

## The Value of Free Music

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The economics of the internet rewards those who share. Recently businesses are finding that it is possible to make money by giving something away. What may have been considered a radical experiment ten years ago is now the foundation for multi-million dollar web services like Google and Facebook. Resulting from low start-up costs and global expanse, the concept of 'free' is spreading, prices are falling and competition is rising. The music industry has yet to adapt to this trend, meanwhile the availability of digital music has led to a sharp devaluing of CD sales (Smith). Yet, instead of evolving with technology, the record labels are still charging disproportionately high prices for music and aggressively enforcing antiquated copyright law. The unwillingness of the labels to evolve is stunting the growth of the bands they represent because they are attempting to restrict music from virally spreading around the internet. Making music free exposes musicians to a larger audience and generously rewards them.

### **Attention Is Valuable – and Scarce**

As a direct result of the exposure provide by the internet, thousands of previously unknown musicians around the world are reaching global audiences. Whereas in the past if a musician wanted to have their album reach the world, distribution and renting studio time would have cost tens of thousands of dollars, nowadays this can be accomplished in much less time and for much less money by anyone who owns recording software and has access to the internet. It is more difficult than ever for musicians to attract new listeners.

In response to this dilemma some musicians have begun releasing full length albums as free legal downloads. Radiohead is often credited as one of the first bands to attempt this experiment. In October of 2007 they released the album *In Rainbows* as a download only release. They shocked the music industry by allowing customers to choose their own price, but gained the respect of their fans. The release was also well received by the media, earning Radiohead far more exposure than they ever would have garnered from the traditional album release.

If up-and-coming musicians place limits on who can listen to their music they risk never being heard. Among musicians there already exists the paradox that the absolute greatest band in the world could exist, but no one will ever hear of them. This idea has previously been the case, but now it's true for different reasons. Twenty years ago a band would release an album and find their greatest challenge was getting radio play. Today there is infinite airtime available on the internet and musician are competing for the consumer's attention. The consumer now has an almost infinite amount of choice. Marketing expert Seth Godin describes the change:

“I could get in the car, turn on the radio and hear a song I wasn't expecting and maybe I would like it. If I didn't like it, it didn't cost [the record labels] anything anyway. Now it's about permission. Now I get on the radio and in my car I have either my mp3s in there or I have satellite in there, I don't hear anything I don't want to hear. So, the model has totally changed.”

The dilemma of obscurity is best dramatized in Jorge Luis Borges's 1941 short story "The Library of Babel". Borges's library is an infinite expanse of bookshelves containing every book that could possibly be written, past or future, and in any language, including nonsensical languages. The library also

includes books that are almost exactly identical with the exception of one character, thus leading to versions with practically unnoticeable error. Yet among incalculable irrelevance lie the most radiant works of art. Nonetheless, as a result of overwhelming choices, a librarian in Borges's library wouldn't have the ability to find books of true value, unless by chance she were to find, as Borges describes it, "a book which is the cipher and perfect compendium of all the rest: some librarian has perused it, and it is analogous to a god" (85).

Applying Borges's library as an exaggerate metaphor for the vast amount of information on the internet, it wouldn't seem unreasonable to say that Google is an unperfected "compendium of all the rest." Taking lessons from Google's search algorithm we will learn that actually finding reliable information comes from ubiquity and reputation. For example, the more other people around the internet cite your name and link to your work the more valuable it becomes. If musicians want to reach the largest audience possible they need more people sharing, blogging and talking about their music.

This idea is further expounded on by Kevin Kelly in his book *New Rules for the New Economy*. In a scientific analysis of how the network rewards generosity he explains,

"Ubiquity drives increasing returns in the network economy. The question becomes, what is the most cost-effective way to achieve ubiquity? And the answer is: give things away. Make them free" (57).

Kelly also supports the theory that giving away one product for free can increase the value of another product you sell. Luckily, musicians are beginning to realize this as well.

In addition to Radiohead, hundreds of bands are partaking in this "experiment" as they have begun releasing digital copies of their music for free. In March of 2008 Nine Inch Nails released their album *Ghosts I-IV*. Despite the album being a free download, Nine Inch Nails brought in \$1.6 million in the first week of releasing the album (Harding).

