Has Baumol's Cost Disease disappeared in the performing arts?

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Summary

According to Baumol's Cost Disease unit labour costs in the performing arts regularly increase because the wage rates rise more quickly than labour productivity, resulting in a secular threat to survival. In contrast, musical festivals have boomed. Festivals cater particularly well for tourists endowed with steadily increasing incomes. Festivals have prospered because they hire artists and other staff at low marginal cost and evade the restrictions imposed by government and unions. They therefore produce more efficiently and attract more sponsors. The "innovation" of festivals overcomes Baumol's Disease while it remains virulent in the conventional venues.

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1. Baumol's Cost Disease

Unit labour cost of production in the live performing arts (or more generally in the service sector) steadily increases because the wage rates in this sector are rising at a rate similar to that in the economy as a whole, while labour productivity in the arts is more or less constant: this is the essence of Baumol's Cost Disease or Baumol's Law. As a result, the live performing arts of opera, concert and theatre are faced with a secular threat to survival because of continually increasing costs relative to other consumption activities (Baumol & Bowen, 1966). Baumol's Law has been challenged on various grounds. In particular if demand rises more quickly than that for other outputs (the income elasticity is larger than one), and the price elasticity of demand is larger than minus 1, prices and revenues perhaps can be raised to keep pace with rising costs. In addition labour productivity may to some extent be increased.
by switching to different art forms, for instance the use of chamber rather than symphony orchestras (see Peacock, 1984; Baumol &
Baumol, 1984), or by reducing the travel time of itinerant performers (Baumol, 1993). The basic idea has, however, been accepted
and provides one of the major building blocks of the economics of the
arts (Blaug, 1976; Throsby & Withers, 1979; Frey & Pommerene, 1989;
Heilbrun & Gray, 1993; Throsby, 1994; gives a balanced account). It provides a convincing explanation for why live perform-
ing arts suppliers are in perennial financial difficulties, and why
many of them have not been able to survive.

Reality, however, modifies the picture if one looks beyond the
conventional forms of performing arts in opera or concert houses
and theatres. Actually, in the form of festivals,† the live performing
arts are flourishing and growing at a very fast rate. In Europe,
ever city or region has its own festival.‡ The term “perform-
ing arts festival” is vague (for example, every art supplier is
free to call his or her activity a “festival”, so that the term is
ill-defined and legally unprotected; there are festivals involving
various locations such as, e.g. the Holland Festival, which takes
place in Amsterdam, Rotterdam, Utrecht and Eindhoven). Experts’
estimates range from over one thousand (Pahlen, 1978; Dümmling,
1992) to two thousand (Galeotti, 1992) festivals a year, all over
Europe. Exact figures for narrowly defined musical festivals are
available for the United Kingdom (Rolfe, 1992: p. 2, lists 529) and
France (Gandillot, 1994: p. 32, counts 450). While a few particularly
famous festivals were founded before World War II (among them
Bayreuth in 1876, Salzburg in 1920, Glyndebourne in 1934), most
of them were established after that, with particularly rapid growth
in the 1980s and 1990s.§

† Economists have tended to ignore this art form as a general phenomenon;
they have confined their attention to the local and regional multiplier effects of
festivals (e.g. Vaughan (1980) for the Edinburgh Festival; Mitchell and Wall
(1989) for the Stratford (Ontario) Festival or O’Hagan (1992) for the Wexford Opera
Festival), to the welfare theoretic implications of subalization (e.g. O’Hagan &
Duffy, 1987; Pommerene, 1992), or to specific festivals (e.g. Frey (1986) for the
Salzburg Festival; Galeotti (1992) for the Spoleto Festival).

‡ There are many different kinds of festivals, e.g. jazz, film, folklore or religious
events apart from the merely musical, operatic or theatrical ones, but attention
will be restricted here to the classical performing arts festivals in the narrow
sense (see Merin & Burdick, 1979).

§ For example, when the official Association Européenne des Festivals was
founded in 1952, there were 15 members as opposed to 88 today. Obviously, this
Association is very restrictive and limited to the most prestigious festivals.
According to Gandillot (1994) six out of 10 festivals in France were founded in
the 1980s and 1990s.

