

**E**uropean  
**C**ultural  
and **C**reative  
**I**ndustries  
**A**lliance

Frontier Economics report prepared for ECCIA

**The contribution of the high-end  
cultural and creative industries  
to the European economy**

November 2014



REPORT PREPARED BY FRONTIER ECONOMICS

European  
Cultural  
and Creative  
Industries  
Alliance

# The contribution of the high-end cultural and creative industries to the European economy

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## Key figures

- Since the publication of the first report presented by the European Cultural and Creative Industries Alliance (ECCIA), **the European Union has recognised the unique nature of the European high-end cultural and creative industries' business model and their role as key drivers of competitiveness, growth and jobs.** In 2014, the European Commission, Parliament and Council endorsed these industries as a model to follow for the European industrial renaissance.
- Based on research commissioned through Frontier Economics, ECCIA is pleased to report that **Europe's high-end culture and creative industries have continued to deliver strong performance,** as demonstrated by the key indicators reported in table 1.

**TABLE 1: Key performance indicators 2010 and 2013**

INDICATOR	2010	2013
Value of Sales (billions of Euros, current prices)	428	547
Europe's share of global sales of high-end industries	70%	70%
Sales as proportion of nominal EU GDP	3%	4%
Estimated direct and indirect employment	1.5 million	1.7 million
Estimated value of exports (f.ob., billions of Euros, current prices)	245	308
Share of EU merchandise exports	17%	17%

- In nominal terms, **the value of goods and services produced by the sectors grew by nearly 28% between 2010 and 2013.** In the same period, the size of the sector, when compared to EU GDP, increased from 3% to 4%. By way of comparison, this would have made the industries, taken collectively in 2013, **the seventh largest economy in the EU and the 20<sup>th</sup> largest economy in the world.**
- As impressive as they are, **these figures understate the full economic contribution of the sector.** This is because they do not capture the value of **significant spillovers** to the tourism and travel industries, and knowledge spillovers to upstream suppliers that support the development of skills-based clusters and manufacturing capability.
- The research commissioned by ECCIA highlights **the value that the EU as a whole would derive from continuing to ensure that a suitable policy framework is in place that would enable the high-end cultural and creative industries' model to flourish.** The key elements of such a policy framework are: selective distribution, the protection of intellectual property, digital governance and market access.

# 1 Introduction

In 2012, the European Cultural and Creative Industries Alliance (ECCIA) submitted a report, prepared by Frontier Economics,<sup>1</sup> to the European Commission and Parliament emphasising the specificity of the European high-end cultural and creative industries and their contribution to the European economy and society.

The report identified high-end industries as a horizontal sector comprised of 12 sectors of activities, including: watches and jewellery, fashion, perfumes and cosmetics, accessories, leather goods, hotels (and leisure experience), gastronomy, furniture and furnishing, design household equipment, cars and yachts, wines and spirits, retail, art and antiques and publishing.

In particular, the report:

- Established the strong comparative advantage enjoyed by these industries globally, as they accounted for nearly 70% of the value of global sales;
- Valued the sales of these industries as equivalent to approximately 3% of EU GDP;
- Estimated that these industries directly generated approximately a million jobs across Europe and indirectly a further half a million jobs.

The findings of the report were subsequently recognised and validated through work undertaken by the European Commission.<sup>2</sup> In particular, **the Commission recognised European luxury industries as being part of the cultural and creative industries and the importance of creating a policy framework that supported their growth.** Particular attention was given to the four pillars of policy that are central to the business model of these high-end industries, namely: **selective distribution; intellectual property; governance of the internet and market access.**

More broadly, the European Commission has also identified the role high-end cultural and creative industries have to play as part of a broader strategy for reinvigorating industrial activity in Europe (described in the strategy for a “European Industrial Renaissance”)<sup>3</sup>. This recognition reflects a number of factors.

First, the particular business model followed by high-end industries helps them to retain comparative advantage for the European Union in a particular area of manufacturing, at a time at which mass-market manufacturing gravitates towards lower-cost emerging economies. This advantage lies in part in the skills and knowledge-intensive nature of these activities, but also in the fact that such industries, by definition, **draw on a cultural heritage and traditions that cannot be replicated by others**, and that act as a point of differentiation for these industries.

Secondly, **high-end cultural and creative industries generate spillovers to the rest of the economy.** These can occur through a number of channels, including: the contribution made to activities such as tourism; the significant investments made by high-end cultural and creative industries in skills and training; the long-standing relationships established with networks of upstream suppliers preservation of traditional

<sup>1</sup> Frontier Economics (2012), *The Value of Cultural and Creative Industries to the European Economy*.

<sup>2</sup> See in particular European Commission (2012), *Commission Staff Working Document – Competitiveness of the European High-End Industries, SWD(2012) 286 final*; and European Commission (2013), *Action Plan for Fashion and High-end Industries*.

<sup>3</sup> European Commission (2014), *Communication for a European Industrial Renaissance, COM (2014) 14/2*.

European *savoir-faire*; and, most importantly, their **contribution to Europe’s “soft power” and their role as an Ambassador of European values** (such as quality, excellence, craftsmanship, creativity, culture) on the world stage.

The purpose of this report is to provide updated evidence of the high-end cultural and creative industries’ contribution to the European economy, particularly in light of the positive policy responses elicited by the previous report, and the continuing need to maintain the four policy pillars, mentioned above, that are supportive of the industries’ contribution. The report also addresses in greater depth specific aspects of the wider economic and social contribution made by high-end industries.

## 1.1 Approach to this project

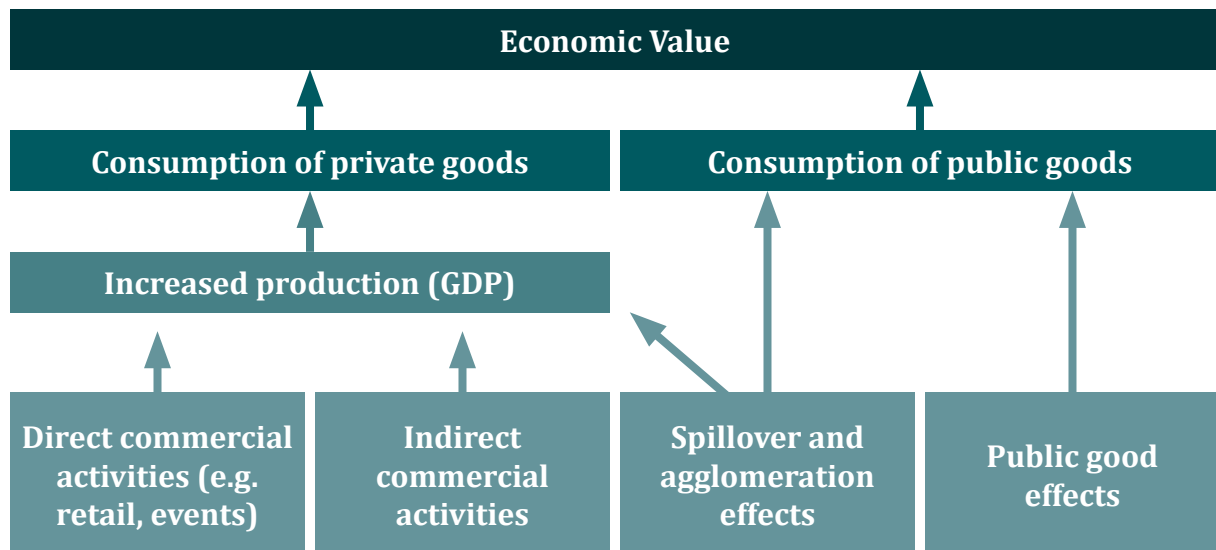
From an economic perspective, the value of a particular set of activities is defined by their **contribution to the overall welfare of society**. By applying this *general* analytical approach, we aim to demonstrate the *specific* contribution made by high-end cultural and creative industries.

