	640
Brazil	600	120	480
Thailand	600	50	550
Poland	600	150	450
Russia*	450	60	390
Pakistan	400	30	370
Total	26,650	2,130	24,520

Total overproduction of discs: 24.5 billion per year

^aAs estimated by IFPI. Only CDs and DVDs

A1.8.1.5 Transportation Routes of Counterfeit Discs

Table A.34

Source	Destination	Means of transport
Singapore	Nigeria	Sea
Paraguay	Brazil, Argentina	Dealers travelling in motorcades of up to 40 buses
Paraguay	Middle East, Europe, Africa, USA	Air courier services (in hand luggage) and large cargoes by sea and air
Russia	Europe, Middle East	
Taiwan	Philippines, South Asian region	

⁵⁸Data from Understanding & Solutions. The formats are CD, DVD, CD-R/W, DVD-R/W, CD-Rom, and Video-CD.

A1.8.1.6 Main Regions for Piracy

The IFPI publishes a blacklist of the 10 states with the highest levels of piracy.⁵⁹ It invariably includes Brazil, China, India, Indonesia, Mexico, Pakistan, Paraguay, Russia, Spain, and Ukraine (Table A.35).⁶⁰

In the countries of the European Union, counterfeiting of CD-R and DVD discs is particularly prevalent in the South, in Greece, Italy, Portugal and Spain.⁶¹ In Poland, after adoption of regulatory standards for the compact disc market, the volume of piracy has fallen and the country came off the list of the 10 most in disgrace. There are major problems with piracy in Estonia, Latvia and Lithuania. In April 2004 a European Union directive was adopted to standardise national legislation in the 25 member countries of the European Union.

Piracy levels in Russia and the Commonwealth of Independent States are consistently above 60%, despite the growth of the licensed product market, which grew by 24% in 2004.

In Latin America in 2003 legal revenues fell by 14%, and sales relative to 1998 decreased from 243 million to 148 million units. In Mexico and Brazil, which at one time were in the top 10 world music markets, legal sales decreased to such an extent that they are no longer in that list. In Peru and Ecuador piracy has virtually destroyed the legal music markets.

Among the countries of Africa and the Middle East, the highest level of piracy is in Lebanon, at 70%, followed by Kuwait at 60%, and Saudi Arabia and Egypt both at around 50%.

Half the world's compact disc factories are located in the Asia-Pacific region. Piracy on physical media predominates in those countries where the Internet is less widely available.⁶²

In IFPI's opinion, the factors which encourage piracy are presented in Table A.36.

A1.8.2 Illegal Distribution of Digital Music

The following engage in Internet piracy:

- web-and ftp-sites whose owners generate user traffic and earn revenues from advertising or otherwise benefit from being well known;
- commercial services;

⁵⁹IFPI statistics include only CDs and DVDs.

⁶⁰In its calculations a variety of criteria are taken into consideration, such as market size in US dollars, the overall market size of licensed products, growth of the pirate sector relative to 2003, and growth of the legal sector after 2003.

⁶¹Data for 2003.

⁶²885 Large-scale connection to the Internet in countries like South Korea, Japan, Hong Kong, and Australia has led to the growth of illegal online exchanging of music.

Table A.35 Piracy levels by country

	Brazil	China	India	Indonesia	Mexico	Pakistan	Paraguay	Russia	Spain	Ukraine	Total
Pirate market size (\$ millions)	79	411	88	91	111	30	18	449	77	42	1,396
Pirate market size (millions of units)	73	460	170	159	76	55	20	243	16	35	1,307
Licensed market size (\$ millions)	374	212	153	85	360	24	2	491	573	42	2,316
Licensed market volume (millions of units)	66	124	130	40	56	40	0.4	119	50	15	640.4
Level of piracy	52%	85%	56%	80%	60%	59%	99%	66%	24%	68%	67%

Source: IFPI

Table A.36

Country	Main reason for high level of piracy
Brazil	Fight against piracy not a priority for the state authorities. Weak customs control.
China	Lack of attention to piracy by state organisations.
India	Inadequate support by the forces of law and order, slow working of the court system.
Indonesia	State does not recognise piracy as a problem.
Mexico	Street piracy.
Paraguay	Lack of customs control.
Pakistan	Excess production capacity, lack of border controls.
Russia	Ineffective application of laws, weak criminal penalties.
Spain	Weak criminal penalties, protracted nature of court investigations.
Ukraine	Lack of severe penalties for pirates.

- peer-to-peer file-sharing networks which do not themselves copy music but help users to exchange music and other files, and benefit from advertising and spyware programs, etc.

Illegal distribution of music, like, indeed, legal music sales, are closely linked with the development of the Internet and peer-to-peer networks. This is examined in detail below, with particular attention being paid to peer-to-peer networks.

A1.8.2.1 Influence of High-Speed Internet on the Sound-Recording Market⁶³

Since 1999 the number of high-speed broadband Internet users has been increasing steadily. In early 2003 the number of broadband subscribers in the USA was 20 million, while by February 2004 almost 40% of Internet users in the USA had a broadband connection.

PriceWaterhouseCoopers predicts that by 2008 the number of families with a broadband connection will have increased by 169%. The greatest leap is expected in Latin America, with growth of 430%.

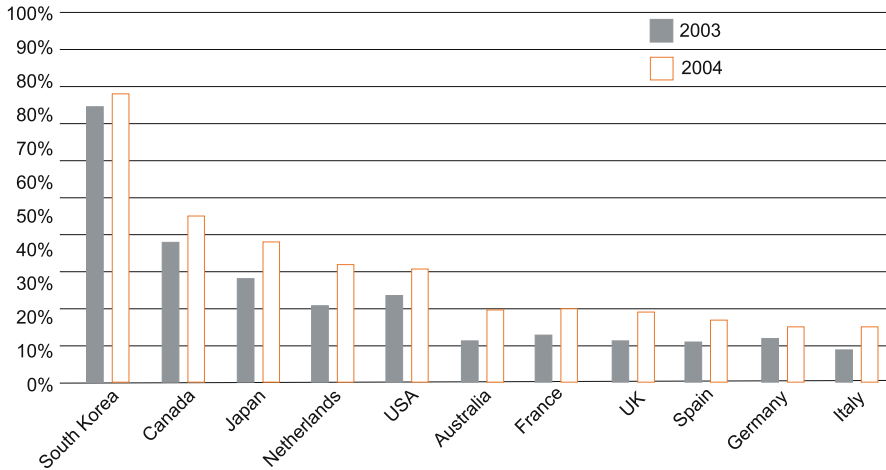
As high-speed Internet expands, Internet providers are turning their attention to music. This is true of Tiscali, MSN, TDC, and BT-Yahoo in Europe, and of AOL (through MusicNet in AOL, Sessions@AOL, and FirstListen) in the USA.

A high-speed Internet connection presents users with new ways of spending their leisure time. The main online activity is searching for information about topics of interest, goods, travel, and news.

⁶³Account based on: IFPI, *Online Music Report 2004; Digital Music Report '05*, International Federation of the Phonographic Industry, January 2005, online. Cited 15 July 2005. Available from URL: <http://www.ifpi.org/site-content/library/digital-music-report-2005.pdf>.

Table A.37 Recommendations to governments for fighting piracy

	Rigorous and up-to-date copyright legislation	Effective system of law enforcement, including measures of restraint	Regulation of compact disc manufacture	Aggressive prosecution of copyright crime	Strengthening of customs controls, changes to customs legislation	National programme for combating piracy	Education programmes	Campaign against street piracy
Brazil								
China	+			+		+		
India	+			+	+			
Indonesia	+		+	+		+		
Mexico				+	+	+		+
Paraguay				+	+			
Pakistan		+	+		+			
Russia	+	+	+	+				+
Spain				+			+	+
Ukraine			+	+	+			+



Source: Understanding & Solutions

Fig. A.22 Increase in broadband Internet users by country

A1.9 The Environment of Online Piracy: Peer-to-Peer Networks

Because of the immense importance of peer-to-peer networks and file-sharing technology for the music market (and all other markets which exploit the Internet) we are devoting a complete section of the Appendix to more detailed consideration of this issue.

A1.9.1 What Are Peer-to-Peer Networks?

There is no precise definition of a peer-to-peer network (also known as peering or P2P networks). One definition is that P2P is a class of computer application which makes possible shared use of dispersed resources: disk space, computing power of personal computers, the contents stored on them, data transfer capacity of communication channels, etc. Another definition is, a dispersed network in which each node can simultaneously act both as client (recipient) and server (supplier of data).

As a rule, the network consists of nodes of equal status, each of which at any one time interacts with only some of the other nodes, since maintaining communication of every one with every other one is impractical because of the participants' limited computing and data transfer capacities. Data transfer between nodes can take place in series, from node to node, or directly, from server to user. The routing and authorisation of communications transferred serially is performed not by a central server but through the individual nodes. P2P technology is currently being applied most successfully in the following areas:

Table A.38 Internet activities in 2000–2001 (% of Internet users)

Type of Activity	March 2001	March 2000
E-mail	100	75
Exchange messages	48	36
Seek information on hobbies	83	64
Go online for entertainment	66	53
Watch video/audio clips	56	40
Listen/download music	40	30
Play online games or network games	40	30
Learn sports scores	38	28
Search for information on goods	82	63
Search for information on travel	72	55
Search for information on films, books, and music	69	53
Read news	64	52
Search for information on health and medical services	64	47
Visit government sites	60	42
Search for information in connection with job	52	41
Obtain financial information	45	38
Seek work	44	31
Seek a place to live	32	20
Seek religious and spiritual information	27	18
Buy goods over the Internet	58	40
Buy a holiday	46	29
Internet banking	25	14
Online auctions	22	12
Buy/sell shares	13	10

Source: Pew Internet Report, March 2002

- Dispersed computing networks (like SETI@home);
- Instant messaging. Popular applications like ICQ and AIM.

Networks for group work (P2P groupware). These applications are as yet relatively uncommon but a great future is predicted for them. The most promising are thought to be Groove Network (a network providing a secure communications space) and OpenCola (data search technology and exchange of references to the most interesting sources). Each user's computer in the network is used as a search engine server.

A1.9.2 The Evolution of Peer-to-Peer Networks

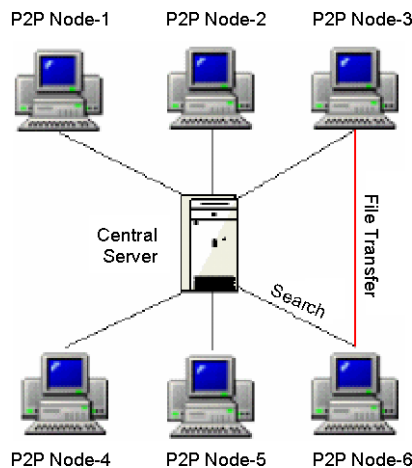
The pioneer of P2P was Napster. Instead of accumulating music files on a single server, Napster stored them on users' computers, while the central server merely

Table A.39 Types of activities engaged in by Internet users depending on type of connection available to them (%)

	Broadband	Dial-Up
E-mail	67	52
Instant messaging	21	14
Chat	10	5
Search for news	46	24
Search for information about goods	32	18
Exchange files with others	17	4
Create web pages	16	3
Download games/video/images	22	4
Download music	17	6
Download films	5	n/a
Watch videos	21	6
Listen to music/radio	19	4
Buy goods	21	3

Source: Pew Internet Tracking, February 2002

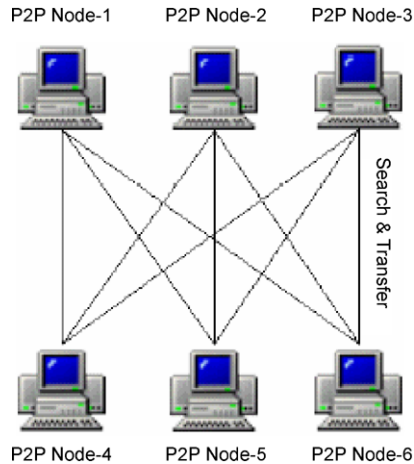
Fig. A.23 A centralised P2P network



linked the titles of tunes with an indication of whose computer they were stored on and enabled searching of lists.

The central link of the Napster network was a dedicated server or, more precisely, a group of servers, to assist users. Users needed an Internet connection and to instal a special program. When first launched this gathered information about the MP3 files stored on that particular computer and sent it to the central server. Thereafter the program functioned as a communication tool between the server and other network participants. In order to download a particular work, the user entered its title in a search line, the program forwarded the request to the central server, and it responded with an on-screen list of computers currently connected to Napster which had the work stored on them.

Fig. A.24 A decentralised P2P network



This is known as file sharing over a centralised peer-to-peer network. Data is exchanged directly between users' computers, but a dedicated server is required to enable this.

A more advanced version of the centralised network was provided by AudioGalaxy. Unlike Napster, where the user was left to choose the computer for file exchange and controlled the downloading of information, AudioGalaxy did this automatically. The user had only to enter the title of the work he was seeking. The AudioGalaxy server also stored lists of the files on users' computers even if they were not connected to the network, which simplified searching for rarer works.

Centralised systems have a number of drawbacks. The architecture is susceptible to the central server crashing. A bug in the software, overloading as a result of a sudden influx of users, or hacker attack could ground the entire network, as happened not infrequently. The only way of improving the network's reliability was to remove the weakest link, the central server. This was the solution adopted by Nullsoft in spring 2000. The Gnutella program created by that company was available from its website for only a few hours before the management of its mother company, AOL, realised that this technological marvel was not in its corporate interests. That brief interval of time was enough, however, for thousands of enthusiasts to appreciate the potential of the new tool. They succeeded in prising open the language code and recreating the network protocol. The first version was soon updated by more convenient versions and the protocol became established. To this day it is known under the name of Gnutella.⁶⁴ It enables network clients to exchange information without a central server. Gnutella allocates the server's functions equally between them. The system is called a true P2P network as there is no inequality between the participants.

The way a decentralised P2P system operates is analogous to a company founded by four friends—Bill, Matt, Frank and Jenny. A fifth person, Andy, meets Bill and

⁶⁴There are currently more than 50 file-sharing client programs based on Gnutella.

asks him if he has a song Andy is interested in. Bill does not have it on his computer, so passes the request on to Matt and Frank. They do the same. The request comes to Jenny who does have the file, and she directly communicates with Andy and transfers it to him.

True decentralised P2P networks are set up in much the same way: each participant maintains contact with N quantity of users. This enhances reliability since, if any of his contacts signs off, the connection is not lost.

Decentralised file exchange networks have many advantages:

- they belong only to their participants;
- it is difficult to stop them from working. If switching off the main server in a centralised system paralyses the whole network, with decentralised architecture there is no off-switch. Switching off individual clients has no effect.

A drawback of decentralised systems is that they are noticeably slower. Clients have to pass requests of other users through their own computers, which reduces the transfer speed of their own files. In theory, a decentralised P2P networks with more than a few hundred thousand clients simultaneously online could collapse under its own weight. Developers of the software are not, however, letting the grass grow under their feet.

Hybrid file-sharing systems combine elements of centralised and decentralised architecture. The best-known example is Kazaa (www.kazaa.com), whose users are numbered in tens of millions. Some estimates put the figure as high as 150 million, and at any given moment there are at least 500,000 users connected to the network.

Kazaa client software is based on a decentralised mechanism, the FastTrack program, which has an in-built option allowing the owner to apply the brakes to operation of the network. This was done in the winter of 2002 when the Kazaa network was transferred from the Dutch Kazaa company to the Australian firm, Sharman Networks. The seller arranged for the network to be halted, and users were without service for a week.

As they have evolved, file-sharing systems, which were initially created for music lovers, have ceased to be so narrowly specialised. Almost all the networks after Gnutella can be used to exchange any files: films, software, photographs, etc.

As soon as file-sharing networks became popular, the major labels started actively seeking to undermine them.⁶⁵ An injunction would be sought against the owner of a P2P network, after which he either stopped the free exchange of files or was bankrupted. Thus Napster, AudioGalaxy, and many others were brought to their knees. The technique does not work, however, for decentralised networks, since there is nobody obvious to sue, unless the creator of the client program. This is often impossible because many such programs have been developed by communities of unattached enthusiasts.

The labels then attacked another vulnerable point, the availability of the Internet addresses of participants of file-sharing systems. Each subscriber of a network knows the IP address of the “neighbours” with whom he exchanges files. This is a

⁶⁵See Appendix 2, “Lawsuits over Peer-to-Peer Networks”.

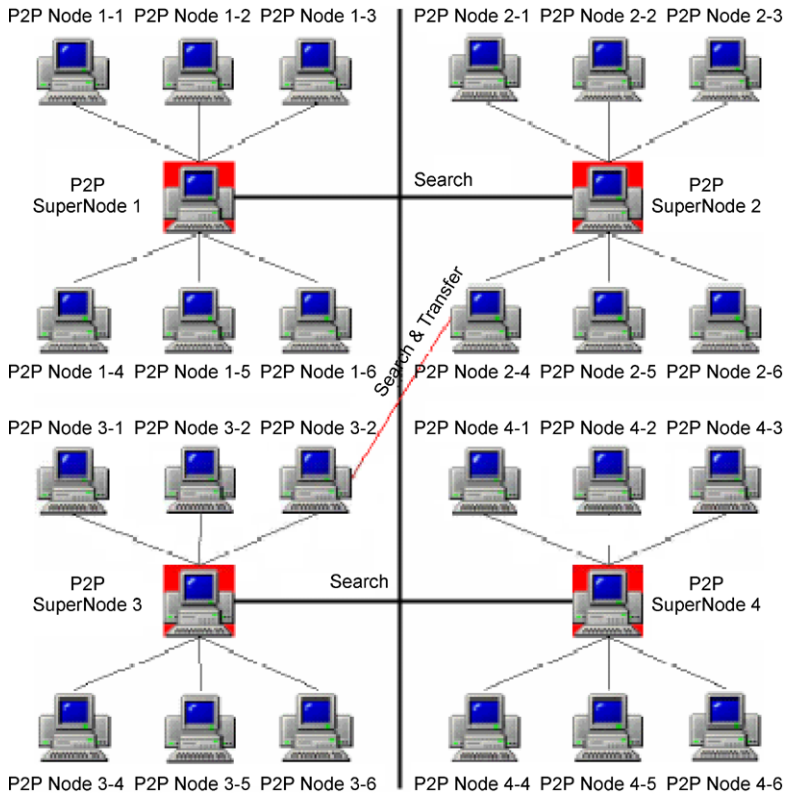


Fig. A.25 A hybrid P2P network

unique combination of four 3-digit numbers which identify all the computers connected to the Internet. In order to convert the IP address into the name and address of the user one has only to approach the Internet provider who issued the address, having first obtained a court order requiring him to disclose data about his customer.

In December 2002 some 150 users of Kazaa and eDonkey in Denmark were identified in this way and fined.

The problem is got round by second generation decentralised peer-to-peer networks, which ensure complete anonymity of users.

The first and so far only functioning example of such a network is Freenet, created in 1998 by Jan Clark, a postgraduate student of Edinburgh University, and launched in spring 2000. The system's approach is similar to that of Gnutella, except that all data is encrypted and copied many times over on users' computers. A participant acquires a file with a song. The client program on his hard disk automatically copies it and sends it to several other computers in the network, ensuring secure storage of the data. At the same time the file is encrypted to prevent anyone altering it in any way. No information about who supplied the file is stored, so the contributor can be sure of his privacy. A user who downloads the song obtains

different pieces of it from several different computers, which the client program automatically assembles and decodes. The owners of the computers from which the file fragments are taken can also be completely at ease. They do not know what is stored on their machines and cannot alter it. Finally, it is impossible from analysis of information passing through the network to ascertain what exactly a particular user is downloading.

Despite its obvious advantages in terms of anonymity and dependability, Freenet has not yet caught on because using it requires supplementary software, but bearing in mind the restrictions brought in against the free sharing of digital music, films and graphics, the prospects for Freenet and analogous systems are thought to be bright.

A1.9.3 Analysis of File Sharing by Content Type

In 2003, with the deployment of broadband Internet, user transfers of video, images, games and software exceeded sharing of music files for the first time. If in 2002 music had accounted for 62.5% of all non-commercial traffic, in 2003 this had fallen to 48.6%.

The average size of an avi file (a common video format) was 162 Mb, against around 4 Mb for the average MP3 file. Music lovers mostly exchange MP3 files in P2P networks, followed by kpl (Kazaa playlists). MP3 files take up about 30% of the space on users' hard disks.⁶⁶ Images in jpg and bmp formats are also frequently exchanged.

A1.9.4 Problems of Peer-to-Peer Network Clients

It takes a peer-to-peer network user less than 15 minutes (13.98 minutes) to find a tune he is interested in, and costs less than a quarter dollar (\$0.24). He can download the music in the comfort of his home, at a time he finds convenient.

P2P does, however, have some serious drawbacks:

1. to be able to use peer-to-peer networks satisfactorily you need a fairly powerful computer and a stable, high-speed Internet connection;
2. a subscriber needs to be technically savvy in order to fine-tune the client software and the computer's security system, since otherwise he will be unable to find the content he needs rapidly, and his computer will be open to hacker attack and viruses;
3. when searching for a file it is often impossible to specify the required technical parameters (for example, the minimum acceptable bitrate, on which sound

⁶⁶Peter Lyman and Hal R. Varian, "How Much Information 2003?", online. Cited 6 July 2004. Available from URL: <http://sims.berkeley.edu/research/projects/how-much-info-2003>.

