Globalisation of Intangibles
Report by Daniel Cohen and Thierry Verdier

Globalisation is everywhere. From software to TV series, from hamburgers to jeans, globalisation is becoming intangible and abstract. It communicates ideas, innovation and symbols that statistics can barely follow. As the effects of globalisation are latent, the French are concerned about preserving French lifestyles and cultural references. The vast majority of the French already find that the US has an excessive influence on the cultural industries. These fears and the resulting political reactions can jeopardise the internationalisation process and the related gains. This report aims to offer a better understanding of the intangible aspects of globalisation.

This report was presented to Christine Albanel, French Minister of Culture and Communication, on 23 May 2008 at the CAE’s plenary session. It was also presented to Éric Besson, Secretary of State for Strategic Studies and Public Policy Evaluation. This report, written under the auspices of the permanent unit outlines the analyses and presents the main conclusions drawn from them.

International trade involves nearly 80% of industrial goods while services in the broadest sense of the term represent nearly 70% of business and employment in a number of countries. Although «tangible» sector is holding strong, globalisation has an increasingly intangible component, which is encroaching on the entire cultural domain.

This report presents an assessment of the situation. For a number of cultural services, globalisation means «Americanisation», since the hierarchy and market share play in favour of the United States. In Europe, France is doing rather well, in terms of cinema and books as well as for other references such as pharmaceuticals. Among the proposals, we would like to put particular emphasis on the proposal suggesting that a book be available in an electronic, downloadable version after a reasonable period of time, offering compensation to cover the publishers’ and authors’ loss of earnings.

Christian de Boissieu
Executive Chairman of the CAE

Globalisation and Americanisation

We see the same pattern in each sector with a strong intangible component. National producers often hold the majority, averaging two-thirds of national production, with two major exceptions, software and cinema. The other third is mainly imported from English-speaking countries. This predominance stems from both economic and cultural factors.

The economic factor is explained by the fact that US firms have a large domestic market that is virtually airtight to foreign imports. As such, they can amortise the fixed costs spent on innovation and design, which facilitates price competition abroad. The fact that the US pharmaceuticals market represents 50% of the global market has a direct impact on the strike force of US laboratories. However, the size of the US market is not an ‘exogenous’ factor. Medicine is more expensive...
in the United States, which makes pharmaceutical companies more profitable. And if French policy succeeded in imposing lower prices, it is partly for this very reason....

The cultural factor is more complex. The United States, through cinema and television, seems to have won over French hearts and minds, giving them incomparable appeal. The high number of books from the United States that are translated into French attests to this, considering publishing is not a sector with a considerable economic advantage. The hypothesis is that the images given by the different sectors of the cultural industry all convey the same message: globalisation essentially means competition between national production, which holds the majority, and US production.

In this respect, the situation of the cultural industry is identical to that in other intangible-intensive sectors. The issue at hand is not so much the threat felt by national producers but involves fears of the advent of a form of globalisation that boils down to imports from the United States. Europe, like the rest of the world, is unable to create the same ‘diversity’, be it cultural or technological. The Europe of culture, of ideas, of intangibles, has yet to come.

The possibility cannot be ruled out that this American preponderance in terms of imports could be due in part to the instruments of economic policy used in France. In both the IT and pharmaceutical sectors, France is torn between the role of ‘illegal passenger’ and that of innovator. It uses knowledge produced elsewhere but is reluctant to produce it in France. The very high level of IT services, which use the latest expertise, should be compared here to the less impressive performance of the software industry. In the cultural industries, television broadcast quotas undoubtedly play a role, which tend towards a dual structure comprised of national producers and US producers, thus undermining the cultural diversity intended.

International trade in services

The first challenge encountered when looking into the globalisation of intangibles involves defining the scope of analysis. The separation is traditionally made between goods (tangible) and services (intangible). However, this distinction has become increasingly blurred. Certain activities that are included as services in fact have a number of features of goods. This is the case for IT programs, films, recorded music, etc., which are often stored on physical media and can therefore be sold as ordinary goods.

The second problem is measurement. Unlike the trading of goods, the international trading of services cannot be measured solely based on the flows recorded in the current account of the balance of payments. This measure only takes into account cross-border provision of services (when the service itself crosses the border) and foreign consumption of services. However, when a service provider sets up long-term operations abroad or physically travels, the sale of services does not appear in the current account.

In the French balance of payments, the trade in services (excluding travel) stood at EUR 60 billion in 2005, imports and exports combined. Three aspects of this figure should be examined more closely. The sub-set of royalties and licences, which generated EUR 5 billion in exports and cost EUR 2.5 billion in imports. IT and information services, which together accounted for EUR 1.4 billion represented EUR 1.1 billion in revenues and EUR 1.5 billion in expenses, coming out at a net import.