Figure 1 sets out the framework we propose to use. At the top it shows that economic value is measured, in the final reckoning, through the value consumers receive from buying goods in the private market and by consuming what are termed as ‘public goods’. For example, if firms become less productive and have to push up the prices of private goods to cover costs, then consumers are worse off and there is less economic value in the economy. Alternatively, if companies located in an area improve the ‘quality of place’, then those that visit that district are consuming a public good and are better off, and economic value is enhanced.

The four boxes at the bottom of the diagram show how this value is generated on the supply side.

- The first box on the left highlights the direct economic contribution of high-end cultural and creative industries through commercial activities. This is the core contribution of high-end activities. This core contribution can require policy support to protect it from market failures - for example, the ability of pressures in the market to undermine the aura and experience associated with the purchase of high-end products.
- The second box highlights indirect effects that are created by linkages with other industries, such as European industries supplying inputs to high-end design. Both the direct economic contribution referred to in the previous paragraph and the indirect commercial linkages will be captured in conventional economic statistics such as GDP, and contribute to economic value through private consumption. Policy action can be required here too – for example, if there is a market failure (or government failure) in the supply of appropriate skills and capabilities to provide high-end inputs.

**FIGURE 1: Overview of approach**



The right hand side of the diagram captures the wider economic benefits referred to above. These are areas that if significant in the sector will require specific policy arrangements.

- The fourth box covers spillover effects (for example, associated with skills and talent-creation) which enhance productivity across not only high-end industries but also other industries of the economy. They also include agglomeration effects – a high density of creative individuals and organisations can attract further talent and skills (not necessarily confined to high-end industries) and thus act as a further catalyst for growth.
- The fourth box includes public goods – for example, the contributions high-end retail outlets make to the quality and attractiveness of city centres.

In summary, our overall approach to assessing the economic contribution of high-end industries will therefore consist in documenting and, where possible, quantifying the various market and non-market channels set out above. On the basis of the analysis, we will consider the implications for policy intervention to enhance performance in each of these areas.

## 1.2 Structure of this report

This report is structured as follows:

- Section 2 summarises the key features of the high-end business model, and links these to policy issues
- Section 3 describes key trends and developments in the economic contribution of high-end industries
- Section 4 describes wider non-market effects
- Section 5 discusses the implications for policy
- Section 6 sets out some conclusion
- Section 7 summarises ECCIA's policy recommendations.

## 2 The key features of high-end cultural and creative industries

Recent European Commission publications and policy pronouncements regarding high-end cultural and creative industries recognise that the business model for these industries rests on a cluster of key concepts. These were also documented in previous work commissioned by ECCIA<sup>4</sup>. The concepts underpinning the business model are also critical to the economic contribution of these industries, and therefore have implications for policy.

### 2.1 Key features

#### 2.1.1 Aura

The aura of luxury relates to the **quality** of the product, and the perception of status and exclusivity that is associated with it, both in the eyes of the consumer and, significantly, amongst the wider public. This aura, combined with the **craftsmanship** involved in producing it, constitutes the key point of competitive differentiation for luxury cultural and creative industries compared to other industries. The aura in part draws on the **cultural and traditional heritage** in relation to the product's provenance, and the fact that this **heritage acts as a signal of quality**. The consumer is aware that when purchasing a product, he or she is accessing this **tradition of heritage and creativity**. An important factor behind the "aura" of luxury industries lies in the **retail service provided to the consumer** through, for example, personalised attention and after-sales care. The competitiveness of luxury cultural and creative industries therefore depends on its ability to provide and control the combination of a luxury product with the highest level of service.

#### 2.1.2 Craftsmanship and creative people

##### Suppliers

The market positioning of luxury products relies on maintaining high levels of quality. This has implications for the organisation of the supply chain. In particular, firms in luxury cultural and creative industries will need to invest substantial resources into screening high quality from low quality suppliers.

As a result, **many supplier relationships in the luxury industries are long-term**, spanning many years. These long-term arrangements are a distinctive feature of the luxury cultural and creative industry supply chain, that **distinguish them from premium and mass-market manufacturers**. In particular, luxury manufacturers do not favour high-frequency procurement from upstream suppliers which is based solely on cost considerations and instead value the importance of predictability of quality and the specific skills born out of a long-term relationship with a particular supplier. The advantage of these long term arrangements is a virtuous circle in that they reduce search costs for the high-end cultural and creative industries, and in turn increase the **incentives for upstream suppliers to maintain quality and to innovate**. Such relationships also favour the tacit transfer of knowledge (see in particular section 4.2.1 for a further discussion).

##### Manufacturing

The leading luxury brands all invest heavily in training and developing their skilled workforce, as well as in developing world-class manufacturing facilities. Analysis suggests that **luxury goods companies spend over €700 per employee on training**. Given the size of the European luxury workforce, this suggests that the sector spends over €700 million per year on training. Initiatives include formal training, courses and partnerships with tertiary institutions engaged in research.

<sup>4</sup> Frontier Economics (2012), *The Value of the Cultural and Creative Industries to the European Economy*.

### 2.1.3 Intellectual Property and Innovation

Given that **research, continued product development, skills and branding are key components of the value proposition to consumers of high-end cultural and creative industries**, and a key source of their competitive advantage, it is unsurprising that intellectual property (IP) plays a vital role in their development. **The protection of IP is also vital to securing innovation and creativity** both in products and in processes.

More broadly, innovation and creativity are central to ensuring the product positioning of high-end producers in the market. In this context, **innovation and creativity in the high-end industries take a different form to innovation in a number of other industries**. In these other cases, cost-efficiency gains are important drivers of competitiveness, and are thus the focus of process innovation. However, cost-efficiency gains are of secondary importance to high-end cultural and creative industries. The **focus of innovative activity is on non-technological innovation such as design and product quality** – hence the need for continued investment in skills and capacity as described in the preceding section.

### 2.1.4 Selective Distribution

**The way in which distribution is organised is essential to high-end cultural and creative industries** since, as observed above, it is a key mechanism through which the aura of the product is communicated. Moreover, the retail experience is an integral element of the bundle of goods and services purchased by the consumer. Key concerns of high-end cultural and creative industries include pricing strategies – in particular, luxury cultural and creative industries do not favour price-discounting since that can adversely affect the aura of the product. High-end cultural and creative industries will also be concerned about the level of promotional effort and customer care.

As with all industries, high-end cultural and creative industries face a choice of managing distribution through vertically integrated structures (i.e. wholly owned retail facilities), or through selective distribution contracts with retailers, who may stock multiple brands. In practice, a range of arrangements are observed, even within the same firm. These reflect, principally, differences in ways in which firms weigh the trade-off between the commercial risks of managing retail operations (which may not lie within the core competence of the firm) and the risks associated with loss of control over retail operations. In sum, **selective distribution is vital in order for the industries to maintain control over their value chain and thereby ensure excellence from the creation of their product to the relationships they develop and nurture with their clients**.