Table A.40

Kinds of content exchanged	Mode of operation/ type of network	Current status	Method of operation	Advantages
Napster www.napster.com MP3	Centralised network	Closed	<ol style="list-style-type: none"> 1. User downloads client program. 2. Enters network and registers on Napster server, providing personal information (files available to exchange, bandwidth). Server enters information in its database. 3. User requests file wanted. Server searches its database, generates reply (list of IP addresses, titles and sizes of files) and transfers to subscriber. 4. User chooses which node to download file from, links directly, downloads using Napster protocol. 5. User informs server of outcome of the operation. 	<ol style="list-style-type: none"> 1. First such service. 2. Substantially simplified searching for music on Internet.
Kazaa www.kazaa.com MP3, avi, mpg, asf, jpeg, gif, bmp, doc, rar, zip, exe and many other formats.	Through central server; hybrid network with elements of both centralised and decentralised architecture.	At present one of the major networks	<p>Method of operation similar to centralised networks, although database is not stored on the server but on hard disc of users' computers. Considerably more powerful uploading mechanism. There are several central nodes to which participants connect. Any client with a sufficiently powerful computer and broad bandwidth can act as a node.</p>	<ol style="list-style-type: none"> 1. Works with all formats. 2. File downloading can be interrupted and resumed. 3. Can download data simultaneously from several sources (one fragment from each user). 4. List of found files gives full information: size, bitrate, artist, title, screen size (for video). 5. File exchange process is shown, indicating who is taking what.

Table A.40 (continued)

Kinds of content exchanged	Mode of operation/type of network	Current status	Method of operation	Advantages
<p>eDonkey2000 www.edonkey2000.com</p> <p>MP3, avi, mpg, asf, jpeg, gif, bmp, doc, rar, zip, exe and many other formats</p>	<p>Through central servers; mixed architecture. Network consists of dozens of independently working servers processing requests from clients connected to them.</p>	<p>Operational</p>	<p>Network built somewhat differently from Kazaa, without any central server. Based on servers appearing under any IP address almost from minute to minute. They exchange information, creating a cluster. Moreover, file search is conducted through all users connected to the service, no matter what their cluster. A feature is that as soon as a user begins downloading a file, he himself can serve as a source for the data. Files are identified not by title but by checksum, which remains constant until the file content is changed. The server, scanning available files identifies them by calculating and comparing their checksums.</p>	<ol style="list-style-type: none"> 1. No central server. 2. Supports all Windows, Linux and Mac OS X operating systems. 3. To accelerate data transfer the program can download a file from several sources at once, combining the streams in the process. 4. Downloading of files can be continued automatically from session to session, like ordinary downloading. 5. Uploading and downloading of files can be performed simultaneously. 6. The cluster architecture reduces the load on each individual server, increasing the network's "liveness".
<p>eMule</p>	<p>Through central servers; mixed architecture.</p>	<p>Operational, and increasingly in demand.</p>	<p>eMule is a client of the eDonkey2000 network. Supported and developed by independent developers as an open-source project.</p>	<ol style="list-style-type: none"> 1. Vast choice, particularly of films. 2. High-speed network. 3. Interface more convenient than eDonkey.

Table A.40 (continued)

Kinds of content exchanged	Mode of operation/ type of network	Current status	Method of operation	Advantages
iMesh www.imesh.com MP3, avi, mpg, asf, jpeg, gif, bmp, rar, zip, exe and others.	Centralised network	Operational	Similar architecture to Napster. Appeared a couple of months after the latter.	<ol style="list-style-type: none"> 4. No advertising. 5. Embedded Russian-language support. 6. Improved download procedure: the rarest blocks of the file are downloaded first. If damage occurs, only the affected part is repeated. <ol style="list-style-type: none"> 1. Fairly stable client program. 2. Does not require a powerful computer and high-speed connection. Works better than Morphicus on Pentium 100 computers at 28 kbit/s. 3. Can be downloaded simultaneously by several users. 4. Downloading can be interrupted and resumed. 5. Assesses quality of access to the file. 6. Reports bitrate, size, etc. of each file type.

Table A.40 (continued)

Kinds of content exchanged	Mode of operation/ type of network	Current status	Method of operation	Advantages
WinMX	Centralised network	Operational. Market veteran	Appeared as a client of OpenNap. After the Napster trial, the OpenNap operators were given to understand by the RIAA that they were next. OpenNap then gradually self-destructed. In order not to lose the massive user base the creators of WinMX released a new version of their product in May 2001 which supported both the protocols of the dying OpenNap and WPNP (WinMX Peer Networking Protocol).	<ol style="list-style-type: none"> 1. Absolutely no spyware. 2. Flexible settings. 3. High quality search. 4. Fairly undemanding on quality of connection. 5. No advertising. 6. For each file type additional parameters can be chosen: for audio, for example, choose between MP3 or OGG, and bitrate.
Gnutella gnutella.wego.com	Decentralised network	Functioning. Very popular some time ago, but now virtually no demand for it	<p>Built on its own technology, without central nodes. Nodes are replaced by users' computers, and the program cannot be disrupted. It will operate for as long as there are people wishing to use it.</p> <p>To connect to the network:</p> <ol style="list-style-type: none"> 1. User downloads client program. 2. If he finds even a single working node and connects to it, he becomes a fully fledged subscriber. User's node is simultaneously a server, processing other subscribers' requests. 	<ol style="list-style-type: none"> 1. Allows several searches simultaneously. 2. Search results comprehensively annotated. 3. In search results, each file is awarded points indicating how well it will download. 4. Can stop and resume download.

Table A.40 (continued)

Kinds of content exchanged	Mode of operation/type of network	Current status	Method of operation	Advantages
<p>Morpheus www.morpheus.com MP3, avi, asf, mpeg, jpeg, gif, bmp and all others</p>	<p>Decentralised network</p>	<p>Functioning. At one time was leader of the P2P Internet but has lost its ascendancy.</p>	<p>Morpheus is an Open Source program based on the already established Gnutella. This considerably improved its resistance to various kinds of unpleasantness.</p>	<ol style="list-style-type: none"> 1. Extensive choice of content. 2. No advertising or spyware. 3. Around 500,000 users daily.
<p>Overnet www.overnet.com MP3, avi, mpeg, asf, jpeg, gif, bmp, doc, rar, zip, exe and many other formats</p>	<p>No central server. Wholly decentralised network</p>	<p>Functioning</p>	<p>Younger brother of eDonkey2000. The developers improved the network in the light of experience</p>	<ol style="list-style-type: none"> 1. Supports all Windows operating systems, Linux and Mac OS X. 2. Functional and transparent interface. Many files in Russian. 3. User can work simultaneously in both the Overnet and eDonkey networks.

Table A.40 (continued)

Kinds of content exchanged	Mode of operation/type of network	Current status	Method of operation	Advantages
FreeNet www.Freenetproject.org MP3, avi, mpg, asf, jpeg, gif, bmp, doc, rar, zip, exe and many other formats	No central server. Wholly decentralised network	Functioning. Growing number of users.	The network is a huge virtual encrypted file system stored on the combined resources of permanent clients. To publish a file the user sends a message to the network, with the file and its unique identity number. The sender does not know which nodes the data will be stored on. To obtain the file a request is sent with the item's identity number. The node storing the requested content connects with the sender of the request and transfers the file. The network's clients are thus unaware of the source of the published data.	<ol style="list-style-type: none"> 1. Supports Windows 95/98/NT/Me/XP/2000 and Unix/Linux systems. 2. Client program contains no advertising modules and is freely distributed under GNU GPL licence. 3. Managed through a web interface. 4. Anonymity of sources.

- quality depends), and files when found do not provide this information. As a result one may have to search for and download the same work several times before finding a high-quality version;
4. deliberate falsification of data. The sound recording companies resort to this, publishing blank files in peer-to-peer networks or files where the title and content are at variance. As it is often impossible to tell the source of the content, it is difficult to distinguish reliable information from trickery;
 5. partially downloaded files. It not infrequently happens that a participant starts publishing a unique file in the network but then for some reason blocks access. At that moment somebody may already have the full copy, but it can also be the case that hundreds of users find they have, say, one-tenth of the data each but are unable to co-operate to reunify it;
 6. reliability of client rating. Information for calculating a user's utility for the peer-to-peer network is stored on his own computer. It is possible to manipulate this in order to jump the queue for uploading;
 7. too many advertising modules and spyware utilities are attached to free client software;
 8. parasitic downloading of content without making available one's own files available in the general exchange pool. For example, in the Gnutella network around 70% of users contribute no files to the pool, and about 50% of the total resources are provided by just 1% of subscribers;
 9. unpredictable working as a result of an enormous number of users and fantastic traffic volume. This is a particular problem in networks based on the Gnutella protocol;
 10. a limited amount of Russian-language music and other russified content.

A1.9.5 Business Models of Peer-to-Peer Networks

P2P uses all sorts of ways of generating revenue:

1. sale of licenses to use the operating protocol in the network;
2. a combination of paid and free options. This model is used, for example, in the Kazaa network where, together with a \$30 dollar charge for the client software, there is free downloading (with advertising banner headings and pop-up windows), and a limit on the number of searches and search results allowed at any one time;
3. provision of free software, but with the addition of advertising modules, parasitic software and spyware which mines information about the user;
4. offers of premium (paid) content. A precedent was set by Sharman Networks with the Kazaa network. The Kazaa Media Desktop programme was distributed with an in-built Altnet code which did not initially affect its functioning. In March 2003, however, 75 million premium files were loaded on to Altnet. In Kazaa searches they were marked with pictograms, were always downloadable over high-quality channels free of charge, but the user was then invited to pay for a key to decode the content.

A1.9.5.1 Business Models with Free Access to Content⁶⁷

The Kazaa free software comes bundled with five applications:

1. New.net enables browsers to “see” unofficial domain names like .kids, .family, and .shop;
2. Webhancer keeps track of the user’s habits and the speed with which pages are viewed. Three others, Cydoor, OnFlow and Ezula, serve or facilitate advertisements, and manage both the frequency and how they are presented.

Some of these programs are classifiable as spyware. They sit on the customer’s hard disk and automatically call outside servers on the Internet to upgrade themselves or receive advertisements. They also track the user’s actions and make it possible to check which sites he is visiting and what content he is downloading.

The companies delivering spyware, like Cydoor and Ezula, pay the peer-to-peer networks 10–20 cents for every download, which is enough to provide a viable revenue stream. One of the reasons Kazaa has lost its market-leading position appears to be its abuse of parasite programs.

The Morpheus client software, built on the same engine as Kazaa, is supplied without plug-ins. LimeWire, a client based on Gnutella, and several other Napster replacements, also avoid plug-ins. Avi Naider, CEO of WhenU.com, comments that they do not want to scare off their users.

A1.9.6 Parasite Programs

Table A.41

Title	Developer	Mode of Operation	Where distributed
Gator	Gator Corp., now renamed Claria Corp	Utility for filling in Internet forms with personal data (contact information, credit card details, etc.). Collects information about the user from sites visited and sends it to Gator. Loads the user’s browser with advertisements based on his surfing habits. Contains the Offer-Companion component within its code which replaces legal advertising banners with its own content.	Grokster, Limewire, AudioGalaxy and Kazaa

⁶⁷Account taken from Damien Cave, “Parasite Economy”, *Salon*, August 2001, online. Cited 20 September 2004. Available from URL: http://www.salon.com/tech/feature/2001/08/02/parasite_capital/index.html.

Table A.41 (continued)

Title	Developer	Mode of Operation	Where distributed
SaveNow	WhenU.com	<p>The most intrusive of spyware programs. Functions irrespective of whether or not the program linked to it has been launched.</p> <p>Tracks sites visited by the user and exploits the information to show him pop-up advertisements, providing information about new offers from advertisers.</p> <p>Keeps a record of the user's movements on the Internet, but these are stored on his computer and not sent to the mother company.</p>	BearShare, iMesh and other peer-to-peer networks
New.net	New.net, a division of Vendare Group	<p>Advertising model enabling a browser to see such unofficial domain names as .kids, .family, and .shop.</p> <p>Delivers a targeted Internet advertising campaign.</p>	Kazaa, AudioGalaxy, Bearshare etc.
Webhancer	webHancer Corp.	<p>Hosting application for monitoring and collecting information on the Internet.</p> <p>Web spyware for marketing campaigns. Tracks user's habits and page speed, including where the user came to a site from, what he was searching for, and where he subsequently moved on to.</p>	Kazaa
Cydoor	Cydoor	<p>Method for remote loading and showing of intrusive advertising banners. Can be embedded in almost any program. Automatically updates its base and shows the user advertisements irrespective of the particular Internet connection. If Cydoor is removed, the host program ceases to function.</p>	Kazaa, AudioGalaxy, eDonkey etc.
Ezula TopText	Ezula	<p>Registers keywords with any sort of relevance to its advertisers, seizes control of the browser and modifies the content of web pages. For example, if a site being visited contains the word 'book', eZula TopText changes it into a reference which the user can click to be transferred to an online store trading in the relevant product.</p> <p>Intrusive advertising.</p>	Kazaa, Grokster
OnFlow	OnFlow	Intrusive email-advertising.	Kazaa
Altnet	Brilliant Digital Entertainment	Internet advertising campaigns.	Kazaa
ClickTil UWin	ClickTil UWin	<p>Invites user to play online lottery, while a plug-in steals his personal data, passwords and IP address.</p> <p>Compiles a database of Internet users.</p>	Grokster, Bearshare, LimeWire, Kazaa

A1.9.7 Further Development of Peer-to-Peer Networks

In 2003 the BitTorrent protocol appeared, developed by Bram Cohen. It offered a new model of file exchange, functioning rather differently from peer-to-peer networks of the previous generation. This is a network with centralised architecture where all the clients' operations are managed by a "tracker server". In order to distribute a file on the network, a torrent file is generated which gives the Internet address of the originator, the name and size of the end file, and also its hash code (a unique line of symbols which precisely identifies an object). The prepared torrent file is published on the Internet in the usual way, for example on specialist sites with collections of references to torrent files, and is accompanied by a brief description explaining what materials it is designed to make available. The user downloads the file he is interested in and launches the client program simply by clicking on the torrent file. The program connects to the tracker server, having read its address from the torrent file. It transfers data to the client from the owner of the document. As the number of subscribers increases, they begin, under the control of the tracker server, to download data not from the owner's computer but from each other. In this way, every file published using BitTorrent technology creates its own local peer-to-peer network, whose purpose is to distribute just that one file.

This does not preclude the downloading of several files at the same time. Here the user participates in several BitTorrent networks, each specialising in distributing one particular file.

Since BitTorrent allows content owners to control the process, the protocol has a number of advantages:

- it cuts out free riders and makes it possible to select optimal partners for exchanging data;
- it increases the trustworthiness of published documents and gets round the problem of blank and fake files;
- it reduces the load on the owner of the resource.

At first BitTorrent was considered a breakthrough in the area of peer-to-peer networks, but some serious drawbacks have been found. The network is linked to a tracker server, and if this malfunctions the exchange of data is halted. It is also relatively straightforward to trace the source of content, which is a disadvantage in the light of the RIAA's writs. The main problem, however, is that BitTorrent has no search system. In order to obtain data, a user must independently search Web catalogues and download a special file with torrent expansion in the usual manner. Although a number of other outside programmes work with torrent files, after the closure of several sites which published references to torrent files, it has become even more difficult to find them. It is questionable whether BitTorrent can even be classified as a peer-to-peer network since global search is one of the key characteristics of P2P.

One of the technologies in which people see the future of peer-to-peer networks is Waste, a program for creating a closed local network for up to 50 or so users. Within it messages can be sent, users can socialise in chat rooms, download files from each

other, carry out searches on other people's computers, and browse folders which are open for public access. This is handy both for a commercial firm and simply for a user community whose members want to communicate over the Internet without worrying that the exchange of information is being controlled by outsiders.

One further intriguing piece of software is the client program Shareaza, based on the Gnutella protocol. This was developed by a team headed by Mike Stokes and made public in 2003. The first Gnutella had a number of significant drawbacks. Because there was no standard for requests to use the software, each subscriber did his utmost to get it to function faster for him than for other participants. As a result, one erroneously written client program could paralyse almost half the P2P network. Additions like chat rooms, not provided for in the first version, only added to the confusion. Shareaza, based on Gnutella 2, got round these problems. This service, like its predecessor, is entirely decentralised and open, but the protocol is designed for a large number of users and enables them to work together rapidly. Moreover, Shareaza makes possible the simultaneous operation and downloading of files from several networks at once, like Gnutella/Gnutella 2, eDonkey200, and BitTorrent.

A1.9.8 The Geographical Distribution of Peer-to-Peer Networks

The number of P2P users in the world grew by 30% in 2004.⁶⁸ BigChampagne estimates that every day something like 50 million search queries are made in peer-to-peer networks. The average number of people simultaneously logged in to P2P services is 4.5 million.⁶⁹ Different networks are preferred in different countries.

In the USA, despite the RIAA's repressive measures, users continued to work in networks based on the FastTrack Technology, like Morpheus, Kazaa, and Grokster. P2P clients in the United States use a total of some 30% of the capacity of broadband service providers. The most active clients are adolescents aged 12–17, followed by students.

In Europe the situation is different. The most popular network in Germany and Israel is eDonkey. Analysts at Sandvine believe that eDonkey and its expanded open source version eMule Plus will stay in the lead for some time,⁷⁰ but they too are threatened with prosecution by the MPAA and RIAA, which could frighten users away. Kazaa, the formerly unchallenged favourite of peer-to-peer networks, as well as Grokster, are rapidly losing popularity because of the lack of anonymity and a dearth of functions.

⁶⁸*OECD Information Technology Outlook 2004: Peer-to-Peer Networks in OECD Countries*, Chap. 5, OECD, Paris, 2004, online. Cited 6 October 2004. Available from URL: <http://www.oecd.org/dataoecd/55/57/32927686.pdf>.

⁶⁹*OECD Information Technology Outlook 2004*, Chap. 5, pp. 3–4.

⁷⁰The reason is that they not only allow the downloading of films, software and music, like other networks, but also provide tools for advanced searching, a rating system for content, multi-point downloading, and more.

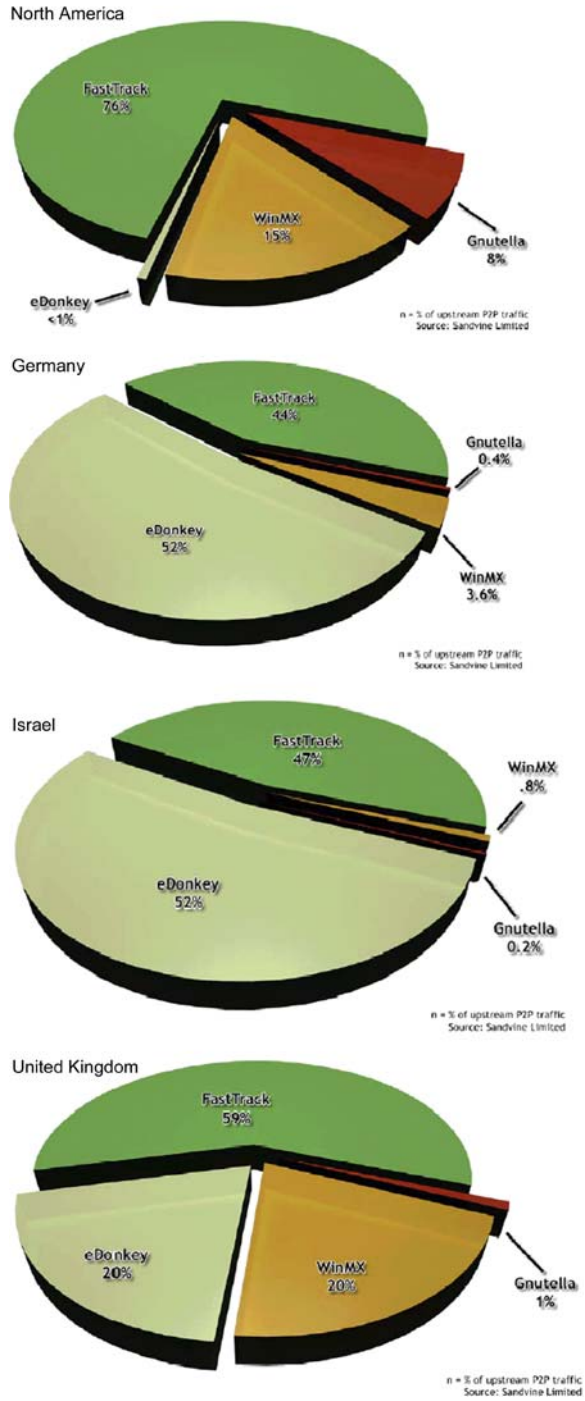


Fig. A.26

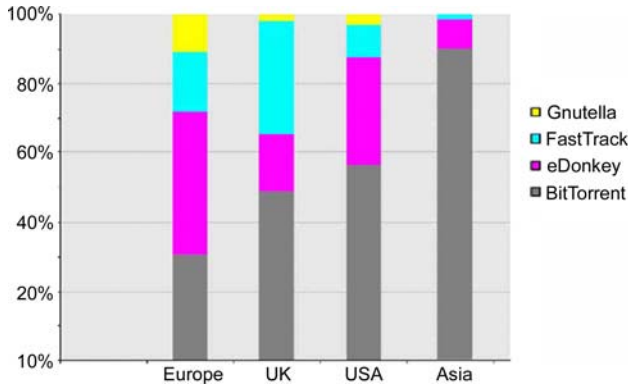


Fig. A.27 Peering traffic (incoming) over a 24-hour period

North America⁷¹

A1.9.9 The Level of Global Peering Traffic⁷²

A1.10 The Struggle Against Internet Piracy

The music industry is combating Internet piracy in a number of ways:

1. technological protection of music;
2. use of anti-piracy software;
3. explanatory and educational work with the population;
4. development of legal music services and co-operation with Internet providers;
5. prosecution of illegal file exchange services and private individuals who use them;⁷³
6. lobbying for laws to combat piracy.⁷⁴

⁷¹Sandvine, *Regional Characteristics of P2P: File Sharing as a Multi-Application, Multi-National Phenomenon*, An Industry White Paper, Sandvine, October 2003, online. Cited 8 October 2004. Available from URL: http://www.sandvine.com/solutions/resource_library.asp.

