

# THE TOUGH REALITY OF COPYRIGHT PIRACY: A CASE STUDY OF THE MUSIC INDUSTRY IN CHINA ♦

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## INTRODUCTION

Several Western commentators contend that the development of information technology has entirely outgrown copyright

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law.<sup>1</sup> Copyright law was originally designed for a brick-and-mortar world where commercial intermediaries played a central role in developing distribution channels and exploiting copyrighted works. The advent of digital technology, however, has removed the physical confines and decentralized the powers of content distribution. This transformation, sometimes referred to as “selling wine without a bottle,” allegedly renders copyright law obsolete together with traditional bottlenecks. Authors would continue to receive enough incentives by other means (that is, advertising, audience tipping, and market lead-time), and consumers would have wider access to low-price or even free works of authorship. In short, a world without copyright law (i.e., a “copyright anarchy”) would benefit everybody except commercial intermediaries.

The skepticism surrounding copyright law is not limited to developed countries. Many developing countries have not built up robust copyright industries, and copyright piracy therein usually targets the works of foreign copyright owners. These countries are thus often considered non-stakeholders in effective copyright enforcement except insofar as copyright royalties would actually result in a transfer of wealth from developing countries to developed countries.<sup>2</sup> Although various international treaties, such as the Berne Convention<sup>3</sup> and the TRIPS Agreement<sup>4</sup> have harmonized national copyright laws at a rather high level, such legislative developments are grudgingly accepted only as a trade-off in international trade negotiations. In exchange for stronger copyright protection to secure export markets for intellectual products from developed countries, developing countries receive lower tariffs on their own exported products, such as textiles and agriculture.<sup>5</sup> To this extent, the relationship between developing countries and copyright law looks more like a “marriage of convenience” than a “marriage of love.”

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<sup>1</sup> See, e.g., Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L.REV. 263, 265-66 (2002); John Perry Barlow, *The Economy of Ideas*, WIRED, Mar. 1994, <http://www.wired.com/wired/archive/2.03/economy.ideas.html>.

<sup>2</sup> See generally Peter Yu, *The Copyright Divide*, 25 CARDOZO L. REV. 331 (2003). Many Chinese officials appear to endorse the viewpoint as well. See Daniel C.K. Chow, *Why China Does Not Take Commercial Piracy Seriously*, 32 OHIO N.U. L. REV. 203 (2006).

<sup>3</sup> Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, 1161 U.N.T.S. 30, as amended on Sept. 28, 1979, S. TREATY DOC. NO. 99-27.

<sup>4</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 [hereinafter TRIPS].

<sup>5</sup> See MICHAEL P. RYAN, KNOWLEDGE DIPLOMACY: GLOBAL COMPETITION AND THE POLITICS OF INTELLECTUAL PROPERTY 12 (1998); Frederick M. Abbott, *The WTO TRIPS Agreement and Global Economic Development*, in PUBLIC POLICY AND GLOBAL TECHNOLOGICAL INTEGRATION 39 (Frederick M. Abbott & David J. Gerber eds., 1997).

Those sentiments in developed and developing countries appear to suggest that a copyright anarchy might actually be the best of both worlds. That being said, the merits of the proposed copyright anarchy in relation to the current copyright regime have yet to be seriously tested in the absence of sufficient empirical evidence. While a limited number of research projects have examined the impact of file sharing on music sales in the United States,<sup>6</sup> the findings are generally fragmentary due to their narrow focus on online piracy and the relatively low level of piracy overall in the United States despite the persistent problem of file-sharing. Moreover, the recent trend of escalating copyright enforcement in the United States and in Europe suggests that any proposal for a copyright anarchy there will remain highly theoretical for the foreseeable future.<sup>7</sup>

On the other hand, China and similar emerging markets may be in a better position to provide a prototype for such empirical research, where copyright piracy is rampant and has forced dramatic evolution in the entertainment and technology sectors. This article aims to examine empirical evidence on how the Chinese music industry has adapted and developed in the shadow of a virtual copyright anarchy. Contrary to the viewpoint introduced at the beginning of this section, the findings here suggest that a high level of piracy could have profound effects on the profitability, applied business models, and creative processes of domestic musicians. In many cases, piracy of foreign works could be more devastating to domestic companies than to foreign companies. Because the competition from low-priced pirated works both online and offline undercuts stable income from royalties, Chinese musicians have witnessed the entire music industry becoming increasingly dependent on alternative revenue streams such as advertising, merchandizing, and live performance. The pressures of paid appearances and extended tours have started to squeeze the time that artists need to spend on music production. The alternative revenue streams also force many music companies to abandon traditional album contracts and operate in a way more like talent agencies that control all aspects of an artist's career. Music companies are inclined to sign talents at a very young age with a long-term agency deal in order to exploit the full value of artists in the advertising market. In addition, the need to attract sponsorship opportunities puts more

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<sup>6</sup> See *infra* note 45 and accompanying text.

<sup>7</sup> For legislation that enhances copyright enforcement in the U.S. and the E.U., see, for example, No Electronic Theft (NET) Act, Pub. L. No. 105-147, 111 Stat. 2678 (1997); Council Directive 2004/48, Enforcement of Intellectual Property Rights, 2004 O.J. (L 157) (EC).

emphasis on non-musical qualities, such as a fresh appearance and healthy public image, which to some extent marginalizes “pure” musicians who have less value in those alternative markets.

Most importantly, as copyright piracy obstructs the communication of consumer preferences to musicians, an increasing number of musical works are created to accommodate the tastes of entrepreneurs (e.g., sponsors and advertisers) rather than those of average consumers, and this has caused a fundamental shift in the creative process of the Chinese music industry. Although entrepreneurs should arguably be willing to take whatever is popular among music fans as a draw to their own products, the expectations of entrepreneurs and consumers do not always meet in a dynamic market setting. For this reason, the interests of less commercial artists and new artists are more likely to be compromised.

Section II of this Article begins with an introduction of the piracy rate in the Chinese music industry, including both online and offline data. It is hardly an overstatement to speak of a copyright anarchy where the piracy rate is consistently in the range of 80%-90%. Section III analyzes the empirical evidence on the development of the Chinese music industry in the wake of rampant piracy with a focus on declining record sales, emerging alternative revenue streams, and changing business models. Such evidence contradicts the hypothesis that the domestic industry is not a stakeholder in copyright enforcement aimed mainly to redress piracy of foreign works. Section IV explains the discrepancy between the empirical evidence and the above hypothesis, pointing out that the latter misinterprets the incentive rationale and overlooks the substitutability among different works of authorship. Section V indicates that the empirical evidence has the potential to supply an intrinsic incentive for China and similar developing countries to establish a robust copyright regime, that is, for the self-interested purpose of preventing domestic music companies and consumers from falling prey to uncontrolled copyright piracy. Section VI concludes this article with a summary of the main issues.

### I. COPYRIGHT ANARCHY

As a result of the still ongoing Sino-US intellectual property dispute, the piracy problem in China has been in the spotlight since the early 1990s.<sup>8</sup> The United States Trade Representative (“USTR”) had listed China as one of the “Priority Foreign Coun-

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<sup>8</sup> For a brief summary of the Sino-US intellectual property dispute, see *INTELLECTUAL PROPERTY IN ASIA* 32-34 (Paul Goldstein & Joseph Straus eds., 2009).

tries” three times in the annual Special 301 report (in 1991, 1995, and 1996), followed by imminent threats of unilateral trade sanctions.<sup>9</sup> However, each time, the two countries managed to avoid a trade war at the last minute by reaching an agreement in which China undertook to take further legislative and enforcement initiatives to improve intellectual property protection and the United States agreed to withhold the sanctions for the time being.<sup>10</sup> Although the threat of unilateral retaliation was rarely used after China joined the World Trade Organization (“WTO”) in 2001,<sup>11</sup> China still topped the “Priority Watch List” in the USTR Special 301 report most years, leading the United States to file a WTO complaint against China’s noncompliance with the TRIPS Agreement.<sup>12</sup>

The ubiquity of the piracy problem in China is apparent from the annual country-by-country reviews that International Intellectual Property Alliance (“IIPA”) prepared for the USTR Special 301 report.<sup>13</sup> As indicated by Exhibit One below, the level of music piracy in China was consistently in the range of 85% to 90% from 2000 to 2007.<sup>14</sup> Furthermore, there is no sign that copyright owners can expect any improvement in copyright enforcement in the near future, as evidenced by the fact that the music piracy rate

<sup>9</sup> See Trade Act of 1974, § 301, Pub. L. No. 93-618, 88 Stat. 1978 (1975) (codified as amended in 19 U.S.C. § 2411 (2006)). Under Special 301 provisions, the USTR will identify those countries that deny adequate and effective protection for intellectual property or deny fair and equitable market access for intellectual property producers. Countries whose intellectual property policies or practices are considered most egregious and having the most significant impact on the relevant U.S. industries will be designated as “Priority Foreign Countries,” followed by further investigation and possible trade sanctions. In addition, the USTR has created a “Priority Watch List” and a “Watch List” under Special 301 provisions. Placement of countries on these lists indicates that they are the focus of increased bilateral attention with respect to intellectual property protection.

<sup>10</sup> INTELLECTUAL PROPERTY IN ASIA, *supra* note 8.

<sup>11</sup> For more on China’s accession to WTO, see generally Raj Bhala, *Enter the Dragon: An Essay on China’s WTO Accession Saga*, 15 AM. U. INT’L L. REV. 1469 (2000); Karen Halverson, *China’s WTO Accession: Economic, Legal, and Political Implications*, 27 B.C. INT’L & COMP. L. REV. 319 (2004).

<sup>12</sup> INTELLECTUAL PROPERTY IN ASIA, *supra* note 8, at 33. For a detailed discussion of the legal merits of the U.S. claims in the WTO complaint, see Lanye Zhu & Jiarui Liu, *Sino-US Intellectual Property Dispute: A New Chapter in WTO History*, 3 OXFORD J. INTELL. PROP. L. & PRAC. 194 (2008). See also Panel Report, *China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R (Jan. 26, 2009), available at [http://www.wto.int/english/tratop\\_e/dispu\\_e/cases\\_e/ds362\\_e.htm](http://www.wto.int/english/tratop_e/dispu_e/cases_e/ds362_e.htm) (reporting that U.S. claims were partly upheld).

<sup>13</sup> See IIPA, 2008 SPECIAL 301 REPORT: PEOPLE’S REPUBLIC OF CHINA (PRC) (2008), available at <http://www.iipa.com/rbc/2008/2008SPEC301PRC.pdf>; IIPA, 2004 SPECIAL 301 REPORT: PEOPLE’S REPUBLIC OF CHINA (2004), available at <http://www.iipa.com/rbc/2004/2004SPEC301PRC.pdf> [hereinafter SPECIAL 301 REPORTS OF 2004 & 2008].

<sup>14</sup> *Id.* The “level of piracy” refers to the share of a country’s market that consists of pirated materials. *Id.* at app. B, available at <http://www.iipa.com/pdf/2004spec301methodology.pdf> and <http://www.iipa.com/pdf/2008SPEC301METHODOLOGY.pdf>.

in 2007 (90%) was even slightly higher than seven years ago (85%). Other major copyright industries in China, including motion pictures, business software, and video games, have also been plagued by copyright piracy and subjected to similar piracy rates of 80% to 99% during this period of time.<sup>15</sup> Categorizing this as a copyright anarchy would hardly be an overstatement given that four out of five of all copyrighted works in the marketplace are potentially pirated.

#### EXHIBIT ONE

PEOPLE'S REPUBLIC OF CHINA							
Estimated Trade Losses Due to Copyright Piracy							
<i>(in millions of U.S. dollars)</i>							
and Levels of Piracy: 2000-2007							
	Industry	Motion Pictures	Records & Music	Business Software	Entertainment Software	Books	Totals
2007	Loss	NA	451.2	2472.0	NA	52.0	2975.2
	Level	NA	90%	80%	95%	NA	
2006	Loss	NA	206.0	2172.0	NA	52.0	2430.0
	Level	NA	85%	82%	NA	NA	
2005	Loss	244.0	204.0	1554.0	589.9	52.0	2643.9
	Level	93%	85%	86%	92%	NA	
2004	Loss	280.0	202.9	1488.0	510.0	50.0	2530.9
	Level	95%	85%	90%	90%	NA	
2003	Loss	178.0	286.0	1787.0	568.2	40.0	2859.2
	Level	95%	90%	92%	96%	NA	
2002	Loss	168.0	48.0	1637.3	NA	40.0	1893.3
	Level	91%	90%	92%	96%	NA	

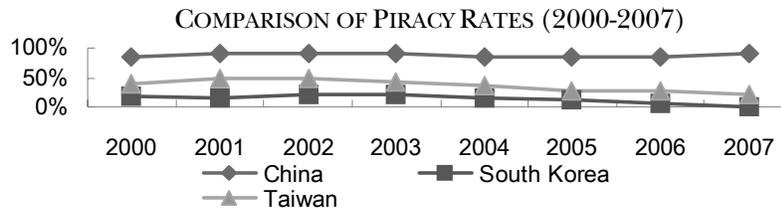
<sup>15</sup> *Id.* Notably, the piracy problem in the Chinese book market does not appear to be as serious as that in other sectors of the copyright industries. For instance, trade losses in the book market due to piracy were merely 11.5% of those in the music market and 2% of those in the business software market in 2007, although the specific level of piracy in the book market is unavailable.

