

Luis César Herrero Prieto  
y Juan Prieto Rodríguez

*La gran suerte de poder (eds.) combinar mi faceta*

*laboral como economista con mi fascinación por el cine,*

*al lado de maravillosos compañeros de viaje, me han*

*hecho un placer durante toda mi profesión.*

# LA ECONOMÍA DE LA CULTURA:

*Frases como "Cuando bebo agua, bebo agua y cuando bebo*  
*wiskey, bebo whiskey" (El hombre del año (1952),*

# UNA DISCIPLINA JOVEN

*"Pasear a vuestro lado por la vida ha sido un gran*

**ESTUDIOS EN HOMENAJE**

**AL PROFESOR**

*placer" (Murió con las botas puestas, Raoul Walsh, 1941),*

**VÍCTOR FERNÁNDEZ BLANCO**

*"Calabaza yo te llevo en el corazón" (Amance que no es jaco)*

*J. L. Guenda, 1989), o la inolvidable "Siempre nos quedará*

*~~Paris~~ Avilés (Casablanca, Michael Curtiz, 1945),*

*me han acompañado durante toda mi vida*



Universidad de Oviedo

2021





# UNIVERSIDAD DE OVIEDO

HOMENAJES



Luis César Herrero Prieto  
y Juan Prieto Rodríguez  
(eds.)

*La economía de la cultura:  
una disciplina joven*

ESTUDIOS EN HOMENAJE  
AL PROFESOR  
VÍCTOR FERNÁNDEZ BLANCO



Universidad de Oviedo



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# **Do we need a new economic approach to the creative economy in the digital era?**

*Ruth Towse*

## **I. Introduction**

What makes for a paradigm shift has been hotly debated in economics as in science (though admittedly by the relatively few economists with an interest in these things). In general, it provides a methodology - the 'rules of the game' - for assessing a fundamental change that represents a break with that which went before, usually a body of thought or a dominant theory. Though the term 'paradigm shift' is often over-used, it can be a useful way of thinking about change – change brought about in the 'real world' by the introduction of new technologies, new market structures and players and new business models, as well as other types of change. But are such changes radical enough to cause a paradigm shift in the economic theories used to interpret them or do they simply evolve? I suggest that the ubiquitous use of what has come to be called platform economics – the microeconomics of two- and multi-sided markets – calls for this kind of analysis. And where better to apply it than in the creative industries which have been profoundly affected by the digital revolution? What I try to do in this chapter is to use these ideas loosely to consider the impact of the recent widespread adoption of digital technologies on the creative industries and to reflect on the change in our view of those industries in cultural economics.

Digitization has brought fundamental change to the creative industries. It has certainly altered the fortunes of some cultural organisations that were previously viewed as inevitably sclerotic from the economic point of view, such as museums and opera houses, and it has enabled new industries to emerge, such as video games. It has fundamentally altered participation and consumption as well as production techniques and especially distribution and sales methods. It has enabled the multitude to display their artistic contributions to the world online but has not, however, essentially altered

the craft of professional creativeness and the time needed to produce it. So the picture is mixed: there has been a shift in the 'manufacture' or processing and distribution of creative work and in expanded opportunities for reaching the market but the economics of the initial creation of new works remains more or less unchanged. The implications for artists' labour markets are accordingly complex.

The question in the title of this chapter was raised for the then so-called 'Information Age' in the book *Information Rules* by Shapiro and Varian published in 1999. Their answer was no, we do not need a new economic approach - 'technology changes, economic laws do not': economics is general and powerful and can be applied to any form of economic activity. Starting in 2000, I taught a course on economics of creative industries and used their book as required reading. The subject seemed pretty revolutionary to me at the time. The question they posed has stuck in my mind ever since and now after twenty years I think the answer is both yes and no (but then an economist would say that! Harry Truman wanted to meet a one-handed economist who would not say 'on the one hand, ...then on the other hand...').

There is a sense in which economics has always done the same thing - analysed supply and demand, the price mechanism and the market economy - certainly since Adam Smith and some historians of economic thought would go back to Aristotle. The *Wealth of Nations* was written on the cusp of the Industrial Revolution in Great Britain and quite a bit of it is as relevant and readable as when it was written but equally, most of it is not. You wouldn't give a class on the economics of the creative industries the *Wealth of Nations* as a textbook, though there are some lovely passages relating to them (and widely used quotes, such as the 'exorbitant payments to opera singers' and the benefits of creativity) but the chapters on colonizing 'new' lands does not go down too well these days. So, is it the context and the stage of economic development that is the barrier or do we need more and better economic theories than Adam Smith provided us with? And if that applies to Adam Smith, so it does to any other path-breaking economist.