⁷²Source: Andrew Parker, “The True Picture of Peer-to-Peer Filesharing”, Press and Analyst Presentation, CacheLogic, July 2004, online. Cited 8 October 2004. Available from URL: http://www.cachelogic.com/press/CacheLogic_Press_and_Analyst_Presentation_July2004.pdf.

⁷³See Appendix 2.

⁷⁴See Appendix 2.

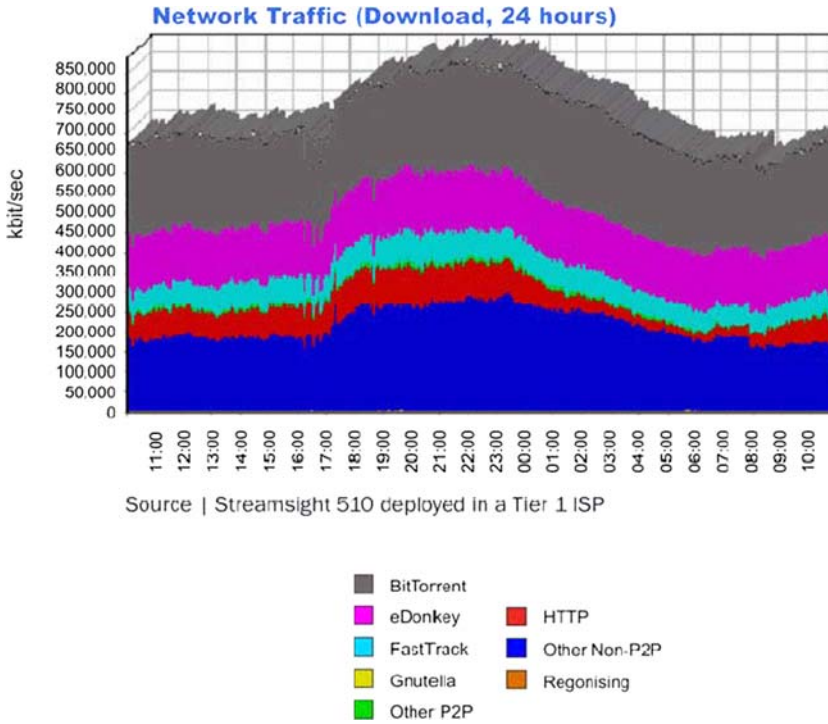


Fig. A.28

A1.10.1 Technical Protection of Content⁷⁵

Attempts are made to protect music both before it is released, in order to avoid leaks, and afterwards in order to avoid large-scale unauthorised copying.⁷⁶ Reliance is being placed on DRM (Digital Rights Management) technology. While attempting not to restrict facilities for users, like streaming, track rental, copying to CD-R, DRM aims to hinder uncontrolled replication.

The technologies for controlling copying are not only used for sound recording, but also for DVDs, computer games, and software.

A1.10.1.1 Principles of Protection

1. *Bit marking.* The digital equivalent of a watermark is added to content which makes it possible to identify rights owners. In itself the watermark does not pre-

⁷⁵The Digital Dilemma: Intellectual Property in the Information Age, National Academies Press, 2000.

⁷⁶Two hundred albums can be copied on to reusable CD-R discs in less time than it takes to record a single C90 audiocassette.

vent illegal distribution, but it makes it possible to establish the true owner of the material and assists identification of the source of illegal distribution.⁷⁷ There are several watermarking technologies. Some (“robust” watermarks) make it difficult to remove the mark without deterioration of the sound quality, while others (“fragile” watermarks) allow this, for example when compressing the file into MP3 format. Both kinds of watermark can be used when releasing a CD, and licensed portable players can be prevented from playing digital music which has only a robust watermark and no fragile one. The robust mark indicates that the music product has just appeared on the market, and the absence of a fragile one suggests that the file may have been copied;

2. Reattaching bits. A first generation copy contains a marker indicating that it is a copy and not the original. If equipment (for example, a digital audio tape player) has a Serial Copy Management System on it, it will be impossible to make a second copy from such a file. This is effective technology, but can be used only on a single-purpose device. On a general-purpose computer the SCMS is ineffective.

In that case a succession of sophisticated technologies can be applied:

encrypt content, obliging the consumer to at least pay for a decryption key; anchor content to a single machine or user. It is not enough merely to encrypt content, since a purchaser may transfer or sell on the encrypted file and the key to go with it; or simply decode the content, store it in a different format, and then transfer it to a third party. There are many ways of anchoring content; one is to code into the decryption key or music file information about the computer, such as the serial number of its primary disc. Before decrypting the tune, the software checks these data. For example, when a user chooses a song on an Internet site and presents his payment details, information about the computer requesting the file is included in the decrypting key. It is then impossible to listen to the music on a different machine.

Persistent Encryption of Content

The user may nevertheless get round the system described above by purchasing and decrypting content, and then selling it to someone capable of modifying the encrypted file. Accordingly, additional protection measures have been devised. For example, decrypted information is present for only a very brief time, and no temporary copies are stored. Over and above this, decryption takes place as physically close as possible to the site where it will be used, which reduces the number of places both inside and outside the machine from which the deciphered data might be siphoned off.

⁷⁷Music can be given a watermark by making very small changes in a number of digital samples. The human ear is not capable of detecting the different, but these changes are easily read by a specialised computer program. It can be decided, for example, that the last 2 bits in every 150th sample will be used not for digitising the music but to encode information about the copyright holder.

Although permanent encrypting is the most effective, it is difficult to implement because it requires complex software to take control of some of the capabilities of the computer, since otherwise there are many places in the operating system or elsewhere in a computer where it would be possible to get at the decrypted information;

Different Terms for the Sale of Content

Music can be sold with a number of restrictions in respect of the period of time or the number of times it can be listened to. Special software checks and enforces these conditions appropriately.

None of the approaches described above, however, provides a complete solution.

In the first place, no protection system lasts forever. It can be cracked and the technology for doing so shared with the Internet community. For example, on 17 August 1999 Microsoft released Windows Media 4.0 for the protection of music and other media files. On 18 August 1999 a number of Internet sites were already offering a program able to circumvent the Windows Media security features. It removed information about the license conditions and made it possible to freely transfer the files. One possible countermeasure is to design protection so that it can be quickly amended.

Secondly, technical protection needs to be simple to use, and the process of decryption should be imperceptible since consumers are likely to be impatient with cumbersome mechanisms designed to protect somebody else's interests.

Thirdly, as a result of anchoring content to a particular device there is a danger that all the information may be lost if the equipment fails or is replaced. Should the purchaser be expected to pay over again for all the music he has already paid for if his portable player breaks down or is lost?

A fourth obstacle is the nature of computers themselves. Since the machines are designed with open architecture, giving the user all-round access to information, there are many ways to access decrypted data as they pass through various internal nodes. For example, the user could modify the software supporting the sound card in such a way that it not only generated a signal for the loudspeakers but also stored the decrypted music. Developers can try to devise counter-measures each time, but this requires considerable effort and expense, and the question is, who will pay? At all events, what ultimately counts is less the technology than the human factor.

A1.10.2 Informational and Educational Campaign

The music industry conducts a global campaign to explain the illegality of uncensored online distribution. This consists of:

Table A.42 DRM systems⁷⁸

Name of Operator	Form of Compression	Limitations for User	Facilities for User	Additional Information
Apple iTunes DRM	AAC (Advanced Audio Coding) combined with FairPlay DRM	Users can burn up to 7 copies to CD and transfer music files to no more than 5 computers	Subscriber can allow other users to preview his playlist	
Microsoft DRM	WMA	Limits number of times burned to CD and copied to computer desktop		One of the DRM solutions, Janus, allows time-restricted use of a music file, encouraging user to transfer to subscription
Music .walmart .com DRM	WMA	Music can be downloaded for 90 days from the moment of purchase and listened to for 120 days. Songs can be neither sold nor transferred to others	Music files can be burned to CD 10 times and transferred to portable players without limitation. They can be downloaded to 1 computer and copied to 2 further computers	
BuyMusic.com DRM	WMA	Restricts the number of burn-ins to CDs to 7–10 songs	Permits transfer of files to 3–5 computers	Price of individual songs and albums varies, as do terms of use

1. creating a coalition of music websites⁷⁹;
2. advertising campaigns;
3. working with schools and universities for which file sharing and P2P client software are a serious problem since they clog their Internet communications channels. Many university networks are unable to cope with peering traffic and edu-

⁷⁸Account based on Peitz and Waelbroeck, “An Economist’s Guide to Digital Music”.

⁷⁹Thus, in 2003 www.pro-music.org was launched with the support of international organisations like FIM, GIART, ICMP-CIEM, IFPI, Impala and GERA-Europe to promote legal online services and discredit music piracy.

Table A.42 (continued)

Name of Operator	Form of Compression	Limitations for User	Facilities for User	Additional Information
Sony DRM	ATRAC3 (used in own Sony Connect Store music service). OpenMG/Magic Gate DRM (used in most of its portable CD-players and digital music players)	Music files can be copied to only 1 computer. Restrictions on use of files depend on specific artist or album. Downloaded content can be reproduced only on Sony SonicStage software and portable players on the OpenMG/ MagicGate platform. Many Sony players do not accept the MP3 standard, although in the future Sony is planning to make them compatible with other standards and formats		
Kazaa/Altnet DRM	Proprietary DRM technology	Users can listen to a song several times to decide whether or not to buy it. After the sampling period the user sees a window with a link to a vendor's site		After sampling, the user has to pay \$0.99 for the song

educational institutions have responded by introducing restrictions within their networks, establishing filters and other technical means of protection. They also send out warning letters to students, and disconnect users of unlicensed music.

4. sending warnings to users of unauthorised services. By informing private individuals of the impermissibility of violating copyright, the recording industry brings psychological pressure to bear. In 2003 RIAA sent out some 18 million letters in the United States. In the same year the associations of sound recording companies in Australia, Austria, Canada, Denmark, and Germany sent local users of peer-to-peer networks some 2 million messages.
5. widely publicising lawsuits against those infringing copyright in the USA. In early 2003 IFPI sent out guidance on the use of copyright content to thousands of firms, government departments and educational institutions in 21 countries.

A1.10.3 Collaboration with Internet Providers

This is the main plank of the music industry's campaign against Internet piracy.

For many years IFPI has notified Internet providers of pirated music appearing on their services. In the overwhelming majority of cases, the providers voluntarily block the sites and remove files known to be illegal. In 2003 IFPI managed in this

Table A.43 Removing counterfeit files from the Internet

	2001	2002	2003
Files removed after notification of Internet provider (millions)	700	1,300	1,600
Web and ftp sites closed down	28,000	38,000	41,000

Source: IFPI

way to shut down some 41,000 pirate sites, more than 1,000 peering servers, and succeeded in insisting on the removal from the Internet of 1.6 billion illegal copies of musical compositions in 101 countries.

Many Internet providers prohibit their customers from setting up anything like a peering server on their individual accounts.

A1.10.4 Release of Anti-Piracy Computer Programs

In their battle against the downloading of illegal music, the corporations resort to the methods of hackers. Anti-piracy software tracks attempts to download counterfeit files and either stops it or slows the process down to a point where the user gives up.

Another method is to distribute fake files so that P2P subscribers receive blank or dysfunctional files instead of the works they were expecting. Overpeer is a company which develops anti-piracy programs. There are plans to launch aggressive modules which would freeze a computer for several hours if an attempt was made to download unlicensed music. Another program searches for all the illegally downloaded tunes on a hard disk and deletes them. A third program causes a major decrease in the speed of the Internet connection.

A1.10.5 Professional Guilds, Societies, and Associations in Russia and the USA for Safeguarding the Interests of Market Participants

The International Federation of the Phonographic Industry (IFPI, www.ifpi.org)

The International Federation of the Phonographic Industry has some 1,450 members, consisting of the major sound recording companies of more than 70 countries. It has affiliated organisations in 48 countries. The aims of the IFPI are to combat piracy and facilitate the development of the technologies of the sound recording industry in the digital era. The anti-piracy team of IFPI numbers some 250 and works in tandem with governments, law-enforcement and customs agencies. These include

an Interpol group investigating intellectual property theft, the Intellectual Property Crime Action Group created in 2002, and also the World Customs Organisation's Intellectual Property Rights Strategic Group. With the assistance of specialist laboratories, IFPI tracks down locations where pirate CDs are being manufactured and assists in organising raids on suspect enterprises.

The Recording Industry Association of America (RIAA, www.riaa.org)

The Recording Industry Association of America is a trade group representing the interests of the sound recording industry. Members of the RIAA manufacture and distribute around 90% of all licensed music in the USA. RIAA awards prizes for sales of music recordings: gold, platinum, multi-platinum and diamond. The mission of this institution is to foster a businesslike and legal climate in the interests of its members.

The National Music Publishers' Association (NMPA, www.nmpa.org)

The National Music Publishers Association brings together more than 700 music publishers of the USA. It engages in interpreting copyright law, advising on matters of licensing, and protecting the interests of its members.

The Russian Society for Multimedia and Digital Networks (ROMS, <http://www.roms.ru/>)

ROMS is the first Russian society for the collective management of authors' and related rights on the Internet. It collects and distributes monies due to authors, performers, manufacturers of sound recordings, publishers and other rights holders. On the basis of the Law of the Russian Federation on Copyright and Related Rights, and also of authorisation it receives from its members, other rights holders and organisations, ROMS negotiates licensing agreements with organisations and individuals using products protected by authors' and related rights.

The Russian Authors' Society (RAO, www.rao.ru)

The Russian Authors' Society is a non-commercial society created by authors for implementing and protecting copyright in the sphere of intellectual activity; it operates on a basis of voluntary and equal membership and democratic self-management.

RAO's mission is:

- to manage on an institutional basis authors' property rights, and those of their heirs and assigns, where implementation of rights by individuals is difficult (public performance, radio and TV broadcasting, recording on various media, reproduction, copying of works of graphic and applied art in industry, etc.);
- to assist individual authors and their heirs in assigning rights for the use of works of science, literature, and art;
- to represent the legitimate interests of authors and their heirs in national and public institutions and organisations at home and abroad in accordance with agreements on mutual representation of interests with partnered foreign copyright societies.

The Russian Society for the Management of Performers' Rights (ROUPI)

Represents the interests of performers (musicians and actors) and conductors. Institutionally manages performers' rights. Participates in the General Agreement on Interaction when implementing institutional management of authors' property and related rights in the exploitation of works and items subject to related rights in digital networks (including the Internet), concluded between RAO, ROUPI, RFA, and ROMS.

The Russian Phonographic Association (RFA, www.fonogram.ru)

The RFA consists of the 17 largest Russian and foreign sound recording companies in Russia and manages their property rights.

The founders of the RFA include: Melodiya, BMG Russia, Universal Music, Sony Music Entertainment (Russia), S.B.A./Gala Records, Real Records, Artstarz Studiya Soyuz, Sintez Records, Kvadro-Disk, VVV. Zapis', Nikitin Gramophone Recording Co., Monolit-ABK, Rais Liss Corporation, S.B.A. Production, Snegiri Muzyka, Hunter Music, and Megaliner.

The RFA cooperates with the Russian office of IFPI.

The National Federation of Phonogram Manufacturers (NFPE, www.nfpf.org)

NFPF is a non-profit partnership which represents the major rights-owning Russian sound recording companies. Works in close contact with the IFPI.

Association of DVD Publishers (www.advdp.ru)

A non-profit organisation created on the initiative of the major Russian DVD companies and manufacturers of DVDs to encourage the evolution of a civilised DVD production market.

Table A.44 Major police operations in 2003–2004

Region	Results of Operation, amount of property confiscated
World Total	68 CD production lines closed, 40 million blank discs confiscated
Latin America	21 million CD-R discs confiscated, plus over 750,000 blank CD-R discs on their way to Southeast Asia. Peru—1 million CD-R; Paraguay—40 trucks with 1 million CD-R discs arrested; Brazil—147 CD-R recording machines destroyed
Mexico	128 CD recorders confiscated and 230,000 discs (along with cocaine, marijuana, and arms); 5,500 recorded CD-R discs and 44 CD recording machines
Malaysia	Underground factory closed, 277 pressing machines and thousands of discs confiscated
Egypt	2 million pirated cassettes seized, 1 million inserts for the discs, 1 million cassette covers, 6 copying machines and 2 printing presses
Russia	Illegal DVD factory closed (capacity 18 million discs per year)
Italy	6 underground laboratories for producing counterfeit items closed; 496 CD and DVD recording machines, 9 persons arrested. 21 persons arrested, 80 highspeed CD-R recording machines confiscated
Greece	Over 200,000 recorded discs and 123 recording machines discovered
UAR	260,000 CDs confiscated

A1.10.5.1 IFPI Against Piracy

With the involvement of IFPI, in 2003 56 million discs were confiscated (against 13 million 2 years previously), 12,021 master discs used for pressing illegal products (6 times more than the previous year), and 14,745 CD-R recorders (against 5,000 in 2002). In 2003–2004 several new blackmarket factories were discovered.

Manufacturers suspected of piracy are subject to criminal prosecution. In December 2003 IFPI for the first time issued 7 writs for damages totalling \$1,366,600 against the Russobit-Soft factory in Moscow. Writs were also taken out against another Russian firm, Roff Technologies.

IFPI collaborates with the Motion Picture Association. Since the beginning of 2003, the IFPI Laboratory has also been conducting research on behalf of the MPA and of the Business Software Alliance. It has unearthed several factories manufacturing pirate DVD discs.

IFPI has suggested 3 key priorities for governments attempting to rein in piracy on physical media:

1. Effective copyright legislation and related performance rights legislation. Laws should prevent the circumventing of technologies designed to protect content and, specifically, should control CD copying. Additionally, the following effective civil, criminal and administrative measures should be taken:
 - compensation for loss;

- permission to search for evidence of illegal activity, confiscation of pirated products, and termination of distribution of illegal copies;
 - right to obtain information, first and foremost about the extent and sources of illegal manufacture and distribution channels;
 - legal prohibitions to prevent or stop violation of laws;
 - criminal sanctions for violations which cause loss to rights holders;
 - confiscation at customs of illegal imports, exports and transit of pirated goods.
2. Licensing of CD manufacture.
Restriction of the number of places where CDs and DVDs may be manufactured.
 3. Effective legal prosecution and custodial sentences.

The IFPI insists that courts should pass sentences which should deter piracy. This a legal requirement under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) which is adopted by all countries entering the World Trade Organisation. Any who fail to fulfil the obligation are subjected to international pressure.

A1.10.6 Independent Civil Rights Organisations

The Electronic Frontier Foundation (www.eff.org), a public association defending the rights of users of new technologies. Created in 1990, its headquarters is in San Francisco, and it is funded by voluntary contributions from its members.

The Foundation's aims are to:

- lobby for laws defending the constitutional rights of citizens when using new communications technologies;
- lobby for observance of standard requirements binding on all Internet service providers to transmit all information without discrimination of any kind;
- form a national public network over which the transfer of data and video information would be equally accessible to all citizens;
- create a variety of communities affording all citizens the right to be heard in the information age.

In addition, the EFF provides financial support in court cases where it considers that civil rights are being eroded, supports the organisation of networks which distribute information irrespective of its content, encourages the provision of free and extensive access to socially relevant documents, and is active in many other areas and issues. Specifically, it has campaigned for abolition of the DCMA Act, and opposes the RIAA's prosecution of users of peer-to-peer networks.

The Global Internet Liberty Campaign is an international movement bringing together a number of mainly non-profit and civil rights organisations. The area of its concern is fighting the violation of human rights in respect of the Internet, primarily freedom of speech and the right to privacy, limitations of access to the worldwide web, and also cryptography and state control of communications.

A1.10.7 Influence of Macro-Economic Factors on the Sound Recording Market⁸⁰

CD sales clearly depend on the economic situation in different countries, since this determines levels of consumer expenditure.

A1.11 Means of Navigation on the Internet

A1.11.1 Recommender Systems Based on DSP Technologies⁸¹

This kind of music recommender system appeared in 2000–2001 when several companies simultaneously announced they had technologies for identifying listeners' preferences and could suggest appropriate musical compositions.⁸²

One such service, Cantamatrix, launched in July 2000, had a completely automated method for searching and classifying music by how it sounded. This was a patented search engine which combined DSP technology, psychoacoustic modelling, and a system of non-collaborative filtering in a single interface. Tunes were

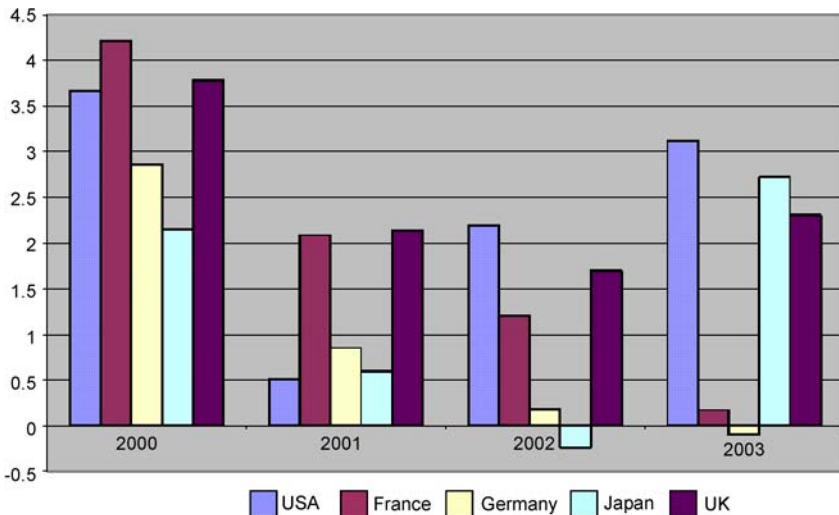


Fig. A.29 Gross domestic product in the main music markets (%)

⁸⁰Account based on Peitz and Waelbroeck, "An Economist's Guide to Digital Music".