Other notable acts continuing the trend of free music include Saul Williams, Harvey Danger, The Charlatans UK and Black Kids. Harvey Danger, a band that formed in 1992 and gained celebrity status in 1998 with the single "Flagpole Sitta", made the following statement regarding the free release of their latest album "Little by Little...":

"Even with the proliferation of websites and magazines paying attention to independent music these days, it remains difficult for bands—especially rock bands—to get exposure, regardless of how good they may be (or how successful they once were). Making the record freely downloadable removes the main barrier that exists between an artist and the world of potential listeners. And we do mean world; the web's reach is everywhere."

Although only a small percent of musicians are actively promoting free digital downloads, an abundance of free and legal streaming music is easily accessible on hundreds of websites. For example, sites like MySpace; Last.fm and seekpod.com offer complete tracks of streaming music from tens of thousands of

musicians. Jamendo.com goes further by offering fully downloadable albums for free from over four-thousand independent artists under Creative Commons licenses. Clearly there is no scarcity of music - only a scarcity of attention.

### **Charging for Music Is a Barrier to Attention**

“Practically everything web technology touches starts down the path to gratis,” explains Chris Anderson, editor-in-chief of Wired Magazine and author of an upcoming book detailing why free is the future of business (144). He notes that when a tangible product can be effectively distributed as an intangible product, we consume it differently. Production costs become less, delivery and storage fees dwindle, and eventually so does market value. Many products once sold for a profit are now free in their digital incarnations: stock quotes, maps, encyclopedias, etc. This trend has already transformed myriad industries, and made others completely obsolete.

Google has anticipated this continuing price depreciation by offering most of their online applications at no cost to consumers. Before Gmail launched in 2004, offering 1GB of email storage, competitors like Yahoo offered only 4MB (256 times less). Three years later, Yahoo has followed the trend and offers “unlimited” email storage. Those who can recognize consumer trends early have the most to benefit. This strategy has been a key factor in establishing Google’s dominance in various online markets. Google uses free products to reach a wider audience, and then they leverage this initial investment by selling alternative products and through advertising. As the price consumers are willing to pay for CDs drops, musicians should anticipate this trend in the music industry and use their recorded music to reach wider audiences.

In Adam Smith’s 1776 publication, *The Wealth of Nations*, he maintains that the “real price of everything...is the toil and trouble of acquiring it.” That is to say that the price of a product is relative to the effort necessary to produce it. The economics of marginal cost pricing support Smith’s theory and illustrate that in a competitive market, prices will fall to marginal cost. Recently, the distribution and manufacturing costs of recorded music have dropped to an all time low. In accordance with this basic economic principle: as the marginal cost of recorded music approaches zero, the price tag should also approach zero.

Another principle used to determine value, especially when dealing with technology, is Moore’s Law. Moore’s Law projects that computer chips generally halve in price and double in processor speed every 18 months. This trend is often cited as an explanation and prediction of price drops in other industries, including the automobile, electronics, and online businesses.

Surprisingly, while the general descent toward free has perhaps transformed how customers value physical albums, the major labels lag behind, struggling to come up with a sound internet distribution model.

The prospect of music file sharing presents a serious problem for the record labels, whose profit comes predominantly from CD sales (Rapaport) . Yet, as explained in the next section, demonetizing music

doesn't pose a large threat to *musicians*—because musicians already earn the bulk of their income without relying on CD sales.

### **Understanding Cross Subsidies**

As more music is distributed digitally the overhead once paid for plastic cases, warehouses and delivery trucks is disappearing, and thus the need to recoup those losses by overcharging for CDs becomes unnecessary. As interpreted by former Talking Heads frontman David Byrne, “Theoretically, as many of these costs go away, they should no longer be charged to the consumer—or the artists.”

It's plausible that musicians could eliminate their dependency on record labels altogether if they self-distribute their music, meanwhile continuing to amass income from ancillary sources. In line with Kevin Kelly's argument on ubiquity, if musicians give away their music for free they will amass greater returns.