It is obvious that the economy has changed over time and that change in technologies and business models alters the context in which economic theory operates. The switch from agrarianism to industrial production made huge changes to people's lives but the basic laws of economics still made sense: there was relative scarcity of resources whose uses were determined by relative costs and prices; some enterprises became large but there were inherent limits to expansion. Now that we live in an information-rich digital economy is that still true? It seems that the underlying economic conditions of production fundamentally have indeed changed. For instance, we need to understand the tendency for the increased development of ever-larger dominant multi-national corporations. Though microeconomic concepts applied in industrial organisation have shifted along with changes in technology, we need to ask whether the underlying economic laws are still relevant in the digital age.

Another aspect is in macroeconomics: national income accounting requires that industries are defined and measured for their contribution to National Income and for growth. As consistency is required so that like may be compared with like the result is that National Income Accounting is slow to adapt to changes in the structure of the economy. New categories may be needed for new goods and processes in the online world in which the boundary between goods and services and assets are blurred but change weakens the ability to make before and after comparisons. When the UK introduced the new category of creative industries and the new 'paradigm' of the creative economy in which copyright became a dominant feature, measuring growth became difficult with the result that unrealistic claims could be made for their economic impact (Towse, 2011).

Such changes are basically matters for government statistical offices but the outcome can be important for policy-making as data are used for lobbying and rent-seeking purposes. Creative industry lobbies have laid claim to attention by national governments and international organisations because the data they produced on their size and growth purported to show that they are significant sources of national income both in less developed economies with strong artistic and cultural traditions as well as in post-industrial economies unable to compete with newer manufacturing economies. Initially, at least, the data on which those claims were based were collected and presented in ways that did not conform to best practice National Income Accounting.

A further aspect in the discussion of the impact of these developments relates to the role of economics in government policy and regulation: we need both microeconomic theories about the response of market economies to creativity and innovation and macroeconomic data on the outcome. In the creative industries copyright law is a favoured form of regulation alongside cultural subsidies; can the law adapt to such technological change and has the rationale for subsidies changed? Is competition law, which applies to all types of industries, effective in a multi-national economy of intangible products? Cultural economics needs to engage with these questions. Evidence, not just data, is needed as a basis for policy and to evaluate policy measures.

The chapter is organised as follows:

Section II introduces what I call the new paradigms of the economy, the reorientation towards the production and consumption of intangible, ephemeral goods produced and distributed electronically, which has ushered in the concepts of the knowledge and/or creative economy. Section III discusses the use of 'old' economic theories in analysing the creative industries and 'new' business models. Section IV turns to the labour markets for creators and performers, the producers of creative goods and services and section V concludes with some final remarks and a brief postscript on the impact of the coronavirus in the arts and creative industries.

## II. 'Paradigms' of the post industrial economy

The decline of heavy industry and then of manufacturing led to the use of the term 'post-industrial' economy with its strong reliance on the service economy. These terms reflect the relative size of those sectors in the national income. By the end of the 20th century, reorientation to the 'Information Economy' and the 'Knowledge Economy' had taken place. The shared characteristics of these terms are the production of goods that are intangible or based on a fundamental input that is intangible. OECD (Organisation of Economic Cooperation and Development) in particular espoused the Knowledge Economy and evolved its own research programme based on the prominence of human capital, acknowledging the increasing spread of computerization and the economic value of the data it generates.<sup>1</sup> Intangible output may be easily replicated and effectively becomes a public good, which with IT as a means of distribution, can be disseminated for a very low or zero marginal cost, often requiring protection through intellectual property law (patent, copyright and trademarks) for the appropriation of value.

Of course, neither public goods nor zero marginal cost were new concepts in economics: public goods have been traced back to Adam Smith and applied to defence, law-making and maintenance of the value of currency as collective goods but applying them to a broad range of the private sector is novel. (Nor are patent and copyright laws new, though Adam Smith and many later economists had little to say about them). The problem of zero marginal cost had been highlighted by Dupuit (in the context of the optimum toll for crossing a bridge: see Blaug, 1986: 66). The analogy in the digital world is the distinction between the creation of content and its delivery that is fundamental to understanding the creative economy - the focus of this chapter.