2001	Loss	160.0	47.0	1140.2	455.0	130.0	1932.5
	Level	88%	90%	92%	92%	NA	
2000	Loss	120.0	70.0	765.2	NA	130.0	1085.2
	Level	90%	93%	94%	99%	NA	

Source: IIPA 2008 and 2004 Special 301 Report: People's Republic of China

A horizontal comparison may shed more light on the gravity of the piracy problem in China. According to the International Federation of the Phonographic Industry ("IFPI"), the overall level of music piracy in the world is slightly above 34%.<sup>16</sup> In advanced markets, such as the United States, Japan, and Western Europe, the levels of music piracy are estimated to be lower than 10%.<sup>17</sup> Even among emerging markets, China probably suffers one of the highest levels of music piracy. Exhibit Two below shows that, between 2000 and 2007, the average level of music piracy was 88% in China,<sup>18</sup> 14% in South Korea<sup>19</sup> and 36% in Taiwan<sup>20</sup> (all of which share the Confucian culture).<sup>21</sup>

## EXHIBIT TWO



Source: IIPA 2008 and 2004 Special 301 Reports for China, South Korea, and Taiwan

<sup>16</sup> See IFPI, THE RECORDING INDUSTRY 2005 COMMERCIAL PIRACY REPORT (2005), available at <http://www.ifpi.com/content/library/piracy2005.pdf>.

<sup>17</sup> *Id.*

<sup>18</sup> SPECIAL 301 REPORTS OF 2004 & 2008, *supra* note 13.

<sup>19</sup> See IIPA, 2008 SPECIAL 301 REPORT: SOUTH KOREA (2008), available at [http://www.iipa.com/rbc/2008/2008SPEC301SOUTH\\_KOREA.pdf](http://www.iipa.com/rbc/2008/2008SPEC301SOUTH_KOREA.pdf); IIPA, 2004 SPECIAL 301 REPORT: SOUTH KOREA (2004), available at <http://www.iipa.com/rbc/2004/2004SPEC301KOREA.pdf> (the 2007 figures regarding music piracy are absent from the 2008 report, therefore the 2008 figures are used as a proxy).

<sup>20</sup> IIPA, 2008 SPECIAL 301 REPORT: TAIWAN (2008), available at <http://www.iipa.com/rbc/2008/2008SPEC301TAIWAN.pdf>; IIPA, 2004 SPECIAL 301 REPORT: TAIWAN (2004), available at <http://www.iipa.com/rbc/2004/2004SPEC301TAIWAN.pdf>.

<sup>21</sup> For a discussion on the significance of the relationship between Confucianism and copyright piracy, see *infra* notes 129-34 and accompanying text.

The recent outbreak of online piracy adds to the continuing struggle of copyright enforcement in China.<sup>22</sup>

Unlike the United States, where peer-to-peer (“P2P”) file sharing is apparently the principal source of illegal music files,<sup>23</sup> China faces a wider variety of infringements among which search engines play a more significant role in breeding online piracy than P2P services. For instance, Baidu, the largest search engine in China with a market share of more than 60%,<sup>24</sup> offers an online music service, Baidu MP3,<sup>25</sup> based on a business model of deep-linking illegal music files situated on third-party websites. Once a user enters a search keyword (e.g., artist name, song title, or album title), Baidu MP3 generates a list of search results that designate available music files organized by such criteria as song title, artist name, album title, lyrics, file format, file size, and download speed. Upon a click on any of these search results, the user may directly download or stream the music file via a pop-up window embedding the hyperlink to the actual IP address. Alternatively, a user may choose from predetermined search terms that normally consist of artist names or song titles. Those predetermined search terms are categorized into various charts and hot lists, based on their popularity, genre, release year, language, and places of origin (e.g., Hong Kong, Taiwan, and Western countries).<sup>26</sup> By browsing such charts and hot lists, a user could reach similar search results without the need to conjure up any keywords herself.

Such a business model enables Baidu MP3 to offer a massive repertoire of music files that drastically dwarf any legitimate music services online or offline. On any given day, the variety of music tracks (excluding redundant copies of the same music files) available from Baidu MP3 can reach more than 8,900<sup>27</sup> and the number of music search requests amounts to 11.6 million.<sup>28</sup> In accordance

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<sup>22</sup> Previous data quoted from IIPA and IFPI are focused on physical piracy (e.g. pirated CDs) rather than online piracy (e.g. file sharing).

<sup>23</sup> See, e.g., *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005); *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

<sup>24</sup> See IRESEARCH, CHINA ONLINE SEARCH ANNUAL RESEARCH REPORT (2007), [http://www.iresearch.com.cn/html/Consulting/online\\_marketing/Free\\_classid\\_18\\_id\\_1108.html](http://www.iresearch.com.cn/html/Consulting/online_marketing/Free_classid_18_id_1108.html). See also Alexei Oreskovic & Melanie Lee, *Baidu Sees New Ad System Boosting Q3 Sales*, REUTERS, July 24, 2009, <http://www.reuters.com/article/rbssTechMediaTelecomNews/idUSN2233794520090724>.

<sup>25</sup> See Baidu MP3, <http://mp3.baidu.com> (last visited Oct. 26, 2009).

<sup>26</sup> See Baidu MP3, <http://list.mp3.baidu.com/list/topmp3.html?id=1> (last visited Oct. 26, 2009).

<sup>27</sup> The number was manually calculated based on the All-Repertoire list in Baidu MP3. See Baidu MP3, <http://list.mp3.baidu.com/song/A.htm?id=1?top8> (last visited Oct. 26, 2009).

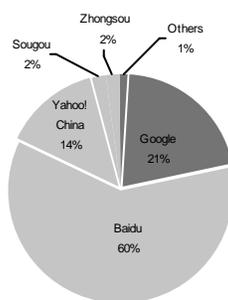
<sup>28</sup> See IRESEARCH, CHINA ONLINE MUSIC RESEARCH REPORT (2007), available at

with recent statistics,<sup>29</sup> users of Baidu MP3 downloaded billions of copies of music tracks,<sup>30</sup> which is likely to be more than a hundred times larger in size than the overall legitimate music market in China during the same period of time.<sup>31</sup> Baidu is by no means unique in its involvement in online piracy. Almost all major search engines in China, except for Google, are engaged in similar online music services, which account for more than three-fourths of the Chinese search engine market (See Exhibit Three) and never receive authorization from the majority of music labels.<sup>32</sup>

### EXHIBIT THREE

#### MARKET SHARES OF SEARCH ENGINES IN CHINA (2007)

*(Those involved in online piracy are in the lighter color)*



Source: iResearch, China Online Search Annual Research Report (2007)

The business model mentioned above would likely be unthinkable in many parts of the world due to its heavy reliance on illegal music files and its potentially massive impact on legitimate online services, such as iTunes and Rhapsody. Probably for this exact reason, these search engines offer the online music services solely within Chinese territory and usually block access by any IP address from outside of China in order to minimize the legal risk of being subject to overseas jurisdiction.<sup>33</sup> Unparalleled involvement of major market players results in an unparalleled level of online piracy. To put this into perspective, among more than 200

[http://www.iresearch.com.cn/html/consulting/digital\\_music/Charge\\_classid\\_29\\_id\\_1052.html](http://www.iresearch.com.cn/html/consulting/digital_music/Charge_classid_29_id_1052.html).

<sup>29</sup> Relevant statistics are on file with author.

<sup>30</sup> This amounted to 8.9 million copies per track. Each user of Baidu MP3 downloaded an average of 840 copies during 2006 and 2007.

<sup>31</sup> For the overall size of the legitimate music market in China, see IFPI, RECORDING INDUSTRY IN NUMBERS (2007 & 2008) (on file with author).

<sup>32</sup> See IRESEARCH, *supra* note 24.

<sup>33</sup> For hyperlinking services that were held liable for copyright infringement outside of China, see, e.g., *Arista Records, Inc. v. MP3Board*, 2002 U.S. Dist. LEXIS 16165 (S.D.N.Y. 2002); *Cooper v. Universal Music Austl. Proprietary Ltd.* (2006) 156 F.C.R. 380 (Austl.).

million Internet users in China,<sup>34</sup> 75.93% have downloaded music files online, and 66.01% have downloaded from various search engines,<sup>35</sup> while it is estimated that 99% of online music files in China are pirated.<sup>36</sup> By contrast, even when the usage of P2P file sharing peaked in the United States in 2002-2003, only 32% of American Internet users downloaded illegal music files (i.e., less than half of the percentage in China)<sup>37</sup> and only 852 million files were downloaded in a month (i.e., one-fourth of the download frequency from Baidu alone).<sup>38</sup> The level of online piracy in China looks even more shocking considering that the legitimate music market in the United States is one hundred times larger than that in China.<sup>39</sup>

Widespread piracy has likely caused consumers to gravely undervalue musical works. A recent study shows that, while 88% of overall music consumption in China is based on online downloading or streaming, only 1.5 million out of 119 million online music users pay for music access, and only 10 out of over 700 music websites are properly authorized.<sup>40</sup> It also indicates that 80% of Chinese consumers are only willing to pay two U.S. dollars or less per month for music and 37% are unwilling to pay any amount for music at all.<sup>41</sup>

Notably, the illegal music market in China is dominated by pirated copies of overseas repertoire rather than those of domestic repertoire. A recent study showed that 83.2% of Chinese consumers who obtain music online favor musical works from outside of mainland China.<sup>42</sup> A hand check of the TOP 500 chart from Baidu MP3 also revealed that about 80% of most popular songs were produced overseas.<sup>43</sup>

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<sup>34</sup> See CHINA INTERNET NETWORK INFORMATION CENTER, STATISTICAL SURVEY REPORT ON THE INTERNET DEVELOPMENT IN CHINA 9 (2008), <http://www.cnnic.cn/en/index/00/02/index.htm> (follow "The 21st Survey Report (2008/3/6)" hyperlink).

<sup>35</sup> This also means that 86.9 % of Internet users who download online music use search engines to download.

<sup>36</sup> See IFPI, *supra* note 31.

<sup>37</sup> See MARY MADDEN & LEE RAINIE, MUSIC AND VIDEO DOWNLOADING (2005), *available at* [http://www.pewinternet.org/PPF/r/153/report\\_display.asp](http://www.pewinternet.org/PPF/r/153/report_display.asp).

<sup>38</sup> See Press Release, NPD, RIAA Lawsuits Appear to Reduce Music File Sharing, According to the NPD Group (August 21, 2003), *available at* [http://www.npd.com/press/releases/press\\_030825.htm](http://www.npd.com/press/releases/press_030825.htm).

<sup>39</sup> See *infra* note 49 and the accompanying text.

<sup>40</sup> See IRESEARCH, *supra* note 24.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> See Baidu MP3, <http://list.mp3.baidu.com/topso/mp3topsong.html?id=1?top2> (last visited Feb. 25, 2009).

## II. THE MUSIC INDUSTRY IN SHADOW

This section explores empirical evidence that reveals how the Chinese music industry has developed in the shadow of rampant copyright piracy, with a focus on two aspects: financial performance and business practice.

### A. *Music Sales*

As indicated by Exhibit Four below, global music sales, as well as music sales in the United States, which account for 30% of global music sales, have been suffering a gradual but constant downturn since 2000.<sup>44</sup> A number of academic studies in this area attribute this decline to the growing usage of P2P file sharing.<sup>45</sup>

China has likewise experienced an overall decreasing trend in music sales during the same period of time as shown by the fact that sales in 2007 were down 25% from 2000.<sup>46</sup> Although the annual figures appear to rise and fall in a wider range (see Exhibit Five), the fluctuation is for the most part artificial and reflective of adjustments in methodologies. For instance, the temporary increase in 2001 is likely because of the inclusion of music videos (DVD and VCD formats), and the slight increase in the 2006 results are most likely due to the addition of digital sales for the first time.<sup>47</sup> Disregarding such methodological factors, the actual decline in China could presumably be even larger. Notably, the piracy rate was relatively stable during the same period ranging from 85% to 90%.<sup>48</sup> This might imply that a long-term high level of piracy, even without exacerbation, could still wear on the development of the music industry.

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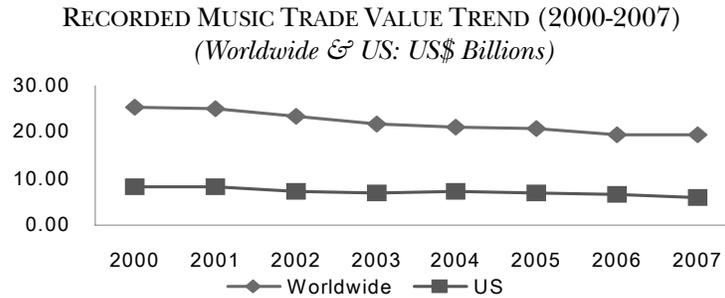
<sup>44</sup> See IFPI, THE RECORDING INDUSTRY IN NUMBERS (2000-2007) (on file with author).

<sup>45</sup> See, e.g., Stan J. Liebowitz, *Filing Sharing: Creative Destruction or Just Plain Destruction?*, 49 J.L. & ECON. 1 (2006); Felix Oberholzer & Koleman Strumpf, *The Effect of Filing Sharing on Record Sales: An Empirical Analysis*, 115 J. POL. ECON. 1 (2007) (finding no causality between the decline in music sales and P2P file sharing); Rafael Rob & Joel Waldfogel, *Piracy on the High C's: Music Downloading, Sales Displacement, and Social Welfare in a Sample of College Students*, 49 J.L. & ECON. 29 (2006); Alejandro Zentner, *File Sharing and International Sales of Copyrighted Music: An Empirical Analysis with a Panel of Countries*, 5 TOPICS ECON. ANALYSIS & POL'Y 1 (2005); Alejandro Zentner, *Measuring the Effect of File Sharing on Music Purchases*, 49 J.L. & ECON. 63 (2006). All of the above articles, except for the article by Oberholzer & Strumpf, found some causality between the decline in music sales and P2P file sharing. Several scholars pointed to the fact that the first major P2P system, Napster, came into being in 1999 and the music industry started to suffer setback immediately in 2000. It was also indicated that the slight increase in 2004 resulted from the massive litigations that the music industry initiated against P2P users in 2003.