⁸¹Digital Signal Processing.

⁸²This survey of recommender services based on DSP technologies draws on information from the website of wired.com.

recognised by analysing the digital signal of a number of fragments. The classification scheme took account of “descriptors” such as tonality, tempo, rhythm, energy level, etc. In its pitch to music-lovers the company emphasised that it provided a highly personalised search, simplified navigation, and that fans would no longer have to be guided by the recommendations of critics.

Cantamatrix was planning to sell licenses for use of its software to e-commerce sites, online music services, and radio stations, but in 2002 it was acquired by Gracenote (www.gracenote.com), which specialised in technologies for classifying music.⁸³ Even before this specialists had doubts about whether DSP technologies were suitable for completely automatic classification of music. They have difficulty in detecting the difference between a happy tune and a sad one.

MoodLogic went further, developing a browser which made it possible to mark music according to mood.

One further technology, MusicGenome (www.musicgenome.com),⁸⁴ was conceptually close to that of Cantamatrix. It was based on analysis of music fragments using 100 parameters: tonality, instruments, tempo, language, etc. Thousands of respondents sampled music at the company’s request. According to its creators, the system provides extremely accurate recommendations.

The MusicGenome engine studies the subscriber’s tastes, then generates a playlist of songs to suit him. Customers do not have to provide information about their preferences, and need only to rank some 10 randomly chosen fragments, awarding them points from 1 (“Can’t stand it!”) to 5 (“I love it!”). On the basis of these answers, the system compiles the subscriber’s profile and from that selects works in various genres or to suit a particular activity or situation, e.g., working out, a melancholy mood, a romantic supper, etc. The differentiation of playlists is possible because of the Multi-Profile Support option, which manages multiple profiles of the same user. By choosing new songs from the recommended playlist, the customer further informs the system about his preferences, his profile is updated, and the suggestions become increasingly accurate.

The MusicGenome software can be used on any platform, on websites, in wireless devices, or electronic kiosks in shops. For example, MusicGenome equipped the Smart Music Terminal electronic kiosks for Media Markt which has 180 music stores in Germany and 140 in other European countries. They simplify searching by allowing customers to listen to music and providing recommendations in the course of shopping.

The next step in the recommender systems market was taken by Gigabeat. Believing that options provided by any single technology were insufficient, the creators of Gigabeat integrated music analysis, collaborative filtering, critical reviews, and user comments.

⁸³Gracenote worked with Napster, helping it, in accordance with the court verdict, to detect numerous variations of songs subject to copyright which were circulating on this file sharing network. As a result the company was well aware of DSP-based software. At that time Cantamatrix’s applications were the best, so the company bought it together with all its intellectual property.

⁸⁴Presented in January 2001 at the music industry’s MIDEM Conference in Cannes.



Fig. A.30 Music Terminal

Despite the rapid development of recommender systems, the Jupiter research agency published a prediction in 2001 that enthusiasm for them would soon pass. Consumers tended to lose interest in one service, move on to the next and the next, and soon forgot what they had found and where. If the sites failed to work in partnership with content providers and distributors, they would become a thing of the past.

Also in 2001 file sharing networks began coming together with recommender services. In the middle of its lawsuit with the RIAA, in March 2001, Napster took over Gigabeat's music recommender service. The plan was to invite subscriptions in summer 2001, but Napster was shot down and it came to nothing. The Gigabeat.com Internet address is currently occupied by a site dedicated to Toshiba's Gigabeat digital audio player, a competitor of the iPod.

A further recommender service belonged to Music Buddha in San Francisco.⁸⁵ The system analysed elements in the sound signal and offered characterisations of digital music for business, as well as recommending music for consumers.

Not all the pioneering recommender technologies have survived but some are still operating successfully, like the trademarked "Music Genome Project" of Savage Beast Technologies.⁸⁶ The system requires no effort on the part of the user, simply

⁸⁵Some time later the applications and intellectual property of the company were sold to pay off debts.

⁸⁶Now known as Pandora Media (www.pandora.com).

Fig. A.31 Savage Beast and its major customers



monitors his behaviour on the Internet, what he searches for and listens to, what kind of songs or albums he likes, which artists' works, and what he buys in partner stores. The information gradually accumulates and makes the profile of the client's preferences more accurate.

This is probably the most powerful navigational and promotion system for music at present. Savage Beast collaborates with online music stores, Internet portals, subscription services, record labels, retail stores (using electronic kiosks), Internet-radio providers, legal P2P services, manufacturers of electronic equipment and suppliers of content for mobile phones.

A whole succession of companies have wrestled with the problem of identifying music by its internal characteristics: AgentArts, Friskit, HiFind, MoodLogic, Mongo Music, Music Buddha, and Savage Beast have drafted in respondents to classify and describe music. Cantamatrix and Mongo Music formed their databases with the aid of mechanical classification of tunes.

A number of problems remain unresolved in this area of extracting information from music: segmenting tunes, separating out voice, identifying the performer, etc.

A1.11.2 Survey of Software for Digital Music Recognition

eTantrum⁸⁷

The eTantrum company put forward a non-commercial open source version of music identification technology, Music ID Service, in September 2000. This was the first system which successfully identified an audio file from its analogue waveform and acoustic characteristics. The service supported such formats as MP3, Vorbis, WAV, and CDs, and allowed users to ascertain what exactly they had downloaded from the Internet. Identical music files circulate on the Web under different titles, since there is nothing to stop anyone from retitling them however they please. The eTantrum technology identified the artist, the album, the name of the song, and its genre, and annotated the file accordingly. When the user began playing a tune, the eTantrum Music ID client software created a unique digital signature for it and sent this as a query to the service's servers. These then returned the correct identification and other data.

⁸⁷No longer in existence.

Uplister

The Uplister software company compiled a database of playlists created by users and allowed the entire Uplister community to share them. A plug-in enabled the subscriber to obtain recommendations from people whose opinion he trusted. The program made it possible to find like-minded music lovers, and to view their playlists with their commentaries, comments and pictures. The database also stored playlists of celebrities. Uplister was planning to launch a subscription service in late 2001, but on 8 October 2001 went out of business, having failed to find sources of finance.

Mongo Music

This service appeared as the result of a marketing war between Microsoft and RealNetworks, which led to Microsoft creating its own service for listening to music. Initially the plan was to offer music only as streaming audio but, with the acquisition of Mongo Music by Microsoft in September 2000, that intention changed. Mongo Music, which specialised in processing the digital signal, offered a recommender technology based on the characteristics of the listener's favourite songs. The music was classified both by individuals and by computer.

Gracenote (www.gracenote.com)

Gracenote developed the Music ID technology. Its Internet service identifies sound recordings by analysing their sound file and comparing the particular recording with metadata. The Gracenote service has the largest online library of audio CDs and CDDB song titles in the world, encompassing numerous online services, including Apple's iTunes Music Service.

Tuneprint (www.tuneprint.com)

Tuneprint is a recognition system which works irrespective of format, degree of compression, and the presence of watermarks. Tuneprint processes the file and provides the system with superior metadata, getting round limitations of information.⁸⁸ Tuneprint uses psychoacoustic and statistical technologies to create a unique annotation for each audio recording. A 5-second excerpt from any tune is compared with the database and rapidly identified.

⁸⁸Existing media systems are based on reading unreliable indicators in the titles of files and identification tags which provide the user with basic options like repeating the title of the song or searching for a particular artist.

Friskit (www.friskit.com)

Friskit is a cross between an audio player (RealPlayer from RealNetworks) and a music search engine. The technology makes it possible to search the Internet for streaming audio content directly from a player. The search can be conducted on the name of a performer, a genre, and ready-made mixes like “Dance Party”, “Hits of the 1960s”, etc. The results are automatically played on the player. The software also allows users to create their own mixes, email the music to their friends, or purchase it direct from online retailers who are partners of the company.

MoodLogic (www.moodlogic.com)

Over a 3-year period the company questioned tens of thousands of respondents about their music preferences, gathering more than 800 million responses. In parallel it developed complex algorithms for systematising the information, and designed a powerful infrastructure to serve business and consumers. The utility scans the user’s music collection, compares the “fingerprints” of files with an online database, and can correct inaccurate tags and metadata (information about the artist, album, tracks, etc.).

MoodLogic enables users with large music collections to create selections easily and rapidly, not by performer or the title of tracks but any number of characteristics:



Fig. A.32

genre, mood, tempo, etc. If a subscriber wishes to listen to happy music in dance rhythms or from the 1990s, the MoodLogic filter will provide a mix of just such tunes. The program will automatically manage a collection of MP3 files without more ado. The user needs only to indicate such parameters as artist, mood, or year and the system will present an appropriate selection. A mix of songs can be put together literally with a single click by selecting a particular tune and clicking on “Mix” for the program to generate an entire list of similar tunes. The user can listen to music on his computer, send it to an MP3 player, or burn it to CD.

Relatable (www.relatable.com)

Relatable is a leading provider of technologies for advanced identification of audio and video content. The patented Relatable engine is based on collaborative filtering combined with content properties. It simultaneously analyses user preferences and such properties of the music listened to as genre, beat, tempo, and acoustic attributes. Acquiring information about the subscriber’s musical interests enables Relatable to introduce users to others with similar tastes, and to create a “virtual grapevine” to assist customers to find new performers and new music. The technology can be integrated with any Internet-enabled device delivering digital music, such as portable players, palm-top computers, or mobile phones.

A1.11.3 Hybrid Recommender Systems

Siren Systems’ Soundflavor (www.sirensystems.com, www.soundflavor.com)

Siren Systems’ Soundflavor is an advanced music search system for navigation and personalised recommendations. It was developed over five years and combines objective metadata, artificial intelligence, and user ratings. Content filtering is based on hundreds of properties, from simple ones like tempo, year, and genre of the work, to more complex characteristics like the prominence of a particular instrument in the tune and the quality of the lyrics. Soundflavor has developed a number of filters, some of which focus on particular properties, e.g. songs with female vocals and an acoustic guitar, while others address moods or listening contexts. Soundflavor detects which genres and performers a person prefers. The website enables visitors to music stores, subscribers to particular services, and various Internet communities to find appropriate works and people with similar tastes.x

Musicmobs (www.musicmobs.com)

The Musicmobs system was created to track listeners’ habits, help search for new music, and make contact with like-minded people. The Mobster utility tracks music played on iTunes and Winamp players and, basing itself on the track currently



On the left is a list of performers already in the subscriber’s music library, on the right performers he does not yet have in his collection.

Fig. A.33

playing, suggests songs or performers. It simultaneously formulates two playlists, one containing tunes the user already owns, the other containing tunes not in his collection. The suggestions are based on consumer recommendations from music-mobs.com.

MediaUnbound’s AudioInsight (www.mediaunbound.com)

The service was formed as a result of partnership agreements between a number of services.⁸⁹

⁸⁹MediaUnbound was created in January 2000 by Harvard University students who started streaming the university radio station, WHRB-FM, over the Internet. Its AudioInsight is a system for

The AudioInsight recommender system compiles a personal music programme by complex analysis of listener preferences, modern methods of modelling customer behaviour, and recognition of internal properties of music. The service is based on a mix of critical assessment by music analysts and intellectual agent technology. The program constantly studies subscribers' priorities and helps them to find and listen to works from the Pressplay catalogue. The software is incorporated in all versions of the Pressplay service, which can be used on Yahoo, MSN, and MP3.com.

A1.11.4 Personally Attunable Internet-Radio Stations

Internet-radio stations began experimenting with collaborative filtering of music in the 1990s. In order to compile preference profiles some, for example the Launchcast radio of Yahoo, invite listeners to rate songs manually, while others, like Last.fm radio, ask nothing of their subscribers and automatically infer priorities from customers' behaviour.

Yahoo's Launchcast (<http://launch.yahoo.com/launchcast/>)

Yahoo's Launchcast allows listeners to select a repertoire. The service can be used both on a paid and an unpaid basis. Non-paying users are offered a limited number of options, but even so can tune the station to play their favourite music genres and performers.

In order to regulate the broadcasting of his personal radio station, a user may start by indicating preferred genres and his four favourite performers or groups. He can then fine-tune, awarding ratings to songs, performers, and albums. This can be done while listening, or on a particular performer's page. The more music he rates, the better Launchcast will select tunes to his taste.

When it broadcasts a song, the Launchcast player will indicate why this is being suggested for the listener. This enables the subscriber to fine-tune his profile and enable the system to choose the broadcast programme optimally to include music he already knows, and some he has yet to hear.

No matter how carefully the listener ranks content in the unpaid mode, however, the system imposes certain restrictions. The programmes compiled by the site's editors may not fully coincide with the customer's priorities, but even here the user is invited to actively rate music and, when compiling later programmes, the editors will bear customers' assessments in mind. Nevertheless, the system will not suggest music if there are issues with the rights owners. This is why the Launchcast catalogue runs to only 150,000 songs.

recognising the internal properties of music and modelling customer behaviour. The platform can be integrated with any online music services, content providers and Internet-providers. In January 2002, MediaUnbound concluded a partnership agreement with Pressplay, founded in December 2001, enabling listeners to download music from the catalogues of Universal, Sony and EMI.

For subscribers to the site, however, many of these restrictions are lifted. For \$35.99 a year or \$3.99 a month, the user gains access to a larger number of stations, is not troubled with advertisements, and the system takes full account of his preferences and weeds out tunes he has rated negatively. The subscriber can jump without limitation from one song, if he does not like it, to another and can also attune the station to his mood by rating several works before listening.

The site's subscribers are offered a further opportunity to discover new music by browsing through profiles and playlists of other registered music lovers and finding a fellow-subscriber whose tastes resemble their own. They can then mark that person as an "influence", with the result that songs the virtual adviser has rated highly will be played on their own radio station.

To facilitate navigation the site offers music news, editors' reviews, interviews with performers, and ratings.

A1.11.5 Partnerships of Independent Recommender Systems with Content Providers (Online Music Services and e-Retailers)

Automated recommender systems are more effective when paired with a content provider, be that a peer-to-peer network, a legal music service like the iTunes Music Store, or an Internet-radio station. A recommender service which is unable to allow users to listen to a complete track is incomplete, and if the user has to pay for the option customers are put off.

GenieLab (www.genielab.com)

GenieLab is an example of an independent recommender system working in partnership with online music services.

If the name of a recommended artist is accompanied by an Amazon, iTunes, or Microsoft MSN Music icon, clicking on it takes the user to the server of that partner firm where he can listen to a sample of the recommended music and, if he so chooses, buy it. The recommender system itself provides information about artists, a photo, and indicates whether the music is available from a partnered music service.

GenieLab has a plug-in called GenieLab Widget which works in tandem with iTunes. It monitors the music the user is playing, and sends GenieLab a query about the performer.

A1.11.6 Recommender Systems in e-Commerce

Many major commercial websites use recommender systems to increase sales. There are three approaches to this:

1. visitors to the site often look at Internet pages without buying anything. The recommender system aims is to suggest goods of interest to the customer;
2. recommender systems can suggest additional goods to accompany the purchase or purchases already made. This may be done at the payment stage, based on purchases in the basket. Competent suggestions can increase the size of the order;
3. winning customers' loyalty. When business competitors are only a mouse click or two away, this business strategy makes sense. By providing additional positive experiences, recommender systems enhance customer loyalty. Sites invest in discovering their visitors' preferences, and then use the information to make well-chosen recommendations and also to create a convenient user interface. Customers react positively to sites which adapt well to their requirements. The more the customer uses the recommender service, teaching it his priorities, the more appropriate the site becomes for him. Customer loyalty is also strengthened by creating links between customers. People return to a site where they make enjoyable contacts.

A1.11.6.1 Examples of Recommender Systems Used in e-Commerce

Amazon.com

Amazon.com operates several types of recommender service.

Like other such sites, Amazon is designed in the form of information pages, one for each particular good. The customer sees the average customer rating of the good, its price, description, a brief editorial remark by Amazon, and comments by customers. The page contains the observation that, "People who bought this good also bought the following. . ."

Amazon is constantly tracking the movements of visitors through its site, which goods they look at, which they buy. On the basis of customer behaviour, the system seeks out items which may interest them.

Amazon also utilises a more sophisticated recommender system. (See Fig. A.34).

Consumer preferences are deduced on Amazon.com from analysis of goods purchased and rated, and also of goods which the customer already owns, and about which he tells the service. The system then compares the customer's tastes with those of other users and, where these coincide, uses them to generate recommendations.

Each time a registered user goes on to Amazon, a "New for You" box advises him of recent acquisitions personally selected for him.

Recommender Service on OD2 (www.ondemandedistribution.com)

This is a joint project for selling music over the Internet between the largest online music service in Europe, On Demand Distribution (OD2), and Microsoft Corpo-

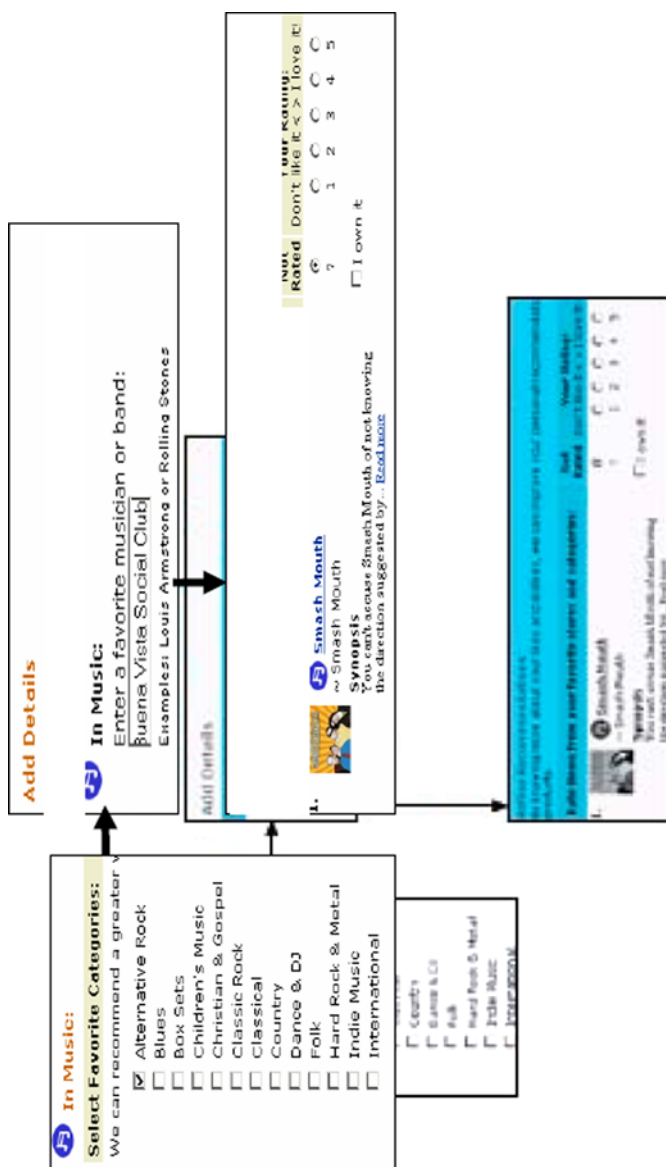


Fig. A.34



RECOMMENDATIONS EXPLORER YOUR COLLECTION IMPROVE YOUR RECOMMENDATIONS

Search All Products: Use Recs Explorer



Recommendations Explorer

Exploring products or interests that you are familiar with and clicking "I own it" or "Not intere just for you. To refine your results, click "More like this."

Show:

1.   **Las Flores De La Vida**
~ Compay Segundo
Average Customer Rating: ★★★★★
Our Price: \$14.99

Amazon.com
At 93, the man who came to international fame with *Buena Vista Social Club* is making sor adventurous, arranging his distinctive son forms for a band that,... [Read more](#)

2.   **Calle Salud [US]**
~ Compay Segundo
Average Customer Rating: ★★★★★
Our Price: \$14.99

Amazon.com
With age-defying suppleness, Cuban vocalist (and nonagenarian) Compay Segundo helpe his own *Lo Mejor de la Vida* with his full-bodied voice. *Calle Salud*, then,... [Read more](#)

Fig. A.35 List of goods recommended by the system

ration.⁹⁰ The SonicSelector for Windows Media Player recommender service allows European users of Windows Media Player to buy music in special OD2 online stores. The service competes with the analogous service from the Apple iTunes Music Store.

SonicSelector offers a catalogue of 350,000 music items, each costing €0.75. The service enables the user to go directly to the OD2 retail stores and download music to portable devices. In order to generate recommendations, SonicSelector analyses the music bought by the user in the past and compares this information with a database of other fans' music preferences. As the customer continues to use the system, his user profile becomes more accurate and the recommendations better targeted.

The eMusic Recommender Service (www.emusic.com)

A combination of the AgentArts recommender service (www.agentarts.com) and eMusic, a leading online music service owned by Vivendi Universal, opened for

⁹⁰The alliance was formed in early 2004.

business in May 2001. As eMusic has an ever-growing music catalogue in which newcomers rub shoulders with celebrity performers, the problem of navigation is considerable. The agreement with AgentArts brought eMusic subscribers a search system which took account of their personal preferences. The system for generating individual recommendations has since been upgraded.