### *The creative economy*

The UN, led by UNCTAD (UN Conference on Trade and Development), produced the first *Creative Economy Report 2008* that embraced artistic, cultural, scientific and technical creativity. The *Report* identified characteristics that underlie the creative industries: they are

*'the cycles of creation, production and distribution of goods and service that use creativity and intellectual capital as primary inputs; constitute a set of knowledge-based activities, focused but not limited to arts, potentially generating revenues from trade and intellectual property rights; comprise tangible products and intangible intellectual or artistic services with creative content, economic value and market objectives'* (UN, 2008: 13).<sup>2</sup>

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<sup>1</sup> See [www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=OCDE/GD%2896%29102&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=OCDE/GD%2896%29102&docLanguage=En). For recent OECD publications in this area, see [www.oecd.org/going-digital/measuring-the-digital-transformation-9789264311992-en.htm](http://www.oecd.org/going-digital/measuring-the-digital-transformation-9789264311992-en.htm).

<sup>2</sup> These developments are discussed more fully in Towse (2019).

This definition was based on several prior ways of identifying the creative industries: the term ‘cultural industries’ (as distinct from ‘the arts’) had been introduced in France in the 1980s and soon entered the lexicon of UNESCO. Now ‘Cultural and Creative Industries (CCI)’ is the tag. Then in 1998 the UK adopted a creative economy programme as a self-conscious means of promoting the UK’s perceived leading position in innovation and creativity in the arts and culture.

Before this somewhat unexpected change, the arts in the UK had been ‘overseen’ by the Office of Arts and Libraries, a very small government department with a very narrow scope, reflecting the UK’s policy of ‘arm’s length’ administration of state support via special bodies, such as the Arts Council, the Crafts Council and, in a different category again, the BBC (which is an independent corporation financed by a licence fee). The UK model of dealing with the cultural sector was very different from that in other European countries in which cultural organisations were (and often still are) typically state-owned (by central, regional and/or local government) and staffed by civil servants. The formation of the UK’s Department of Culture, Media and Sport (DCMS) in 1998 involved marshalling together into one ‘sector’ oversight of these arm’s length bodies and elements from other departments of the UK government, such as sound recording and film production, which were previously in the domain of the Department of Industry and Trade. It also included taking over responsibility for copyright from the old Patent Office, which, as discussed below, came to be seen as the lynchpin of the creative industries in the UK (as elsewhere). The motive for the transfer was almost entirely political but the realignment established the need for reorganisation of industrial classification in the national income accounts, therefore involving economics. These developments, however, pre-dated the widespread adoption of digitization in the creative sector and the new business models that accompanied it that now require realignments or maybe even revolutionary change (Coyle and Mitra-Kahn, 2017).

### *Creative industries in the UK*

The *Creative Industries Mapping Document* published in 1998 by the DCMS used as its definition ‘those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property’. This definition resulted in a list of industries which has been revised several times. Since 2017 it has comprised: advertising and marketing, architecture, craft, product design, graphic design, fashion design, film, TV, video, radio and photography, IT, software, video games and computer services, publishing and translation, museums, galleries and libraries, music, performing arts, visual arts and cultural education, which together now define the UK’s Creative Economy.



The data DCMS produced in the first place, however, were not consistent with established National Income accounting criteria. There had been no previous category in the accounts that included all those industries and the industries had typically produced their own data, often in order to maximise their contribution to GDP (Gross Domestic Product) and its rate of growth. They hyped up their ‘economic importance’ for rent-seeking purposes in support of the claim for reform of copyright law and to obtain government financial support. In the case of the ‘high’ arts, there is an added ‘moral blackmail’ element in the ‘merit goods’ appeal for greater subsidy. One way or another, the creative industries argued they should be treated differently from other industries: the adjective ‘creative’ is the key here.

Eventually the National Statistical Office in the UK stepped in and creative industry data are now routinely handled by it as part of their regular reporting. They show that the creative industries account for around five per cent of GDP (Gross Domestic Product), rather than the eight per cent previously claimed, and that the rate of growth (also at around five per cent) has consistently exceeded that of all other sectors of the UK economy. In contrast to the arts, though, it is the IT, software, video games and computer services sub-sector that forms the largest grouping of industries and constitutes nearly two-thirds of total creative industry GVA (Gross Value-Added) in the UK. The arts risk being swamped by the industries’ concerns.

### *Digitization and copyright in the creative industries*

Though several of the creative industries were quick off the mark to adopt digital methods in their production process, they appear to have been taken by surprise by consumers’ ability to gain access to their products without payment. Piracy led to a huge worldwide campaign following the Napster case to pressure national governments and international organisations to increase the scope, term, penalties and enforcement of copyright, which has been pursued successively over the last 20 or so years. The World Intellectual Property Organisation (WIPO) instigated a programme of measuring the ‘economic value’ of copyright in a large number of countries, adopting the underlying and unproven assumption that without copyright these industries would either not exist or would contribute much less to GDP.<sup>3</sup> The fact that overall, the only net exporter of copyright works was and remains the USA was ignored and institutions were set up in less developed countries with their strong music and craft sectors) persuading them that this was a route to their economic growth. Once in place, though, payment for foreign (often US) cultural content had to be formalised along with that of the local industries.