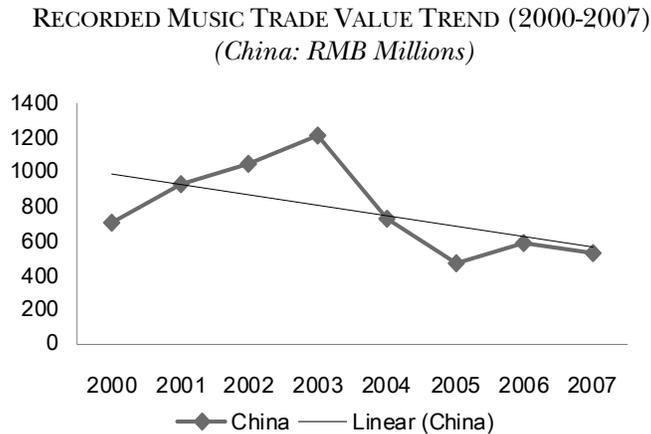
<sup>46</sup> See IFPI, *supra* note 31.

<sup>47</sup> See IFPI, *supra* note 44.

<sup>48</sup> See SPECIAL 301 REPORTS OF 2004 & 2008, *supra* note 13.

**EXHIBIT FOUR**

Source: IFPI the Recording Industry in Numbers 2000-2007

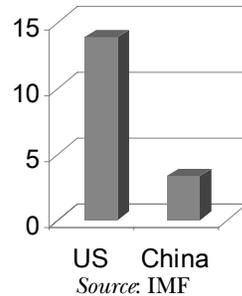
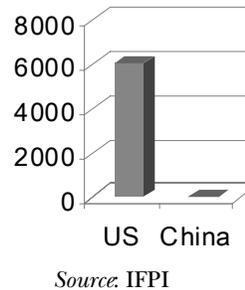
**EXHIBIT FIVE**

Source: IFPI the Recording Industry in Numbers 2000-2007

Regardless of the overall trend in music sales, the Chinese music industry is significantly underdeveloped. For instance, the overall Chinese economy is 23.5% of the overall U.S. economy in size (see Exhibit Six).<sup>49</sup> By contrast, the music industry in China is just 1.1% of the music industry in the United States (see Exhibit Seven).<sup>50</sup> In this sense, the music industry in China is extremely disproportionate to the overall economy.

<sup>49</sup> International Monetary Fund ("IMF"), *World Economic Outlook Database, October 2008*, <http://www.imf.org/external/pubs/ft/weo/2008/02/weodata/index.aspx> (last visited Oct. 27, 2009).

<sup>50</sup> See IFPI, *supra* note 44 (the data of music sales herein refer to the total industry trade value).

**EXHIBIT SIX****GDP 2007 (US\$ Trillions)****EXHIBIT SEVEN****Music Sales 2007 (US\$ Millions)**

It may also be inferred from Exhibit Eight below that the overall economic environment has little to do with the stumbling of the music industry in China. Because the overall Chinese economy has been enjoying 10% growth almost every year since 2000, there is no reason to speculate that the decline in music sales is a consequence of the weakened buying power of the Chinese people.<sup>51</sup>

**EXHIBIT EIGHT****CHINA GDP GROWTH (2000-2007)**

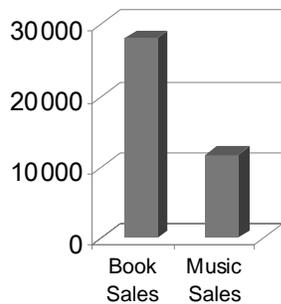
Source: IMF World Economic Outlook Database

The censorship system in China<sup>52</sup> should also be ruled out as the principal cause of the underdevelopment in the music industry. In the United States, music sales amount to 42% of book sales

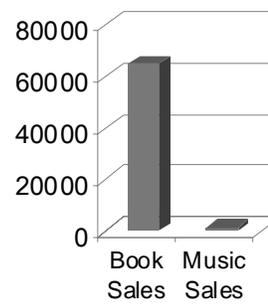
<sup>51</sup> See IMF, *supra* note 49.

<sup>52</sup> China introduced a unique censorship system for all kinds of publications, including books, newspapers, journals, movies, and music. Reproduction, distribution, and importation of new products as well as the establishment of new companies in those industries are subject to extensive scrutiny by governmental authorities. The United States also filed a WTO complaint against the censorship system in China in 2007. See Panel Report, *China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R (Aug. 12, 2009), available at [http://www.wto.int/english/tratop\\_e/dispu\\_e/cases\\_e/ds363\\_e.htm](http://www.wto.int/english/tratop_e/dispu_e/cases_e/ds363_e.htm).

(See Exhibit Nine).<sup>53</sup> In China, music sales are only equivalent to 2.3% of book sales (See Exhibit Ten).<sup>54</sup> Given that there is no obvious reason for the Chinese Government to differentiate between books and music in terms of censorship criteria,<sup>55</sup> we should turn to other reasons for the huge gap between the market sizes of books and music. A more convincing explanation appears to be that, as mentioned above, the piracy levels of books remain at significantly lower levels than those of other forms of copyrighted works, including music.<sup>56</sup>

**EXHIBIT NINE****US 2006 (US\$ millions)**

Source: US Census Bureau

**EXHIBIT TEN****China 2006 (RMB millions)**

Source: GAPP

It is also noteworthy that the market share of domestic sales in China has been gradually declining from 55% to 13% in recent years as illustrated by Exhibit Eleven below.<sup>57</sup> One may further infer that the gap of market shares between domestic and overseas music would have grown wider but for the censorship system that

<sup>53</sup> See U.S. CENSUS BUREAU, THE 2009 STATISTICAL ABSTRACT, available at <http://www.census.gov/compendia/statab/tables/09s1098.pdf> (book sales); and <http://www.census.gov/compendia/statab/tables/09s1102.pdf> (music sales, which designate the total industry retail value).

<sup>54</sup> See GENERAL ADMINISTRATION OF PRESS AND PUBLICATION (“GAPP”), BASIC STATISTICS OF NATIONAL PRESS AND PUBLICATION INDUSTRIES (2006), [http://www.chuban.cc/yw/200706/t20070627\\_26938.html](http://www.chuban.cc/yw/200706/t20070627_26938.html).

<sup>55</sup> Legally speaking, the censorship criteria are in fact identical for books and music. For comparison of Article 26 of the Administrative Regulation for Publication, <http://www.gapp.gov.cn/cms/html/21/396/200601/447334.html>, and Article 3 of the Administrative Regulation for Audio and Video Products, <http://www.gapp.gov.cn/cms/html/21/396/200601/447329.html>.

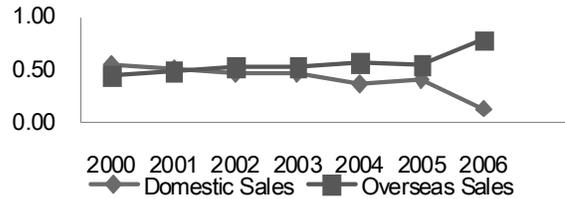
<sup>56</sup> See SPECIAL 301 REPORTS OF 2004 & 2008, *supra* note 13, at 65.

<sup>57</sup> See IFPI, THE RECORDING INDUSTRY IN NUMBERS (2000-2006) (on file with author). For the purpose of this article, “overseas music” or “foreign music” refers to all music produced outside of mainland China. Please also note that the chart does not include the market share of classical music, which began to be calculated separately from domestic and overseas music as of 2005.

indirectly imposes an import barrier to foreign musical works.<sup>58</sup>

### EXHIBIT ELEVEN

MARKET SHARES IN THE CHINESE MUSIC MARKET (2000-2006)



Source: IFPI Record Industry in Numbers 2000-2006

#### B. Alternative Revenue Streams

As indicated above, the high level of copyright piracy leads to significant undervaluation of musical works in the marketplace.<sup>59</sup> In the digital environment, consumers are now predominately exposed to free music from various illegal sources. It ceases to be a viable business model to rely solely on record sales when consumers are habituated to pay very little (if anything) for musical works. Musicians have to look at other ways to make a living. Recent copyright literature abounds with hypothetical business models designed to help copyright owners preserve the incentive for intellectual creation in the face of prevalent online piracy.<sup>60</sup> In the meantime, the Chinese music industry has long been adapting to copyright piracy and has created various forms of alternative revenue streams from grassroots perspectives.<sup>61</sup> As a matter of fact, some Western observers have already begun to champion China for shedding light on the future of the music industry worldwide.<sup>62</sup>

<sup>58</sup> See *supra* note 52 and accompanying text.

<sup>59</sup> See *supra* note 40 and the accompanying text.

<sup>60</sup> For example, several scholars have proposed a levy system, which basically consists of taxing information technologies and distributing tax revenues among authors by simulating the market demand. This scheme is somewhat akin to compulsory licenses that exist in copyright laws of many countries. See WILLIAM W. FISHER III, PROMISES TO KEEP: TECHNOLOGY, LAW AND THE FUTURE OF ENTERTAINMENT 199-258 (2004); Peter Eckersley, *Virtual Markets for Virtual Goods: The Mirror Image of Digital Copyright?*, 18 HARV. J.L. & TECH. 85 (2004); Neil Weinstock Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1 (2003). For attempts to implement those theoretical suggestions into practice, see Noank Media, <http://www.noankmedia.com> (last visited Oct. 27, 2009); Electronic Frontier Foundation, *A Better Way Forward: Voluntary Collective Licensing of Music File Sharing*, <http://www.eff.org/wp/better-way-forward-voluntary-collective-licensing-music-file-sharing> (last visited Oct. 27, 2009).

<sup>61</sup> See Wang Qian, *Pop, But Not Music*, XINMIN WKLY., Aug. 25, 2008, [http://weekly.news365.com.cn/wh/200808/t20080826\\_2005062.htm](http://weekly.news365.com.cn/wh/200808/t20080826_2005062.htm); Liu Gang & Wang Anyou, *The Piracy Problem in the Chinese Music Industry*, [http://www.paper.edu.cn/paper.php?serial\\_number=200606-38](http://www.paper.edu.cn/paper.php?serial_number=200606-38).

<sup>62</sup> See Kevin Maney, *If Pirating Grows, It May Not Be the End of Music World*, USA TODAY, May

The following section will study those alternative revenue streams one by one and examine their long-term effects on the sustainable development of the music industry.

### 1. Live Performance

Live performance (i.e., touring)<sup>63</sup> has always supplied a reliable source of revenue for many artists. In a conventional sense, live performance also plays a more important role in promoting record sales. It is therefore not a coincidence that every time a music band releases a new album, they set out for extended touring around the country in addition to frequent media interviews and record store signings.

The relative roles of live performance and record sales are essentially reversed in the Chinese music industry. As copyright piracy diminishes the prospect of making any profits from record sales, artists become increasingly reliant on live performance for their bread and butter. It is reported that revenue from live performance makes up more than half the total income of Chinese pop artists.<sup>64</sup> The artists, as well as music companies, are accustomed to tolerating the free sharing of their music and marketing their albums at a price low enough to compete with pirated copies with the hope that the resulting popularity of the artists will enhance live performance markets and make up for the losses in record sales. In this sense, recorded music appears to deteriorate into a promotional role for live performance.

It is somewhat ironic that when Chinese artists are finally able to directly distribute their works to consumers free from the physical constraints of compact discs and record shops, they end up having to depend more on other forms of physical constraints, such as theaters or stadiums, to earn a decent living. Live performance unavoidably entails substantial initial investments in venue renting, equipment purchasing, travel logistics, concert promotion, and supporting staff payroll. More importantly, given the limited

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3, 2005, at B3, available at [http://www.usatoday.com:80/tech/columnist/kevinmaney/2005-05-03-music-piracy-china\\_x.htm](http://www.usatoday.com:80/tech/columnist/kevinmaney/2005-05-03-music-piracy-china_x.htm) (quoting the chairman of IFPI, Jay Berman: "The business model for the record industry worldwide is moving toward resembling what we see in China today."). See also Thomas Crampton, *In China, Record Companies Find New Ways to Do Business: Pop Stars Learn to Live with Pirates*, INT'L HERALD TRIB., Feb. 24, 2003, at 1, available at [http://www.iht.com/articles/2003/02/24/tl\\_55.php](http://www.iht.com/articles/2003/02/24/tl_55.php) (indicating that the reality in China "is beginning to draw attention in Europe and the United States, where music companies face falling revenue from compact disk sales as Internet piracy increases.").

<sup>63</sup> For a concise introduction of touring businesses, see Bobby Borg, *Potential Revenue Streams, Live Performance and Touring*, [http://www.musiciansfriend.com/document?doc\\_id=93022](http://www.musiciansfriend.com/document?doc_id=93022) (last visited Oct. 27, 2009).