Upto11 (www.upto11.net)

P2P technology facilitates the legal and illegal sharing of music, but how are users to hear about new works and find new tunes to their taste? Peer-to-peer networks alone are unable to provide a solution. Upto11 is a server which generates recommendations on the basis of music collections shared on peer-to-peer networks.

A1.11.7 Recommender Systems as a Means of Promoting Independent Performers

iRate Radio (<http://irate.sourceforge.net>)

With the exception of the Gods of Music website (www.godsofmusic.com), which publishes reviews of MP3 files, printed publications and radio stations take no interest in independent musicians distributing their work over the Internet. For creative artists not signed up with the major labels publicity is an acute problem. The Internet contains a vast number of free MP3 files which nobody knows anything about.

The iRate radio software has been developed by New Zealander Anthony Jones to enable users to find the music of independent performers.⁹¹ It searches for legal and freely distributed MP3 files on the Internet, builds a corresponding database, and plays the music like a radio station. iRate radio does not allow the user to download the MP3 files, but provides a reference to the location from which its subscribers can download it. The software works on three platforms: Linux, Windows, and Mac.

In generating recommendations, iRate radio bases itself on the ratings of listeners with similar tastes (collective filtering). The server analyses a subscriber's assessments and compares them with the points given by other users. The more songs listeners assess, the better the collective filter works. The service is run entirely by volunteers. iRate radio is a collective filtering system with client/server architecture.

⁹¹While working with the Napster and Gnutella peer-to-peer networks, Anthony Jones noticed that if he came across a track he liked, that user usually had several other tunes of interest to him. He discovered a number of good groups in this way, but had the strong impression that file sharing systems were unable to acquaint users with new music, so he decided to twin P2P technologies with recommender systems.

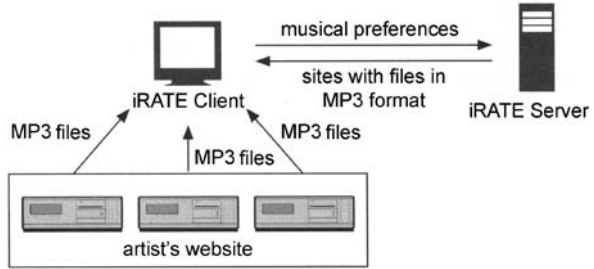


Fig. A.36

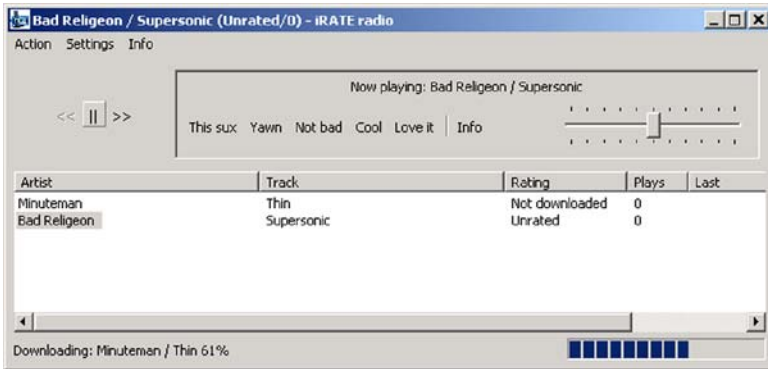


Fig. A.37

Any sites which do not wish to be included in iRate radio’s listing are removed.

inDiscover (<http://indiscover.net/>)

One further service developed to introduce listeners to the music of independent performers is inDiscover. Artists from all over the world supply the site with song files in MP3 format. Predictions are compiled using collaborative filtering technology. After a user has assessed the song, he is offered two playlists, one containing songs he is sure to like, the other songs he will probably like. After obtaining ratings of music of different genres and for playing in different contexts (for example, during workouts), the system is capable of compiling the a wide variety of playlists. The more actively the user rates music, the more accurate the service’s recommendations.

A1.11.8 Users’ Ratings of Recommender Systems⁹²

⁹²Research by the Pragmatics of Culture Foundation, December 2004.

Table A.45

Title of site	Users	Titles in catalogue	Recommendations in system	Average assessments per title	Average assessments per day	Average assessments per user	Characteristics and options	Accuracy of recommendations
Movielens (films)	93,500	8,641	11,278,712	1,300	4,000		Very straightforward. User first rates a minimum of 15 popular films, then obtains recommendations. If a favourite film is not in the index it can be added. Films can also be added to a wishlist in order not to forget what you want to watch.	Awarding 4 stars to a single Russian film ("Moscow Does Not Believe in Tears") resulted in a recommendation to see "Battleship Potyomkin". If only American films are rated, the recommendations accord with the user's tastes approximately 70% of the time.
Music Recommendation System (http://music.cs.uiuc.edu/)	5,658	2,010,458				355	Created to work with iTunes. Analyses the client's playlist and compares the information with data of other users before issuing recommendations. Permits choosing titles from the catalogue and rating them.	Recommendations corresponded to users' tastes roughly 30% of the time, which may explain why the service has relatively few subscribers.
Musicstrands	770						Music can be downloaded from the site, and a playlist created or downloaded, create your own filters for mood, activity, place, etc. Also offers monitoring of user's behaviour. Recommendations may be based not only on the subscriber's own playlist and personal ratings but also on information about his behaviour. If the user likes someone's recommendations, he can include him in a list of "influences".	Very awkward navigation, few active customers. Recommendations accord with users' expectations 50% of the time.

Table A.45 (continued)

Title of site	Users	Titles in catalogue	Recommendations in system	Average assessments per title	Average assessments per user	Characteristics and options	Accuracy of recommendations
Last.Fm	117,000	The system has accumulated an enormous collection of music profiles, which it uses when generating recommendations. The prediction is based on coincidence of profiles (if the customer likes Cesária Évora he will be offered Yuri Buenaventura, whose profile is similar). The subscriber can also view what people with music preferences similar to his own are listening to.	9,705	The most popular system. Convenient navigation. People feel they are hunting for good music, although the search does take time.	Very good overall impression. Successful recommendations about 75% of the time.	Best system asking for users' opinions. Very clear and convenient. Recommendations accord with user's tastes approximately 90% of the time.	
Filmaffinity (films)							
MusicMobs							
MediaUnbound							

A1.11.9 Recommender Systems and Mobile Phone Communications

Recommender systems have also attracted the interest of mobile phone manufacturers, since all analysts foresee explosive growth for sales of entertainment content for mobile phones. Expanding bandwidth and increasing memory facilitate discovery, playing and storing of content. Wireless connection makes possible local file exchange and discovering like-minded people, so creating communities.

Nokia and AgentArts (www.agentarts.com) are jointly developing solutions capable of improving services for owners of smartphones. The platform responsible for generating recommendations can quickly offer advice and options for purchasing content over the Internet or from the communications service provider. These might be ringtones, games, or video. The platform consists of three modules, one of which generates recommendations, while another compiles a personal profile of the user, and the third analyses the data obtained and maintains feedback. The preferences profile is formed by tracking the sites the user visits, the information he downloads to his smartphone, and the purchases he makes on the Internet and from the provider. This serves as the basis for recommendations of content.

Examples of individually selected entertainment content:

1 Personalised menus and content recommendations

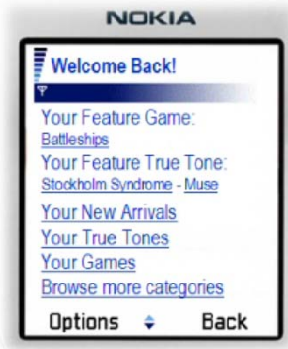


Fig. A.38 Recommendations and menu headings are based on the consumer's preferences profile



Fig. A.39 Personalised recommendations: new arrivals, content types. Recommended ringtones are divided into those which the user should like and those which he may like

2 Juxtaposition of Profiles of People with Similar Tastes The consumer’s profile is based on information about web pages visited, data downloaded, and purchases.

Users can personalise the profile by adding photographs and other information.

Makes it possible to send messages and add profiles of like-minded users and friends to a contact list.

The company is developing Icy Pole, a program capable of transforming someone with a mobile phone into a walking music station capable of sampling. A new

Fig. A.40 Enables viewing of user profiles similar to the customer’s own. Provides a basis for forming online communities of people with shared interests

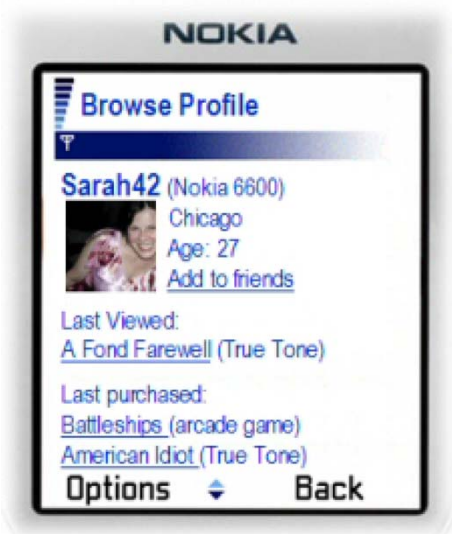
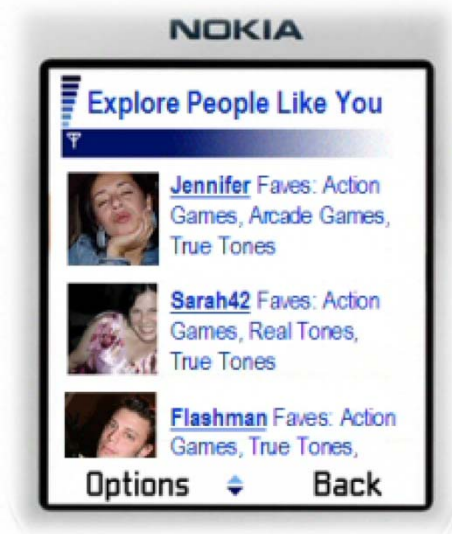


Fig. A.41

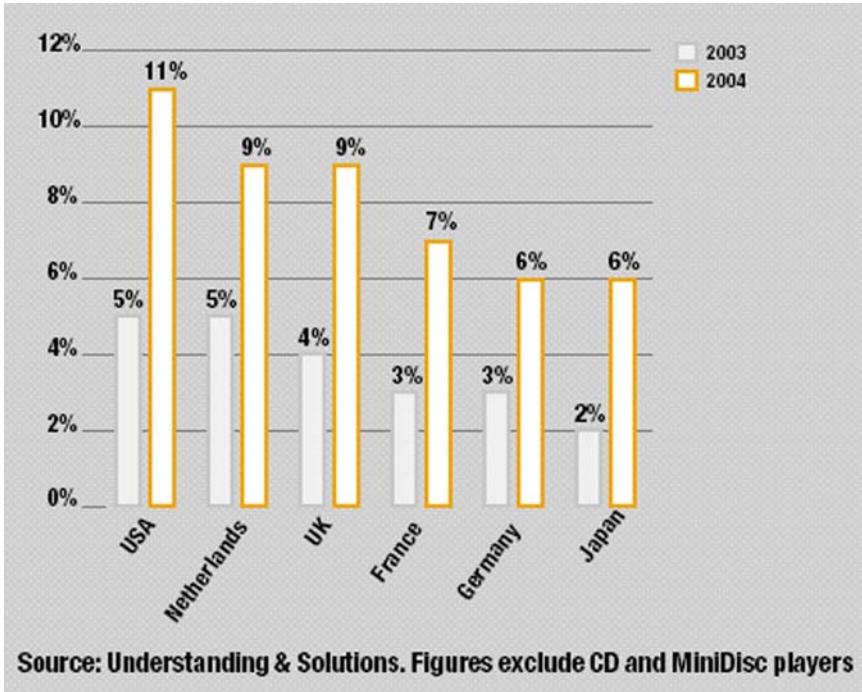


Fig. A.42 Distribution of portable digital players (IFPI, *Digital Music Report '05*)

application for smartphones from AgentArts uses Bluetooth technology to search for similar devices. As soon as the program detects music within a certain distance which corresponds to the preferences in the user’s profile, the device notifies him and allows him to listen in to the music wirelessly, and also to make the acquaintance of his like-minded music lover.

A1.12 Related Markets

A1.12.1 The MP3 Player Market

In 2003 the size of the world market for digital players was estimated at \$4.4 billion, and in 2004 at \$7 billion.⁹³ IDC predicts that by 2007 the world market for MP3 players will have increased to \$44 billion and that the annual growth rate will be 30%. Creative Technology in Singapore, the second largest manufacturer of MP3

⁹³Data from IDC.

players in the world, believes development will be even more dramatic. Apple, the market leader in this niche, has about 70% of the market.⁹⁴

Types of Players⁹⁵

Several types of portable players are currently being manufactured, of which the most widespread are based on the MP3 format. These come in three varieties: MP3 players using flash memory; CD players which play compact discs with MP3 files; and MP3 players with hard disks.

Flash Players

MP3 players with in-built or plug-in flash memory are the most compact. They have no moving parts and hence, unlike MD players, CD players and other kinds of MP3 player, are shock proof.

The first MP3 flash player was marketed in 1998 by the US company, Rio Audio (now part of D&M Holdings). This was the Rio PMP 300, and it had 32 Mb of memory. Since then MP3 flash has advanced considerably, with the amount of memory increasing markedly. Few models now have less than 128 Mb, and the overall dimensions have reduced noticeably.

Flash players can be divided into several groups: traditional, weighing 60–70 grams, with a large display, accommodating flash cards; super compact, weighing 30–35 grams but which because of the reduction in size, cannot accommodate memory cards and have a relatively small display; and players using USB flash drives which are compact and do not require special software to record music.

The growth in MP3 player sales has been driven by the rapid fall in the price of flash memory, the incorporation of MP3 in an ever wider range of devices, and the appearance of legal music downloading sites on the Internet.

CD Players Supporting the MP3 Format

The MP3 CD-player plays ordinary audio CDs and can also duplicate CD-ROM discs with the MP3 files recorded on them. There are “thick” and “slim” varieties.

⁹⁴Anna Volkova, “Playing for Money: MP3 Player Sales Will Increase Every Year” [“Igra na den’gi: Prodazhi MP3-proigryvatelei budut rasti kazhdyi god”], *Kommersant*, No. 10 (24 January), 2005.

⁹⁵Account based on *Chip Special*, No. 6, 2004 and the website <http://mp3play.hut.ru>.

Hard Drive (HDD) Players

MP3 players with a hard disk are the latest development in the MP3 family.⁹⁶ An 8-Gigabyte hard disk, for example, can hold about 90 hours of MP3 format music, or the equivalent of 15 CD-ROM discs. Devices with miniature hard disks have appeared recently which have a capacity of 1.5–4 Gb. The undisputed leader in this field is Apple, and its iPod, developed in 2002, is considered to set the standard in this segment. The latest iPods have 20–40 Gb of memory and can store up to 10,000 songs, compared to some hundreds of songs on MP3 flash players.

The price of MP3 HDD players is higher than MP3 flash players and they use more energy. Like flash players, HDD players can be used to transfer data between computers.

Unlike the first players, which supported a single music compression format, and even then were restricted in terms of a maximum and minimum bitrate, the latest sound reproduction technology recognises many formats. Manufacturers of players which support the greatest number of formats have a competitive advantage, but some of the leading MP3 player manufacturers continue to support only their own formats in order to keep their competitors under pressure.

A1.12.1.1 MP3 Players and Their Influence on the Development of the Music Market⁹⁷

The most popular portable digital player is the iPod, with 50% of the world market (including flash players and HDD players). Since its first appearance, sales have reached 10 million units. Alongside Apple's iPod, Creative, Rio, Sony and others are promoting their audio reproduction hardware. The leading consumer electronics manufacturers behind the major online music services, Apple, Microsoft, Sony, and RealNetworks, all have their own devices and software to push. Apple's iTunes service is currently compatible only with the iPod, and a number of prominent online services and manufacturers of players had used Microsoft technology. As a result they are compatible with each other but not with the technologies of Apple, Sony and RealNetworks. The Sony Connect online service, for example, offers songs in Sony's ATRAC format, compatible only with Sony players.

In parallel, the DVD player market is also growing rapidly. In 2001 penetration of American households by DVD players was 41%. In 2003 this rose to 70%. In 2001 for Western Europe and Japan this indicator was 19 and 28% respectively, while by 2003 it had risen to 47 and 42% (data from IFPI, 2003). Deliveries of DVD players in 2003 in the USA reached 22.92 million units, and in Japan 5.93 million. Jeita predicts that world sales of DVD players in 2006 will reach 88 million units.

⁹⁶The first examples of HDD MP3 players appeared in 1999. One of the pioneers was Remote Solution's PJB-100 from the South Korean HanGo Electronics.

⁹⁷Account based on IFPI, *Digital Music Report '05*; IFPI, *Online Music Report 2004*; Peitz and Waelbroeck, "An Economist's Guide to Digital Music".

*A1.12.2 The Ringtone Market*⁹⁸

The ringing of a mobile phone has been transformed from a means of attracting the subscriber's attention into an indented high-tech product which can vary in price from \$0.99 to \$2.05, and sometimes even up to \$4.⁹⁹

Various estimates put world sales of ringtones in 2003 at about \$3 billion, roughly 10% of the entire global music market. In 2005 more than 2 billion ringtones were sold at an overall cost of \$600 million [\$6 billion?]. The size of the international music market is in the region of \$12 billion [\$30 billion?]. In 2005 twice as many ringtones were bought as in 2004. The firm A.T. Kearney predicts downloads of tunes for mobile telephones in 2006 will reach 30% of total music sales [about \$9 billion/\$3.6 billion?].

In 2005 The most popular tunes for ringtones in the West were "50 Cents" (Candy Shop, 1.9 million downloads) and "Hollaback Girl" (Gwen Stefani, 1.2 million downloads). Most popular with Russian users, according to content providers, was "Night Watch" by the Umaturman Group and "Eyelashes" by The Brothers Grimm. In the first half of 2006 the top seller in Europe was "Crazy Frog", which prompted more than 20 million downloads. The most popular ringtone in China shifted 300 million units!

Recently novelty ring-back tones have been gaining popularity, a tune or other content heard instead of the normal ring-back tone when a number is called.

The main kinds of ringtones are a straightforward ringtone for an inexpensive telephone; a polyphonic melody adapted for a particular model; a shortened version of an existing music composition; and specially composed music.

The ringtone market is considered to have appeared in the USA in 2002 when Sony Corporation took over a modest New York company, Run Tones, which specialised in entertainment content for mobile phones. This was followed by an announcement by Warner Music Group that they were selling ringtones on their website. In late 2003 the Internet search company Infospace bought Moviso LLC for \$25 million, one of the main intermediaries between the sound recording companies and telecom operators. In 2004 the Japanese telecommunications company For-side.com took over two smaller competitors of Moviso. As the ringtone market grew, *Billboard* magazine in collaboration with the consulting company Consect LLC began publishing charts based on the sales of tunes for mobile phones.

⁹⁸Account based on E. Chiniaeva, "Tunes and Rhythms of a Ringing Telephone" ["Melodii i ritmy telefonnykh zvonkov"], *Kommersant*, 1 December 2004; A. Shul'gin, "80 Million Euros for a Crazy Frog, or Music Goes Down the Mobile Phone" ["80 mln evro za sumashedshui liagushku, ili Muzyka ukhodit v mobil'niki"], *Vzgliad*, 4 October 2005, online. Cited 14 November 2005. Available from URL: <http://www.vz.ru/columns/2005/10/4/8862.html>; "The Ringtone Market as a New Stimulus for Musicians" ["Rynok ringtonov – novyi stimul dlia muzykantov"], *CyberSecurity*, 26 January 2006, online. Cited 11 May 2005. Available from URL: <http://www.lyramax.ru/net/7858.html>.

⁹⁹For comparison, a song from iTunes costs \$0.99. A ringtone lasts only 30 seconds and has no vocal component. In addition, analysts are commenting on the increase in prices: if in early 2005 the costs of a mobile phone tune in the USA averaged \$1-1.50, by the end of the year a download was costing \$2.50.

The growth in the popularity of ringtones has occurred largely through the efforts of telephone manufacturers. All models of recent generations fully support the MP3 format. Western content providers now refer to an MP3 tune for mobile phones as a “mastertone”.

The growing ringtone market has encountered a number of problems, not least of which is reconciling the interests of the various parties when negotiating contracts to turn songs into ringtones. Negotiations dragged on for almost six months over the hit “Yeah!” by the hip-hop star Usher because of disagreements between T-mobile USA and the agent representing one of the seven artists. Only in August 2004, when the song was already out of the charts, did the company relent and “Yeah!” was released. With sales of 40,000 copies a week it became an instant bestseller, but the lengthy delay cost all the parties to the negotiations millions of dollars of lost revenue. Another problem is piracy. Forrester Research has found that, of hundreds of sites offering ringtones, very few have agreements with recording companies. Unlimited downloads for a year from a “grey” operator costs only \$9.99. The UK company Envisional, which surveys the Internet, estimates that losses to the music industry from illegal downloading of ringtones may be as high as \$1 million a day.

One way of combating piracy is through agreements between mobile phone manufacturers, mobile communications operators, and the recording companies. In 2003 Motorola signed a \$70 million 3-year agreement with MTV to develop and distribute ringtones. Musicians themselves join in the battle against piracy: the Eminem album “Encore” included a ringtone created on the basis of one of the songs in the album.