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<sup>3</sup> Empirical estimates by Waldfoegel (2018) have shown that overall the effect of piracy on output is probably neutral.

The involvement of WIPO in the creative industries is another indication of their perceived value in national income creation in both less developed countries as well as developed ones. It also highlights the hype that goes with the creative economy and the supposedly crucial role of copyright in its size and growth. As new business models have developed, the level and impact of piracy has been muted at least in some countries. Overall, business models have proved more successful in displacing piracy than the technological protections measures (TPMS) that were brought in with much fanfare by WIPO at the end of the 1990s (economics trumped technology!).

The discourse above lays down the basis for discussing the role of economic theory in gaining understanding of the creative economy, perceived here as representing a paradigm shift in both its conception and in practice due to the digital nature of its products and production processes.

### **III. Old and new industrial organisation and creative industries**

In previous stages of the economy dominated by agriculture, heavy industries and manufacturing, industry size was tied to land, labour and capital as factors of production, in which the individual enterprise (the firm) reached natural limits through diminishing returns to a factor or to the scale of production, with the consequent effect on costs. Rising costs and attendant higher prices would eventually kill off demand. In this 'heavy' economy, producers both created their products and supplied them to the market.

An exception to this self-regulating scenario is natural monopoly in which there are no decreasing returns to scale over a very large output so that marginal costs never rise above average costs. Traditionally applied to utilities, such as electricity and telephones – industries with high fixed costs of production and an extensive distribution network – the model has also been applied to cultural goods and services, including those such as theatrical performance and museum exhibition (Towse, 2020a). The problem for the profit-maximising producer is that marginal cost pricing cannot cover long run average costs and so utility industries were typically state-owned or regulated once privatised. The 'classic' natural monopoly is regulated to maximise welfare: the consumer pays the marginal cost (the lowest possible price) and the sunk or fixed cost of the plant is financed by some formula set by regulators or (as in the case of arts organisations) by a subsidy. Regulation works via the price mechanism. Regulation and privatisation of utilities also split up the production of the good from the delivery system, for example, the production of electricity from its distribution network.

There are strong resonances of this model in the digital world in which it is necessary to distinguish the initial production of content (content creation) from distribution, for example by platforms. Although for many goods and services fixed or sunk costs have not changed much in the production of the 'prototype', digital products are non-rival and non-excludable when they are made available online, hence the case for copyright to 'privatise' what are

essentially public goods. On the distribution side, the use of IT and the Internet has vastly reduced the costs of marketing and delivering content. Digital producers are natural monopolists due to ever increasing returns to scale in distribution. In the digital creative economy, though the model fits, there has been no such established mode of regulation such as that found in utilities, however. Only recently has regulation of FANGS begun to be on the agenda. Another concern, for example on the part of OECD, has been the question of how to regulate multi-sided markets for ‘intangible’ goods and services (OECD, 2018).

While monopoly is universally regarded as a bad thing and competition as a good thing, regulated natural monopoly is an exception as are copyright and other types of intellectual property monopolies: awarding exclusive control to the creator is justified in terms of their welfare-enhancing role in stimulating creativity and innovation (Landes, 2020). Schumpeter famously argued that as (temporary) monopoly enables charging a price greater than marginal cost, it provides the entrepreneur with the incentive to innovate and therefore monopoly is necessary for economic growth. Monopoly offers the entrepreneur ‘lead time’ to capture the returns on her invention (his focus was on patents - he omitted to apply it to copyright, see Blaug, 2005) before competitors enter the market and compete down the price, coining the phrase ‘creative destruction’ for the process.

The theory of creative destruction has been applied to the music industry: record labels were vulnerable to ‘destruction’ because they failed to adapt to digital downloads and streaming (Handke, 2010). Creative destruction requires ever more technological innovation and alert entrepreneurs who have the funds to invest. Those who already invested in earlier technology (incumbent firms) are likely to be stuck with it for a while, enabling new entrants to stake their claim in the market. Not every innovation is successfully adopted long term, however: in the creative industries there is some evidence, for instance, that e-publishing is declining while hard copy book sales are rising (Hviid *et al.*, 2019).