According to Isabelle Bensidoun and Deniz Ünal-Kesenci, as high as these figures are, they underestimate the international flow of services. Moreover, we should add to these figures the trade in services that correspond to a service supplier’s commercial presence in the host country which is the consumer of the service (third mode of supplying services under the GATS). This is far from insignificant: in France, approximately three fourths of international flows of services are through this mode.

General issues for economic policy

The economy of intangibles is set apart by high increasing returns, static and dynamic externalities due to network effects, the winner-takes-all principle, size effects, predomination of oligopolies. These features give cause for concern over how well-adapted specific public policies are at the national, regional or global level.

From the point of view of standardisation, the issue at hand is the best way of pricing these goods. On a strictly theoretical level, the answer is clear. ‘One-shot’ payment is the worst system since consumers unnecessarily ration themselves. Once the intangible good is created, it can be consumed by as many consumers as possible at no additional cost. Any price similar to a set price is the best option. However, the cultural industries have thus far always focused on the one-shot payment system. A book, CD or DVD is the physical package that requires the consumer to make an individual purchase. As Olivier Bomsel so eloquently put it, we pay for the signifier to get to the signified. In fact it is the package that is the most expensive, the author’s and publisher’s share does not exceed one fourth of the total value.

The digital world has turned this model upside down since the good consumed is totally dematerialised, hence deprived of its package. That is why it has shaken up pricing policy. For cultural industries with a business model that cannot dissociate the one-shot payment from the physical package, this is indeed a revolution (with radio and television being the exception).

The report examines this problem for each sector.

Publishing

For now, books seem to have better resisted the intrusion of digital products than music. The sale of novels, art books and manuals has not changed or has changed very little. Why is that? Several explanations can be given, but the simplest is that the unit between the signified and the signifier resists wear over time. Buying a book without waiting until it comes out in a paperback version is a source of pleasure in itself: the pleasure of the paper remains, like that of browsing through a bookstore or keeping it in a library.

Françoise Benhamou notes that, despite this privileged relationship we have with books as objects, some areas of the publishing sector will end up having to switch to digital. The world of books has been disrupted by Google’s universal library, which has set out to digitise public domain books and extracts from books that are still under copyright. Two observations should be made. First, a large number of classic books are already digitised and paperback book sales do not seem to be suffering, which confirms the appeal of books as objects. Second, an overwhelming majority of books that are not yet in the public domain eventually fall into oblivion to lie forever dormant.

Proposal No. 1. We could consider that, after ten years, a book can be digitised and downloaded (subject to the rights of eligible parties). The loss of earnings, which would appear to be low, would be refunded to publishers and authors by the Minister of Culture on a prorata basis based on downloads or actual sales over the first ten years.
Music

Measuring the globalisation of the music sector is even more difficult than for the publishing sector. The development of downloaded music and the growing importance of other forms of music consumption whose flows are difficult to track (concerts, radio/TV broadcasts, synchronisation) make any measures uncertain.

Music is the sector that is the most threatened by P2P (peer-to-peer). A non-cooperative game has been established between service providers, components manufacturers and content providers, to the detriment of the content providers. The iPod, which was thought to contribute to a model for one-shot payment, has turned out to be a Trojan Horse of free downloads. The ideal formula would actually be a set subscription rate offered by providers for free access to their entire libraries. In addition, these subscriptions would ideally be multimedia: mobile phone and internet without paying twice.

Proposal No. 2. The Conseil de la concurrence (Competition Council) should act as a stimulus by looking into the subscription interconnection.

According to the studies available, it would appear that internet users are willing to spend EUR 7 per month for an unlimited subscription to music. According to François Moreau, it would only take one third of internet users to pay for this subscription for the entire business (excluding physical distribution costs but including margin and promotional costs) to be financed. What is stopping them? For now, the sector still considers that it makes more money with the one-shot payment system. The profits gained by one-shot payment are diminishing but attractive enough to be maintained.

A remark should be made on this point. The music industry does not miss its past glory so much as its recent glory. The excellent revenues generated in the 1980s and 1990s are primarily due to the fact that consumers had to buy their favourite music from their youth a second time in going from vinyl to digital. New technologies helped them make a lot of money without doing much. What one technology gives, another takes... It should also be noted that downloading mainly concerns best sellers. They may not want to live off the sale of derivative products, i.e. giving concerts or selling T-shirts. But what is the difference with living off radio advertising?

Pharmaceuticals

Claude Le Pen shows that the sector fully participates in the economy of intangibles. The pharmaceutical industry is actually one of the largest creators of ‘intangible added value’ in France. Ironically, in France, and more generally across Europe, socialised financing of healthcare spending often helps put this observation into perspective: the pharmaceutical industry is undoubtedly the only industry whose growth is being capped by politicians! Or, they fall into contradiction by favouring the development of research and laboratories while trying to curb growth in revenues.