Recent research suggests a trend towards greater direct control: the share of direct retail is projected to increase from 31% to 40% between 2013 and 2020, even though multi-brand wholesale and department wholesale are set to remain important channels too. The share of online sales relative to overall personal consumption is projected to increase from under 5% in 2013 to 14% by 2020.<sup>5</sup>

### 2.1.5 Orientation towards global markets

European high-end cultural and creative industries have actively drawn on their appeal, which is intrinsically connected to long-standing traditions of craftsmanship and Europe's cultural heritage, to tap into global markets. In recent years, the high-end cultural and creative industries have achieved strong growth in affluent and aspirational customer segments in emerging market, notably in South America, East and South East Asia, Eastern Europe, the Middle East, and parts of Western and Southern Africa.

While exporting to these markets is an obvious mechanism, **a substantial proportion of sales to customers in these markets occurs through travel and tourism** i.e. customers from these markets travelling to Europe to purchase these products as an integral part of their travel experience. This has given rise to the phenomenon of "Shopping Tourism", which we explore in greater detail in section 4.2.1.

5 Research conducted by Exane Paribas for Altgamma. (2014), *Altgamma Retail Evolution – 2nd edition*

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## 3 The economic impact of high-end industries: recent trends and developments

### 3.1 Key indicators

#### 3.1.1 Value of output

High-end cultural and creative industries have recorded strong growth in sales, employment creation, and exports, building on the trends already documented in the previous study submitted by ECCIA in 2012. **This continued high level of performance reflects the core elements of the business model that has allowed the industries to retain their competitive edge.** The industries have proved their resilience in the face of two key unfavourable trends: persistent slow growth in European and other advanced economies, which admittedly has been partly offset by the strength of emerging markets; and the continuing problem of counterfeiting. As documented in section 3.2, the incidence of counterfeiting activity, as measured by customs interceptions, increased by around 15% between 2010 and 2012.

The global market for high-end cultural and creative industries was valued at a little over 790 billion Euros in 2013. Table 2 and figure 2 report, respectively, the value in euros, of sales in key high-end industries<sup>6</sup>, as well as shares between Europe and the Rest of the World.

**The results show the continued dominance of Europe for these high-end markets as a whole** (70% of total sales) and in all specific industries with the exception of luxury yachts, and hotels and leisure.

**The value of total sales accounted for by Europe in 2013 represented around 4% of total EU GDP.** By way of comparison, **if high-end industries taken together were an economy, in 2013, they would be the seventh largest in the European Union and the 20<sup>th</sup> largest economy in the world.**

<sup>6</sup> We note that this figure does not currently include a global estimate of the value of the retail, auction house and publishing industries, and so will underestimate the total value of the global high-end market.

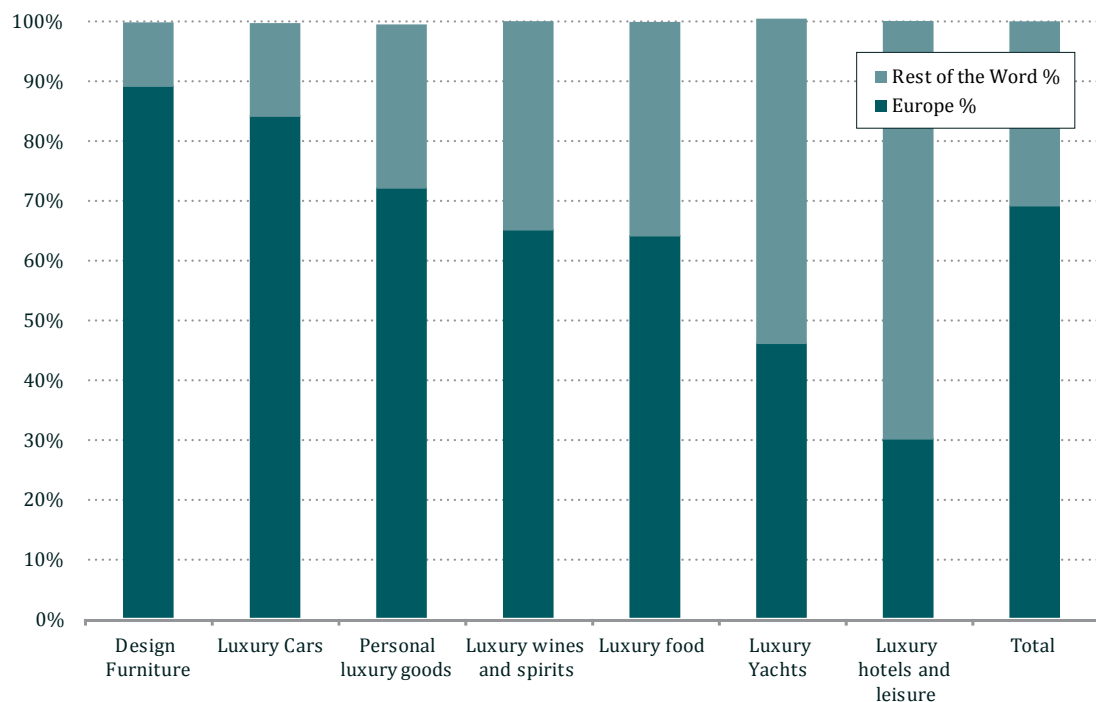
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**TABLE 2: Breakdown of value by geography (2013)**

	GLOBAL VALUE € BILLION	EUROPE € BILLION	REST OF THE WORLD € BILLION
High-end Cars	318	268	50
Personal high-end goods	218	158	60
High-end hotels and leisure	138	42	97
High-end wines and spirits	55	36	19
High-end food	38	24	14
Design Furniture	19	17	2
High-end yachts	7	3	4
Total	792	547	245