Another weapon in the battle is to restrict the playing of ringtones. The ringtonejukebox.com site offers a large collection of unusual sounds, including “Evil Chant” and “Shooting in a Panic-Stricken Crowd”. These, however, work for only four Motorola models. Nokia offers technology which allows users to create their own ringtone, but the sound quality is only high on Nokia phones. Motomixer from Motorola allows the user to choose a music style (jazz, latino, or rock), and add a guitar solo or faster percussion, but the resulting ringtone is supported only by AT&T Wireless and Cingular Wireless. Madonna sells ringtones of her hits, including “Into the Groove” and “Lucky Star” in collaboration with m-Qube, a company which hires professional musicians to create ringtone versions. The operator Sprint offers them only for three Samsung models, and Verizon Communications offers them only for LG Electronics and Motorola phones.

How the ringtone market develops will depend largely on what the various participants agree among themselves, and here the key issue is how revenues from the sale of tunes is to be shared out.¹⁰⁰ Competition is mainly between the music publishers and recording companies. Revenues from ringtones based on existing melodies usually go to publishers, who own the rights to the words and music. Their cut is 30% of the retail price.

¹⁰⁰These are considerable sums. Consect’s data indicates that customers of Sprint bought 500,000 copies of the ringtone version of Beyoncé’s hit “Crazy in Love” at \$2.50 a time.

Recording companies, which own the rights to a particular performance, try to increase their share of the profit from ringtones which excerpt an existing recording, by claiming that this is an ordinary sale, only in a different format, meaning that a larger cut should go to them. For now the recording companies are in the lead, with a 40–50% share of sales, but this means that only part of the music publishers' catalogue is available in ringtone format. As technologies develop the recording companies are hoping to exploit mobile phones to distribute high quality recordings. Many are working with their top performers to record remixes providing briefer versions, from one and a half to two minutes, for ringtones, and also creating short, specially written songs.

If previously the recording companies were mainly concerned with how a song would sound on radio, now they first consider how it will sound as a ringtone. Britney Spears does not sell well in ringtone format, which may affect her prospects. A performer who sells well only in obsolescent media is going to bring in a diminishing proportion of company income. Cedric Ponsot, head of the telecommunications division of Universal Music International, has warned that mobile phones are the key channel for distributing music in the future, and that it is essential to rethink how content is created and distributed.

Appendix 2

Lawsuits Against Peering Networks

As soon as peer-to-peer networks began becoming popular among music lovers,¹ the sound-recording industry embarked on large-scale litigation against file-exchange services. The first proceedings, which also had the greatest impact, were brought against the pioneer of P2P, the Napster network.

A2.1 The Case of RIAA versus Napster²

A2.1.1 Discussion of Sampling in the Napster Case

In the court proceedings against Napster the main debate centered on the issue of sampling. Could the free downloading of music in this file-exchange network be classed as sampling (making tunes available so that a buyer can decide whether to purchase a CD or digital music)?

Napster tried to persuade the court that the service's activity was the equivalent of sampling, and could be considered analogous to listening without payment to sound recordings in a shop or to tunes on a retail website.

The court did not agree, on the grounds that:

1. Napster's customers were obtaining a copy of the song for permanent use, irrespective of whether they went on to buy a CD or music in digital format.
2. Napster allowed users to store music on their hard disk without limitation of time, whereas sites trading music legally offered either 30–60 seconds of listening time to a musical work in streaming audio format, or trailers with a limit on how often they could be downloaded and listened to.
3. Napster's customers could download an entire album, whereas in sampling only a few tracks were offered for listening.
4. File exchange using the Napster network facilitated the rapid, unsanctioned distribution of copyright material because subscribers could copy pirated works to a CD, send them to their friends over the Internet, or make them available for downloading to millions of the service's customers.

¹See Appendix 1, Sect. A1.9.

²Based on the court ruling of 26 July 2000.

A2.1.2 The Nature and Extent of Napster's Guilt

Attempting to show that Napster was undermining the market for legal trading in music, the plaintiffs insisted that its actions was causing three main kinds of damage:

1. It was reducing retail sales (especially among college and university students);
2. It was hindering the development of legal commercial online trading;
3. It was devaluing music socially by distributing it free of charge.

Both parties called a number of experts and conducted their own research.

On behalf of the plaintiff, Dr E.D. Jay noted that 41% of students participating in her research gave explanations of their reason for using the Napster service which suggested Napster was displacing CD sales. Nevertheless, she found that 21% of respondents considered that Napster helped them decide what music to purchase and optimised their choice. Dr Jay's overall conclusion was, however, that, the more tunes Napster users downloaded, the sooner they found this was reducing their music purchases.

The defence presented data from a different survey³ which concluded that users did not see MP3 files as an acceptable substitute for CDs, and that accordingly file exchange did not reduce sales of licensed tracks and could even enhance them.

Analysis of actual CD sales could be interpreted in different ways. Sales were investigated in the vicinity of and remote from university quarters.⁴ The hypothesis was that students were the principal users of Napster, and differences in sales volumes would make it possible to determine the service's effect on the retail trade. Sales had, however, fallen equally everywhere.⁵ Statistics relating to Internet stores like Amazon or CDNOW were ignored, although these had increased their sales after the appearance of Napster.

Other research was conducted, specifically by the economist David Teece on behalf of the sound-recording companies, and by Robert Hall on behalf of Napster. The results were again contradictory.

³The defendant quoted a report by Professor Peter Fader in which it was claimed that 60% of Internet users who downloaded digital music without payment did so in order to listen to music before buying a CD. Another Fader document reported that around 28% of Napster users said their music purchases had increased since they had started using its software. Since, however, Fader was said not to have conducted independent research in the first case, and not to have controlled the second closely, his reports were not regarded as definitive. In fact, the research methods of both sides were open to question, although it was only Napster's methodology which was severely criticised by the court. Throughout the case the judge appeared to take a stricter approach to Napster.

⁴Three control groups were chosen: wholesale stores, retail outlets far removed from student quarters, and small stores close to technologically well equipped university residences. For the latter, sales were found to have fallen exactly the same amount as in the two former cases, which showed that Napster was not having an effect on overall sales volumes.

⁵The negative effect Napster had on sales was apparently less obvious because MP3 files were at first a less than perfect substitute for compact discs.

Dr R.E. Hall, an expert witness called by the defendants, on the one hand claimed that music could be sold at a high price despite its being distributed free on the Napster network. He stressed that indeed Napster's activity increased sales of computers and the software necessary for obtaining and playing MP3 files, and would thereby enhance the volume of the plaintiffs' online sales. On the other hand, he noted that an injunction against the defendant's activity would destroy its business, since users would switch to kindred services. In other words, if Napster were to be closed, music lovers would most likely just move to other sites offering free MP3 files. This was tantamount to an admission that free file exchange put serious obstacles in the way of the development of a commercial downloading market.

In considering Napster's influence on the development of commercial downloading, the court concluded that given a choice between Napster's free download service and sites offering music on a paid basis, users were likely to prefer Napster.

In conclusion, although the plaintiffs failed to substantiate their claim of huge losses, the court did not accept that free exchange of files stimulated CD sales. Indeed, the court found, it caused them to decline. The court concluded that the obstacles placed in the path of commercial distribution exceeded the advantages asserted by the defendant. The plaintiffs, the sound-recording companies, had demonstrated a significant probability that widespread non-commercial use of Napster would unfavourably affect their marketing of digital downloading.

Moreover, this deprived music publishers of royalties for their songs. Unauthorised downloading of the plaintiffs' music in order to listen to songs with a view to deciding whether or not to buy a CD would not be lawful even if this increased CD sales.

Now, several years later, the issue is no longer so controversial although, in a broader perspective, the answer remains unclear to this day. From an economic viewpoint, the real significance of sampling is not what the plaintiffs and the court believed it to be. What declines is not the sales of recordings listeners liked when they heard them as free MP3 files but of songs which failed to pass this test.

A2.2 The Grokster Case

The Grokster case, heard before courts of various instances over a period of years, was of great importance for all the file-exchange services because it created a legal precedent.

The chronology of events was as follows:

25 April 2003 The Federal Court in Los Angeles decreed that the Grokster P2P service offered by the company of the same name, and the Morpheus service offered by StreamCast Networks, which were accused of abetting piracy, were not guilty of violating copyright. Judge Stephen Wilson concluded that these two peer-to-peer

networks differed fundamentally from Napster because of their decentralised structure, and were accordingly not liable for the exchange of pirated files between their users. Relying on the 1984 Sony precedent,⁶ 930 judge drew a parallel between P2P networks and the video recorder manufacturers. Just like video-recording equipment, P2P networks were, to a significant degree, used for legal purposes and accordingly could not be considered illegal in themselves, even if their subscribers sometimes broke the law. The judge accepted that network owners were unable to control the flow of all files exchanged by their customers. Accordingly, liability for illegal file exchange rested solely with users.

After this decision, the RIAA (Recording Industry Association of America) resorted to a tactic of prosecuting private individuals using P2P networks.

20 August 2003 Dissatisfied with the not guilty verdict of the Los Angeles court, the RIAA and MPAA⁷ appealed to a court of higher instance. They hoped not only to overturn Judge Wilson's verdict, but also to obtain official confirmation that P2P networks were illegal in principle. They referred to the decision of the Ninth Circuit Court of Appeal, which found Napster guilty, and claimed that likening P2P services to video recorders was as absurd as comparing suppliers of chicken meat to organisers of cockfights.

19 August 2004 The Ninth Circuit Court of Appeal of America upheld the decision of the court of lower instance and acquitted the P2P networks belonging to Grokster and StreamCast Networks (P2P Morpheus). All three judges involved in reviewing the case deemed the sound- and movie-recording companies' appeal to be without foundation. They noted that these peer-to-peer networks were simply offering users a facility for exchanging information. Since the networks' architecture was decentralised, the owners were effectively unable to monitor their subscribers' actions. Accordingly, if users were infringing copyright, the organisers could not be held liable for this.

Judge Sidney Thomas also commented that it would be unwise to impose restrictions on new technology in haste, since time and the market usually restored the balance between the interests of users and those of copyright owners. This rule was equally fair in respect of photocopying machines, video recorders, and computers.

The verdict of the Californian court did not suit the RIAA and MPAA. They could have gone on to bring proceedings against individual users of P2P networks, but this would have been far less effective than shutting the services down completely. Representatives of these organisations announced their intention of launching a further appeal to the US Supreme Court.

⁶The Betamax Case, 1984. For further detail, see Sect. A2.4 of this Appendix.

⁷The Motion Picture Association of America.

29 March 2005 Hearings began in the US Supreme Court of the case of the Grokster and Morpheus P2P networks. The statement of claim was signed by 28 sound-recording companies and Hollywood movie companies.⁸

27 June 2005 The US Supreme Court resolved that the manufacturers of file exchange technologies bore liability for infringement of copyright laws by their customers.⁹

A major factor in the ruling was Grokster's decision to position its software as a means of obtaining free content. The Supreme Court took the same 1984 Sony precedent, but considered that their colleagues in California had considered only the technological aspect, overlooking the P2P business model. This was quite different from the Sony situation, since the service's developers were deliberately promoting their product as a means of infringing copyright. If the earlier courts had based their verdicts on technological issues (how and where the music and films involved in file exchange were stored), the experts now emphasised intention. As a result, basing itself on that same 20-year old precedent, the court overturned the prior verdicts of the US circuit courts which had absolved the developers of P2P software of responsibility. In the opinion of the Supreme Court, Grokster and StreamCast, the owners of the Grokster and Kazaa services, were liable for infringement of copyright by their users.

The reaction of American society was mixed. Instead of basing their verdict on technology, in which the courts are not expert, the findings were reached on the basis of something they were familiar with: intention or motive, according to Edward Samuels in his *Illustrated Story of Copyright*. A number of independent civil rights organisations, by way of contrast, condemned the new verdict. The US Supreme Court had initiated a new era of legal uncertainty for US firms introducing cutting-edge technologies, declared Fred von Lohman, a prominent lawyer for the Electronic Frontier Foundation¹⁰ which represented the interests of file-sharing companies.

The court's ruling did not, however, bring about the immediate closure of Grokster.

7 November 2005 An announcement appeared on the Grokster network website stating that it was ceasing its activities. In the opinion of the plaintiffs and of the court, Grokster and its parent company StreamCast had made no effort in the months since 27 June to stop the distribution of pirated MP3 files. The company agreed to switch off its computers and cease to distribute updated versions of its software.

⁸In the meantime it became known that Sony BMG Music Entertainment and Grokster were working on a joint project to create a service which would make paid-for and free music content available for download.

⁹Judge David H. Souter summarised the court's unanimous decision. File-sharing services were liable for illegal activity which they incited. The case materials were full of facts confirming that from the moment Grokster and StreamCast began distributing their free software, each had openly declared an intention of enabling users to download content protected by copyright, and both had actively connived at breaking of the law.

¹⁰See Appendix 1, Section A1.10.6.

A2.3 Chronology of Lawsuits After the Closure of Napster¹¹

19 September 2003 The Recording Industry Association of America (RIAA) sued iMesh, an Israeli firm which owned one of the oldest file-exchange systems. It was accused of condoning piracy.¹²

19 December 2003 The Supreme Court of the Netherlands found that the administration of the Kazaa P2P system was not liable for the actions of users of the system, including infringement by them of copyright law. This confirmed the ruling of the Dutch Appeal Court in 2002 on a petition from the Buma/Stemra organisation which represents the interests of the sound-recording industry in the Netherlands.

Representatives of Kazaa emphasised that the verdict absolved not only their system of liability for infringement of copyright but all other file-exchange networks in the European Union.

The International Federation of the Phonographic Industry (IFPI) expressed its dissatisfaction at the ruling of the court and commented that there was no doubt that a majority of users of file-exchange systems were violating copyright law.

February–March 2004 On 6 February 2004 in the course of hearings into the case of Universal Music Australia versus Sharman Networks (proprietor of the Kazaa peering network) a number of searches¹³ were conducted in the offices of Sharman Networks and Brilliant Digital Entertainment, at the residences of their directors, and the offices of a number of Internet providers. The intention was to collect evidence confirming infringement of Australian copyright law which would be presented to the Federal Court of Australia.

On 10 February 2004 Sharman Networks claimed the search had been illegal.

On 4 March 2004 the Federal Court of Australia rejected Sharman Networks' objection. An attempt to have all the evidence discovered during the search declared inadmissible failed. The court also refused to delay consideration of the case in the Australian courts until the Grokster case had been decided in the US Court of Appeal.

25 March 2004 The American Senators Orrin Hatch and Patrick Leahy proposed a "Pirate Act", to impose fines and terms of imprisonment of up to 10 years for the exchanging of unlicensed content in peer-to-peer networks.

May 2004 The RIAA initiated lawsuits against 493 anonymous peer-to-peer network users, the so-called "John Doe Case". Since the beginning of January 2004 the RIAA had threatened court proceedings against some 2,500 peer-to-peer network subscribers.

¹¹Except for the Grokster case, which was considered in the previous Section.

¹²iMesh was a decentralised file-exchange system based on FastTrack technology, which was also used in the Grokster and Kazaa P2P networks.

¹³The searches were approved by Music Industry Piracy Investigations (MIPI), which was part of the Australian Recording Industry Association (ARIA).

23 June 2004 A bill was introduced in the United States Senate on “The Inducing Infringement of Copyrights Act”, banning peer-to-peer file-exchange networks.

July 2004 The Israeli company, Bridgema Services, owner of the iMesh file-exchange network, reached a settlement in a case brought against it by the RIAA, thereby becoming the first peer-to-peer network to reach agreement with representatives of the music industry.

iMesh agreed to pay the sound-recording companies compensation of \$4.1 million, in future to ban the exchange of music and video under copyright, and to conform fully with copyright legislation. The head of RIAA, commenting on this agreement, called peer-to-peer technologies very promising and expressed the hope that iMesh would be able to exploit their benefits without infringing copyright.

10 September 2004 The House Committee on the Judiciary of the House of Representatives approved the “Pirate Act” bill (“The Protecting Intellectual Rights Against Theft and Expropriation Act, 2004”). Under its provisions, those convicted of distributing more than 1,000 tunes in peer-to-peer networks faced up to three years’ imprisonment. The committee also considered bills for criminal sanctions for installing unauthorised spyware on users’ computers.

Late September-early October 2004 On 28 September hearings began in the US Senate on a bill to ban peer-to-peer networks, “The Inducing Infringement of Copyright Act”, abbreviated to “The Induce Act”. This was energetically promoted by Senator Orrin Hatch. The discussion stalled, and on 8 October the bill was postponed to the following year on the grounds of its major social implications and complaints from technology companies.

October 2004 The RIAA obtained \$10.5 million from the Puretunes.com internet music archive, which for a considerable period of time had been selling tunes whose rights holders were members of the RIAA.

The owners of the site were said not only to have been making illegal sales but also misinforming users by claiming that the site was legal and that they were paying dues to songwriters and composers.

The case against Puretunes.com was heard in the Los Angeles Circuit Court. In the course of the proceedings a settlement was reached under which the company operating the MP3 archive, which was based in Spain, agreed to pay compensation for the manufacturers’ losses, which were put at \$10 million. In addition, four individuals who owned the archive were obliged to pay fines totalling \$500,000 and enjoined in future to refrain from illegal distribution of music. The website has since ceased to function.

8 July 2005 The Sony BMG Music Entertainment conglomerate concluded a license agreement with the iMesh file-exchange network under which Sony BMG would license its digital content for distribution by iMesh, and musical works not protected by copyright.

5 September 2005 The Federal Court of Australia reached its verdict in the lawsuit against the Kazaa peer-to-peer network. The network's creators were found guilty of abetting infringement of the music labels' intellectual property rights and required to pay 90% of their costs.

It was, however, added in the verdict that the service had the right to continue to exist if an unavoidable keyword filter was inserted in versions of the Kazaa client and maximum pressure was put on users to upgrade their software. The TopSearch search engine was to be modified to find only files not under copyright.

It was further pointed out in the verdict that the labels themselves were doing nothing to protect their files from distribution on peer-to-peer networks, since this was against their financial interests.

September 2005 The RIAA sent warning letters to companies operating file-exchange networks, demanding that they should introduce filters to block the distribution of illegal sound recordings without delay. The firms were given an ultimatum either to set up the filters, or face lawsuits and liquidation.

October 2005 The popular e-Donkey file-exchange service announced, under pressure from the RIAA, that it was transitioning to legal operation. Slightly earlier, similar announcements were made by several other peer-to-peer networks, including Kazaa. The WinMX service closed down.

October 2005 In Sweden, 28-year old Andreas Bauer was the first person to be found guilty of illegal file exchange. He was fined 16,000 crowns (US\$2,000) for illegal distribution of films on the Internet.

Sweden had been criticised for its lax attitude towards internet piracy, and accordingly a more rigorous law was passed in July 2005. The maximum punishment for file exchange was now two years' imprisonment, but in this case the court took into account the fact that Bauer had not sought financial gain.

November 2005 A Hong Kong court sentenced 38-year old Chan Nai-Ming to three months' imprisonment for distributing films protected by copyright, using BitTorrent technology. This was the first case when the user of a peer-to-peer network had been imprisoned rather than receiving a fine. Chan Nai-Ming refused to plead guilty.

December 2005 Sharman Networks, under pressure from the Australian courts, blocked the downloading of client software for the Kazaa network for Australian users. The plaintiffs, the record labels, alleged that Sharman Networks had, despite the court's verdict, been in no hurry to add blocking filters to its search system. Music industry representatives demanded the arrest of the company's directors for contempt of court and refusing to correct the search mechanisms for music content.

15 December 2005 The RIAA instituted proceedings against 751 users of file-exchange networks. The number of such writs since September 2003 now totalled

17,100. Of these, 3,800 were settled by voluntary payment of the sum demanded by the defendants, which might have been substantially higher in the event of a court hearing.

December 2005 The lower house of the French parliament approved amendments to the law permitting non-commercial use of peer-to-peer networks for the exchange of files protected by copyright, on payment of modest subscription fees. These were to be included in the payment for broadband internet access.

February 2006 The authorities in Switzerland and Belgium closed down Razorback 2.0, one of the largest file-exchange servers in the eDonkey network. The server's owner was accused of making profits from advertising and collecting donations.

This, however, did not disrupt eDonkey. Razorback 2.0 had a number of mirror sites which the police failed to close, and after the operation even more such sites sprang up.

March 2006 The amendment legalising exchange of music in return for a modest subscription failed to win a majority in the French parliament. At the same time the deputies considered a proposal to deprive musical works of copyright protection when a file was changed from one format to another.

23 March 2006 A law was passed in Germany criminalising the downloading of films and music from the Internet from 1 January 2007. Downloading items protected by copyright for personal use could be punished by two years' imprisonment. Those commercially exploiting films and tunes obtained by such means faced a prison term of up to five years.

April 2006 The International Federation of the Phonographic Industry (IFPI) issued 2,000 writs against European users of the FastTrack (Kazaa), Gnutella (BearShare), eDonkey, DirectConnect, BitTorrent, Limewire, WinMX and SoulSeek peer-to-peer networks. This brought the total number of writs issued by the IFPI to 5,500. The number of countries whose residents had been caught illegally sharing files rose to 18.

A2.3.1 Regional Lawsuits Against Peer-to-Peer Networks

Services whose operations have been deemed illegal by the courts:

- MMO peer-to-peer service (Japan);
- Soribada peer-to-peer service (Korea);
- Weblisten (Spain);
- MP3.com, Aimster.

Web and FTP sites condemned by the courts:

- MpP3WmaLand (Australia). In 2003 the courts found three Australians guilty of organising a complicated network of sites for free downloading of music. The loss to the music industry was put at Aus\$ 60 million;
- Bruvik/Napster.no (Norway). As a result of court proceedings in 2003 the site was found guilty of providing references to unauthorised copies of music files.