The greater return for musicians will come from cross-subsidies. Through the typical standard distribution deal agreed on between most musicians and the labels, the musician agrees to a smaller amount of profit from album sales in exchange for a higher return in external sources of income. In economics this is known as a cross-subsidy: earning less on 'Product A' in order to promote 'Product B', where in the end overall earnings exceed the cost. Wal-Mart does this by offering DVDs below cost in order to lure you into their store (Anderson 148). They assume people will buy other products while in the store, thereby eclipsing the loss taken from underselling DVDs. To draw a parallel, musicians can undersell their album (or give it away as I'm arguing) and assume people will buy other products.

Touring, merchandising and licensing are have proven to be valuable products for musicians. Accordingly, it would be more advantageous to develop those assets regardless of how well albums sell.

Improvements in technology afford musicians that opportunity. The cost of recording, distributing and marketing an album is continuing to drop, thereby releasing musicians from their dependency on the record label and offering alternatives to physical media distribution.

### **Musicians Already Rely On Cross-Subsidies**

Traditionally, musicians earn very little from CD sales thereby making it reasonable for musicians to sacrifice royalties for a larger audience. Although the retail price of an album typically fluctuates around the \$15.00 mark, most musicians never see more than 6% (\$1.00) from each album sale. Over the last few decades, 94% of album-generated revenue has been procured by record labels in order to recoup distribution and manufacturing costs (Byrne 140). Accordingly, this has caused professional musicians to rely on external income. The revenue musicians earn from touring, merchandise and licensing has been, and will continue to be, greater than the revenue earned from selling CDs.

An NPR interview with The Dresden Dolls from 2007 documents the importance of these cross-subsidies. Singer Amanda Palmer explains that the bulk of their income is from merchandise sales. Palmer explains, “We make almost no money off our recordings.” She goes on to explain about the value of other profitable measures such as music licensing and how they earned \$40,000 from allowing their song “Coin-Operated Boy” to be in a TV ad in Austria.

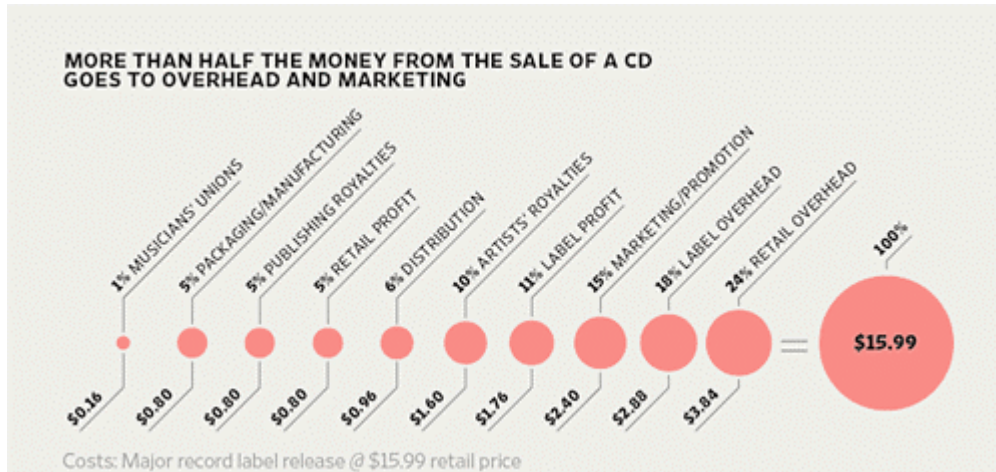


Figure 1. (Byrne, 2008, p. 128)

The argument raised at this point may claim that one dollar of profit multiplied by even a relatively low 100,000 units sold is \$100,000, which is a decent sum of income. The answer is that the musicians' profits are quickly sliced by standard distribution agreement contingencies. For the most part, artists that sign to a major label enter a standard distribution agreement that grants them a royalty percentage on album sales. Initially the label awards the musician a large advance to cover the recording and living expenses. However, the musician will only begin to earn a profit after all these costs are repaid to label. The largest percent of royalties goes to overhead and marketing (Figure 1). In the end, the debt is so high that most musicians (over 85%) can never pay it off (Baskerville 35). For example, a band would need to sell over 250,000 albums (earning \$1.00 in royalties from each album) just to pay off their \$250,000 advancement – though the advancement is negotiable it's usually around \$250,000 (Borg 49). It's for this reason that musicians rarely make a living on album sales alone.