Source: Altgamma/Bain

**FIGURE 2: Shares of sales, Europe vs Rest of the World**



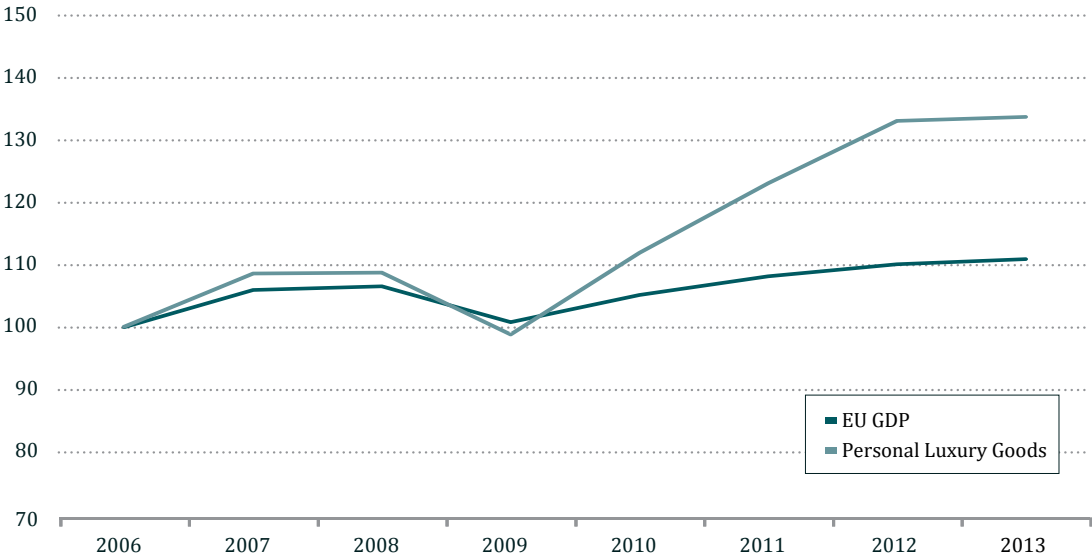
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In order to measure the contribution of high-end cultural and creative industries to GDP, it is necessary to consider the value added of high-end industries (i.e. the value of output produced by the high-end industries, once the value of all inputs consumed is accounted for). Estimates of sectoral value added can be derived from input-output tables. The main difficulty is that the sectoral definitions used in such tables are much coarser than the definitions used in the study of high-end industries, including those used in this report. As a reminder, **luxury goods have been recognised at European level as part of the cultural and creative industries**<sup>7</sup>. However, economic analysis of the sector tends to not reflect the 12 sectors of activities defined as being part of the high-end cultural and creative industries<sup>8</sup>. For example, sales of high-end products such as fashion are likely to be included under clothing, whereas the retailing of these products may be classified under retail. Similarly, footwear will be classified under leather products generally.

While it is possible to estimate the value of sales of particular high-end cultural and creative industries as a proportion of overall sector sales (e.g. high-end fashion as a proportion of clothing), this is not necessarily a reliable guide to the share of value added in general. This is because high-end cultural and creative industries are likely to have a much higher added value than other products in the overall category reflecting the value of intellectual property and branding.

In any event, output data suggests that **high-end cultural and creative industries have recorded faster growth than the EU economy as a whole**. Figure 3 below shows an index of European GDP growth and personal luxury goods output growth over the last decade. While spending on high-end goods declined as a consequence of the financial crisis, recovery has been much faster than for the EU economy as a whole. This reflects in part the fact that high-end cultural and creative industries have been able to tap into fast growing emerging markets – either directly through exports or through tourists and travellers purchasing goods. These figures suggest in turn that the share of GDP accounted for by high-end cultural and creative industries has been increasing over the last decade.

**FIGURE 3: Comparative growth performance of the personal luxury goods sector and European GDP**



Source: Frontier analysis of Altgamma/Bain and Eurostat data (2014)

7 European Commission Communication on “Promoting cultural and creative sectors for growth and jobs in the EU”, COM(2012) 537.  
8 “The high-end industries rely on a strong cultural and creative input. These industries are made up of the high-end segments of several products and services markets, such as fashion, jewellery and watches, perfumes and cosmetics, accessories; leather goods; furniture and furnishing, household equipment; and in a wider sense they can even include gastronomy, wines and spirits, cars, boats, hotels and leisure experience, retail and auction houses and publishing” European Commission Staff Working Document on the Competitiveness of the European High-end Industries, SWD(2012) 286 final.

## > The economic impact of high-end cultural and creative industries: recent trends and developments

### 3.1.2 Contribution to employment

The previous study estimated the direct employment for the high-end cultural and creative industries by using the following methodology, which

- Identified the ratio of employment to turnover for a sample of companies in each sector that we considered; and
- Applied that ratio to the output figures for each sector.

On the basis of this approach, based on 2010 data, we estimated that direct employment for the luxury goods sector in Europe was approximately 990,000. We estimated that a further 500,000 jobs were associated indirectly with the high-end industries, giving a total of around 1.5 million jobs.

On the basis of observed growth in these activities since the previous reporting period, it is reasonable to conclude that employment by these industries has grown, once inflation and productivity gains have been accounted for. Drawing on data for inflation and productivity gains, and accounting for growth in the capital stock, we infer that **employment grew by up to 12% over the three years from 2010 to 2013.**<sup>9</sup> This implies that **total employment in these industries was equal to around 1.7 million**, broken down into 1.1 million direct jobs and around 600,000 indirect jobs.

This reported growth in employment is in strong contrast with overall trends in the European Union. Employment growth across all sectors was virtually stagnant between 2010 and 2013; while employment growth in European industrial sectors as a whole was -0.5% in 2011 and -1.5% in 2012.<sup>10</sup>

The indirect employment effects essentially reflect the extensive network of upstream suppliers that provide specialist inputs into the production of high-end goods and services. As documented in the European Commission's action plan for high-end cultural and creative industries, the upstream supply chain is dominated by small scale manufacturers – typically micro-enterprises with 10 or fewer employees. For example, the upstream French jewellery sector consisted in 2008 of an estimated 3,400 firms, employing around 12,000 staff. The majority of these firms had two or fewer employees. Around 80% of high-end fashion suppliers in France had 4 or fewer employees.<sup>11</sup>

In general, small and micro enterprises have experienced severe adverse impacts as a result of the global financial crisis, notably through the tightening of credit markets, reflecting an increase in risk aversion on the part of lenders.<sup>12</sup> In this context, upstream suppliers to high-end industries have two advantages: their linkages, via downstream firms, to global export markets that are outperforming host economies; and the effects of entering into longer term supply arrangements, which in turn improves their financial position, and potentially, their ability to access credit.

<sup>9</sup> Data provided by Altgamma suggests that around 11.25% of the reported increase in the value of sales is attributable to inflation and to productivity increases. On the basis that the remainder of the total increase in the value of sales (a total of 28%) is attributable to changes in employment and to investment, this suggests a growth in direct and indirect employment of just under 12%, once estimated growth in the capital stock is accounted for (and bearing in mind that the industries are labour-intensive).

<sup>10</sup> Source: Eurostat database.

<sup>11</sup> Comité Colbert (2008), *Le Luxe, un Atout de Croissance pour l'Europe du XXIeme Siecle*.

<sup>12</sup> OECD (2009), *L'impact de la crise mondiale sur le financement des PME et de l'entrepreneuriat et es réponses en termes d'action des pouvoirs publics*.

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### 3.1.3 Contribution to exports

Finally, turning to exports we see that the **luxury cultural and creative sector is a key contributor to Europe's export performance**. Recently published research by HSBC Global Research shows the breakdown of sales for a number of Europe's leading luxury brands. This shows that **on average 62% of sales of goods manufactured by European luxury brands are sold outside of Europe** (for some brands the figures are significantly higher, rising to over 90%). Applying this figure to the European luxury brands' total output of €547 billion, suggests that exports from Europe would be in the region of €339 billion, as valued at the point of sale. Adjusting these to free-on-board (f.o.b.) values would yield a figure of around €308 billion.

Given that European merchandise exports (f.o.b.) were approximately €1,700 billion in 2013, this suggests that **luxury goods exports accounted around 17% of all European merchandise exports in 2013**.

These figures do not take into account the fact that a significant proportion of high-end industries are purchased by travellers and tourists to Europe. The rise of Shopping Tourism is another aspect through which high-end industries contribute to the EU's external trade (see section 4.2.1 for more information).

## 3.2 Sensitivity to policy shocks

The findings of the previous sections point to the robust performance of high-end industries and the wider economic impacts that arise as a consequence. The findings further highlight the role that the industries could play in furthering an industrial renaissance in Europe.