Thus ‘traditional’ economic models have proved capable of overcoming the problems of financing public goods in these industries – still non-rival but now excludable – and re-establishing economic ‘normalcy’.

In fact, some industries with public goods characteristics prior to digitization have experienced the process in reverse, enabling the market to work. Over the air broadcasting is one example: the signal is accessible to all with equipment (radio and TV sets) that is readily available on the open market. In the past it was also non-excludable and was financed either by advertisements or by state funding. State broadcasters used to operate a licence fee but could enforce payment only by door to door monitoring. When TPMs were developed, enforcement costs were reduced but in many cases, it has been deemed preferable to simply finance public service broadcasting through taxation rather than a licence fee (a route not yet adopted in the UK for the BBC, however). Now, though, digital technology has

enabled splitting the signal (which is auctioned off to suppliers), enabling private competitors to enter the broadcasting market with use controlled by digital rights management (DRM) to enforce charging. What were previously public goods have been privatised via technology. The production of public goods may also be market-based through privately organised collective finance; the growth of crowdfunding, especially for start-ups in the cultural sector, is evidence of the possibility (though not all the enterprises supported in that way produce public goods).

A similar story applies to the music industry. Believed post-Napster to be non-viable because of piracy, it subsequently reduced free-riding by offering a menu of payment options, one being advertisement-based free supply to the consumer and another being a straightforward subscription, both for a huge bundle of musical tracks (Towse, 2020a). Netflix offers the same for films and TV shows. In both cases, subscription fees are small and affordable by many consumers (who need to purchase the hardware to access the service).

The above economic theories and business models are well-established, some older than others, and they may be applied to the creative economy. Of course, they were novel in their day and supplanted or challenged 'incumbent' theories. The process of creative destruction also applies to innovation in economic theory!

### *New economic theories and the creative industries*

The digital creative industries are subject to both increasing returns to scale and also to network effects, the combination leading to predictions that they are likely to grow into even bigger natural monopolies.<sup>4</sup> In digital format, there is no limit to the number of consumers or other users who can obtain a perfectly cloned copy of a digital good or join a social media platform and there are no barriers of entry to creating your own website. There is plenty not scarcity in digital production. The limit in the digital economy is the scarcity of time and attention on the part of consumers/users and their numbers, something understood by Herbert Simon with his notion of the 'attention economy' for which *inter alia* he won the Nobel Prize in economics in 1978 (Blaug, 1986).

Network effects are demand-side benefits emanating from the uses of online services, such as platforms and social media sites. Unlike other external benefits of consumption, though, network effects can be captured commercially via online markets. The more people who buy the good or use the social media network, the greater the value to others using it, the greater the value derived from it resulting in a higher willingness to pay. Moreover, the greater the benefits from the network, the more valuable it becomes and

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<sup>4</sup> 'Scalability' to use one of the four 's's' of the intangible economy according to Haskel and Westlake (2018): the others are sunkness, spillovers and synergies. See Towse (2020d) for a review of the book.

more people join the network, creating exponential growth. Furthermore, multi-homing – the practice of using several online platforms – amplifies these consumption network effects. Thus, technological developments have largely overcome possible negative network effects, such as congestion. Only bandwidth restrictions would limit their scope.

In addition, benefits can be captured during the process of searching for and consuming digital goods. Information provided on people's websites provides online data that can be manipulated electronically to develop individual consumer profiles that have value to others besides the immediate seller (Belleflamme and Peitz, 2020). Discrete websites are amalgamated to produce user profiles and information that is sold to other companies for commercial, political and a range of other purposes.

These effects suggest that 'big' is likely to get ever 'bigger': there are no market-based checks to expansion. With robots and AI able to reproduce, the cost of innovation may decline thus thwarting 'creative destruction'. The market economy therefore cannot self-regulate as perceived in previous technological eras. That is a paradigm shift in technology with strong economic and political implications.

#### *Platform economics: Two-/multi-sided markets*

A change in economic organisation that has evolved quickly in the digital economy is that of two or multi-sided markets, though as with so many such developments, there are some precursors. One of the oldest two-sided market models in the creative economy was that of advertisement-based commercial radio (and later TV) with the broadcaster as the platform: the consumer tolerates the ads in order to receive free access to programmes. Advertisers buy slots according to the putative audience, thus financing the service. A similar business model exists for ad-financed 'free' digital music distribution. These models have evolved with online platforms offering multiple products and experiences. The key change is complementarity and the fact that network effects produce demand-side externalities associated especially with online consumption. They are the source of positive benefits to both sellers and buyers of goods and services as well as to users of online services, such as e mail and social media sites. As argued above, there are no diminishing returns to scale or long run scale diseconomies to set an eventual limit to their size or number.