### Copy and Copyright

Musicians should forfeit the exclusive 'right to copy' in order to fully maximize the financial potential of cross-subsidies. A brief overview of intellectual property law will explain which rights are better sacrificed.

Intellectual property (IP) is a bundle of exclusive rights granted to the creator of abstract properties such as musical, literary and artistic works. The rights pertaining to recorded music are classified under the term *copyright*. These rights are intended to protect the interest of the musician.

The value of copyright comes from the future income associated with its ownership. Without a pretense of future value there would be little reason to maintain copyright laws.

Basically, copyright law gives the copyright holder four exclusive rights:

- the right to copy their work

- the right to be credited for performance of their work
- the right to allow derivatives of their work
- the right to benefit financially from their work.

### **Criticism of Intellectual Property**

Critics attack the exclusive 'right to copy' claiming that it threatens civil liberties and stifles innovation. Often referred to as the *free culture movement*, critics promote the democratizing power of internet as a tool for sharing information. Author and outspoken intellectual property critic Cory Doctorow explains, "Fundamentally, the stuff we call 'intellectual property' is just *knowledge* - ideas, words, tunes, blueprints, identifiers, secrets, databases" (The Guardian). The idea is that an attempt to control intellectual property as though it were a physical property harms the public.

Further opposition recognizes the non-rivalrous nature of intellectual property. Rivalry in economics regards goods (often tangible goods) that cannot be simultaneously consumed by more than one customer. For example, if I am riding my bicycle, you can't also be riding it at the same time. On the other hand, a non-rivalrous good is something that two people or more can share at the same time (often intangible goods). A common example would be television and internet services. As the history of recorded music advances from tangible compact discs to intangible file-downloading, consumer habits are evolving as well. Piracy is going up while music sales are going down.

### **Pursuing Copyright Infringement Costs**

On the other side of the argument, The Recording Industry of America (RIAA) is aggressively fighting copyright infringement, having brought around 20,000 cases against people in the United States (Electronic Frontier Foundation). They continue to funnel money into the court system seeking statutory damages from accused "illegal file-sharers" in sums upward of \$222,000 (RIAA efforts against file-sharing).

The RIAA's main goal, as stated on the group's official website, is to "protect intellectual property worldwide and the First Amendment rights of artists." Admittedly this is true, but because they are a trade group represented and funded by the record labels, they are ultimately dedicated to protecting the record labels. They are not interested in exploring the issues of the free culture movement because without album sales there would not be an RIAA. Therefore, artists signed to record labels supported by the RIAA are continuing to deprive themselves of album earnings (This includes the 5 major labels: Sony, EMI, UMG, Time Warner and BMG). In the end, after extreme efforts to quell illegal downloading, the RIAA is slowly losing funding from the record labels, and still struggling to effectively enforce copyright (Bangeman). If the ultimate goal is to directly benefit the musicians, intellectual property must be examined without a bias toward keeping alive the record labels. Getting to the root of the problem, copyright laws must be updated if musicians hope to extinguish this wasteful industry spending, and ultimately to better serve the musician's cross subsidies.

Not many people know this, but copyright is automatic. An original work is legally under copyright the moment it is created, and does not require the signing of official documents from the government. Accordingly, the moment John Smith writes a new song, he is free to exercise all exclusive rights granted

by law. He is now the sole decider of who reproduces his new song. But what if John wants his music to be legally copied and spread around the internet without having to grant individual permission to each of his new fans? That brings us to another thing that most people don't know: the copyright holder can keep their copyright, but specify conditions by which others are allowed to make copies.

Creative Commons is a non-profit corporation granting free licenses which extend copyright so that the copyright holders can decide how their works are reproduced. Whereas a copyright grants the creator total control, "all rights reserved", a Creative Commons license allows "some rights reserved". The basic set of rights from which to choose is as follows:

- 1) **Attribution:** You let others copy, distribute, display and perform your copyrighted work — and derivative works based upon it — but only if they give credit in the way you request.
- 2) **Noncommercial:** You let others copy, distribute, display, and perform your work — and derivative works based upon it — but for noncommercial purposes only.
- 3) **No Derivative Works.** You let others copy, distribute, display, and perform only verbatim copies of your work, not derivative works based upon it.