Notwithstanding these findings, it is useful to highlight the sensitivity of the industries' performance to changes to the key enabling conditions that support sector performance. As observed in section 2.1, the operation of high-end industries rests on a number of key elements: the preservation of their aura, the skills embodied in the craftsmanship, intellectual property, and access to global markets. In this section we update the results of the study conducted in 2012 to examine the effects of "shocks" that affect these specific elements, and the impact this has on three measures of the direct contribution of high-end industries: output, direct employment, and fiscal contributions (changes to tax receipts and welfare spending on unemployment). This will help to inform the policy discussion in section 5.

We model a series of shocks. These include three negative shocks:

- An increase in counterfeit products
- An loss in the control of selective distribution
- A decrease in the aura attached to high-end industries and an increase to the cost-base associated with inputs into high-end industries.

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We also model one positive shock: a reduction in tariff barriers overseas (see section 5.4 for a justification). The results of this exercise are reported below in Table 3 and Table 4 respectively.

**TABLE 3: Summary of impact analysis (2015)**

PILLAR	SCENARIO	OUTPUT LOSS	EMPLOYMENT LOSS	TAX AND WELFARE LOSS
IP	Impact of a 5% increase in IP infringement	€25 billion	57,000	€8 billion
	Impact of a 15% increase in IP infringement	€75 billion	172,000	€24 billion
Selective distribution	Reduced control over distribution leads to a 20% decline in output	€110 billion	252,000	€36 billion
Aura and Access to Craftsmanship and creativity	10% increase in the cost base	€14 billion	33,000	€5 billion
	20% increase in the cost base	€29 billion	65,000	€9 billion
	5% decline in demand as a result of reduced aura	€25 billion	57,000	€8 billion
	10% decline in demand as a result of reduced aura	€50 billion	115,000	€17 billion

Source: Frontier analysis of Altagamma/Bain data

### 3.2.1 IP Infringement

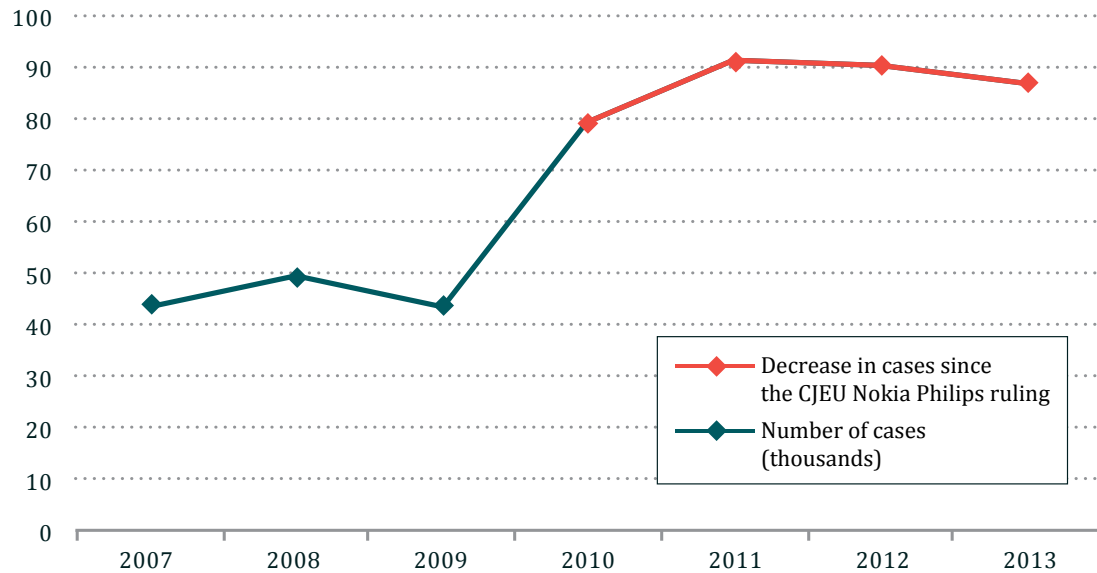
Notwithstanding significant efforts by the authorities to address the issue, counterfeiting remains a considerable policy challenge. Figure 5 shows that the incidence of counterfeiting, as measured by customs interceptions, more than doubled between 2007 and 2012. We also observe that since the previous report, which referred to 2010 data, there has been a further significant increase in the incidence of counterfeiting (nearly 15% between 2010 and 2012).

The data almost certainly understates the extent of the problem, given that actual interceptions will typically account for a fraction of actual trades in counterfeit goods. Moreover, **data reported since 2012 are likely to reflect the impact of a ruling by the European Court of Justice (ECJ)<sup>13</sup> that stated that it was not within the scope of EU customs authorities to seize counterfeit goods**, the provenance of which was outside the EU, and which were in transit through the EU to a market outside the EU. In practice, consignments of counterfeit goods ostensibly destined for extra-EU markets are frequently intended for EU markets, false labelling being a mechanism to escape seizure by customs.

<sup>13</sup> The ruling was in cases brought respectively by Nokia against HRMC, and Philips against various Chinese, and one European, manufacturers and/or distributors of consumer electronic products. See <http://curia.europa.eu/juris/document/document.jsf?docid=115783&doclang=en>

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**FIGURE 4: Number of counterfeit cases (interceptions by customs)**



Source: European Commission – Report on EU Customs Enforcement of Intellectual Property Rights

To measure the impact of continued increases in the rate of IP infringement over the next 5 years, two scenarios were considered: a five percentage point increase in the rate of IP infringement (low impact scenario) and a 15 percentage point increase in the rate of IP infringement (high impact scenario). We base these projections taking into account the increase in infringements over the last decade, and the levelling out of these increase in recent years (the 15% figure reflecting the increase between 2010 and 2012).

The results of both these scenarios are reported in full in table 9, but the key message is that the high impact scenario could lead to an estimated fall in output of €75 billion, a reduction in employment of 172,000, and a loss to European governments of €29 billion through lower taxes and higher welfare spending<sup>14</sup>. The latter figure is based on reduced VAT, corporation taxes, export taxes and personal income taxes as well as increased welfare payments for those who lose their jobs. These estimates show that the impact of changes to IP legislation can be particularly large and undermine the luxury goods business model.

The data also provides a guide to costs incurred both by high-end industries and society more broadly. In particular;

- The lost value of production, under the high-impact scenario, is equivalent to losing just over 50 days' worth of work by these industries.
- The lost employment is roughly equal to jobs created between 2010 and 2013.

<sup>14</sup> In order to determine the effect on genuine products outputs, the model assumes that 30% of those who purchased counterfeit products did so unknowingly. Under the assumption that 95% of those who purchased counterfeits unknowingly would have bought genuine products, and that of those who knowingly consumed counterfeits 40% would purchase genuine goods, we can calculate the displacement effect from increases in IP infringement. 'Brand damage' is assumed to be directly proportional to the number of counterfeit goods in the market, so that when counterfeit products in the market are 5% then brand damage is 5%, for example.

## > The economic impact of high-end cultural and creative industries: recent trends and developments

### **3.2.2 Selective distribution**

Changes to distribution channels can have a similarly significant impact on output and employment effects in the luxury goods sector. This is because a significant loss of control of the distribution channels can lead to declines in sales in European stores, as brand control weakens, which would reduce sales in other markets.