Multi-sided markets have several different groups of users on a platform: a classic example is a dating club, which attract more men than women so price is differentiated to offer incentives to women to join. The market form also applies to video game console entrepreneurs in the games industry which need to appeal to both game developers and players. The platform adopts pricing and other strategies to keep multiple sides engaged, thereby internalising externalities across the various participants. There are many more examples, both visible and invisible.

Subscriptions to large bundled repertoires of song, book and film titles have emerged from these market forms enabling consumers to pay to avoid the advertisements. These aggregations are no longer in the hands of the 'original' industry, however, but are done by online providers, the platforms. These changes in buying and selling works are novel but they were not developed specifically for the digital economy, though digitization and mass use of platforms has nurtured them.<sup>5</sup> Economists have acknowledged these business models and incorporated them into industrial economics: the methodological question is whether this is a revolutionary paradigm shift or an evolutionary change. I would opt for the latter interpretation.

#### **IV. The creator and the creative industries**

So far, the focus of this chapter has been on industrial organisation. The first step in the chain of production in the creative industries (as the DCMS quote above makes clear), however, is the creator - an artist, craftsperson, author or performer. The creative process involves skill and talent, long training, experimentation and time at the end of which a work is produced whose success on the market is uncertain. The greater the novelty, the higher the risk. The risk and cost of production of novel creative work is in the first instance borne by the creators who then have to engage with cultural entrepreneurs (the 'industry') to get the work to market. Once established, the enterprise may finance further work by the creator, offering them a longer term contract with or without an upfront payment, thus to different degrees sharing risk.

Copyright law exists to protect creators and performers from theft of their work, thereby offering them an incentive to produce and offer their work to the market. Contracts are negotiated between with the author (creator/performer) and publisher (record label, film company *et al*) in a deal that exchanges the right to produce and market a good or service based in the underlying copyright work for a royalty payment. Generally speaking the creator or performer, unless she is a superstar, has the weaker bargaining position, which is exacerbated by the extent of concentration in the industry: the stronger the concentration, the weaker is her position in relation to the enterprise. The result is that many authors and performers end up signing away all rights to their work.

The implications of the economic organisation of creative enterprises for the artist are analysed in detail for various sectors of the creative industries by Caves (2000). He applies contract theory to the creative industries, building up a picture of contract complexity from the simple 'handshake'

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<sup>5</sup> Readers of Jane Austen will remember that in England in the 18<sup>th</sup> century the local Assembly Room acted as a platform, offering dances, concerts a library and other facilities for a subscription. The more the 'right sort' of people took part, the greater the value to other members.

contract between an artist and art gallery to those in the film industry involving multiple skills and personnel. Caves' proposition is that the transfer of the rights to creators' and performers' works is required by the industry (rather than a licence to use them for a limited time) in order to protect the sunk investment ('sunkness') from later hold-ups in a sequential chain of production.

All contracts offer terms governing the use of the work and the reward due, though they may take different forms. In some creative organisations the creator or performer has an employment contract, either permanent or temporary, which means the copyright of work done under that contract belong to the employer. Other contracts range from a transfer of all rights to a work for a single fee (a 'buy-out') to a royalty contract, in which rights may be split up and negotiated separately, for example, the film rights of a book title may be retained by the author in a publishing deal and contracted separately (as in the case of JK Rowling). Different contracts offer different incentives and rewards and also influence or are influenced by the structure of the industry. In some, employment contracts are the norm, for example, for players in an orchestra, while a pop group would have a royalty deal transferring the rights to their performance to a record label. There are many mixed examples as well but the underlying economic principles are the same.

### *Impact of digitization on creators' labour markets*

Contractual arrangements and contracts have changed over time in the arts and creative industries: royalty contracts are now the norm in musical and literary publishing, though only since the last century, before which flat fee payments which bought out all rights were common (for example, see Towse (2017) for music publishing). The growth of state subsidy for the arts led to secure employment for some performers in orchestras and opera and dance companies, though not for all, but insecure funding leads to creators having to face many temporary contracts and low incomes, as consistently reported in surveys of artists' labour markets. For a while, royalties from copyright were threatened by piracy but the threat was always greater for the industry side than the artist, since for most, a royalty deal did not (and does not) constitute a substantial part of their income (DiCola, 2013; Kretschmer *et al.*, 2019).