<sup>64</sup> 'Chaos' of China's Music Industry, BBC NEWS, Feb. 21, 2008, <http://news.bbc.co.uk/go/pr/fr/-/2/hi/asia-pacific/7251211.stm>.

number of physical venues suitable for live performance, the market inherently favors established artists, who are able to attract high-value audiences or larger audiences in general.<sup>65</sup> Up-and-coming and alternative artists with limited popularity and a smaller fan base are less likely to succeed in a music market featuring numerous entry barriers that were once lowered by digital technology but re-erected by live performance requirements.<sup>66</sup>

## 2. Sponsorship

Just as famous NBA players receive sponsorship from sneaker and beverage manufacturers, pop artists may seek opportunities to endorse commodities of other companies. The artists are normally required to participate in promotional events, appear in various commercials, or otherwise use their star power to influence potential purchasers in exchange for corporate sponsorship.<sup>67</sup> Other forms of sponsorship include product placement in music videos and banners on stage. As trademark lawyers may say, these artists are exploiting their right of publicity.<sup>68</sup>

It is not surprising that advertisers only approach a small number of superstars for sponsorship deals because the success of such advertisements basically hinges on the popularity and fan loyalty of those artists.<sup>69</sup> The vast majority of pop musicians cannot realistically consider sponsorship a viable source of income. Furthermore, it proves difficult even for famous artists to strike satisfying deals with business partners that fit into their goals, their

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<sup>65</sup> In China, although the main consumers of recorded music are students and other young people, concert-goers are mostly older generations. The reason is that, compared to low prices of music records (e.g., one to two U.S. dollars for legitimate copies and near zero for pirated copies), concert tickets are much more expensive (e.g. ten to one hundred U.S. dollars). Therefore, music fans start to frequently attend concerts only when they have a stable source of income. This means that even though an artist's album is well received, she probably has to wait several years more for a lucrative live performance market. See Song Yan, *Music Businessman Song Ke*, CHINA INTERNET WKLY. June 13, 2005, <http://www.enet.com.cn/article/2005/0613/A20050613423518.shtml>.

<sup>66</sup> Notably, even established artists have questioned the vitality of live performance markets as the main source of revenues in China. Ticket sales are often so insufficient to cover the expenses for live performance that many artists have also needed to imbed advertisements in their concerts or seek other commercial sponsorship. See Cui Jian, *There is No Real Rock Fan in China*, BEIJING TIMES, July 8, 2006, available at <http://music.ent.tom.com/1026/1027/200678-73923.html>.

<sup>67</sup> For a few examples of corporate sponsorship in China, see *Pop Band Yu Quan Endorsed Intel Microprocessors*, CNET NEWS SERVICE, June 20, 2007, <http://www.zhanxian.cn/MingxingZhuanlan/mingxingdaiyan/2007/06/20/06201157437405.shtml>; *Pop Singer Li Yuchun Endorsed Crest Toothpaste*, CRI ONLINE, Apr. 6, 2006, <http://gb.cri.cn/9964/2006/04/06/114@986782.htm>; *Win the Game in Wahaha*, <http://www.wahaha.com.cn/playland/star/leehom.shtml> (last visited Oct. 27, 2009) (showing that pop singer Wang Leehom endorsed Wahaha bottled water).

<sup>68</sup> For a detailed discussion of the right of publicity, see generally J. THOMAS MCCARTHY, *THE RIGHTS OF PUBLICITY AND PRIVACY* (2008).

<sup>69</sup> Just imagine how many NBA players as a matter of fact have sneaker deals.

lifestyles and, more importantly, their messages in music. More often than not, sponsorships can end up putting artists on the short leash of corporate powers.<sup>70</sup> In order to preserve and enhance the advertising values of sponsored artists, corporate sponsors are inclined to set various boundaries for artists' careers (through contracts or music companies that also live on sponsorship), out of fear that any mischief could derogate their public appeal.

### 3. Bundling

As copyright piracy draws the price of musical works down towards the marginal cost, which is near zero in the digital environment, several music companies have attempted to indirectly appropriate the value of their music by bundling free music with the sales of other products.<sup>71</sup> The bundled products are normally complementary goods in connection with music consumption, such as MP3 players, cell phones, and broadband services. Complementary goods in economics refer to two goods that consumers would like to buy and use together. In other words, the more one good is consumed, the more the other good is also consumed.<sup>72</sup> The cross-elasticity of demand is therefore negative for complementary goods, which means a decrease in the price of one good will result in an increase of the demand of the other good. There are many kinds of complementary goods in everyday life, including printers and ink cartridges, video games and consoles, and, more radical examples, left shoes and right shoes.

In this sense, information products (particularly copyrighted works) and information technology products (particularly those often being sued for contributory infringement ranging from VCR to P2P) are inherently complementary goods. Mindful of this, music companies appear to hope that free music would enhance the value of the bundled products (say MP3 players), which would in turn increase the willingness of MP3 player manufacturers to pay royalties for copyright licenses or to invest directly in music production. The uncontrolled piracy could, however, give rise to the

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<sup>70</sup> For example, the private equity firm, Terra Firma, which bought music publishing group EMI, recently announced that it would try more direct band sponsorship. It sent "the music industry into a tailspin with leading artists like Coldplay threatening to withhold their albums from EMI." *'Chaos' of China's Music Industry*, *supra* note 64.

<sup>71</sup> For instance, music companies have licensed Lenovo to pre-load a large number of music tracks in its cell phone products. See Zhou Zhen, *How Far Legitimate Websites Need to Go Before Making Any Profits*, CHINA CULTURE POST, June 5, 2006, <http://www.ccdy.cn/pubnews/451267/20060605/492322.htm>.

<sup>72</sup> For discussions of complementary goods in the context of copyright law, see PAUL GOLDSTEIN, *COPYRIGHT'S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX* 98-99 (2003); Stan J. Liebowitz & Richard Watt, *How to Best Ensure Remuneration for Creators in the Market for Music? Copyright and Its Alternatives*, 20 J. ECON. SURV. 513, 527-530 (2006).

problem of free riding even in the context of complementary goods.<sup>73</sup> To optimally price complementary goods, a supplier of the two goods must be able to lock in consumers so that they prefer to buy the two goods from the same supplier. Only in this way will a decrease in the price of one good lead to an increase in the demand of the other good offered by the same supplier.<sup>74</sup> If an MP3 player maker invests in music creation and the resulting music is simultaneously accessible to all brands of MP3 player products, it would create a powerful incentive for competitors to free ride others' investment. This indicates that free music does not necessarily mean "copyright-free" music, with the latter actually resulting in the underproduction of free music.<sup>75</sup>

#### 4. Advertisement-Supported Music

In another attempt to survive free pirated music, several licensed websites have started to provide free music streaming and downloading services in order to attract eye traffic, and to eventually benefit from increased rates of online banner advertisements.<sup>76</sup> Akin to the bundling discussed above, this business model suffers from the free riding problem. Among other issues, legitimate websites that incur significant costs in the form of copyright royalties are less capable of sustaining low advertisement rates than pirate websites. In the long run, price competition by pirate websites is likely driving most licensed websites out of the advertisement market. In this sense, advertisement-supported music is just another business model based on copyright protection.

A related but slightly different suggestion is that free music could have a positive correlation with music sales because of certain "sampling effects" (also called "exposure effects").<sup>77</sup> It draws from the intuition that consumers who have good experience with

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<sup>73</sup> For detailed discussions of free riding and public goods problems, see *infra* note 90-95 and accompanying text.

<sup>74</sup> This is also the reason why video games are generally incompatible with consoles of a different brand, and why print cartridges are incompatible with printers of a different brand.

<sup>75</sup> Because a bundled product is usually used with multiple musical works, the wealth-maximizing approach is actually to engage in price discrimination in a way that sells the bundled product at a lower price and then has consumers reveal their different valuation of the utility through the quantity of musical works purchased. Bundling free music with high-priced products reverses the pricing scheme. It would impede the entry by consumers and result in a suboptimal consumption of musical works with more dead weight loss. See generally Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55 (2001).

<sup>76</sup> Legitimate websites that adopt this business model include Sina Music Database, <http://music.sina.com.cn/yueku/> (last visited on Oct. 27, 2009) and the Google-supported Top100.cn, <http://www.top100.cn> (last visited Oct. 27, 2009).

<sup>77</sup> See Liebowitz & Watt, *supra* note 72.

P2P file sharing or other forms of free music are more likely to buy recorded music, in the same way that food sampling in grocery stores promotes food sales. Furthermore, it is contended that free music may be particularly beneficial for up-and-coming artists who would be more than happy to see a popularity boost. This line of arguments is flawed, however, in that it blurs the distinction between rivalrous goods (e.g., food) and non-rivalrous goods (e.g., information). While sampling rivalrous goods can generate more consumption of the *same* goods, sampling non-rivalrous goods would have positive effects only if the goods sampled are somewhat *different* from the goods ultimately offered for sale. For instance, online streaming may lead to paid downloading for full enjoyment; downloading a few tracks from an album may lead to purchase of the whole album with more tracks; and free distribution of the debut album may lead to sales of future albums by the same artist. However, in a world without copyright, all albums and all tracks in any album would be freely available for all kinds of exploitation by anyone. Such free music is in essence not sampling, but a substitute for purchase because there is no juncture where authors and copyright owners can cash in on the reputation resulting from previous good experience of consumers.

### 5. Merchandizing

Chinese music companies also put an increasing emphasis on the market for physical merchandise such as t-shirts, posters, and dolls, whether bundled with musical works or not.<sup>78</sup> They have become more involved in selling artist merchandise either by acquiring specialist firms or by forming partnerships with existing suppliers.<sup>79</sup> The music industry has at times alleged that merchandizing creates a market for so-called “unpiratable products,”<sup>80</sup> which is in fact another example in addition to live performance that copyright owners reluctantly turn back to physical constraints to recoup their investment in the digital era.

The marketing of merchandise products relies principally on the fame of related artists, as illustrated by the intuition that a poster signed by the featured artist is usually much more valuable

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<sup>78</sup> It is not necessary to bundle merchandizing with music, as the sales of merchandizing rely on the fame of artists rather than the value of their music.

<sup>79</sup> For instance, the pop duo Yu Quan has tapped into the markets of comic books and toys featuring their images. See Feng Xing, *Songke Model – Exploring New Ideas in the Recording Industry*, NEWS WKLY., Feb. 17, 2004, available at <http://www.chinanews.com.cn/n/2004-02-17/26/402869.html>.

<sup>80</sup> See IFPI, DIGITAL MUSIC REPORT 2009 12-13 (2009), available at <http://www.ifpi.com/content/library/DMR2009.pdf>.

than one without a signature. As a consequence, this market is inherently prejudiced against up-and-coming artists who have yet to develop a reputation among music consumers. More interestingly, those who expect the prosperity of a merchandise market in China appear to assume that a haven of copyright piracy would somehow be free of counterfeiting.

## 6. Synchronization

The Chinese music industry has also witnessed that many leading musicians are shifting the focus of their careers from making records to producing soundtracks for movies, television shows, video games, and advertisements.<sup>81</sup> Because synchronization rights piggyback on those more investment-extensive creations, which are in a relatively small quantity, the opportunities available for musicians are limited to the established ones. Notably, in the synchronization market, the direct customers are usually entrepreneurs, such as moviemakers, video game developers, and advertisers. Unlike passive consumers, these entrepreneurs oftentimes insist on extensive involvement in the creative process to insure that the messages in music should be consistent with the characteristics of the products supported by the music. Such artistic control is more obvious in the case of background music made for commercials.<sup>82</sup>

It is also questionable whether synchronization may provide a sustainable stream of revenue for musicians in a world without copyright. After all, movies and video games are just as reliant on copyright protection as music. In the wake of rapid development in Internet broadband and digital compression technologies, movies and video game industries are also faced with the looming challenge of copyright piracy.<sup>83</sup>

## 7. Multi-Dimensional Artists

It is hard to imagine a more cliché motivational story than that about a young musician who had to take a day job as a waitress or cashier for a living and practiced with her underground band at

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<sup>81</sup> Top Chinese musicians that devote most of their time into synchronization include San Bao, Lao Zai, and Chen Tong. See Li Guangping, *Balancing the Pressure of Living and the Pride of Life*, PEOPLE MUSIC, May 2007, <http://qkzz.net/magazine/0447-6573/2007/05/1146682.htm>.

<sup>82</sup> For instance, pop artist Pu Shu wrote the song "Colorful Day" for Toyota Vios commercials and another song "Rush Out of Your Window" for Microsoft Windows commercials. See Feng Xing, *supra* note 79.

<sup>83</sup> In the first generation of P2P lawsuits, the music industry was the driving force. Only a few years later when copyright owners targeted the second-generation P2P providers did the movie industry start to take the leading role. See, e.g., *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005); *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

night. It is possible that the drama would become a reality for most musicians and for most of their careers in China, where music companies are increasingly keen on developing “multi-dimensional” artists. Because the music market alone is not enough to support the musicians’ livelihoods, they are encouraged to take roles in movies, become television show hosts, and have other “day jobs” to support their music careers.<sup>84</sup> Being a full-time musician might soon become a luxury that only a small group of superstars can afford. This is also reflective of music companies’ attempt to diversify their investment portfolio in response to the increased risk in the music market. As a result, when auditioning a new artist, music companies eagerly look for the multi-talent potential and sometimes simply strike a music deal with an established actor or other celebrity.

### C. Changing Business Model

The role of record companies in the music value chain was traditionally limited to production, promotion, and distribution of recorded music. Given the critical importance of alternative revenue channels in the era of widespread piracy, Chinese record companies are reshaping their business models to become more like those of talent management agencies, which handle and share revenues from all aspects of a musician’s entertainment-related businesses, from record sales to touring, merchandise, brand sponsorship, music publishing, fan club, website, and television and film appearances.<sup>85</sup> These all-encompassing deals are often called the “360 Degree” model,<sup>86</sup> by which musicians essentially sign over the entirety of their careers at least during the contractual term.<sup>87</sup>

“360 Degree” deals may give rise to several phenomena that were unseen in traditional business models. First of all, record companies prefer to sign new artists at a relatively young age and for an extended period of time. Alternative revenue streams (e.g.,

<sup>84</sup> See Yan Qian, *With the Shrinking Market, Traditional Music Companies Are Facing Transformation*, SICHUAN DAILY, Apr. 28, 2007, <http://www.sichuandaily.com.cn/2007/04/18/20070418613254654725.htm>.