The scenario reported in table 9, and summarised below, models for a reduction in control over distribution that leads to a 20% decline in output, although this can apply more generally to issues that restrict brands' ability to exert control over the distribution and retail of their products and services. This scenario leads to an estimated fall in government income of €36 billion through tax and welfare impacts, as well as a fall in employment of 252,000 and drop in output of €110 billion. Thus, according to this paper's modelling, a substantial loss of control of luxury good distribution channels would have a very significant impact on the sector, particularly unemployment and the associated costs for government of increased welfare payments and reduced tax revenue.

### **3.2.3 Aura and Access to Craftsmanship and creativity**

In order to assess the consequences of changes in policy that negatively impact on the aura of luxury associated with high-end luxury goods, scenarios have been modelled to show the impact of the policy changes on the cost base of the industry as well as on the brand's image, and therefore sales, directly.

Modelling for these impacts is naturally complex, and changes in policy will usually have differing consequences for different brands, yet it is still vitally important to demonstrate the potential consequences of changes to the aura of luxury goods and services, due to the fundamental importance of the aura of luxury in determining the value of these goods.

The scenarios run to assess this impact look at the consequences of an increase in the cost base of the sector and the impact of this change on output, employment and tax/welfare costs. These scenarios show that for a 10% and 20% increase in the cost base of the sector, one should expect a fall in output of €14 billion and €29 billion, a reduction in employment of 33,000 and 65,000 people, and a loss to European governments of €5 billion and €9 billion through lower taxes and higher welfare spending, respectively.

Furthermore, reductions in demand due to loss of aura can have a large impact on output and employment. According to this paper's analysis, declines in demand lead to a fall in outputs of €25 billion and €50 billion for a 5% and 10% fall in demand respectively. The consequences for employment are similarly large, with an estimated increase in unemployment of 57,000 and 115,000 and a loss to European governments of €8 billion and €17 billion through lower tax revenue and higher welfare expenditure, for a 5% and 10% fall in demand respectively.

### **3.2.4 Market access**

To illustrate the range of benefits that can arise through a fall in protectionist measures affecting the high-end cultural and creative industries, this paper models the impact of reductions in tariff barriers.

By assuming a reduction in price tariffs of 5% and 10% for the luxury goods sector as a whole, this paper shows the potential benefits of rolling back protectionist measures and liberalising trade in luxury goods.

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The results of this analysis is set out in table 9, which essentially shows that a decrease in tariffs leads to a moderate reduction in benefits and similarly moderate increase in tax revenue, but a marked increase in employment and turnover of 14,000 and €6 billion for a 10% decrease in price tariffs. These estimates are conservative – with the results assuming the price elasticity of export demand to be just 0.3%.

**TABLE 4: Summary of impact analysis (2015)**

PILLAR	SCENARIO	OUTPUT GAIN	EMPLOYMENT GAIN	TAX AND WELFARE GAIN
Trade barriers	5% decrease in price tariffs	€3 billion	7,000	€1.0 billion
	10% decrease in price tariffs	€6 billion	14,000	€2.0 billion

As reported in section 3.1.3, high-end industries “export” products indirectly through the purchases made by tourists to the European Union. Barriers to these indirect “exports” include administrative measures that deter tourists from accessing the EU market. The European Commission has estimated that the deterring effect of the visa regime led to 6.6 million “lost” tourist arrivals in 2012.<sup>15</sup>

A rough estimate of the costs to high-end industries from these foregone arrivals can be derived by using data on tax refunds at the border. These are valued at roughly Euros 40 billion per year, or roughly 75 Euros per tourist visitor. Drawing on estimate of foregone tourists cited above, that implies foregone spending on high-end products of up to nearly Euros 0.5 billion in 2012 alone.

<sup>15</sup> European Commission (2013), *Study on the Economic Impact of Short Stay Visa Facilitation on the Tourism Industry and on the Overall Economies of EU Member States being part of the Schengen Area*.

## 4 Capturing wider economic effects

### 4.1 Main types of wider effects

An important aspect of these wider effects is that they are not usually coordinated within firms, or between firms by contracts or other commercial mechanisms, in the way sales and purchases are. This means that the monetary value of these effects cannot be observed directly through market transactions. These “non-market effects” create scope for policy action because in the absence of markets, goods and services that are socially valuable are likely to be underprovided as the beneficiaries may not pay for them. We consider three main (related) types of non-market effects that are applicable to the luxury cultural and creative industries. These are: spillover effects, agglomeration effects, and public goods that are connected to the value of place. The importance of these non-market effects is reflected in the European Commission’s policy documents, that relate to industry in general, and to high-end industries specifically.

#### 4.1.1 Spillovers

In economic terms, spillovers are a form of externality – that is, they refer to the consequences on a third party of actions (say, investment decisions) undertaken by a particular entity. More specifically, in the context of this analysis, spillovers refer to the beneficial effects, in the sense of increasing profitability, the actions a particular firm’s decisions may have on other firms.

Consider the case of tourism and travel, for example. Travellers are significant consumers of luxury goods – recent research commissioned by Altagamma suggests that, globally, around 37% of purchases from luxury industries are attributable to tourists. This means, for example, that when providers of travel-related services (hoteliers, transport providers) invest in their activities, they confer a benefit to high-end industries, since all else being equal, more travel is likely to lead to a higher consumption of high-end industries.

At the same time, **high-end cultural and creative industries support travel and tourism services**. This is because the **ability to access high-end industries – such as high-end products – are one possible determinant of the choice of destination**. Hence, investments by business in the high-end industries confer benefits to businesses in the travel and tourism industries. This is **widely recognised by EU citizens**, as a recent study has shown that **77% of them see high-end cultural and creative industries as a contributor to Europe’s economic development by increasing the attractiveness of Europe for tourists**<sup>16</sup>.

Firms may try to coordinate amongst themselves to capture the benefits of spillovers, through for example joint marketing effects, or through vertical integration (for example, fashion designers investing in the development of proprietary hotels). However, firms in the travel sector will not have a direct say in the investment and strategic decisions of the high-end cultural and creative industries and vice versa (short of firms in the one sector being acquired).

The existence of spillovers in the context of high-end industries has been recognised by the European Commission.<sup>17</sup> The existence of spillovers can open the scope for public policy. For example, spillovers in research and development can create a role for financial support of such activities. At any rate, such spillovers underscore the importance of establishing an overall enabling framework that encourages the flourishing of activities, such as high-end industries, that generate the spillovers.

<sup>16</sup> TNS Sofres study on the European Citizens’ Perception of the European High-end Cultural and Creative Industries (2013).

<sup>17</sup> See for example, European Commission (2010), European Competitiveness Report 2010, pp 163-164.

## > Capturing wider economic effects

### 4.1.2 Agglomeration effects

Agglomeration effects are closely related to the concept of spillovers. They reflect the fact that economic activities tend to cluster, partly because of linkage and spillover effects of the sort discussed in the preceding sections.<sup>18</sup> Other driving forces for agglomeration effects include labour markets. Firms, particularly in industries such as high-end cultural and creative industries, are heavily dependent on talents and skills. The costs of searching for such talent are reduced when firms cluster, since the clustering will serve to attract individuals who have the required talent and skills. Another driving force for agglomeration effects are economies of scale. For example, certain types of infrastructure (transport terminals, power and telecommunication networks) have high fixed costs. When a greater number of firms locate in an area, the unit cost for all firms will decrease, up to a certain point.