Superstars are likely dominate artists' labour markets even more in the digital era due to the expanded markets the Internet offers. The greatest impact of digitization on artists' earnings, though, has been the transfer to rights to use creators' work to a platform by the publisher in a deal in which the creator has no say. Though ad hoc arrangements are made for paying the creator, for example, a streaming rate, these are not contractual arrangements between the creator and the platform (Towse, 2020a). Bearing in mind that many initial contracts were (and often still are) for the life of copyright (which varies for authors and performers but for both extends well beyond their

lifespan), many find themselves locked-in with only moral rights available to control subsequent use made of their work.<sup>6</sup>

The digital economy has affected the economic organisation of creative labour markets as well as product markets in the creative industries. The cost of creation of the underlying content remains basically similar, however, regardless of the means by which it is delivered to the consumer. It still takes as long to write the book or the song. The presence of social media platforms has opened up the possibility for creators to offer their work directly to the public and many do so, both professional and amateur; in fact, that distinction is increasingly becoming difficult to maintain. So far, digital technologies appear to have assisted the distribution of creative work in some industries rather than substituted for it (Bakshi and Throsby, 2014; De la Vega, 2020) but there has been little work on the demand side of the equation; adoption of AI might change that, however (Peukert, 2019). There has been some research showing that those self-publishers who succeed online are offered contracts with enterprises in the industries, such as publishing and games (Hviid *et al.*, 2019) but the full extent for the practice is not known.

An ‘unintended’ outcome is that online offers by creators have reduced the search costs (A&R) of enterprises in the creative industries so that they are able to select the successful ones, thus reducing their risk in marketing the work. There is an irony here in that the early perception of the Internet was that it enabled a ‘long tail’ of market participation by creators counteracting the superstar tendency.<sup>7</sup> There is some suggestion that this has led to improved contractual arrangements for those who are approached this way as the publisher’s risk is reduced. The topic requires further research. Digitization has therefore altered the status quo in various ways.

Whatever the impact of these changes on the way artists’ labour markets are organised, it does not seem to call for new economic theories to explain the underlying logic of contracting. Moreover, copyright law, which has been adapted to the digital economy, is probably not as significant as an economic incentive as is claimed since the critical point lies in the contractual arrangements made rather than the law itself and, indeed, for most, royalties make up only a small proportion of artists’ earnings.

## V. Final remarks

The question that this chapter tries to address is the extent to which the paradigmatic shift in the creative economy due to the adoption of digital

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<sup>6</sup> Some EU countries, notably Germany, and the USA have ‘use it or lose it’ rules whereby the creator can reclaim the work and possibly renegotiate terms (see Kretschmer [https://musicbusinessresearch.files.wordpress.com/2012/04/ijmbr\\_april\\_2012\\_martin\\_kretschmer\\_final.pdf](https://musicbusinessresearch.files.wordpress.com/2012/04/ijmbr_april_2012_martin_kretschmer_final.pdf)).

<sup>7</sup> There has been some confusion in the use of the concept: some use it to mean that in a statistical distribution of incomes in an occupation, there are more individuals to be found in the middle. Others use it in the sense of the superstar effect introduced by Rosen (1981), who showed that increasing market size favoured a few top earners.



technologies has impacted on the economic theories we use to understand it. Is economic theory in fact so general and so robust that it can override changes in the economic organisation of the means of production regardless of the technologies adopted? Shapiro and Varian suggest that it is.

The switch to an economy of plentiful supply in which network effects produce data as a joint product has made significant changes to many parts of the creative economy but the sizeable external, even public goods, effects ('spillovers') have been internalised by private enterprise. The same technological changes that enabled them have led to the growth of very large online corporations, which have quickly come to dominate markets in the creative industries. The issue here, though, is whether radically new economic theory is called for or, indeed, has emerged to inform that process. It seems that traditional industrial economics has been successfully extended to cope with the digital creative economy and we already have adapted economic concepts for analysing it. Economic theory has responded by evolution rather than by revolution. So, the answer to Shapiro and Varian is that they were on balance right.

Some institutional arrangements require root and branch change, however, notably National Income Accounting. Given the positive feedback of internalised externalities, regulation of monopoly requires rethinking; copyright law is believed to be capable of adaptation, though to some legal scholars the change required is so radical as to make it infeasible. One of the main problems for these types of regulation, however, is that they can only work on an international basis, requiring extensive trade negotiations, which are slow and expensive.