2. Why so many festivals?

Factors on both the demand and the supply side are responsible
for this explosion in the number of festivals. On the demand side,
the interaction of two factors is responsible for much of the increase.
On the one hand, the large gains in real disposable income since
the war have increased spending for vacations. Real growth has
been accompanied by significant decreases in working time (at
least in Europe: a typical German employee or worker today enjoys
5–6 weeks’ vacation), so a substantially increasing share of the
population now goes away from home on vacation and is prepared
to spend large sums for this purpose. The growth of real disposable
income has at the same time led to an increase in demand for
culture. But as the live arts are highly time-intensive there has been
a countervailing effect on demand so that the share of expenditure
devoted to such activities does not necessarily increase. Indeed,
the empirical evidence is unclear about whether the income elasticity of
demand is larger than one.† Festivals are well adapted to both
sources of demand: most festivals take place during the tourists’
high season and have been created to cater for the cultural interests
of vacationers, or to attract them in the first place (see, for the
case of the Wexford Opera Festival; O’Hagan, 1992). One can also
say (following Stigler & Becker, 1977) that the commodity “enjoying
one’s spare time in summer” is efficiently produced (for many, if
not most people) by combining the good vacation with the good
cultural performance.

The individuals’ cost of attending a festival has tended to fall
relative to expenditures for comparable activities. While the op-
portunity cost of time has in general risen as a result of the secular
rise in income (which makes it more costly to spend time in the
concert hall or opera house), the time cost of attending a festival
has, due to the increase in vacations, decreased substantially. Most
performances take place in the evening, so that attending them is
a welcome opportunity for entertainment with little or no time
opportunity cost (see Gapinski, 1988: p. 963, for the case of London).
At the same time, the cost of travelling has fallen (e.g. today’s low
cost of flying between America and Europe). As a result, individuals
have experienced a steadily rising incentive to take advantage

† Throsby and Withers (1979: p. 113), for example, estimate an income elasticity
for performing arts services of 1.5 for the United States 1949–73, and of 1.4 for
Australia 1964–74 (full income). Krebs and Pommerene (1994) reviewing the
different estimates conclude that the short-run and long-run price elasticity of
demand lies between 0.4 and 1.6. If the lower estimate applies, the expenditure
share for the live arts will thus decrease. Brosio and Santegata (1992: p. 11), on
the other hand, find for Italy that the share of expenditures for visiting the opera,
ballet and concerts in total consumption expenditures rose from 2.9% in 1970 to
2.6% in 1988.
of the economies of scope provided by combining vacations and culture.

Another relative price effect working in favour of festivals consists in the lower transaction cost compared with attending performances at a concert or opera house. One of the great handicaps of attending a conventional orchestra or opera performance is the trouble of getting tickets and committing oneself to a particular evening. In the case of festivals, the tickets are often provided by the travel agency booking the complete vacation. Hence no additional effort to attend a festival is needed. Moreover, as people tend to think in relative terms, the entry fee is perceived to be lower than the same sum spent for a conventional orchestral or operatic performance (spending $100 is taken to be little if the vacation itself costs $5000; see Thaler, 1980).

A strong demand for festivals has also been exerted by the musical recording industry and corporate sponsors. Discs and videos of classical music have become a huge commercial enterprise with correspondingly high profits. Festivals provide an excellent opportunity to bring superstars under contract before what are often very large crowds of spectators. This effect is greatly magnified if the performances are televised and propagated by discs and videos.† The recording companies also use festivals to launch the careers of their future stars. As festivals are less regulated than concert and opera houses (see below), these companies can more easily influence the programme to favour the artists they have under contract [this has been particularly noted for the Salzburg Festival (Frey, 1986)]. The same applies to the sponsoring activity of companies producing goods unrelated to the arts. At festivals they can appear more prominently and can therefore expect more publicity from a performance for a given sum of money.

On the supply side, two major factors account for the rapid growth of festivals. First, the additional costs of setting up a festival are relatively low compared with live performances at a conventional venue. Many festivals, especially newly established ones, strongly rely on volunteers for administrative and technical tasks, as well as for supernumeraries in opera performances (for U.K. festivals, see the evidence in Rolfe, 1992) which reduces cost considerably. Almost all the paid staff are hired on a short time basis. This also applies for well established, old festivals. Even the Salzburg Festival employs most artists—soloists, actors, directors and musicians as well as administrative and technical staff—on a seasonal basis (about 55% of total cost) while fixed salaries make

† E.g. the record breaking performance of the three tenors Carreras, Domingo and Pavarotti in the Roman Caracalla ruins. The phenomenon of superstars has been introduced into economics by Rosen (1981); see also Adler (1985) and Tsewa (1992).