A2.3.2 Lawsuits Against Private Individuals

Since 2003 the American sound-recording industry has begun actively prosecuting individuals for infringing copyright law. The sanctions have been targeted not at those who occasionally downloaded a few files but at flagrant violators who copied thousands of music files and opened the relevant directories on their computers to provide free access and enable copying by millions of anonymous users. As a result of the prosecution of major uploaders, by December 2003 awareness among the US population that unauthorised file exchange was illegal had risen to 64%. This led to the conclusion that legal proceedings should be instituted universally in order to rein in the growth of illegal activity.

Court Cases Against Individuals Engaging in Unauthorised File Exchange in Various Countries:

- Denmark. Civil cases brought against 150 users of peer-to-peer networks, December 2002;
- Germany. Police raids targeting peer-to-peer uploaders and server operators, April 2003;
- Italy. Police raids targeting 75 peer-to-peer subscribers and 1 server operator, May 2003;
- Switzerland. Active file exchange participant convicted, May 2003;
- Taiwan. Criminal investigation targeting users of peer-to-peer networks;
- Korea. Prosecution initiated of 100 customers of peer-to-peer networks, December 2003.

A2.4 The Betamax Case

In lawsuits against peer-to-peer networks the courts frequently referred back to the Betamax Case of 1984. At that time the US Supreme Court considered the case of Universal City Studios versus Sony. The point at issue was whether Betamax, a video recorder manufactured by Sony, was a tool abetting infringement of copyright. A result of the hearings was formulation of the concept of “legitimate use”. Essentially this meant that a manufacturer was not liable for the actions of purchasers who could copy works under copyright on his equipment. It was held that the sale of copying equipment and other goods did not count as abetting violation of the law if the goods could in the main be used for legal purposes. Even though Sony

or Xerox might know that their products would be used by some, or even many, users for illegal purposes, by continuing to provide maintenance and updating, and thereby indirectly providing support for such activity, they did not incur liability for abetting the violation. The only contact between Sony and Betamax users occurred at the time of purchase of the device. As there was no evidence of active complicity in the violation of the law, Sony was found not guilty.

The testimony gathered indicated that the main use of video recorders was in recording television programmes, which was perfectly legal. Moreover, Sony advertised the Betamax as a means of recording television programmes, not films. Accordingly the court decided that the video recorder was principally intended for private use, and Sony was found not guilty.

The 1984 lawsuit is seen as signalling the start of the attack by the record labels and movie companies on creators of technologies for freely distributing music and video.

Appendix 3

Types of Free Licenses

Public Domain Items of intellectual property in this category are free of all copyright. Anyone may use and modify them as he sees fit, on condition only that the authorship of the original must be indicated, if the creator is known.

Different countries have different laws regarding the transition of works of art into the public domain.

Under American copyright law, any work published on the territory of the USA before 1 January 1923 is regarded as being in the public domain. A work published in 1923 or later can be copyrighted. The date of 1 January 1923 is fixed, and will not be altered before 2019.

A work may sometimes move into the public domain even though it was created after 1 January 1923. For example, an image receives public domain status 50 years after the death of its creator. In Great Britain a work (including an image) which was published 50 years ago is also in the public domain.

If an original is in the public domain, then a scanned or photographic copy will also be in the public domain. Thus, if a painting is photographed frontally, the photograph will not create a new copyright (Bridgeman versus Corel).

GNU General Public License A copyleft license for free software created under the GNU project of 1988 (abbreviated to GNU GPL, or simply GPL).

The purpose of GNU GPL is to afford the user the rights of copying, modifying, and distributing programs, and also to guarantee that the users of derivative products will receive the same rights. The principle of inheritance of rights was devised by Richard Stallman from the Massachusetts Institute of Technology. He was obliged to take an interest in this by computer programs which malfunctioned and which could not be updated because their source code was secret.

All derivative products protected by GNU GPL inherit the same rights as are afforded by a copyleft license, and the copyright symbol may not subsequently be applied to them. This is the difference between the conditions of copyleft and public domain status. All works protected by copyright pass with time into the public domain and can subsequently be used for creating “closed” (that is, copyright-protected) works.

GNU Free Documentation License¹ (abbreviated to GNU FDL, or simply GFDL). This is the same as the GNU GPL license, only the former was created for documentation (instructions for using software, etc), and the latter for software.

¹Copyleft is a license for free content created by the Free Software Foundation, a non-commercial organisation founded by Richard Stallman in October 1985 to implement the GNU project and support the free software movement.

When distributing and copying materials under this license there is no obligation to indicate authorship, but a copy of the license itself must be attached.

Design Science License (DSL) A copyleft license for free content in the form of text, images and music derived. Devised by Michael Stutz.²

The Design Science License was created specifically to ensure the free, but proper, distribution of works of art and scholarly materials. The license requires that:

- Any modifications of a work protected by it shall be published under the same conditions as the original license, without any additional restrictions on its distribution and/or modification;
- A derivative work must be given a different name in order to distinguish it from the original;
- In the new work authorship must be accurately indicated (exactly which parts were created by the original author, which by the new author, and any other changes and the date on which they were made).

Free Art License³ (<http://artlibre.org>). An English-language version of the License Art Libre, a French copyleft license for works of art. This license is an attempt to create a free license in the spirit of GNU GPL applicable to works of art. It permits copying, distribution and modification of an author's work.

Ethymonics Free Music License (www.ethymonics.co.uk). Devised in August 2000 by a small music company, Easy Monarchs, on the basis of GNU GPL specifically for works of music. This license allows any person to copy, download, and perform a musical work, and even to sell copies of it, because this is seen as a way of making the music widely known. All subsequent copies inherit the same rights.

The conditions of the Ethymonics Free Music License, once applied to a musical work, are irrevocable. The aim of the Ethymonics Free Music License is to establish authorship and free circulation of a musical work without proprietary control by the rights owner.

Creative Commons (CC) One of the copyleft licenses devised by the non-profit organisation Creative Commons,⁴ it is a flexible licensing scheme which makes pos-

²The URL of the DSL site, owned by Michael Stutz, used to be www.dsl.org. At the present time it is not functioning. A copy of the text of the DSL is kept by the Free Software Foundation.

³The license appeared in early 2000 in Paris in the course of the Copyleft Attitude meeting which, for the first time, brought together specialists in computer software, activists of the free software movement, artists and representatives of the art world.

⁴Creative Commons is a non-commercial organisation founded in the USA in 2001 by Lawrence Lessig, a professor of Stanford Law School and expert on legal issues of the digital age. The aim of Creative Commons was to assist people who wanted to share rights for copying, distributing or modifying their works, and at the same time to support those who wanted to make legal use of other people's work in their creations without having to make payments to the authors or publishers.

sible the retention of authorship while protecting only certain rights (Some Rights Reserved). CC is based on already familiar free licenses plus an original technical solution. Unlike GNU FDL, there is no obligation to attach a copy of the licensing agreement.

On 16 December 2002 the Creative Commons website went online (creativecommons.org), with the templates for a variety of licenses available without payment which simplify the use of authored material. It is a kind of automated license generator whose purpose is to assist users to choose the license they need and provide it in the form of a traditional web attachment. If none of the standard licenses is suitable, the user can synthesise his own license, including only the stipulations appropriate to the author's aspirations for the future of his work. For example, one can permit only non-commercial use of the work, or require that the author should be informed or his written permission obtained in advance. This kind of personalised license is known as the Creative Commons Custom License.

The copyright owner can simply fill in a form on the Creative Commons website and obtain an electronic copy of the license. Since no mark of authorship is obligatory, there are no standard methods for finding published materials. Creative Commons licenses have electronic tags, written in XML language, an expanded metadata language, to enable web-crawler programs to find this category of works.

In order to make use of this license, a third party needs only to indicate the author of the work and the fact that it is being distributed on Creative Commons terms.

In making his work available under this kind of license, the author (rights holder) does not renounce copyright. It is understood that he is offering certain of his rights to any user on certain conditions. At the present time, 11 types of licenses have been devised. These include:

- CC-BY: copying, distribution, display and performance of a work (image) and derivative works is permitted providing it is made clear who the work is by;
- CC-SA (ShareAlike): distribution of derivative works is permitted only if they are distributed on the same conditions as the initial work;
- CC-NC (Non-Commercial): copying, distribution, and display of the work are permitted, but commercial exploitation is not allowed;
- CC-ND (NoDerivs): alteration of the original work is not permitted.

Combined licenses can be used. For example, CC-BY-SA indicates that copying, distribution, and display of the work or image is permitted providing the author of the initial work is indicated, and it may only be distributed under the same license as the original.

This project is growing in popularity throughout the world. CC is presently recognised in 29 countries. Russia is not among them.

EFF Open Audio License A free license for music and other audio-content, based on the GNU GPL and devised in 2001 by the Electronic Frontier Foundation⁵ (www.eff.org).

⁵The Electronic Frontier Foundation is a non-commercial group of activists participating in various campaigns and lawsuits in defence of electronic rights, including online piracy, the struggle against

Table A.46 Rights afforded by open music licenses

	Green	Yellow	Red
Personal use	+	+	+
Modification for personal purposes	+	+	–
Creation of derivative works for personal purposes	+	+	–
Personal distribution	+	+	+
Broadcasting for personal purposes	+	+	+
Commercial use	+	–	–
Modification for commercial purposes	+	–	–
Creation of derivative works for commercial purposes	+	–	–
Commercial distribution	+	–	–
Commercial broadcasting	+	–	–

This license permits access, copying, modification, distribution and public performance of licensed works providing attribution is given to the performer of the original work.

EFF is currently urging people to use the Creative Commons license in preference to its own Open Audio License.

Open Music Licenses These are a further attempt to transfer the GNU GPL to the music sphere (<http://openmusic.linuxtag.org>). The Open Music License, devised in Germany in 2001, is a set of licenses which permit the use and distribution of music while retaining the opportunity for the author to make money from his works.

The following Open Music Licenses are available:

- Green: allows unrestricted use;
- Yellow: gives all rights except that of commercial exploitation;
- Red: personal use and distribution only;
- Rainbow: allows the creation of any combination of rights on the basis of the three preceding licenses.

All Open Music Licenses require attribution to the rights holder.

Mozilla Public License (MPL) This is a license for open source/free software, devised by Mitchell Baker⁶ (<http://www.mozilla.org/MPL>).

The license is a soft form of copyleft. It requires attribution to the author of the original software, documentation of changed files, and distribution of derivative software under the same conditions as the original license, but it can be combined

Digital Rights Management (DRM) systems, and also supporting various alternative systems of manufacturing and distributing digital content. See also Appendix 1, Sect. A1.10.6.

⁶The first version of this license was devised by Mitchell Baker while she was a lawyer at Netscape Communications Corporation. She finished working on it when she moved to Mozilla Foundation.

with software protected by copyright. Accordingly, a closed version of the software can be issued based on programmes with open source code protected by the MPL. This makes the license incompatible with GNU GPL.

Berkeley Software Distribution License (BSD License) Another widespread license for free software, devised at the University of California, Berkeley. Its latest version was presented in 1999. The license allows anybody to do anything they like with program code protected by BSD on condition that due attribution is given to the author (rights holder) in accompanying documentation. Accordingly, the license is acceptable both to creators of commercial products and also to those who wish their solutions to be installed in software products which may in the future become somebody else's property. BSD is close to the "public domain" and is compatible with GNU GPL.⁷

MIT License This license was devised at the Massachusetts Institute of Technology for working with particular kinds of software. It affords the same freedoms as BSD, on condition that due attribution is given to the author (rights holder) and is compatible with GNU GPL.

⁷Compatibility with GPL means that the developer has the right to combine two modules, GPL itself and the module compatible with it. Further distribution of the resulting software must follow the terms of GPL.

Appendix 4

The Theatron and Cinema Projects¹

Theatron and Cinema are two sets of experiments conducted between May 2003 and March 2004 by the Pragmatics of Culture Foundation in theatres and cinemas in Moscow. In the course of the experiments the public attending a performance or film were invited to rate their attitude towards the cultural product and the quality of the time they had spent, in monetary terms.

The research method is described below, but let us first explain what the experiments were being used to model.

The Research Topic

Prices for cultural products are uniform,² as a result of which money is unable to perform its signalling function and does not facilitate consumer navigation in what is on offer. Because payment is made in advance while value is discovered in arrears of the viewing, reading, or attendance at a performance, money does not work as an indicator of cultural consumption. A consumer of culture has no means of signalling his perception of quality, and there is no technology with which to receive signals from other people. Each member of the community essentially experiences cultural products on his own. The enormous volume of certification which is being conducted in parallel by a very large number of people has little effect because there is no exchange of experiences.

At the same time, because prices do not signal the quality of works of art, quality ceases to be a priority and is sacrificed in favour of quantity. The result is that there is a growing tendency towards adverse selection in culture.

A possible solution of the problem is to involve the public in the process of ranking. If a fast-track exchange of opinions can be set up, the experience costs will be shared among consumers. This will provide an antidote to adverse selection and bring about an improvement in the quality of goods. If the wiles of advertisers can be seen through before purchase, producers of low-quality products will be deprived of their information advantage.

¹The concept of the Theatron and Cinema projects belongs to the present author, who is the director of the Pragmatics of Culture Foundation. Further information can be found at <http://new.artpragmatica.ru/reports/in/pic/slajds.pdf>; http://www.artpragmatica.ru/ab_dolgin/.

²For example, all cinema tickets, CDs (both hits and classics), whether a 2-track disk or a max, are sold at the same price. The same applies to books, sound and video recordings.

For a system of social inspection to work properly, it is essential to reach agreement on certain aspects of rating. Spectators, listeners, or readers do not need to critically analyse the work of art as such; they need only to assess the subjective effects produced by the work, an area in which the consumer is unquestionably competent. It is no drawback that their judgment will be individual, subjective, and dependent on many extraneous factors: the place, time of consumption, the company they are in. For the system to work, that is precisely how things should be. How can we move on, however, from establishing the value-for-oneself to producing a rating meaningful to others?

There are a number of requirements for this:

1. For the consumer signal of quality to be informative, it should be generated after quality has been assessed, that is after consumption;
2. Consumer signals must be responsible³;
3. The rating scale must be comprehensible, generally accessible, and perceived in more or less the same way by all participants in the process;
4. A system of incentive is needed which will encourage participation in the rating process. For example, the inspection mechanism should simultaneously generate recommendations, improving the effectiveness of consumer navigation.

Money satisfies all the above conditions of relevance, clarity, motivation, instantaneity, and economy.

Signals of perceived quality should be generated in the course of making post factum payments for cultural well-being. The consumer should have the right to determine a premium payment or to receive compensation on the basis of his consumption.⁴ In order to implement this, payment is staged: the first stage is payment for the right of access to the content; the second is payment of a voluntary premium for perceived quality (or refunding of money).

This scheme is novel for agents. The hypothesis underlying the Theatron and Cinema experiments is that for cultural exchange the most promising way forward is voluntary, post factum payment. What was needed was to establish whether consumers would accept new rules of payment, and if so, whether money was capable of signalling perceived quality of the cultural product.

The aim of the research was to test the feasibility of post factum payment for cultural goods.

³This is one of the reasons why ratings in the experiments were not expressed in points. People's attitude towards points varies too much, and they are likely to be awarded without sufficient thought.

⁴Analogous payment schemes are familiar in relational contracts, but these are too costly and require an arbiter. The approach suggested makes it possible to reduce the cost of a relational payment system.

Tasks of the Research

1. To establish the extent of consumer interest in changing methods of paying for cultural products;
2. To assess an audience's willingness to make gratuity payments;
3. To establish the socio-demographic characteristics of those participating in the experiment.

In the course of the experiment the following hypotheses were tested:

1. Spectators are capable of using money to rank the quality of a film/performance they have seen.
2. Considerations of self-interest would not prove dominant.
3. The correlation between post factum gratuity payments and the quality of films and performances as assessed by professional critics would be observed.

Research Method

Within the Cinema experiment, a survey was conducted of 1,044 spectators of nine films: "Terminator-3", "Dirty Pretty Things", "Goodbye, Lenin!", "The Swimming Pool", "Dogville", "Koktebel", "Bad Boys" and "The Return". The experiment was conducted between early July and late October 2003 at the MDM, Fital, Kodak-Kinomir, and Pushkinsky cinemas.

Within the Theatron experiment the survey covered 1,503 spectators of 23 plays then playing in 13 Moscow theatres. Among the productions selected were "The Penultimate Concert of Alice in Wonderland", "Ladies' Night, Women Only", "The Anatomical Theatre of Yevno Azef, Engineer", "Roi Ubu", "King Lear", "Astronomy for Insects", and others.

The respondents were chosen from among the spectators immediately before the performance using random selection. They were handed an envelope with the questionnaire and an envelope containing 6 × 10-rouble notes, and were also offered a brochure with a detailed description of the project, its aims and tasks. These members of the audience were invited to rate the quality of the time they spent watching the film or play, using money. If their impression was positive and they wished to make a gratuity payment, they could put from 10 to 50 roubles of their own money into the envelope, depending on their impression. If the time spent was rated negatively, respondents could remove an appropriate amount from the envelope, between 10 and 50 roubles. If all 60 roubles were removed, the questionnaire was considered invalid on the grounds that the individual might have been guided by mercenary considerations.

The Cinema experiment produced 524 questionnaires which were considered valid, and the Theatron experiment yielded 1,503.

The Results

The experiments showed that a large number of people, 65% in the cinema and 34% in the theatre, were prepared to play by the rules suggested and publish their assessment of the time spent by voluntarily indicating consumer surplus (see diagram).

Only 8% in the theatre and 16% in the cinema misbehaved, removing all the money without regard to their impression.

Table A.47 Attitude towards the idea of post factum monetary reaction, Cinema

Attitude towards the idea	Goodbye, Lenin	Swimming Pool	Dogville	Koktebel	Bad Boys 2	Return
Positive	79%	70%	75%	76%	43%	65%
Negative	18%	24%	20%	23%	24%	27%
Don't know	3%	6%	5%	1%	33%	8%

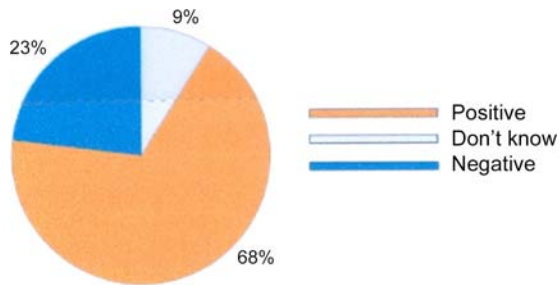


Fig. A.43

Out of the total number of spectators surveyed, 35% in the theatre and 38% in the cinema added their own money, expressing a positive assessment of the time spent and of the quality of the product. Roughly one in six spectators removed money, signalling disappointment. The remaining spectators in the theatres and cinemas were “don't knows” and left the money alone.

Theatron Project

The Theatron and Cinema experiments made it possible to draw one further significant conclusion. Monetary signals from consumers of a cultural product are informative: they signal really quite accurately the perceived quality of films/ performances and the quality of the time spent. (The correlation between monetary and emotional ratings was checked by comparing payments and the characterisations spectators gave in the questionnaires.) Among the films and performances were works which induced the public to make generous supplementary payments. At the same time sharply negative reactions were also evident. See the graphs of spectators' ratings of the various films and performances.