The creative economy consists of both the creation of content and its delivery – and the effects of digitization on each have differed. While content can be disseminated to vastly expanded markets for virtually zero cost to the supplier, the cost of content creation remains more or less unchanged. Many of the activities of the older parts of the creative economy that are building-based and therefore subject to the limitations of time and space visitors (such as the performing arts and museums) are now available to 'visitors' for online participation or through other digital means. I can go to my local arts centre in a small town in the UK and pay to watch a narrowcast live performance ('event cinema') from the Metropolitan Opera from New York and even that may be subject to excess demand for seats but it also can be replicated 'as though live' in various ways. I can similarly 'view' an exhibition from the British Museum. With improved technology at home (surely only a step away if demand were great enough) I could view these events without going out, thereby lifting restrictions of time and space. It remains to be seen what the long term impact of the lockdown due to the coronavirus has on the taste for home consumption – another possible paradigm shift.

The initial creation of these events, however, remains fundamentally unchanged due to the skill and time required to create them in the first place,

regardless of the means whereby they reach the audience. Though digital technologies may be used to assist the creative process, they have not been a substitute for the human effort involved. Artificial intelligence may change that: some music has been generated that way and 'played' electronically (raising awkward questions for copyright law). Digitization has so far not really altered the cost of professional content creation, though it has increased overall supply by others and, perhaps more significantly (though this is rarely discussed), has enabled the resurrection of masses of older content that now competes directly for consumers' attention, the commodity that is ultimately in short supply.

As stated earlier, the limitations of time and attention on the part of consumers may be more significant factors than cost on the production side, though people are more accustomed to multi-task – listening to music while travelling, working or reading and engaging with social media. The market repeatedly demands more content, both new and old. The most serious competition for new work, therefore, probably comes from the repeated reuse of earlier work. By contrast to online consumption in the home, though, games enthusiasts flock to large venues and pay entrance fees to observe professional gamers playing video games remotely, with the potential for scarcity of places in the space. Diminishing returns to home consumption may eventually set in, something cultural economists should be considering. A start has been made by Bakhshi and Throsby (2014) and more recently by De la Vega *et al.* (2020), both of which find complementarity between the live and the online experience. With the coronavirus pandemic causing the closure of live performances and other activities, a natural experiment presents itself: having had to participate only on line for several months, will consumers return to live events?

All this suggests that we currently live in a dual creative economy, in which the time and skill needed for creativity is more or less unchanged while the uses to which creative work are put have changed fundamentally with digitization. At bottom, people still want to experience art and be entertained and there are many talented creators and performers ready to offer their services, despite the relatively low average reward. Those services are supplied in both traditional and new modes of delivery. Demand for novelty has probably increased but there is no suggestion that diminishing returns have set in for its supply.

Changes in economic organisation have raised questions about regulation: which side of a multi-sided market should be regulated? They have also made copyright excessively complicated as it struggles to adapt, so much so that many individual creators for whom its protection is designed fail to either understand or apply it to their work. Furthermore, governments failed to grasp the changed nature of the information economy, taking a *laissez-faire* stance waiting to see how things evolved; by the time it was clear that big was only ever going to get bigger, it was too late to apply national law and taxation to control the unwanted effects.

Finally, historians of economic thought may question the relevance of this discussion about the way that economic theories accommodate the new forms of economic organisation introduced by digital technologies. It seems to me that understanding the ‘new’ digital economy has led to changes in the way economists think even if it has not resulted in a revolution in economic theory. Either way, it certainly has strong implications for cultural economics.

*Post script: the Coronavirus pandemic and the cultural and creative industries*

During the revision of this chapter, the Coronavirus pandemic was wreaking havoc in the cultural world. It has dealt a severe blow to some sub-sectors, notably the live performing arts, while boosting the consumption of online provision and home-based production, thus potentially increasing copyright royalties. In two short articles on the impact in the UK, I laid out the analysis of artists’ labour markets, explaining why the schemes to support employees during the pandemic fall short of assisting many artists, especially performers. Similarly, the equivalent system for the self-employed also fails. Moreover, they both ceased after the initial period of the full lockdown, leading to a specific allocation of funds for the arts sector (details in Towse, 2020*b,c*)

Due to social distancing rules many theatres in the UK are closed with little prospect of them reopening for the foreseeable future at the time of writing and arts organisations like other businesses cannot cover costs with reduced visitor numbers. Arts organisations in the UK rely on box office revenue to a varying extent: they are mostly private non-profit enterprises in receipt of subsidy from various sources in addition to subsidy from the state. The most heavily subsidised are the opera companies and other ‘flagship’ organisations. It seems inevitable that they will get the lion’s share of the emergency funding, if only because they are the biggest and most prestigious. The result will be that many smaller and probably more innovative producers will go to the wall. It should be possible to follow up this unfortunate ‘natural experiment’ in cultural production and consumption, for instance by participation and artist labour market surveys.

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