<sup>85</sup> See Baiwu, *Are You Still Buying Music in 2007?*, CHINA CULTURE POST, Feb. 2, 2008, available at <http://ccm.gov.cn/show.php?aid=57501&cid=280>; Ed Peto, *Music in China: The Inside Story*, THE REGISTER, Nov. 1, 2007, available at [http://www.theregister.co.uk/2007/11/01/music\\_in\\_china\\_feature](http://www.theregister.co.uk/2007/11/01/music_in_china_feature).

<sup>86</sup> For the media usage of the term “360 Degree Deals,” see, e.g., *Music Firms Tune into New Deals*, BBC NEWS, June 30, 2008, <http://news.bbc.co.uk/2/hi/business/7480183.stm>; Pete Paphides, *The Guy to Save the Music Industry?*, TIMES (London), Jan. 18, 2008, available at [http://www.timesonline.co.uk/tol/comment/columnists/guest\\_contributors/article3207048.ece](http://www.timesonline.co.uk/tol/comment/columnists/guest_contributors/article3207048.ece).

<sup>87</sup> See Huang Jingjing, *Reshuffling Recording Companies*, ZAobao.COM, Nov. 13, 2008, available at <http://stars.zaobao.com/pages6/stars081113.shtml>.

live performance, sponsorship, and merchandizing) in most cases entail long-term investment in growing the artists' reputation and influence in peripheral markets. A long-term contract helps recoup the heavy initial investment in young artists who also have less bargaining power than established artists in deal negotiations. Second, although one may presume that digital technology empowers artists with more autonomy in music creation, record companies become even closer to wielding "360 Degree" control over an artist's creative process and even personal life to maintain her commercial value in advertising and merchandizing markets. Not only does the music need to convey the same message as the products promoted, the public image of the musician also needs to be consistent with mainstream perception. For example, a rock star lifestyle in the original sense would hardly attract a robust stream of sponsorship revenues in the relatively conservative Chinese culture. It is not an overstatement in most cases that a "360 Degree" deal has a tendency of turning every aspect of an artist's life into a commodity for music companies. Third, while music companies are searching for new artists, they are increasingly focused on non-musical properties, such as an attractive appearance and a healthy public image, again in order to accommodate the need for alternative sources of revenues. It is no longer enough to be a pure musician. If an artist has no potential to tour and spin off into ancillary forms of revenue such as movie and advertising opportunities, music companies might eventually pass up an otherwise unparalleled music talent.

### III. PIRACY AND INCENTIVE RATIONALE

As mentioned above, developing countries are often considered non-stakeholders in copyright enforcement to the extent that they do not have well-developed copyright industries and copyright piracy only concerns products of foreign companies in most cases.<sup>88</sup> Some argue that, while copyright piracy mainly undermines the incentive to produce and the ability to compete on the part of foreign companies, local companies might actually have a competitive edge and enjoy healthier growth.<sup>89</sup> This point of view, however, appears to be based on a misinterpretation of the incentive rationale.

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<sup>88</sup> See *supra* note 2 and accompanying text.

<sup>89</sup> See, e.g., Peter K. Yu, *From Pirates to Partners (Episode II): Protecting Intellectual Property in Post-WTO China*, 55 AM. U. L. REV. 901, 950-51 (2006) ("Indeed, if its competitors had been less protective of their products, the publisher's actions might have driven the pirates to its competitors, increasing their losses while reducing their ability to compete.").

The incentive rationale begins with an understanding of the economic features of copyright subject matters.<sup>90</sup> Information products, including works of authorship, are believed to have certain characteristics of a public good, such as “non-excludability” (or “inappropriability”) and “non-rivalry” (or “indivisibility”).<sup>91</sup> “Non-excludability” means that once information is created and distributed, it is physically difficult to exclude others from enjoying it. The consumption of information is “non-rivalrous” where it may be enjoyed simultaneously by an infinite number of people without diminishing the enjoyment by others. In economic terms, the marginal cost of extending the consumption to another person is negligible or near zero. Under such circumstances, it is extremely difficult for authors to recoup the fixed costs of creating their works in a market without property rights. Competitors, who are free to copy the same works without incurring the fixed costs, will soon drive the prices towards the marginal costs of reproduction and distribution.<sup>92</sup> The market therefore tends to undersupply those valuable works by failing to provide sufficient incentives for intellectual creation. Copyright law is intended to solve the incentive problem by granting authors exclusive control for a limited period of time over reproduction and distribution of their works, which in turn creates an opportunity for authors to price their works above the marginal costs.<sup>93</sup>

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<sup>90</sup> For a detailed survey of economic theories in connection with copyright law, see PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT (3d ed. 2005); Gillian K. Hadfield, *The Economics of Copyright: An Historical Perspective*, 38 COPYRIGHT L. SYMP. 1 (1992).

<sup>91</sup> See, e.g., PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 37 (17th ed. 2001); ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 135 (1988); William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 326 (1989).

<sup>92</sup> From an *ex post* perspective, once a work is created, the author would be unable to internalize the fixed costs and, therefore, would suffer a competitive disadvantage over free riders who do not bear the fixed costs. From an *ex ante* perspective, even if the author tries to negotiate a price with all potential users before the work is created, the gaming theory suggests that many users would likely undervalue the work in an attempt to free ride other consumers' contributions.

<sup>93</sup> Notably, this article leaves aside the thorny question of optimal production. On the one hand, economy efficiency dictates that an intellectual product should be created as long as the social benefits of the product exceed the social costs of creation. On the other hand, an intellectual product should be further consumed by yet another user as long as the marginal benefits of the additional consumption outweigh the marginal costs of further communication. These two seemingly conflicting dimensions imply that any attempt to achieve an optimal level of copyright protection has to take into consideration the total surplus created by a new work and the deadweight loss created by increased copyright protection for existing works in order to induce the new work. To make things more complicated, deadweight loss may paradoxically be minimized not only by relaxed copyright enforcement, but also by heightened copyright protection that enhances market competition. Therefore, it is not surprising to see that even leading economists complain about the difficulty to ascertain optimal production of information. See, e.g., Liebowitz & Watt, *supra* note 72.

The incentive rationale has given birth to three diverse but related approaches in copyright scholarship, which may be loosely called the “bargain approach,” the “autonomy approach,” and the “market approach.”<sup>94</sup> Based on empirical evidence, none of these three approaches would support the point of view that copyright piracy mostly targeting foreign works is irrelevant or even beneficial to domestic companies. On the contrary, these approaches illuminate that the quantity, variety, and quality of music production in the domestic market could undergo significant setbacks incidental to rampant piracy.<sup>95</sup>

#### A. *Bargain Approach*

The “bargain approach” refers to the line of arguments that regard copyright law as a bargain between authors and the general public.<sup>96</sup> From the perspective of the general public, copyright protection should only be offered to the extent absolutely necessary to induce the creation of works that otherwise would not have been created. In other words, copyright protection is not desirable as long as authors would continue to create works of no less quantity, variety and quality, either based on alternative revenue streams or for non-commercial reasons.

The empirical evidence discussed above indicates that the market size of the Chinese music industry, as measured by the quantity of music sales, has been steadily shrinking in recent years despite the fact that the overall economy in China has been growing rapidly at an annual pace of 10%.<sup>97</sup> Moreover, the Chinese music market is significantly underdeveloped, not only compared to those in Western countries (e.g., only 1% of the U.S. music market in an economy one-fourth the size of the U.S. economy), but also compared to other cultural markets in China (e.g., only 2% of the Chinese book market while the same ratio is 40% in the U.S.).<sup>98</sup>

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<sup>94</sup> For general introductions of these three approaches, see *infra* notes 96-119 and accompanying text. It appears that the third approach has more intuitive appeal although a comprehensive comparison of the three approaches will have to be analyzed in a future article. For existing literature, see, e.g., Neil Weinstock Netanel, *Copyright and a Democratic Civil Society*, 106 YALE L.J. 283 (1996).

<sup>95</sup> In this article, “quantity” refers to the overall size of the market as measured by music sales; “variety” means the total number of different works produced and the range of differentiation among the works; and “quality” refers to how well the works approximate the preference of consumers.

<sup>96</sup> See generally Arnold Plant, *The Economic Aspects of Copyright in Books*, in SELECTED ECONOMIC ESSAYS AND ADDRESSES 57 (1974); Stephen Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies, and Computer Programs*, 84 HARV. L. REV. 281 (1970); Robert M. Hurt & Robert M. Schuchman, *The Economic Rationale of Copyright*, 56 AM. ECON. REV. 421 (1966).

<sup>97</sup> See *supra* note 51 and accompanying text.

<sup>98</sup> See *supra* note 53 and accompanying text.

Such evidence implies that the quantity of music production likely suffers (not to mention hardly benefits) from copyright piracy prevalent in China.

Alternative revenue streams appear to contribute very little to redressing the losses from music sales. First, those alternatives would still be available and supplementary to music sales even without the piracy problem. To this extent, copyright piracy generates net losses for music companies.<sup>99</sup> Second, alternatives such as advertisement-supported music, synchronization, and bundling also need to be premised on a robust copyright regime to avoid free riding among different entrepreneurs.<sup>100</sup> Third, it is not inconceivable that “day jobs”<sup>101</sup> in alternative markets (e.g., paid appearances, acting in television or film, and touring) would compete with music production for artists’ time and energy. Lastly, most of the alternative revenue streams, including live performance, sponsorship, merchandizing, synchronization, and acting, are based on the popularity of the musicians rather than the quality of their music. Over-reliance on those alternatives discriminates against artists with smaller niche audiences.<sup>102</sup> It would also heighten entry barriers for new artists who would find the road to success much longer and narrower without copyright royalties. Discrimination against the less commercial and up-and-coming artists would inevitably result in losses in the quantity (and possibly the variety) of music.

It is less straightforward to find concrete evidence on the potential losses in variety and quality, although we have heard numerous complaints from high-profile musicians about the lack of a healthy environment in China for music genres other than urban pop.<sup>103</sup> There are also sporadic news reports with respect to the

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<sup>99</sup> One might argue that copyright piracy helps boost the popularity of artists and therefore enhances their values in alternative markets, e.g., advertisement and sponsorship. This argument appears to overlook the fact that most piracy targets artists with existing reputations rather than unknown artists. Furthermore, opportunities for advertisement and sponsorship are in most cases available exclusively to established artists.

<sup>100</sup> In other words, for those alternative markets to exist, copyright protection must be effective at least in the corporate market.

<sup>101</sup> See *supra* note 84 and accompanying text.

<sup>102</sup> See Posting of Cayocosta to RecProAudio, <http://recproaudio.blogspot.com/2007/11/free-music-model-and-middle-class.html> (Nov. 18, 2007, 18:34) (commenting that “[w]hat remains indisputable however, is the fact that under a free-music platform the overall likelihood of artists being able to earn a living would be reduced . . . consequently the line at which success is delineated would be higher, thus freezing out a larger portion of the professional music middle-class.”).

<sup>103</sup> A leading rocker, Cui Jian (think of him as the “Chinese Bruce Springsteen”), alleged “rock & roll is a fad rather than a culture in China.” *Cui Jian: China’s Rock and Roll with the Phenomenon of Non-culture*, CULTURE.PEOPLE.COM, June 5, 2006, <http://culture.people.com.cn/GB/40473/40477/4435104.html>. A leading rock band, Beyond (think of them as the “Chinese Beatles”), claimed that “there is no music but only entertainment.” See Beyond Search, <http://tieba.baidu.com/f?kz=19062557> (last visited Oct. 27, 2009).

drop in new album releases in recent years.<sup>104</sup> Theoretically speaking, music companies would be more averse to developing new forms of music and new artists if copyright piracy impedes their ability to recoup the fixed investment of creation through music sales. The reason being that, in response to the uncertainty of public tastes, music companies traditionally invest in a large portfolio of varied musical works in the hope of cross-subsiding less popular music with high sales of hit music.<sup>105</sup> In contrast, copyright piracy naturally tends to be focused on bestsellers and in doing so undermines the revenues that copyright owners could otherwise collect from hit sales. Music companies would, therefore, be financially handicapped in taking chances in new forms of music and new artists, which likely causes losses in the variety and quality of the music.

It is reported that some copyright owners have started to lower the price of legitimate products in order to compete with pirated products.<sup>106</sup> Sustainable price competition normally entails substantial cost-cutting. For this reason, copyright owners are also expected to invest less in music production, which again would affect the variety and quality of music. This might be one of the reasons why music plagiarism, an obvious way to cut creation costs, has become a more frequent scandal despite the fact that the threshold for plagiarism is understandably high in the pop culture.<sup>107</sup>

### B. *Autonomy Approach*

The “autonomy approach” suggests that,<sup>108</sup> although authors create for a variety of reasons, many of which may actually be non-

<sup>104</sup> See, e.g. Han Ying, *Is There a Cure for the Domestic Music Industry?*, SG.COM.cn, Mar. 14, 2007, <http://ent.sg.com.cn/ent/mrkh/80229.shtml> (reporting that the annual releases of new albums in China shrank to approximately 110 units in 2006, which was half of the annual releases of new albums in 2005); Joe McDonald, *Piracy Hurting China's Own Industries*, FOXNEWS.COM, July 1, 2006, [http://www.foxnews.com/printer\\_friendly\\_wires/2006Jul01/0,4675,ChinaPiracyChineseLosses,00.html](http://www.foxnews.com/printer_friendly_wires/2006Jul01/0,4675,ChinaPiracyChineseLosses,00.html) (reporting that “[l]osses to piracy have made film studios and music companies reluctant to finance new releases at a time when they might be cashing in on rising foreign interest in Chinese pop culture.”).