up only about 19% of the cost (Gandillot, 1994: p. 32). In a corresponding fixed venue, such as, e.g. the Viennese Burgtheater, the fixed cost of employment is a very high share of the total. Indeed, at this particular theatre, many artists and directors are fully employed but do not perform at all, which drives up costs significantly (see Wahrnehmungsbericht des Rechnungshofes, 1994: pp. 16–19). Most employees (administrative, technical and artistic staff) paid by a festival during summer have their main and permanent occupation at a concert or opera house, which covers the overhead costs of retirement benefits, health insurance and vacation time. These expenditures today can constitute a considerable share of the gross income of such employees. Festivals may therefore hire people at a correspondingly low cost. The deal is profitable for both sides: the employees receive additional income during their "holiday" time, and the festival gets artists and workers whom it would otherwise find too costly to hire. This does not mean that a festival’s artists and employees are badly paid; the opposite is often true.† The prospective employees do have bargaining power, especially when they constitute part of a festival’s image, which is true for instance for the Wiener Symphoniker and the Salzburger Festspiele. The festival directors are, on the other hand, not helpless as they can threaten to turn to different orchestras and artists and can thereby prevent their own rent from being dissipated.

The festival directors also have the opportunity to exploit the fact that most artists have double (or multiple) employments. They can implicitly cross-subsidize the festival by shifting part of the cost to someone else. A director may, for instance, pay an employee more at his concert or opera house than he or she would get on the market, with the understanding that he or she will work at a lower than market wage at the festival he or she is involved in. In this case, both the festival organizers and the employee are better off, and the cost is paid by the taxpayers who have to make up for such employment practices by increased subsidies.

In many cases, festivals reduce production costs by using existing structures and production technology of a permanent musical concert or opera house. As the hall and theatres are normally unused during the festival period (in summer), the owners are generally prepared to rent them at a low price, or free of charge. This also applies in the many cases where festivals take place in a church or a historic monument such as a Roman arena.

A second major factor favouring festivals on the supply side is that they permit evasion of the restrictions imposed by the

† As, for instance, at the Salzburg Festival, where workers, the administrative staff and the artists get incomes clearly above market wages, i.e. they derive sizeable rents, as shown by Frey (1986).
government and unions on conventional venues. Established (stationary) musical institutions have increasingly been burdened by a straitjacket of restrictions which makes it difficult, and sometimes impossible, for enterprising conductors and other musicians to reach their artistic and personal goals. In Europe, typical houses are either closely controlled by, or are simply part of the public administration. They are moreover unionized, which strongly restricts flexibility and kills incentives (for empirical evidence, see Frey & Pommerehne, 1989: chapters 2 and 3). The restrictions are related to salaries and wages (there are fixed scales independent of performance), hiring and firing (after some years it becomes impossible to dismiss an artist under contract), the collaboration with private and corporate sponsors and recording companies, and the prohibition of appropriation of the gains from successful commercial enterprises in the arts. Festivals, in contrast, are usually established as private institutions in which the government’s role is at most one part of the whole, and where, as a consequence, the organizers are much freer to pursue a policy that suits their own wishes. Unlike the traditional venues where the government often imposes maximum salaries (this is, for example, the case in Italy), festival directors may hire superstars even at high salaries if they expect them to attract sufficient additional visitors, and facilitate a sufficient rise in entry fees, to be profitable. As the festivals play only temporarily (often only one or two weeks), there is practically no permanent employment, so that trade unions restrictions on hiring and firing are irrelevant. Moreover, the organizers can seek the form of collaboration with sponsors and recording companies that is in their own interest. Indeed, while concert and opera houses often have fixed contracts with recording companies, festival organizers may play them off against each other, improving their bargaining position. The commercial fruits of a festival can to a large extent be appropriated by the organizers; the profits achieved can, for instance, be used freely to pursue other, loss-making artistic ideas (cross subsidization), but they can also be used for more mundane purposes, above all to increase one’s income.

These two supply factors are the major reasons why so many festivals have been founded and have expanded all over Europe. The situation is different in the United States, where at least some opera houses—the Lyric Opera in Chicago and the Metropolitan Opera in New York for instance—and many orchestras are private though they get indirect (and some direct) government support as donations are tax-exempt (see Netzer, 1978) and therefore do not suffer from public regulations to the same extent as do European performing arts institutions. Organizers of festivals in the U.S. have, for the same reason, fewer opportunities to shift fixed costs to the existing concert and opera houses. One would therefore expect that the incentive to run musical festivals is weaker than in Europe. Though there certainly exist several festivals in the United States—the best known being the Berkshire Music Festival known as Tanglewood, the Aspen Music Festival in Colorado and the Wolf Trap Festival near Washington, DC (for a survey see Rabin, 1990)—there are fewer of them than in Europe (Merin & Burdick, 1979). Thus, the empirical evidence is consistent with our theoretical proposition.