One reason for this paradox is based on the quite accurate idea that the development of biopharmaceutical research is worldwide, and the social welfare deficits are local! As each government regulates its own healthcare spending, with the pharmaceuticals component often changing, it is unaware that it could be putting global research in any danger. Except if, as in the prisoner’s dilemma, this selfish attitude spreads, which could possibly end up in a stable balance that is less than optimal. It is most certainly this attitude that has driven European prices far below those practiced in the United States, as the price difference is the primary factor behind the performance of the pharmaceutical industry in the two regions.

Proposal No. 3. To avoid this non-cooperative balance, it would seem natural for European authorities to try to harmonise pricing policy. Without going so far as creating a government agency that would set prices applied by the different national health systems at the European level, we could at least consider how to provide an indication of appropriate prices.

IT sector

In 20 years, the IT sector has gone from the hardware era to the intangible and service era. In 2006, IT spending represented EUR 460 billion in Europe (of which EUR 76 billion in France) as opposed to EUR 560 billion in the United States. According to these figures, IT spending would not differ that greatly between the United States and Europe. However, the United States pours much more into R&D (20% of total R&D in the United States, versus 8% in France) and production than the French.

It is perhaps odd, though, that technological implementation is slower in the United States. For example, in terms of computerisation, US banks are fifteen years behind French banks. US companies must amortise the heavier innovation expenses. As a result, they are more reluctant to change systems, as they prefer to amortise the hardware already installed. However, they do not hesitate, once the new technologies are installed, to take advantage of the benefits, notably by reducing staff whose positions have become obsolete. The opposite situation is at play in France. As the French are not on the creation frontier, they benefit from the lag to use the best technologies. However, they are behind in reorganising work in proportion to new technologies. These two opposite effects may cancel each other out, which might explain why France is not that far behind the United States in terms of work productivity. This symmetry is found in business start-up statistics. In the software sector, the portion of French companies is one third, while other suppliers are from the United States (IBM, Oracle, Microsoft, etc.). However, in IT services, the portion of French companies is 69%, here again reflecting the supremacy of national companies when dealing with end consumers.

Cinema

This sector confirms the polarisation of the domestic market between French and American cinema. On the French market in 2004, the market share for national films was 38% and 48% for American films. It should be noted that United States is even more present in the rest of Europe, where it has reached 71% of the domestic market. The biggest box office successes that are not French or American films are, minus a few very rare exceptions, imitations of Hollywood productions, with recent ex-am-ples being Harry Potter (produced in the United Kingdom) or the Lord of the Rings (New Zealand). Pierre-Jean Benghozi pointed out that France is an exception, insofar as the market share for French cinema on its domestic market is far higher than the national cinema of our main European neighbours, as is the performance of French cinema abroad.

Television

Again, on the domestic television market, there are two dominant cultures: national and American programs. According to the CSA (Conseil Supérieur de l’Audiovisuel), in 2001, French fiction represented 26% of all fiction programmes on the terrestrial network, while American fiction represented 52% and non-American fiction 17%. As Jacques Peskine pointed out, if we look at prime time programming, which is more representative of radio and television consumption, 75% of fiction programmes on the main French networks are French and 25% are American.
Moreover, the report examines the utility of programming quotas in terms of how they can be applied efficiently to policy aimed at ‘cultural diversity’. Against the backdrop of international media competition, quotas notably end up favouring firms that already have a large domestic market, basically, US firms. Ironically, the end result is far from preserving access to cultural diversity at a European level but reinforces the cultural ‘hub & spokes’ situation. As the United States enjoys the central ‘hub’ position, exporting its cultural production to European ‘spokes’ in which competition only comes into play between fragmented local production and imports of American programmes.

From an economic point of view, favouring a more price-based policy and pricing system for foreign programmes, both with the objective of promoting cultural diversity, presents clear advantages. First of all, government action would be more transparent. With a single objective, pricing policy could be observed directly in the prices, and these effects are easier to quantify in terms of government policy. This allows for a better appreciation of the gains and losses and therefore improved democratic debate on the validity of this policy. Therefore, a move in favour of a pricing policy tends to reduce the anti-competition effects of quantitative restrictions in the case of oligopolies. At the same level of foreign penetration, economic efficiency would be increased in favour of the consumer. Moreover, by reducing the segmentation effects of the European market, this kind of change would minimise the adverse effects that result in privileging quantity over quality in the choice and allocation of television programmes. Lastly, a pricing instrument helps generate tax revenues that can be used to facilitate reform from the point of view of economic policy. These revenues can be allocated to certain segments of the sector so as to compensate the losses caused by the change in policy and thus justify the reform politically.

Proposal No. 4. One suggestion would be to lower the quotas on European programmes to 50% in line with the proportion applied in most other countries. In exchange, the tax on revenues generated by broadcasters, including new broadcasters (notably mobile phones) could be raised. How to use these additional revenues would be discussed amongst professionals. They could be used to structure better offers and broadcasts of European programmes, with the backing of, for example, Eurimage of the European Council.