<sup>105</sup> See Paul Goldstein, *Copyright*, 55 LAW & CONTEMP. PROBS. 79, 83 (1992); Barry W. Tyerman, *The Economic Rationale for Copyright Protection for Published Books: A Reply to Professor Breyer*, 18 UCLA L. REV. 1100, 1121 (1971).

<sup>106</sup> See Kate Kelly, et al., *Movie, Music Giants Try New Weapon Against Pirates: Price*, WALL ST. J., Mar. 7, 2005, at B1. Several scholars have applauded such pricing strategies; see generally, Peter Yu, *supra* note 89, at 948; Jing Zhang, *Pushing Copyright Law in China: A Double-Edged Sword*, 18 DEPAUL J. ART, TECH. & INTEL. PROP. L. 27, 69 (2007).

<sup>107</sup> See Qian Yongjun & Guo Dingchang, *A Critical Review of the Philistinism Tendency of Pop Music Culture*, CNKI.COM, May 28, 2007, <http://www.cnki.com.cn/Article/CJFDTotal-QSZZ200705028.htm>.

<sup>108</sup> Cf. Netanel, *supra* note 94, at 341 (referring to this approach as a “democratic paradigm”).

commercial, copyright law provides the necessary financial independence for a robust creative and expressive sector that could stand up to political interference and commercial manipulation. Copyright law supplies a powerful incentive for creativity not in the sense that authors would not create but for money, but in the sense that money protects authors' autonomy in literary and artistic expression.

The losses in music sales, however, tighten the "breathing space" for intellectual creation. Mindful of the declining likelihood of commercial success, perspective artists would be more prepared to sacrifice creative freedom for commercial concerns. Furthermore, if alternative revenue streams, such as sponsorship, advertisement, and bundling, play a major role in the music industry, it would compel artists to depend heavily on corporate patronage and relinquish their autonomy in creative expression. In order to make sure that the musical works, as well as the musicians, are consistent with the messages of the products being endorsed or bundled, those corporate patrons are inclined to allow less risk-taking and to impose more hand-holding in the creative process. Music companies would likewise be eager to wield complete control over every aspect of a musician's professional and personal life to preserve her marketing value for alternative revenue sources. It is, therefore, unsurprising that the "360 Degree" model,<sup>109</sup> which essentially allows music companies to take over a musician's entire career, is gaining momentum in the Chinese music industry.

### C. *Market Approach*

From the perspective of the "market approach,"<sup>110</sup> copyright law preserves the market as the principal mechanism to allocate resources to intellectual production and to connect authors with consumers in the most direct way possible. Consumer demands will signal the appropriate levels of pricing and production of vari-

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<sup>109</sup> See *supra* note 86 and accompanying text.

<sup>110</sup> See, e.g. GOLDSTEIN, *supra* note 72, at 200 ("[T]here is no better way for the public to indicate what they want than through the price they are willing to pay in the marketplace."); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1 (1969) (arguing that production and consumption of information cannot be judged independently). In fact, the "market approach" may date back as early as to Adam Smith. See ADAM SMITH, LECTURES ON JURISPRUDENCE 82-83 (R. L. MEEK et al. eds., Clarendon Press 1987) (1762):

[Copyright] is perhaps as well adapted to the real value of the work as any other, for if the book be a valuable one the demand for it in that time will probably be a considerable addition to his fortune. But if it is of no value the advantage he can reap from it will be very small.

*Id.* at 83.

ous intellectual products while generating sufficient compensations for authors in proportion to the value of their works to society.<sup>111</sup> The market mechanism has the potential to work better in the digital environment where new technological tools have become available to measure consumer preferences more precisely.

Copyright piracy, however, obstructs the market signals through which authors could directly communicate with the audiences. Musicians engaging in new creation would be unable to take into consideration the preferences of those who consume pirated products. Accordingly, there is no guarantee that the works created would accurately match the tastes of the public.

With the signaling of audience preferences jammed by copyright piracy, an increasing number of musical works are created to accommodate the tastes of entrepreneurs, such as sponsors and advertisers, rather than those of average consumers. Although entrepreneurs should arguably be willing to take whatever is popular among music fans as a draw to their own products, the expectations of entrepreneurs and consumers do not always meet in a dynamic market setting. Firstly, viewing music merely as a promotional tool, corporate patrons are only interested in musical works that appeal to potential purchasers of the products endorsed or bundled.<sup>112</sup> The wider variety of musical preferences in the general public would be ignored or undervalued to the extent that they do not correlate to the marketing scheme of corporate patrons. Secondly, corporate patrons normally prefer music production that caters to mainstream tastes and interests in order to bolster the public image of their own products. As a result, there are much fewer opportunities for less commercial and controversial musicians.<sup>113</sup> Thirdly, the need to adapt to the advertising and sponsorship markets attaches more importance to non-musical qualities such as fresh appearance, healthy image, and acting ability, which to some extent marginalizes pure musicians who have less value in alternative markets. This change in talent searching criteria has

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<sup>111</sup> The “market approach” discussed here is more of *ex ante* justification in that it suggests how to allocate resources for the creation of intellectual products. This is different from *ex post* justification that teaches how to allocate existing intellectual products to their highest, socially valued uses. See Netanel, *supra* note 94, at 309. For the differences between *ex ante* and *ex post* justifications, see generally Mark A. Lemley, *Ex Ante versus Ex Post Justifications for Intellectual Property*, 71 U. CHI. L. REV. 129, 148-49 (2004).

<sup>112</sup> See Crampton, *supra* note 62 (“Warner Music soon plans to begin a talent search for members of a five-girl band to be called Mei Mei, with the winners signed up for a two-year contract to promote M&M candy.”).

<sup>113</sup> See Mark Godfrey, *Pop Piracy in China*, CLUAS.COM, Oct. 2003, [http://www.cluas.com/music/features/piracy\\_china.htm](http://www.cluas.com/music/features/piracy_china.htm) (“The safe-playing attitude of record companies has meant that original but more adventurous acts are enjoying much less record company attention.”).

contributed to the widespread use of lip-synchronization in various concerts and other important events supposedly to conceal the lack of musical talent of the performing “musicians,”<sup>114</sup> who are more accurately called “actors with microphones.”<sup>115</sup>

To summarize, the music industry that is mainly driven by corporate patronage has an alarming tendency to misinterpret consumer preferences and to compromise both the variety and quality of music production, because the value of music has to be indirectly measured by its ability to promote sales of other products to consumers who are not necessarily music audiences.

Even in an alternative market where the consumers of music and bundled products tend to overlap to a great extent (e.g., bundling MP3 players with music), the interests of music fans could still be compromised. The reason is that musicians ideally should be able to engage in price discrimination by lowering the price of MP3 players and accurately measuring consumer preferences via the amount of music consumed. Such price discrimination would therefore facilitate as the widest music consumption possible and meanwhile enable recoupment of the full value of music. However, the bundling market for the Chinese music industry essentially requires pricing music at zero and recouping music production costs through the increased prices of MP3 players. This actually reverses the conditions appropriate for price discrimination and increases the entry barrier for music audiences. Those who cannot afford the increased price of MP3 players would have to forgo all music consumption.

By following these three approaches, the above analysis demonstrates a sharp disparity between the empirical evidence and the hypothesis that piracy of foreign works only undermines the incentive to foreign authors. This disparity underscores an overlooked dimension of the incentive rationale: domestic works and foreign works are often good (albeit not perfect) substitutes for each other.<sup>116</sup> Consumption of foreign works, whether or not by means of pirated products, would also displace the demand for

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<sup>114</sup> For examples of lip synchronization by which the live singing of an performer is replaced by the pre-recorded voice of the same or another performer, see Mark Magnier, *China Abuzz over Lip-Syncing Singer in Olympics Opening Ceremony*, L.A. TIMES, Aug. 13, 2008, at 15, available at <http://www.latimes.com/sports/olympics/la-fg-lipsync13-2008aug13,0,5944370.story>.

<sup>115</sup> See Cui Jian, *I Don't Mind Being a Music Activist*, NEWS WKLY., Aug. 29, 2002, <http://www.chinanews.com.cn/2002-08-29/26/216930.html>.

<sup>116</sup> See Goldstein, *Copyright*, *supra* note 105, at 84 (stating that “[a]lthough we would prefer not to admit it, one author’s expression will always be substitutable for another’s”); also Edmund W. Kitch, *Elementary and Persistent Errors in the Economic Analysis of Intellectual Property*, 53 VAND. L. REV. 1727, 1730 (2000) (arguing that “copyrights do not prevent competitors from creating works with the same functional characteristics”).

domestic works. As a result, piracy of foreign works would likely impact domestic industries as much as (if not more than) foreign copyright owners. The high degree of substitutability between foreign and domestic works lies primarily in several legal doctrines in copyright law. In many countries, copyright protection only extends to expressions rather than to ideas in a work of authorship.<sup>117</sup> The idea/expression dichotomy suggests that a subsequent author could intentionally imitate a pre-existing work as closely as possible, provided the borrowing is limited to unprotected ideas. Another relevant feature of copyright law is the originality requirement, under which a fixed work of authorship would be eligible for copyright protection as long as it is created independently and with a “modicum of creativity.”<sup>118</sup> Furthermore, independent creation of a new work, even if it happens to be identical to a pre-existing one, would not constitute copyright infringement.<sup>119</sup> As permitted by these two copyright doctrines, similar works of authorship abound in the marketplace due to either deliberate imitation or coincidental repetitiveness.

There are also practical reasons that foreign works may take over the market shares of domestic works. Many consumers have a fixed budget for music consumption, which can only be spent on a certain quantity of music purchases regardless of whether the music is pirated or legitimate. More importantly, consumers only have less than twenty-four hours a day to enjoy music no matter how much they download. The more they listen to pirated music, the less likely they will listen to something else. In fact, time could become one of the most significant costs in association with music consumption, given that digital technology has drastically reduced the cost of production and distribution. Notably, language is not a significant market barrier for foreign music in China, not only because a large portion of the Chinese audiences are better educated nowadays, but also because the majority of foreign works marketed

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<sup>117</sup> It is not an overstatement that most countries recognize the idea/expression dichotomy since the TRIPS Agreement includes such a provision; see TRIPS, *supra* note 4, at art. 9(2) (“Copyright protection shall extend to expressions and not to ideas, procedures, methods of operation or mathematical concepts as such.”). For an introduction to the idea/expression dichotomy in China, see Jiarui Liu & Fang Fang, *The Idea/Expression Dichotomy in Cyberspace: A Comparative Study of Web Page Copyrights in the United States and in China*, 25 EUR. INTEL. PROP. REV. 504, 507-508 (2003).

<sup>118</sup> See *Feist Publ'ns, Inc., v. Rural Tel. Serv. Co.*, 499 U.S. 340, 346 (1991). For an introduction to the originality requirement in China, see Jiarui Liu, *Preserving Originality in Cyberspace: What China Can Learn from the United States and the European Union about Database Protection*, 6 J. WORLD INTEL. PROP. 593, 600 (2003).

<sup>119</sup> See *Sheldon v. Metro-Goldwyn Pictures Corp.*, 81 F.2d 49, 54 (2d Cir. 1936) (“[B]ut if by some magic a man who had never known it were to compose anew Keats’s Ode on a Grecian Urn, he would be an ‘author,’ and, if he copyright it, others might not copy that poem, though they might of course copy Keats’s.”).

there is not Western music but music from Hong Kong and Taiwan, areas that speak the same languages (Cantonese and Mandarin) as mainland China.

#### IV. A COPYRIGHT THEORY FOR EMERGING MARKETS

Various justifications for copyright, as well as for intellectual property in general, are regularly grouped around two loose labels, "natural right" and "utilitarianism," which are not always mutually exclusive in the copyright law of any particular culture.<sup>120</sup> The "natural right" rationale is considered dominant in continental Europe that follows Locke's labor theory and Hegel's personhood theory.<sup>121</sup> Starting from the premise that everyone has property in her own person and the labor of her own body, Locke suggested that one could acquire private property by the means of mixing natural resources with her own labor while leaving enough in common for others.<sup>122</sup> Accordingly, an author deserves a copyright in a work with which she mixed her intellectual labor. Hegel's writings implied that, because a work of authorship is the natural extension of the author's personality, the author should have a fun-

<sup>120</sup> See, e.g., GOLDSTEIN, *supra* note 72, at 136 (showing that the differences between the two rationales are more rhetoric than realistic); Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 TUL. L. REV. 991, 992 (1990) (explaining the early traces of "utilitarianism" in French copyright law and "natural right" in American copyright law). Notably, there is a worldwide trend of harmonization of natural right and utilitarian theories. On the European side, see Council Directive 93/98, Harmonizing the Term of Protection of Copyright and Certain Related Rights of 29 October 1993, pmbl. 10, 1993 O.J. (L 290) 9 (EEC) ("[Copyright] protection ensures the maintenance and development of creativity in the interest of authors, cultural industries, consumers and society as a whole."). On the U.S. side, see Peter Jaszi, *Caught in the Net of Copyright*, 75 OR. L. REV. 299, 302-04 (1996) (discussing the natural law elements in Information Infrastructure Task Force, Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights (1995)); Alfred C. Yen, *Restoring the Natural Law: Copyright as Labor and Possession*, 51 OHIO ST. L.J. 517 (1990) (providing a thorough treatment of natural law influences in pre-Internet American copyright law).