One of the implications of agglomeration effects is that once **firms tend to cluster, and thus increase the competitiveness of the region in that particular activity**, the effect can be self-reinforcing. This explains why the question of agglomeration effects has become central to understanding patterns of trade internationally. As agglomeration effects rely, in part at least, on externalities including spillovers, they create scope for public policy responses. At the European level, the policy focus on knowledge-based industries, including high-end cultural and creative industries, has in turn required a discussion of agglomeration effects.<sup>19</sup>

### 4.1.3 Public goods

“Public goods” are goods or services that cannot be provided to one individual without providing it to all individuals in the community, and ones where the consumption of the good or service by one individual does not reduce the opportunity for another individual to consume the good or service. In technical terms, we refer to these two characteristics as ones of non-excludability and non-rivalry in consumption. These two characteristics mean that public goods are likely to be underprovided by markets, absent suitable policy.

**Luxury cultural and creative industries undertake investments, for commercial reasons, that have impacts that could be characterised as a public good.** For example, high-end fashion, jewellery and watch manufacturers, hoteliers and restaurants invest in facilities and buildings as part of their commercial strategies to attract and retain customers. The experience of visiting an attractive shop or dining in a setting is part of the bundle of services sold to the consumer, in addition to the actual product.

**But such investments contribute to the attractiveness of the location in which the facilities are situated** – indeed, the commercial value of the investment is directly predicated on its public attractiveness. This has benefits to the community beyond the individuals consuming the product or service, since the quality of a particular location is enhanced. This is notably the case in cities featuring zones or streets that have an international reputation for the clustering of high-end industries. This enhancing effect on the quality of a location is a public good in the sense that it is enjoyed by the community independently of the consumption of high-end products, and because it demonstrates the two characteristics of non-rivalry and non-excludability referred to previously.

The existence of such clusters also highlights the links between these public goods and the agglomeration effects highlighted in the preceding section of this report. Moreover, the fact that these public goods are to do with the attractiveness of a location, underscores their relevance to the spillover effects described in relation to tourism.

<sup>18</sup> See in particular Krugman, Paul, 1991, *Geography and Trade*, Cambridge: MIT Press.

<sup>19</sup> See for example, European Commission (2010), *European Competitiveness Report 2010*, pp 177-180.

## 4.2 Evidence of wider effects

### 4.2.1 Spillovers

#### Tourism and travel

As already observed in section 4.1.1, **there are significant spillover effects between tourism and high-end cultural and creative industries**, namely:

- Consumption by travellers of certain high-end products accounts for a significant share of the overall consumption of these products;
- The availability of high-end products and services at destinations affects the choice of destination.

There are two distinct channels through which spillovers from the high-end cultural and creative industries to the travel and tourism industries operate. The first is through decisions made by travellers to purchase or consume particular high-end products as part of their travel experience. An example of this is found in the phenomenon of “Shopping Tourism”. Shopping Tourism is defined by the UN World Tourism Organisation as a “form of tourism fostered by individuals for whom purchasing goods outside of their usual environment is a determining factor in their decision to travel”.<sup>20</sup> It follows from this definition that attractive destinations for shopping tourists will be ones that can provide access to a shopping experience, that includes not only access to high quality products, but to a high quality of service.

Most studies reveal that tourists from China spend the most on shopping, as well as tourism in general. Table 3 provides a ranking of the leading countries in terms of overall tourism spending and spending on shopping overseas, the latter being proxied by the value of tax free shopping.<sup>21</sup>

**TABLE 5: Shopping Tourism - Big Spenders**

TOP 5 SPENDERS ON TOURISM (WITH TOTAL SPENDING IN BILLIONS OF EUROS)	TOP 5 SPENDING NATIONS ON SHOPPING TOURISM IN EUROPE (BILLIONS OF EUROS)
China – 99.2	<b>China – 10.8</b>
USA – 66.2	<b>Russia – 6.8</b>
Germany- 66.2	<b>USA – 1.6</b>
UK – 40.8	<b>Kuwait -1.2</b>
Russian Federation – 40.8	<b>Japan -1.2</b>

Sources: UNWTO and Global Blue/ BAIN. Conversions from dollar amounts based on Eurostat exchange rate data.

<sup>20</sup> UNWTO (2014), Global Report on Tourism Shopping, p.13.

<sup>21</sup> It is difficult to estimate the total value of spending by shopping tourist.

## > Capturing wider economic effects

Though tax free shopping does not consist solely of high-end products, the latter account for the majority of purchases by value by tourists from China, Japan and the USA (at 71%, 78% and 66%, respectively, of tax free spending) and a substantial proportion of purchases by Russian consumers (around 47%).<sup>22</sup>

According to data reported by the Economist, Chinese consumers accounted for around 29% of global purchases of high-end products, of which two-thirds took place outside China, and a fifth in Europe. Data collected by Altgamma indicates that whereas the number of travellers increased by a factor of 3 between 2004 and 2013, spending on high-end cultural and creative products increased by a factor of 16. One study suggested that shopping was a vital part of a trip for nearly 82% of Chinese tourists.<sup>23</sup> Another reported that 68% of Chinese travellers surveyed spent between 21% and 50% of their travel budget on shopping.<sup>24</sup>

The UNWTO reports that of visitors to Vienna, 82% listed shopping as one of their key motivations for visiting, with 19% citing as a primary determinant. The importance attached to shopping is significant given the rich cultural heritage of the city. The products particularly sought after are watches, jewellery and fashion articles. Russian travellers are cited as a key group driving the trend toward tourism shopping in Vienna.<sup>25</sup>

Shopping tourism is also prevalent in locations – primarily major cities – that have clusters of firms creating concentrated high-end shopping opportunities. This is valuable to shoppers, principally because it reduces search costs, facilitates comparisons of price and quality, and allows them to match products that, in their view, are complementary (for example, different articles of clothing and footwear from different producers). This is a reflection of agglomeration effects, which we shall return to in subsequent sections.

While price factors (notably differences in tariffs and indirect taxes) are among the drivers of shopping tourism, important considerations include the assurance that goods are not counterfeit, the clustering of stores that increase choice, the quality of service and the attractiveness of the setting.

One of the implications of shopping tourism, and specifically the fact that shopping possibilities are a determinant for travel, is that the tourism and travel industries in a particular location will grow faster, the more potential visitors value the shopping opportunities in that location. This logic is reflected in the marketing initiatives of tourism authorities in jurisdictions such as Spain, France and Italy, which have deliberately emphasised the shopping experience available in key major cities in order to attract tourists.<sup>26</sup>

Other specific initiatives are promoted based on recognition of the links between these particular activities, and the profile they lend to the city. Examples include the Milan Design Fair and the Milan Fashion Week.<sup>27</sup> In London, the New West End Company emerged to coordinate the various interdependencies that exist between tourism and shopping, specifically luxury shopping.

These observations in turn suggest that **investments undertaken by firms in the high-end cultural and creative industries that enhance the attractiveness of their product offerings, have significant spillover effects to the tourism and travel industries**, and that these industries would have been smaller, along with their contribution to the wider economy, without the investments undertaken by the luxury cultural and creative industries. In other words, these investments can be said to have a genuine multiplier effect on the economy.