Table A.48 Attitude towards the idea of post factum monetary reaction, Theatron

Attitude towards the idea	Positive	Negative	Don't know
Who Says Lazarus Was Resurrected?	33%	24%	43%
Artaud and His Double	38%	25%	38%
Measureless Kim Tango	32%	13%	55%
The Penultimate Concert of Alice in Wonderland	15%	45%	40%
Anatomical Theatre of Yevno Azef, Engineer	33%	23%	43%
Cyrano de Bergerac (V)	32%	32%	36%
Ladies' War	49%	19%	32%
Double Bass	39%	21%	40%
Senor Todero, Proprietor	33%	19%	48%
Cyrano de Bergerac (M)	38%	25%	36%
King Lear	25%	35%	40%
Bluebeard's Birthday	26%	29%	44%
Guilty Without Guilt	14%	50%	36%
The Betrothal	25%	22%	52%
Divorce Feminine-Style	28%	30%	42%
The Karamazovs	21%	34%	45%
Roi Ubu	35%	20%	45%
Astronomy for Insects	49%	13%	37%
Songs of Our Communal Flat	32%	9%	59%
Mixed Feelings	19%	28%	53%
Erast Fandorin	22%	33%	45%
Ladies Night, Women Only	41%	12%	47%
The Triad	55%	15%	30%

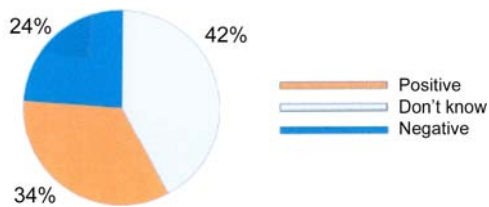
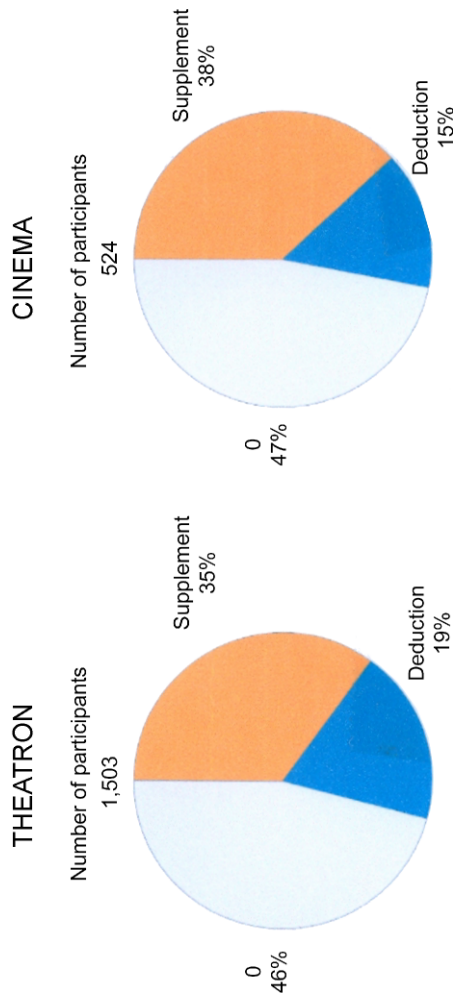


Fig. A.44

Monetary Rating of Quality of Time



“0” in the diagrams indicates that questionnaires were deemed valid, although no money was inserted or removed from the envelope

Fig. A.45

The Cinema Project

Table A.49

	Films in the Main Part of the Experiment						Pilot	
	Goodbye, Lenin!	Swimming Pool	Dogville	Koktebel	Bad Boys	The Return	Terminator-3	Dirty Pretty Things
Average monetary assessment of the film (roubles)	12.93	-2.7	5.12	5.93	2.39	10.08	-16.21	-1.88
-50	3%	4%	7%	10%	7%	2%	31%	2%
-40	2%	5%	2%	1%	1%	0%	1%	2%
-30	4%	3%	5%	2%	3%	1%	4%	6%
-20	1%	9%	5%	6%	1%	1%	4%	0%
-10	2%	3%	2%	0%	0%	2%	1%	0%
0	33%	55%	39%	41%	60%	52%	42%	80%
10	12%	11%	10%	5%	10%	10%	10%	8%
20	9%	3%	5%	5%	4%	10%	4%	0%
30	9%	4%	5%	13%	0%	11%	1%	2%
40	10%	1%	7%	5%	0%	7%	1%	0%
50	14%	2%	12%	13%	12%	5%	1%	0%
Total deductions	12%	24%	22%	20%	13%	5%	41%	10%
0	33%	55%	39%	41%	60%	52%	42%	80%
Total supplements	55%	21%	39%	40%	27%	43%	17%	10%

Table A.50 Structure of spectator's supplements/deductions after performances and screenings

Amount of supplementor deduction in roubles															Supple-	No. of
Average	Average	-50	-40	-30	-20	-10	0	10	20	30	40	50	Deduc-	0	Supple-	No. of
rating	rating														ment	partic-
	(omitting 0)															ipants
Who Says Lazarus	12,86	0%	0%	0%	0%	14%	29%	24%	5%	14%	5%	10%	14%	29%	57%	21
Was Resurrected?																
Artaud and His Double	12,33	2%	5%	0%	2%	2%	33%	12%	12%	16%	5%	12%	11%	33%	56%	43
Measureless Kim Tango	-7,37	13%	0%	11%	8%	3%	39%	16%	5%	5%	0%	0%	35%	39%	26%	38
The Penultimate Concert of Alice in Wonderland	25,22	4%	0%	0%	0%	0%	17%	17%	13%	4%	0%	43%	5%	17%	78%	23
Anatomical Theatre of Yevno Azef, Engineer	-17,33	20%	10%	13%	3%	3%	40%	7%	0%	35%	0%	0%	50%	40%	10%	30
Cyrano do Bergerac (V)	2,24	4%	5%	2%	5%	3%	46%	14%	3%	2%	4%	9%	21%	46%	33%	91
Ladies' War	-8,45	20%	3%	5%	2%	3%	44%	14%	6%	1%	1%	3%	32%	44%	25%	110
Double Bass	9,43	2%	3%	2%	0%	2%	50%	11%	8%	6%	3%	14%	9%	50%	41%	123
Senor Toderro, Proprietor	3,54	4%	1%	5%	3%	1%	48%	17%	8%	4%	4%	4%	15%	48%	37%	99
Cyrano de Bergerac (M)	8,75	3%	4%	2%	3%	1%	46%	9%	9%	7%	3%	14%	13%	46%	42%	104
King Lear	-1,43	5%	6%	2%	7%	2%	52%	10%	7%	4%	1%	4%	22%	52%	26%	84
Bluebeard's Birthday	-4,71	16%	3%	1%	7%	3%	44%	7%	4%	6%	3%	4%	31%	44%	25%	68

Table A.50 (continued)

Amount of supplementor deduction in roubles																	
	Average rating	Average rating (omitting 0)	-50	-40	-30	-20	-10	0	10	20	30	40	50	Deduction	Supplement	No. of participants	
Guilty Without Guilt	27,33	41	0%	0%	7%	0%	0%	33%	0%	0%	0%	7%	53%	7%	33%	60%	15
The Betrothal	9,55	24,62	1%	0%	0%	0%	3%	61%	10%	4%	4%	1%	13%	4%	61%	34%	67
Divorce Feminine-Style	-5,33	-11,71	17%	1%	2%	7%	1%	54%	4%	2%	4%	0%	7%	28%	54%	18%	90
The Karamazovs	-0,52	-0,98	14%	3%	1%	4%	4%	47%	3%	9%	1%	4%	10%	26%	47%	27%	77
Roi Ubu	-5,95	-11	19%	0%	5%	4%	3%	46%	7%	4%	4%	5%	3%	31%	46%	23%	74
Astronomy for Insects	5,22	7,14	12%	6%	1%	3%	1%	27%	15%	7%	6%	4%	16%	24%	27%	49%	67
Songs of Our Communal Flat	33,64	46,25	0%	0%	0%	0%	0%	27%	5%	0%	0%	9%	59%	0%	27%	73%	22
Mixed Feelings	5,16	19,41	2%	0%	2%	0%	2%	73%	6%	5%	2%	2%	8%	6%	73%	23%	64
Erast Fandorin	-1,03	-3	5%	0%	3%	5%	5%	66%	5%	3%	2%	2%	3%	19%	66%	15%	58
Ladies Night, Women Only	18,12	29,07	3%	1%	1%	1%	1%	39%	6%	4%	9%	4%	30%	8%	39%	53%	69
The Triad	10	15,7	0%	5%	2%	5%	5%	36%	8%	15%	14%	3%	9%	17%	35%	48%	56%

Average Monetary Rating

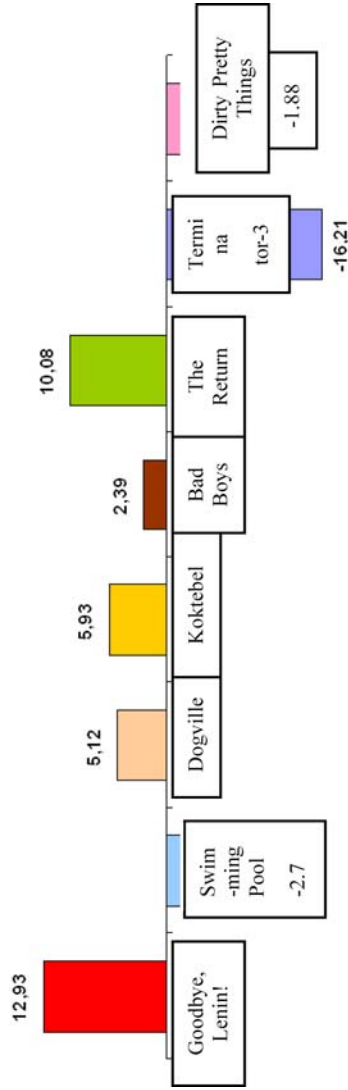


Fig. A.46 The Cinema project

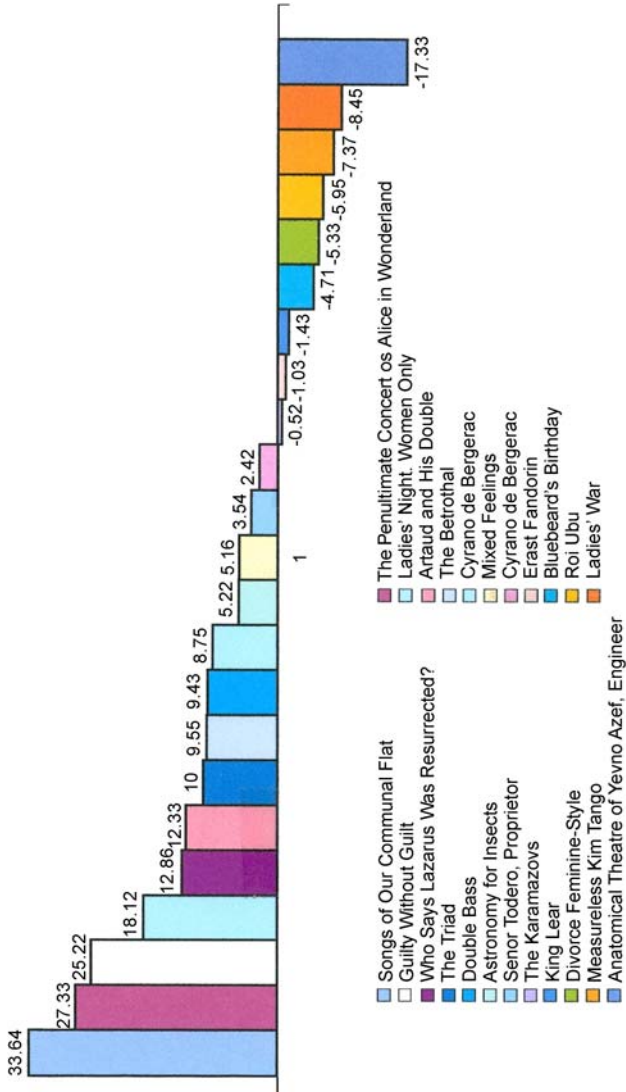
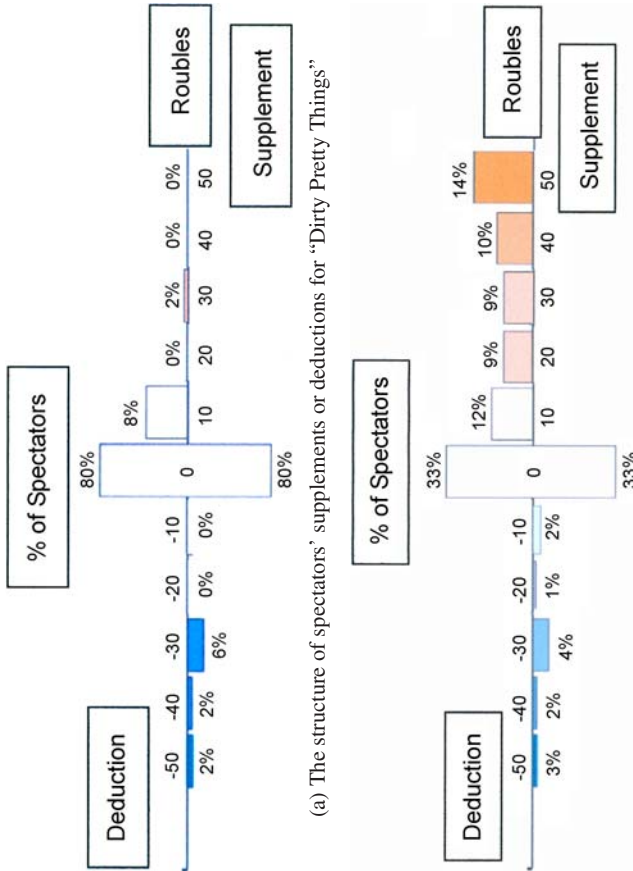


Fig. A.47 The Theatron project

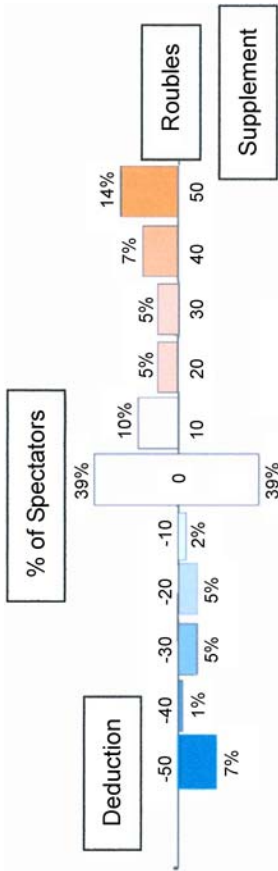
The Structure of Spectators' Supplementary Payments and Deductions by Particular Works



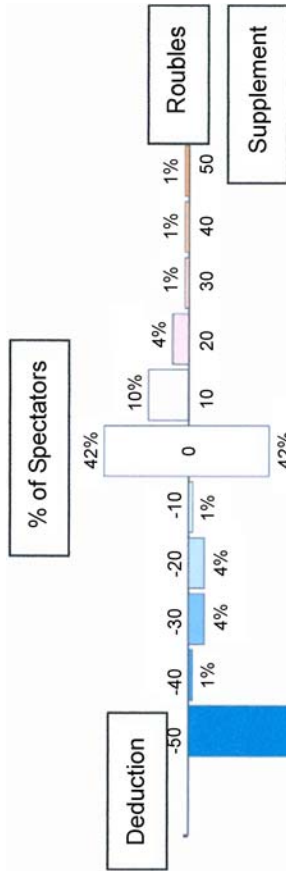
(a) The structure of spectators' supplements or deductions for "Dirty Pretty Things"

(b) The structure of spectators' supplements or deductions for "Goodbye, Lenin!"

Fig. A.48 The Cinema project

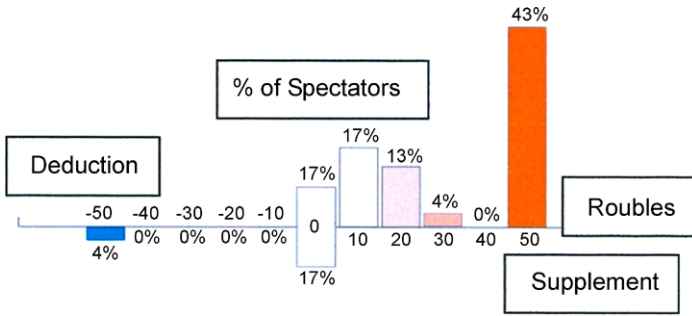


(c) The structure of spectators' supplements or deductions for "Dogville"

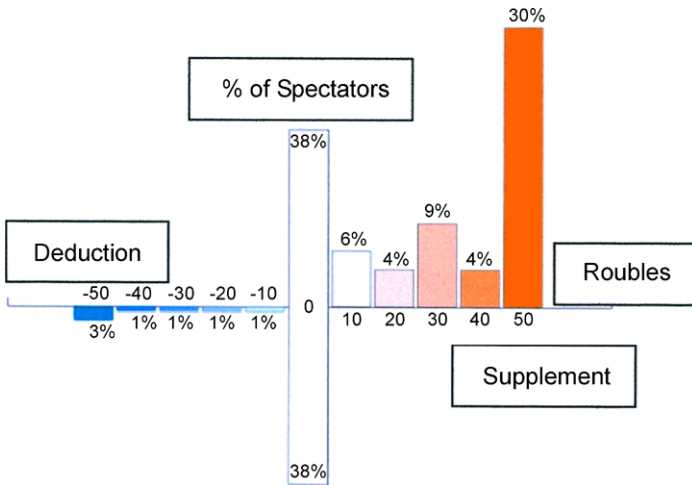


(d) The structure of spectators' supplements or deductions for "Terminator-3"

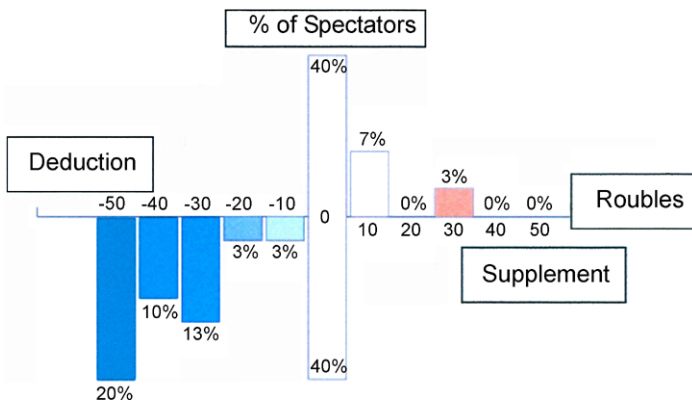
Fig. A.48 (continued)



(a) The structure of spectators' supplements or deductions for "Penultimate Concert of Alice in Wonderland"

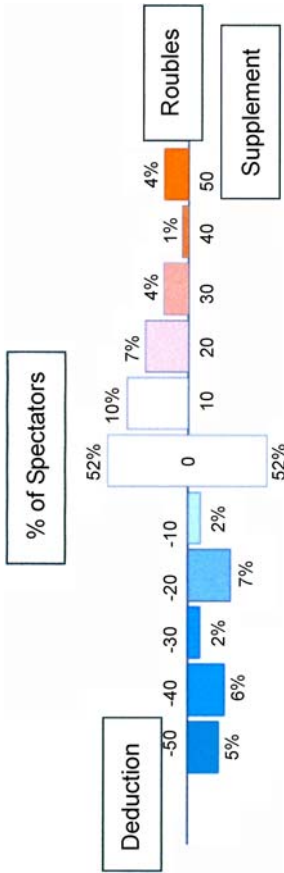


(b) The structure of spectators' supplements or deductions for "Ladies Night. Women Only"

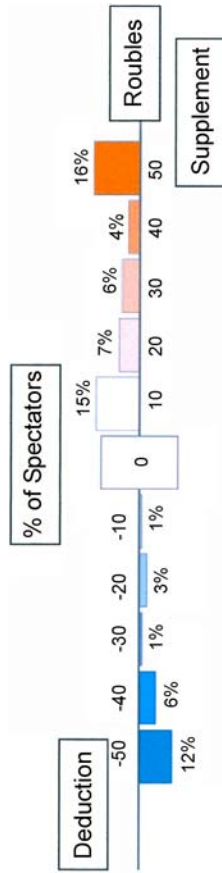


(c) The structure of spectators' supplements or deductions for "The Anatomical Theatre of Yevno Azef, Engineer!"

Fig. A.49 The Theatron project



(d) The structure of spectators' supplements or deductions for "King Lear"



(e) The structure of spectators' supplements or deductions for "Astronomy for Insects"

Fig. A.49 (continued)

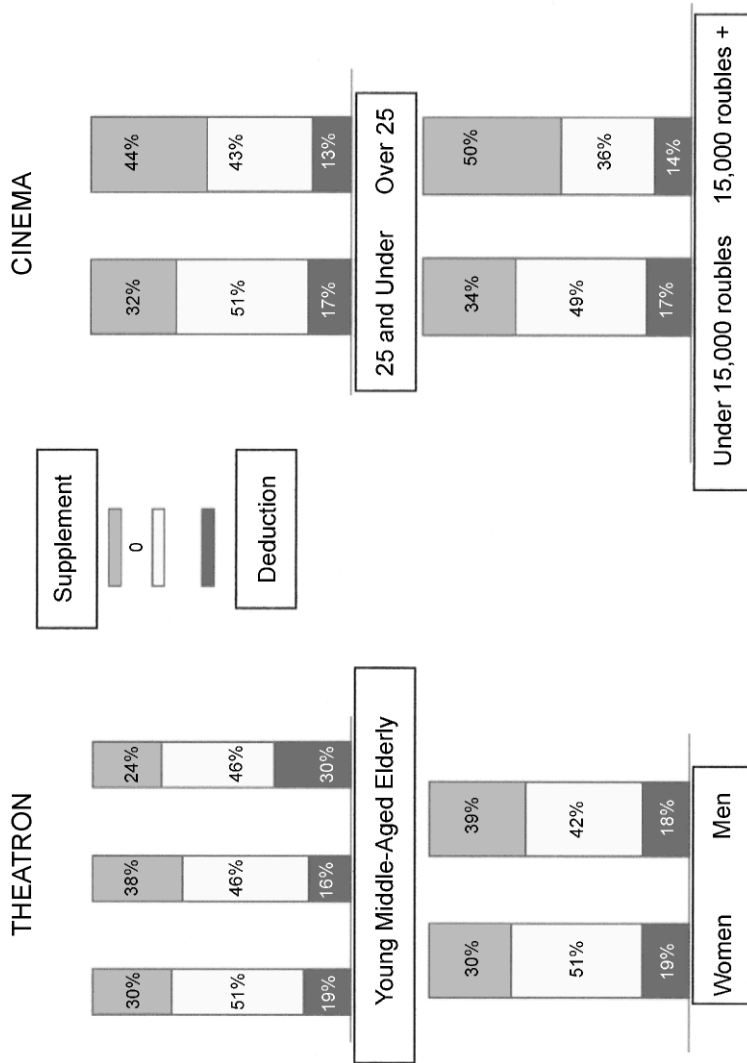


Fig. A.50 Influence of age, sex, and income on supplements/deductions

In total, in the course of the experiments more than 20 different correlations were identified. In particular, there was no correlation between age and sex on the inclination to give a monetary response. Income has a weak positive influence. The emotions experienced influence the inclination to make a supplementary payment, as does the purpose of the visit, if it is achieved.

In sum, the hypothesis of the possibility of expressing consumers' responses in monetary form was vindicated. Although, quite clearly, only an approximate modelling of real behaviour is possible under experimental conditions, the most fundamental of the hypotheses was confirmed. This made possible a move to practical implementation of the idea of post factum monetary payments. In the spring of 2006 a large-scale business project was begun to create a universal recommender service constructed on the principle of monetary collaborative filtering.⁵

⁵For further detail on this, see Chap. 1, Sect. 1.3.4.

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