<sup>121</sup> See, e.g., Wendy J. Gordon, *A Property Right in Self-Expression: Equality and Individualism in the Natural Law of Intellectual Property*, 102 YALE L.J. 1533 (1993) (providing a focused treatment of the Lockean theory in the context of intellectual property); Neil Netanel, *Copyright Alienability Restrictions and the Enhancement of Author Autonomy: A Normative Evaluation*, 24 RUTGERS L.J. 347 (1993) (providing a tremendous application of Hegelian theory to copyright law); Justin Hughes, *The Philosophy of Intellectual Property*, 77 GEO. L.J. 287 (1988) (providing an excellent introduction to both Lockean and Hegelian theories of intellectual property).

<sup>122</sup> See JOHN LOCKE, TWO TREATISES OF GOVERNMENT, SECOND TREATISE, §§ 25-51 (Peter Laslett ed., Cambridge Univ. Press 2d ed. 1967) (1690):

Though the Earth, and all inferior Creatures be common to all Men, yet every man has a Property in his own Person. This no Body has any Right to but himself. The Labour of his Body and the Work of his Hands, we may say, are properly his. Whatsoever then he removes out of the State that Nature hath provided, and left it in, he hath mixed his Labor with, and joyned [sic] to it something that is his own, and thereby makes it his Property.

Id. § 27.

damental personal right to decide whether, when, and how to communicate her work to the general public.<sup>123</sup> In summary, the “natural right” approach proposes that an author has a natural entitlement to her work of authorship as an extension of her labor and personality.

The “utilitarianism” approach, which emphasizes more the role of copyright law as a means to achieve the end of social welfare, is the foundation of Anglo-American copyright regimes. For example, the Statute of Anne, the first copyright statute in human history, was titled with a clear utilitarian bias: “An Act *for the Encouragement of Learning*, by Vesting the Copies of Printed Books in the Authors or Purchasers of Such Copies, during the Times therein mentioned.”<sup>124</sup> The U.S. Constitution likewise declares that “The Congress shall have power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”<sup>125</sup> As the legislative history of the U.S. Copyright Act further explains,

[t]he enactment of copyright legislation by Congress under the terms of the Constitution is not based upon any natural right that the author has in his writings . . . but upon the ground that the welfare of the public will be served and progress of science and useful arts will be promoted . . .<sup>126</sup>

The incentive rationale that justifies the grant of exclusive rights as a means to avoid underproduction of information goods fits squarely into the utilitarian approach to copyright law.<sup>127</sup>

Chinese Copyright Law, on its face, appears to echo both the “natural right” and “utilitarianism” theories:

<sup>123</sup> See generally GEORG WILHELM FRIEDRICH HEGEL, HEGEL'S PHILOSOPHY OF RIGHT 41-45 (T. M. Knox trans., Oxford Univ. Press 1967) (1821) (“Attainments, eruditions, talents, and so forth, are, of course, owned by free mind and are something internal and not external to it, but even so, by expressing them it may embody them in something external and alienate them.”). *Id.* at 41.

<sup>124</sup> Statute of Anne, 8 Ann., ch. 19 (1710), available at <http://www.copyrighthistory.com/anne.html> (emphasis added).

<sup>125</sup> U.S. CONST. art. I, § 8, cl. 8 (emphasis added).

<sup>126</sup> H.R. REP. No. 60-2222, at 7 (1909). For the U.S. Supreme Court's interpretations of copyright justification, see, e.g., *Sony Corp. of Am. v. Universal City Studios, Inc.* 464 U.S. 417, 429 (1984) (“The monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved. It is intended to motivate the creative activity of authors . . . by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired.”); *Mazer v. Stein*, 347 U.S. 201, 219 (1954) (“The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in ‘Science and useful Arts.’”); *U.S. v. Paramount Pictures*, 334 U.S. 131, 158 (1948) (“The copyright law, like the patent statutes, makes reward to the owner a secondary consideration.”).

<sup>127</sup> See *supra* notes 91-96 and accompanying text.

This Law is enacted, in accordance with the Constitution, for the purposes of *protecting the copyright of authors* in their literary, artistic and scientific works and the rights related to copyright, of *encouraging the creation and dissemination of works* which would contribute to the construction of socialist spiritual and material civilization, and of *promoting the development and flourishing of socialist culture and sciences*.<sup>128</sup>

Nevertheless, it has been pointed out as the root of the piracy problem is that China lacks the natural law tradition essential for fostering the growth of intellectual property institutions, despite the wholesale transplantation of modern copyright concepts from Western countries.<sup>129</sup> Confucian ethics dominant in the Chinese tradition attach utmost importance to transmission of older teachings rather than innovation.<sup>130</sup> Indigenous forms of legal prohibition against unauthorized reproduction did not arise from recognition of private property or personal rights, but merely reflected state attempts to control dissemination of ideas and maintain empire power. Leaving aside the academic debates over the accuracy of historical narratives,<sup>131</sup> it is, however, fair to say that state censorship was also a recurring theme in the early history of copyright law in Western civilization,<sup>132</sup> and Asian countries follow-

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<sup>128</sup> See Copyright Law, art 1 (P.R.C.), available at <http://www.chinaiprlaw.com/english/laws/laws5.htm> (translation by the National Copyright Administration of China) (emphasis added). See also XIAN FA art. 47, (1992) (“Citizens of the People’s Republic of China have the freedom to engage in scientific research, literary and artistic creation and other cultural pursuits. The state encourages and assists creative endeavors conducive to the interests of the people made by citizens engaged in education, science, technology, literature, art and other cultural work.”), available at <http://english.people.com.cn/constitution/constitution.html>.

<sup>129</sup> See WILLIAM P. ALFORD, *TO STEAL A BOOK IS AN ELEGANT OFFENSE: INTELLECTUAL PROPERTY LAW IN CHINESE CIVILIZATION* 19-23 (1995) (contending that virtually all examples of efforts by the state to provide protection for intellectual property in China prior to the twentieth century seem to have been directed overwhelmingly toward sustaining imperial power).

<sup>130</sup> Alexander C. Chen, Note, *Climbing the Great Wall: A Guide to Intellectual Property Enforcement in the People’s Republic of China*, 25 *AIPLA Q.J.* 1, 10 (1997) (indicating that Confucianism provided strong barrier to the development of intellectual property in China); Andrew Evans, *Taming the Counterfeit Dragon: The WTO, TRIPS and Chinese Amendments to Intellectual Property Laws*, 31 *GA. J. INT’L & COMP. L.* 587, 588-90 (2003) (suggesting that Confucian ethics has been a philosophical obstacle to combating Chinese counterfeiting and piracy).

<sup>131</sup> See ZHENG CHENGSI, *INTELLECTUAL PROPERTY LAW: A NUMBER OF RESEARCH FOCUSES AT THE BEGINNING OF THE NEW CENTURY* 154-58 (2004) (arguing that ancient China provided a copyright-like protection against book piracy out of respect for authorship rather than maintenance of state censorship); Charles R. Stone, *What Plagiarism Was Not: Some Preliminary Observations on Classical Chinese Attitudes Toward What the West Calls Intellectual Property*, 92 *MARQ. L. REV.* 199, 230 (2008) (arguing that “[t]he assertion that China did not develop intellectual property rights for the written word because the Confucian tradition did not consider the provenance of borrowed material important is therefore not persuasive.”).

<sup>132</sup> See BENJAMIN KAPLAN ET AL., *AN UNHURRIED VIEW OF COPYRIGHT* 4 (Matthew Bender & Co. 2005) (1967) (“[C]opyright has the look of being gradually secreted in the interstices of the censorship.”).

ing Confucian values were by no means exceptional in this regard. In any event, this cultural perspective is more helpful in explaining why intellectual property institutions did not emerge spontaneously in ancient China than in tackling the persistence of rampant piracy in modern China.<sup>133</sup> Remarkably, the fact that Taiwan and South Korea are also deeply rooted in the Confucian tradition does not prevent them from offering intellectual property protection in a far more effective way. As indicated earlier, the piracy level in China is over two times higher than in Taiwan and over six times higher than in South Korea.<sup>134</sup> This comparison indicates that the residual influence of Confucian heritage does not necessarily account for the contemporary piracy problem.

Although there is copyright literature arguing that the Chinese intellectual property regime is more reflective of utilitarian concerns,<sup>135</sup> the cost and benefit calculation inherent in the utilitarianism approach does not lead to a straightforward answer for China. As discussed above,<sup>136</sup> many Chinese people including governmental officials tend to believe that a high level of copyright protection would primarily benefit foreign companies and has little relevance to domestic interests since copyright piracy mostly targets foreign works. In addition, the insufficiency in intellectual property protection does not appear to pose any meaningful deterrence to the flow of foreign investment aimed mainly to take advantage of the low labor cost and the large market size in China.<sup>137</sup> In any event, copyright is much less useful than patent and trade secret for the encouragement of technology transfers, upon which the Chinese government places a high premium.<sup>138</sup>

On the other hand, it has been stressed that the existence of

<sup>133</sup> It is sometimes argued that Confucian ethics might help rather than impede the development of an effective intellectual property regime in China. See, e.g., Wei Shi, *The Paradox of Confucian Determinism: Tracking the Root Causes of Intellectual Property Rights Problem in China*, 7 J. MARSHALL REV. INTELL. PROP. L. 454, 467 (2008) (“The rampant [intellectual property rights] enforcement problem is not due to the existence, but rather, due to the decline of the Confucian values.”).

<sup>134</sup> See Exhibit Two, *supra* p. 627.

<sup>135</sup> See, e.g., Eric Priest, *The Future of Music and Film Piracy in China*, 21 BERKELEY TECH. L.J. 795, 819 (2006); Cui Guobin, *A Critical Review of the Lawmaking by Intellectual Property Judges*, CHINA LEGAL SCIENCE, Issue I (2006) (on file with author).

<sup>136</sup> See *supra* note 2 and accompanying text.

<sup>137</sup> For the relationship between intellectual property protection and foreign investment, see, e.g., Carlos A. Primo Braga & Carsten Fink, *The Relationship Between Intellectual Property Rights and Foreign Direct Investment*, 9 DUKE J. COMP. & INT’L L. 163 (1998); Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT’L L. 109 (1998).

<sup>138</sup> See Priest, *supra* note 135 at n.246 (arguing that “[t]he government apparently considers patents to be most essential to China’s overall economic growth and stability than copyright.”).

copyright piracy might in many ways be helpful for the domestic growth in China.<sup>139</sup> For instance, copyright piracy, by driving the prices of copyrighted works to the marginal costs, apparently helps widen access to knowledge and lower barriers to education,<sup>140</sup> especially for the average Chinese person whose annual income is less than one thousand U.S. dollars.<sup>141</sup> In addition, copyright piracy is at times considered a powerful boost to local economies. It is reported that, in certain areas, piracy businesses actually account for a substantial portion of local commerce, creating job opportunities for residents and tax revenues for the government.<sup>142</sup> It is therefore not inconceivable that, faced with serious challenges to social stability, including high unemployment rate and rural-urban gulf and public health problems, the Chinese government finds it difficult to justify making copyright protection one of the top priorities of the country.<sup>143</sup>

While neither a natural right tradition nor a self-interest motivation provides an adequate explanation for the rapid development of Chinese copyright law, the legislative history reveals that international pressure is likely to be the principal driving force behind major legislative initiatives in the copyright regime.<sup>144</sup> In the early 1990s, the trade threat from the United States and the desire to join the Berne Convention gave rise to the first Copyright Law as well as the first Computer Software Protection Regulation in the People's Republic of China.<sup>145</sup> These two statutes were subsequently amended in 2001 as a result of China's efforts to enter into WTO and comply with the TRIPS agreement.<sup>146</sup> In 2006, the Regu-

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<sup>139</sup> See Chow, *supra* note 2 at 219.

<sup>140</sup> See, e.g., Jing Zhang, *supra* note 106, at 28-29 (discussing how those that have free speech concerns may be sensitive about the negative effects of rigid copyright enforcement).

<sup>141</sup> For relevant statistics, see CHINA POPULATION INFORMATION AND RESEARCH CENTER, 2006 CHINESE RESIDENTS INCOME DISTRIBUTION ANNUAL REPORT (2006), [http://www.cpirc.org.cn/tjsj/tjsj\\_cy\\_detail.asp?id=7938](http://www.cpirc.org.cn/tjsj/tjsj_cy_detail.asp?id=7938).

<sup>142</sup> See DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 440 (2003) (describing that in Yiwu, China "[i]t is no exaggeration to say that the entire local economy . . . is built on the trade in counterfeit and pirated goods and that shutting down this illegal trade would be tantamount to shutting down the local economy.").

<sup>143</sup> *Id.* at 442 ("Any decision by central authorities to suppress local protectionism will involve significant political and social costs at a time when the PRC faces many difficult problems competing for the limited resources of the central government.").

<sup>144</sup> See Peter Jaszi, *Caught in the Net of Copyright*, 75 OR. L. REV. 299, 306-307 (1996) ("Often in recent years, as I've suggested, we are told that we must enact this or that piece of domestic copyright legislation, even at the cost of curtailing public access, in order to 'keep up' with developing international norms."). Interestingly, among a long list of countries that recently revised their copyright laws in accordance with international standards was the United States.

<sup>145</sup> See Peter K. Yu, *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*, 50 AM. U. L. REV. 131, 141-42 (2000).