In the case of our musician John Smith, the "attribution" requirement will let John's new fan Mary share John's song with her friends as long as she credits the work to John. If Disney wants to use John's song in a movie, based on John's "noncommercial" requirement, they will know whether or not they will need John's consent. If U2 wants to perform John's song on their next album and John has the "No Derivative Work" requirement, they will need his permission.

If musicians are interested in increasing exposure to their cross subsidies and saving money by not supporting the RIAA's enforcement of traditional copyright, they will at least want to retain some of their rights. Musicians interested in extra income from music licensing will need to make "noncommercial" reproduction a necessary requirement. In addition, "attribution" is necessary for self-promotion, because as the world shares John Smith's music he will want them to come back to his website and buy other products. With a Creative Commons license John can explore new ways to market himself to future fans.

### **The Network Makes Music More Available**

The internet has become the best market tool for musicians seeking more fans because the marginal cost for sending a song to one person or one-million people is exactly same.

Most touring musicians seem to have a My Space page with a few free tracks available as streaming audio. On the same page, musicians collect thousands of fans and comments. Better known bands like The Shins have over 43 thousand fans while lesser known bands typically have at least a few hundred. Why do so many bands stream music and collect friends on social networking sites? Obviously it is because they hope that these internet friends will become real life (paying) fans. Musicians dreaming of stardom want their music to spread from the web and onto every iPod in the world. The power of the network makes this possible.

Network effect can be described as the benefits that manifest as more people continue to join a network. This phenomenon is best illustrated by Alexander Graham Bell's telephone. When he first invented the telephone the thrill of sending one's voice electronically into an adjoining room clearly exhibited unprecedented marvel. Each telephone added to this network expands the network thus adding collective value.

Network effect on the internet can be thought of as virtual-word of-mouth. Musicians can take advantage of this to spread their music and hopefully improve attendance at live shows.

Yet what if something prevented your biggest fans from telling other people about your music? That something can be thought of as copyright. Copyright adds an obstacle by making it illegal for fans to spread music and news about your band to new people. Of course copyright protectionists may say that the public can listen to the few tracks on My Space or buy the CD to find out about a band, but the truth is that with so much other content on the web people are low on free time and will most likely choose the option with the least amount of interference.

## **Conclusion**

Musicians are more inclined for prosperity if they embrace the free music model instead of fighting it. Forgoing control of whom and how people share music, as long as it is credited to the musician and used non-commercially, helps more people connect with the real product which is not music, but the band itself. The band is a brand.

A musician's achievements used to be measured in "Gold" and "Platinum". These certifications are awarded by the RIAA to recognize units sold. Today brand equity is measured in the value of a band's cross-subsidies and is considerably more valuable than an RIAA certification.

Free music is now the marketing tool: Nine Inch Nails gave away their latest work, yet sold all of the \$300 limited edition copies of their latest album in only minutes after it was released. Black Kids released their first album for free, but months later they were playing sold out shows around the world. Harvey Danger claims to have given away "Little by Little..." because they are "smart capitalists" trying to sustain their lives as musicians.

As musicians continue to experiment with the idea of free they will notice that the things which are most valuable in this new economy are those which can't be copied: experience, immediacy and authenticity.

For a musician the live show is a personal experience for which they have a monopoly. If Radiohead is performing in New York City tonight there is no other venue in the world where you could have that experience.

As the internet continues to grow into something more closely resembling Borges's library, authenticity and immediacy are assets that only the band itself can offer. There may be hundreds of versions of a particular Rolling Stones song on the internet, but finding a high quality download or particular live

version could be a challenge. Similarly, finding it quickly may be a challenge. The authenticity of knowing that it comes directly from the band is something that is unique for the consumer.

Eventually, I predict the music industry will see a tipping point: a large enough quantity of music will be free that musicians will realize they are at a greater loss by not making music free. Until then early adopters will continue to gain notoriety simply for being brave enough to experiment. As Cory Doctorow sees it, “each free copy of my book is a seed of possibilities, an opportunity for someone out there to buy a physical copy of the book, to commission work from me, to bring me in for a speech.”

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