



## **Art Executive Briefing**

**Europe Economics  
Chancery House  
53-64 Chancery Lane  
London WC2A 1QU  
Tel: (+44) (0) 20 7831 4717  
Fax: (+44) (0) 20 7831 4515  
[www.europe-economics.com](http://www.europe-economics.com)**

**14 May 2009**

# The Particular Economics of the Creative Industries



## *The Problems of Art and Culture*

The markets for the arts and culture notoriously fail to operate as efficiently or fairly as other sectors.<sup>1</sup>

The output of arts and culture is often a “public good” having positive spillover effects that are not accounted for by the market; for example, a Shakespeare sonnet that compels one to learn new words. In the absence of government intervention, the free market generally leads to the underprovision of these goods.

In the wake of technological breakthroughs over recent decades that have buoyed productivity and output in the global economy, many (although not all) industries in the arts and cultural sectors have been left in the dust: although Jaguar may rely on a single engine type to produce a range of car models, the screenwriter of Frost/Nixon cannot simply appropriate the same script that was written for *The Queen*. This chronic demand for innovation — “the need never to replicate” — in the creative industries, Baumol’s cost disease in economics jargon, has led to significant lags in real productivity levels among many creative industries, especially for the performing arts.<sup>2</sup>

The difficulty experienced by many firms in recouping costs has often meant compromising on quality. Cost disease has compelled leading institutions to understandably prioritise economic security over artistic risk. Where a group exhibition of emerging *avant-garde* artists may not generate enough revenue to cover expenses, a Van Gogh retrospective would cover its costs and likely generate a wholesome profit.

With globalisation and information technologies leading to increased ease of access and lowered barriers to entry comes a proliferation of questions over the definition and exchange of intellectual property, most obviously in the digital music industry. Yet recent economic literature suggests that these trends may embody change, rather than merely problem: artists remain divided over the issue of strong copyright, and reasons for this become more apparent when non-monetary incentives are taken into account. Radiohead, for example, would never have attained so much press coverage had they not initially released their latest album online...and priced it according to consumer willingness to pay!

## *The Creative Society*

The arts and cultural sectors generate real economic benefits. In 2008 the creative industries, broadly defined, accounted for economic output of at least £60 billion per annum, equivalent to over 7 per cent of UK GDP,<sup>3</sup> outranking both construction and tourism. Another report in 2007 identified thirteen sectors which make up the UK’s creative economy, and reported that together they account for 1 million direct jobs and another 800,000 in related upstream and downstream sectors.<sup>4</sup>

The UK has been a beacon for much of Europe in its attainment of a delicate balance between government regulation on the one hand, and creative freedom of expression and innovation on the other.<sup>5</sup> Unfortunately, the current economic crisis is not likely to make things any easier for the arts and culture sector. Budget cuts and drops in consumer spending mandate prudent and aggressive strategising to make each pound go as far as possible.

## *Solutions*

Economists have historically been regarded by the creative world as Philistines. However, as economics continues to expand into new territory, it presents novel approaches for analysis. Since Bentham’s equivalence of the value of arts to that of a game of push-pin, we have come to appreciate the very real value attached to art and culture, as well understand the methods for quantifying it.<sup>6</sup>

Europe Economics has experience working closely with private organisations such as the BBC, DACS, and a major international entertainment conglomerate. However, contracts with government bodies in the arts and culture sector, such as the DCMS, have enabled us to cultivate an understanding of contrasting perspectives, and an awareness of the most appropriate areas and effective mechanisms to be targeted.

In the sectors requiring repeated sunk costs, Ramsay pricing schemes — the concept of setting prices based not on incremental cost, but rather against elasticities of demand — may be used as a second-best solution for recouping investment where linear price structures are not practical. This can enable firms with high fixed costs to manage to avoid drifting into NGO status.<sup>7</sup> Where government funding may be required, economists use bargaining theory to shape negotiations so as to enable private enterprise to retain creative autonomy; to this goal, vital subsidies and grants should be petitioned, but sparingly so.

Statistical and econometric analyses can inform museums, opera houses, theatres, broadcasters or publishers on what artistic risk they can afford to take, and what returns may be expected in doing so, including likely effects on government funding.<sup>8</sup> So-called key performance indicators can confirm or disprove the success of special initiatives.

More than for other sectors, the arts and culture cannot flourish in the absence of adequate funding, effective economic planning, and a sanguine regulatory framework. A solid understanding of the underlying economics governing the arts, if carefully and correctly applied, may help to ensure its short-term success, and longevity.

## The Particular Economics of the Creative Industries



For further information or advice, please contact Adam Paul Levine ([adampaul.levine@europe-economics.com](mailto:adampaul.levine@europe-economics.com)) at Europe Economics on 020 7831 4717.

---

<sup>1</sup> Acknowledging that defining “arts” and “culture” is not a straightforward task by any means, for an economic context we adopt the Eurostat classification which maps the “domains” of artistic and monumental heritage, archives, libraries, books and press, visual arts, architecture, performing arts and audiovisual/multimedia to the “functions” of conservation, creation, production, dissemination, trade and training.

<sup>2</sup> Baumol, William J., and Bowen, William G. (1968) *Performing Arts-the Economic Dilemma*, Cambridge, the MIT Press.

<sup>3</sup> DCMS (2008) “Creative Britain: new talents for the new economy” [http://www.culture.gov.uk/reference\\_library/publications/3572.aspx](http://www.culture.gov.uk/reference_library/publications/3572.aspx).

<sup>4</sup> Work Foundation (2007) “Staying ahead: the economic performance of the UK’s creative industries”

---

<http://theworkfoundation.com/research/publications/publicationdetail.aspx?itemId=176&parentPageID=102&PubType=>

<sup>5</sup> The Work Foundation also reports that the OECD found that “the UK’s creative industries make up a greater share of GDP than in other nations.”

<sup>6</sup> Push-pin was an English child’s game, played by two or more players, popular in the 1500s and 1600s. Each player set one pin (needle) on the brim of a hat, and took turns tapping on the sides of the hat trying to cause pins to cross one another. He or she then took the pins that crossed.

Jeremy Bentham wrote in *The Rationale of Reward*, “Prejudice apart, the game of push-pin is of equal value with the arts and sciences of music and poetry.”

<sup>7</sup> We have experience in a number of projects on Ramsay pricing, in sectors as diverse as telecoms and pharmaceuticals.

<sup>8</sup> Econometrics is the application of statistical and mathematical analysis to economic or financial variables. Econometric methods are frequently applied in marketing, criminology, operations research, climatology, geography, psychology, biology and medicine.