<sup>146</sup> See XUE HONG & ZHENG CHENGSI, CHINESE INTELLECTUAL PROPERTY LAW IN THE 21ST

lation for the Protection of Right of Communication over Information Network took effect as part of China's preparation to sign the WIPO Copyright Treaty ("WCT") and the WIPO Performance and Phonogram Treaty ("WPPT").<sup>147</sup> Due to mounting international pressure, China is among one of the few countries that has established a modern copyright framework in an extremely short period of time.<sup>148</sup>

The conflict between international pressure and domestic perception creates a "legal collusion" with respect to copyright enforcement in China.<sup>149</sup> On paper the Chinese government constantly updates copyright statutes to conform to international standards. In reality, however, enforcement authorities, including the courts and administrative bodies, without true appreciation of the value of copyright protection<sup>150</sup> only implement such statutes half-heartedly by means of sporadic enforcement campaigns and modest penalties.<sup>151</sup> Pirating enterprises are consequently undeterred by copyright law and are willing to take the risk of legal penalties as part of the costs of doing business. This legal collusion inevitably gives rise to a huge gap between copyright law on the books and copyright law in action.

The empirical findings in this article have the potential to break this legal collusion. The evidence shows that, contrary to

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CENTURY 5 (2002).

<sup>147</sup> China joined the WCT and WPPT on July 9, 2007, one year after the enactment on July 1, 2006 of Regulation for the Protection of Right of Communication over Information Network.

<sup>148</sup> Rafael A. Declat, Jr., *Protecting American Intellectual Property in China: The Persistent Problem of Software Piracy*, 10 N.Y. INT'L L. REV. 57, n.18 (1997) ("[Chinese copyright laws] [have] cover[ed] in a little more than a dozen years, a distance which took other developed countries scores of years, even a hundred years, establishing a relatively comprehensive legal system for the protection of intellectual property rights.") (quoting on official statement of China's State Council in WHITE PAPER, INTELLECTUAL PROPERTY PROTECTION IN CHINA (June 16, 1994), translated in BBC Summary of World Broadcasts (June 20, 1994)).

<sup>149</sup> "Legal collusion" refers to the conspiracy of relevant interested parties (sometimes including law enforcement) to bypass legal requirements. For examples outside of the copyright arena, see LAWRENCE M. FRIEDMAN, *AMERICAN LAW IN THE 20TH CENTURY* 436 (2002) (describing collusion under the fault-based divorce law); Xin He, *Why Do They Not Comply with the Law? Illegality and Semi-Illegality Among Rural-Urban Migrant Entrepreneurs in Beijing*, 39 LAW & SOC'Y REV. 527, 532 (2005) (discussing collusion under the business permit regime in China).

<sup>150</sup> The judiciary system is not independent in China. The administration controls its finance and personnel allocation. See Veron Mei-Ying Hung, *China's WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform*, 52 AM. J. COMP. L. 77, 100-01 (2004) (describing the problem of China's lower courts' lack of resources, education, and training in the area of high-tech knowledge).

<sup>151</sup> See, e.g., Gregory S. Feder, *Enforcement of Intellectual Property Rights in China: You Can Lead a Horse to Water, But You Can't Make It Drink*, 37 VA. J. INT'L L. 223 (1996) (discussing the insufficiency of China's effort to enforce her domestic intellectual property laws and to discharge her international obligations); Glenn R. Butterton, *Pirates, Dragons and U.S. Intellectual Property Rights in China: Problems and Prospects of Chinese Enforcement*, 38 ARIZ. L. REV. 1081 (1996) (providing economic and cultural explanations for China's intellectual property enforcement problems).

conventional wisdom, piracy of *foreign* works could impose a formidable threat to the livelihood of domestic industries in the same way that piracy of *domestic* works does. Furthermore, ill-advised toleration of piracy by law enforcement will likely end up contributing to the dominant position of multinational companies in the home market.

First, multinational companies generally have better financial abilities to withstand piracy in an emerging market for a prolonged period of time, much longer than domestic companies are able to hold out. Multinational companies by definition have multiple markets around the world. Barring parallel import, copyright piracy in an emerging market generally has no more of an impact on multinational companies than the loss of market share in that particular market. Such piracy would not significantly affect their overall financial soundness as long as they may continue to reap investment through sales in their home markets and/or other major markets (e.g., the United States, Europe, and Japan). By contrast, smaller domestic companies are usually confined to the home market, where their inability to secure their copyrights and to make profits would entirely cut off their sources of livelihood.<sup>152</sup> To this extent, domestic producers are more likely to be driven out of the market at early stages.

Second, copyright piracy could create a variety of market entry barriers for domestic companies. The shortage of music sales and an overreliance on the popularity of musicians to explore alternative markets would significantly increase the risk of investment in new talents and prolong the process of recouping investment (if ever). Under such circumstances, potential competitors would not enter the market without the prospect of survival for a substantial period of time before recovering the initial fixed costs. This would naturally deter smaller domestic companies that have less staying power to weather the storm of copyright piracy.

In addition, the long-term consumption of pirated products, which are predominantly foreign works, would likely shape the listening habits of the Chinese audiences to form natural entry barriers. For instance, music fans would more likely become entrenched with or addicted to the tastes of foreign works. They would also be inclined to build up their loyalties around foreign artists. Herd mentality and the resulting collective unconscious-

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<sup>152</sup> There are also examples outside of the music industry. For instance, devastated by software piracy, many domestic software companies had to give up their own R&D and became OEM factories of foreign software developers. See Jiarui Liu, *New Development in Digital Copyright Protection in China: The Landmark Case of Zheng Chengsi v. Shusheng*, 28 EUR. INTELL. PROPR. REV. 299 (2006).

ness would reinforce the star powers of foreign artists.<sup>153</sup> Though China should eventually change gears in copyright enforcement and manage to foster a healthier market environment for music production, once Chinese consumers are somehow “locked in” with foreign music, it will take much longer, to say the least, for Chinese musicians to crack the “hard shell” of consumer entrenchment even if China should eventually change gears in copyright enforcement and manage to foster a healthier market environment for music production.

Third, compared to foreign companies, the competitive advantage of domestic producers is supposed to be the low fixed costs of creation, including labor and infrastructure costs. However, such an advantage disappears when copyright piracy has driven the prices of musical works close to the marginal costs, which are naturally insensitive to the difference in fixed costs and are usually identical for both foreign and domestic works.

A Chinese official once told his counterpart in the U.S. Copyright Office that “China will begin to enforce copyright when it is in China’s national interest to enforce copyright.”<sup>154</sup> If such a statement holds true, this article will be able to provide an economic underpinning as well as an intrinsic incentive for China and other similarly developing countries to establish a robust copyright regime wholeheartedly. The purpose of this potentially powerful incentive is to prevent domestic music companies and consumers from falling prey to uncontrolled copyright piracy. The empirical evidence suggests that the improvement of the copyright regime in China matters more for domestic authors than to foreign multinationals. Keeping this in mind, the Chinese government would likely be more reluctant to gamble the future of the Chinese music industry for the short-term gains from piracy-based economies.

On a related note, the effects of copyright piracy may also be useful as a benchmark for evaluating a particular enforcement mechanism. For instance, Chinese copyright law is characterized with a bifurcated enforcement regime where an aggrieved copyright owner may file a complaint to either the judiciary or to the administrative authority. In the latter case, the administrative authority leads the investigation of the alleged infringement and has

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<sup>153</sup> For further discussions of herd mentality and collective unconsciousness, see generally David Throsby, *The Production and Consumption of the Arts: A View of Cultural Economics*, 32 J. ECON. LITERATURE 1, 3 (1994) (analyzing taste addiction in connection with the consumption of artistic works); Sushil Bikhchandani, et al., *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. POL. ECON. 992 (1992) (explaining herd behavior by informational cascades).

<sup>154</sup> See Ralph Oman, *Copyright Piracy in China*, 5 J. MARSHALL REV. INTELL. PROP. L. 583, 586 (2006).

a quasi-judicial power to issue a penalty decision ordering injunction, forfeiture of infringing products/tools and illegal profits, and/or payment of a monetary fine (but not damages). There is never a shortage of harsh criticisms against this public enforcement mechanism, which is often accused of wasting administrative resources and lacking due process safeguards.<sup>155</sup> By quoting the TRIPS Agreement, some observers have pointed out that copyrights are essentially private rights so that copyright owners should protect their private rights at their own expense rather than at the expense of taxpayers.<sup>156</sup>

The findings of this article might arguably supply a justification for public enforcement under certain circumstances. If uncontrolled piracy is proven to have devastating effects on domestic industries and consumers, then the spending of tax money on copyright protection appears to be a necessary evil for the preservation of local markets rather than for the sole benefit of aggrieved copyright owners. In addition, by narrowing the public enforcement only to cases involving such “public interests,”<sup>157</sup> the authority would be able to focus administrative resources on copyright piracy that truly warrants governmental interference, thereby alleviating the concerns of abusing discretion and lacking due process.

## VI. CONCLUSION

Copyright protection has increasingly become an international concern due to the worldwide nature of the Internet. As demonstrated by recent P2P cases,<sup>158</sup> copyright enforcement is rarely effective if online pirates can find shelter simply by migrating to low-protection countries. Although various international treaties have harmonized national copyright laws at a rather high level, many developing countries only reluctantly accepted harmonization as a trade-off in international trade negotiations. As such,

<sup>155</sup> See PETER FENG, *INTELLECTUAL PROPERTY IN CHINA* 90 (2d ed. 2003); SANQIANG QU, *COPYRIGHT IN CHINA* 400 (2002).

<sup>156</sup> See Tang Guangliang, *Intellectual Property Protection Is the Obligation of Right Holders*, STATE INTELL. PROP. OFFICE OF P.R.C., June 5, 2009, [http://www.sipo.gov.cn/sipo2008/mtjj/2005/200804/t20080401\\_362718.html](http://www.sipo.gov.cn/sipo2008/mtjj/2005/200804/t20080401_362718.html).

<sup>157</sup> See NAT'L COPYRIGHT ADMIN. OF P.R.C., MEASURES OF COPYRIGHT ADMINISTRATIVE ENFORCEMENT (promulgated Jul. 6, 2003, effective Sept. 1, 2003) art. 3, *available at* <http://www.ncac.gov.cn/GalaxyPortal/inner/bqj/include/detail.jsp?articleid=9436&boardid=176&boardid=11501010111602>.

<sup>158</sup> *Compare* *Buma & Stembra / Kazaa*, *Gerechtshof [Hof] [Court of Appeals], Amsterdam*, 28 maart 2002, LJN-nummer AE0805 (Neth.), *available in English at* [http://w2.eff.org/IP/P2P/BUMA\\_v\\_KAZAA/20020328\\_kazaa\\_appeal\\_judgment.html](http://w2.eff.org/IP/P2P/BUMA_v_KAZAA/20020328_kazaa_appeal_judgment.html) *and* *Universal Music Austl. Proprietary Ltd. v. Sharman License Holding Ltd.* [2005] F.C.A. 1242 (Austl.), *available at* [http://www.austlii.edu.au/au/cases/cth/federal\\_ct/2005/1242.html](http://www.austlii.edu.au/au/cases/cth/federal_ct/2005/1242.html).

copyright rules, no matter how ideal on paper, are not implemented wholeheartedly in practice, absent true appreciation of the value of copyright by domestic industries, therefore creating loopholes in the international copyright market.<sup>159</sup>

It is also understandable that developing countries appear to be more interested in stronger international protection of traditional knowledge, folklore, and generic resources, given that many countries attach utmost importance to their own histories and traditions.<sup>160</sup> Nevertheless, the future of their cultural heritage largely lies in the hands of a carefully crafted copyright regime that is capable of providing powerful incentive to sustain long-term creativity. Furthermore, the advent of digital technology actually creates plenty of opportunities for developing countries to make strides in the copyright industries. Digital technology has drastically reduced the infrastructure investment required for initial market entry as costly production lines, distribution channels, and retail shops have in many cases been replaced by several clicks on the mouse.<sup>161</sup> Equipped with low-cost creative tools, indigenous artists are now in a much better position to compete with their Western counterparts, especially in the domestic market where they enjoy unparalleled cultural advantages. However, a misguided copyright policy would likely overshadow the digital future of domestic copyright industries.

Chinese bureaucrats often seem to believe that when foreign works are dominant in the domestic market, a high level of copyright protection primarily serves the interests of foreign firms and a toleration of piracy helps boost local economies. Without getting into moral debates, this Article demonstrates that such a viewpoint is fundamentally flawed even from a purely pragmatic and self-interested perspective. By pointing to the fact that the piracy of foreign works poses a threat to the livelihood of domestic authors in a more formidable way than to foreign firms, this Article supplies a compelling reason for developing countries to tighten up copyright enforcement and create a healthy legal environment for the sustainable development of indigenous cultural industries.

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<sup>159</sup> See, e.g., Butterson, *supra* note 151; Patrick H. Hu, "Mickey Mouse" in China: Legal and Cultural Implications in Protecting U.S. Copyrights, 14 B.U. INT'L L.J. 81, 99 (1996); Brent T. Yonehara, *Enter the Dragon: China's WTO Accession, Film Piracy and Prospects for the Enforcement of Copyright Laws*, 9 UCLA ENT. L. REV. 389, 404-05 (2002).

<sup>160</sup> See PAUL GOLDSTEIN, INTERNATIONAL INTELLECTUAL PROPERTY LAW: CASES AND MATERIALS 88 (2d ed. 2008).

<sup>161</sup> For a brief introduction on digital technology, see BRUCE A. LEHMAN, INTELLECTUAL PROPERTY AND THE NATIONAL INFORMATION INFRASTRUCTURE: THE REPORT OF THE WORKING GROUP ON INTELLECTUAL PROPERTY RIGHTS 7-17 (1995).