3. What remains of Baumol’s Cost Disease?

The discussion so far has identified major differences between traditional (fixed) venues and festivals on both the demand and supply sides. While the consequences for unit labour cost have been mentioned, we have not analysed whether festivals enjoy a lower growth rate of unit labour cost than the traditional venues or whether they enjoy a lower unit labour cost level. This difference is crucial: if there is lower growth in cost, Baumol’s Cost Disease can be permanently overcome, and the live performing arts can flourish in the form of festivals. If, on the other hand, the unit cost level of festivals is lower, Baumol’s Cost Disease is only temporarily alleviated. The overall cost level of live performing arts is only shifted downwards as long as the share of cultural activities in festivals rises at the cost of the traditional venues. Once an equilibrium is reached, i.e. when the output shares between the two sectors of live performing arts are constant, the Cost Disease again raises its ugly head. The growth rate in unit labour costs would then not be different from the one in the traditional venues, and the growth in wage rates would again dominate the low or non-existent growth in labour productivity.

Among the differences identified, two factors lead to a permanently lower growth rate in unit labour costs. Both relate to institutional differences. The first is the fact that festivals are not part of the public sector, and therefore have considerable leeway and incentives to introduce technical progress and to adjust quickly to the permanent relative price changes. The second institutional factor contributing to a permanently lower growth in unit costs is the smaller influence of trade union restrictions and regulations. On the other hand, several of the differences identified constitute a lower cost level only. Thus, employment during the holiday season, the larger share of volunteers, the more extensive use of low cost performance sites, and the easier access to the support by recording firms and sponsors constitute a once-and-for-all cost advantage of festivals relative to traditional venues. As long as there is a shift of activities towards festivals nourished both by these cost advantages as well as by demand, live performance
activities have a lower labour unit cost increase than if there were only the traditional opera, concert and theatre activities.

In order to assess how far the Cost Disease applies in reality it is useful to distinguish four stylized stages of the relationship between festivals and traditional venues.

Stage (1). The fixed live performance establishments dominate and the festivals are quantitatively unimportant. Baumol's Cost Disease then fully applies.†

Stage (2). Festivals attract an increasing share of all visitors to live performance events. This has been the situation over the last decennia (for evidence, see the Deutsche Theaterstatistik 1990/91). At this stage Baumol's Cost Disease is at least partly overcome in the live performing arts by the structural shift from high unit cost production in the traditional venues to the lower cost production in festivals.

Stage (3). Festivals attract a constant share of visitors to live performance events. This situation is reached in those countries in which the scope for festivals has been fully exploited. This is likely to be the case in countries with a very large number of festivals of serious music, theatre and opera, in particular in France and Italy (see the evidence in Section 1). In such countries, both the traditional venues and festivals experience continuous cost pressure, and Baumol's Cost Disease is virulent.

Stage (4). In the long run, festivals may not even enjoy a lower level of labour unit costs than the traditional venues. The major reason for this development is that long-established festivals become increasingly similar to the fixed venues and therewith lose their cost advantages. In many ways, festivals such as Salzburg, Glyndebourne, Stratford or Bayreuth are confronted with the same problems as the fixed venues (see Frey, 1986; Mitchell & Wall, 1989). In particular, government and trade union intervention becomes important, which results in inflexibility and rent seeking instead of efforts to increase labour productivity. In so far as such festivals have themselves become “established” and “fixed”, they have to pay similar gross wages, and capital costs. Such festivals usually have their own houses and have to carry the corresponding maintenance and capital costs. The very success of the festivals undermines one of their major cost advantages: they can no longer “exploit” traditional venues by hiring many of their employees during the holiday period, but they now have to deal with freelance workers.

† The provisions mentioned in Section 1, of course, apply. In particular, the financial difficulties of the fixed venues are mitigated in the case of operas, theatres and concert houses profiting by an income elastic, and a price inelastic demand. See the empirical evidence in the footnote on page 3.

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artists and workers who are no longer regularly employed in a traditional venue. Already today, a significant share of superstars are not regular members of an opera house, theatre, or orchestra. Under these conditions, the Cost Disease is in full vigour in the live performing arts.

4. Conclusions

The analysis has shown that the emergence and even “explosion” in the number of festivals has important effects on live performing arts. At the present time, as long as they constitute an increasing share of the corresponding art supply, and as long as they profit from favourable institutional conditions (little government and trade union intervention) they are temporarily able to overcome Baumol's Cost Disease. However, the more they grow in importance, and the more established they become, the more they lose their capacity to exploit their cost advantages and to raise labour productivity. While festivals have made important contributions to the survival of the live performing arts, cost pressures are likely to become severe again. Looked at from this perspective, the future of the live performing arts looks rather grim again—except if there is another, as yet unknown, innovation as the festivals were previously. But this is mere speculation since it is (by definition) impossible to predict innovations.

References