22 Source: BAIN/ Global Blue for Altgamma, accessed at <http://www.altgamma.it/temp/1010501647146841827file.pdf>

23 Research by Global Blue, cited in "Tourisme et achat luxe", L'AGEFI – Agence Economique et Financiere de Geneve, 14 January 2014, accessed at <http://www.agefi.com/une/detail/archive/2014/january/artikel/tourisme-et-achat-luxe.html>

24 Based on a survey conducted by Global Blue, as reported in UNWTO (2014), Global Report on Tourism Shopping, p.34.

25 UNWTO (2014), Global Report on Tourism Shopping, pp 30-31.

26 UNWTO (2014), Global Report on Tourism Shopping, p 24.

27 See for example, Universita IULM, Camero de Commercio Milano (2012), *L'Europa Vede Milano*.

While the spillovers described in the preceding paragraphs stem from the private consumption of luxury goods, a second type of spillover stems from the enjoyment of the public goods associated with high-end cultural and creative industries. As reported in section 1.1.1, these are usually associated with enhancements to the attractiveness of locations. In a report on the linkages between tourism and cultural industries, the OECD observes, specifically in relation to design activities, that “Urban design adds to the atmosphere of places, making them more attractive to local residents and tourists alike”.<sup>28</sup> This observation is supported by the prominence attached to fashionable districts in promotional material developed by tourism authorities.

This enhancing effect stems from the investments that luxury cultural and creative industries make in facilities to improve their attractiveness, and the effects on urban geographies of these investments are further reinforced by the clustering effects referred to in section 4.1.2.

### **Knowledge spillovers**

As already observed in section 3.1.2, the high-end cultural and creative industries have an extensive network of contractual relationships with upstream suppliers, particularly in industries such as textiles, fabric and leather. The primordial commercial importance of product quality places a heavy premium on ensuring that the upstream suppliers that are selected have sufficient skills and are able to adapt to changing requirements. In such circumstances, upstream suppliers have incentives for developing a reputation for reliability and skilled workmanship, and downstream purchasers have an interest in securing long-term supply relationships to ensure continuity of supply and to reduce transactions costs.

Such arrangements are conducive to a particular form of knowledge spillovers. In part these may be associated with training and other initiatives that high-end cultural and creative industries may undertake to develop the skills of suppliers. These initiatives themselves are not spillover effects but they may generate spillover effects. As suppliers improve their skills, some of their knowledge and expertise is likely to spread to other supplying firms, either through observation or through informal networks.

Suppliers are also likely to benefit from learning-by-doing and the tacit transfer of knowledge, quite independently of any formal efforts undertaken by the high-end cultural and creative industries. These tacit effects are generally observed where there is repeated and frequent interaction, as is the case with luxury cultural and creative industries.<sup>29</sup> Such learning-by-doing effects are generally considered to be one of the main channels through which the stock of skills and knowledge increases within an economy as a consequence of trade and investment.<sup>30</sup> We would expect such learning by doing effects to diffuse across supplying firms in any given region.

Knowledge spillovers are significant since they increase the stock of skills in an economy. Some of these skills may be generic, for example those relating to entrepreneurship, while others will be specific and tied to the activity in question. The key point is that but for the dense network of subcontracting relationships developed by the high-end cultural and creative industries, these spillover effects would have been unlikely. Given the close relationship between skills and productivity, and between productivity and economic growth, these knowledge spillover effects associated with high-end industries constitute a genuine multiplier effect. Essentially the economy would have been smaller in their absence.<sup>31</sup> The spillover effects are particularly important in Europe at a time of high youth employment, as they increase the skills sets of younger workers and hence their competitiveness in the labour market.

28 OECD (2014), *Tourism and the Creative Economy*, p 60.

29 See for example, Von Hippel, E. (1994), “Sticky Information and the Locus of Problem Solving: Implications for Innovation,” *Management Science*, 40, 429-439.

30 See in particular Young, A. (1991) ‘Learning by Doing and the Dynamic Effects of International Trade’, *The Quarterly Journal of Economics*, May, pp369-405.

31 Arrow, K. (1962), ‘Economic Welfare and the Allocation of Resources for Invention,’ in R. Nelson (ed.), *The Rate and Direction of Inventive Activity*, Princeton: Princeton University Press.

## > Capturing wider economic effects

Policy responses to knowledge spillovers include investments in vocational training, such as the design of apprenticeship schemes. Such schemes are an important pillar of the European Commission's strategy for an industrial renaissance, for example through the European Alliance for Apprenticeships which aims at bringing together public authorities, businesses, social partners, VET providers, youth representative and other key actors in order to promote apprenticeship schemes and initiatives across Europe.

### 4.2.2 Agglomeration effects

The preceding sections have referred to the importance of agglomeration effects and clustering. On the basis of that discussion, we can discern differing levels of agglomeration effects:

- The clustering of high-end cultural and creative activities that interact directly with customers. This is most obviously visible in luxury design, services and retail activities in cities (downstream agglomeration effects); and
- The clustering of supply chain activities related to luxury, cultural and creative industries, reflecting knowledge-related spillovers (upstream agglomeration effects).

#### Downstream agglomeration effects

Clustering of high-end activities that interact directly with customers create important agglomeration effects in relation to tourism and travel, as documented in section 4.1.1, either through spillovers via what we have called the Shopping Tourism channel or through the Public Goods channel.

Other sources of agglomeration effects are related to the contribution high-end cultural and creative industries play in developing of a knowledge-based economy. The concept of a knowledge based-economy has become central to policy towards competitiveness in Europe.<sup>32</sup> Knowledge-based activities are typically capital and skills intensive, and generate a high degree of local value added through proprietary knowledge. High-end cultural and creative industries themselves are part of the knowledge-based economy. As a result their tendency to cluster in specific cities will stimulate the knowledge-based economy in their host regions and countries.

But they also contribute indirectly to the development of the knowledge-based economy. An important channel is through labour-market effects. High-end cultural and creative industries usually rely on a highly skilled and creative cohort of managers and sales staff, who are attuned to global markets and competing in demanding market segments. These skills and know-how are portable across industries that require similar managerial and sales skills sets. The fact that luxury cultural and creative industries cluster in specific locations increases the stock of these skills in those areas, which can make it attractive for other knowledge-based activities to locate to the same area. This is because in doing so, they are able to reduce their search costs by better matching available skills with the requirements of these activities.<sup>33</sup>

These agglomeration effects via labour markets provide one explanation why cities that feature a high concentration of high-end cultural and creative industries also tend to feature a high concentration of other high value-added activities, such as retail services, professional services, telecommunication, and financial services.

<sup>32</sup> See in particular European Commission (2012), European Competitiveness Report 2011, pp 55-83.

<sup>33</sup> See for example, Henry G. Overman & Diego Puga, 2010. "Labour Pooling as a Source of Agglomeration: An Empirical Investigation," in: E. Glaser (ed) Agglomeration Economics, pages 133-150 National Bureau of Economic Research, Inc.

A secondary channel through which luxury cultural and creative industries generate agglomeration effects in relation to knowledge-based activities is through their contribution to the quality of place (see following section). Improvements to the quality of place enhance the quality of urban settings. This is important as the labour force associated with knowledge-based activities is typically more mobile than the average. Enhancements to the quality of place can thus increase the attractiveness of particular locations.

### **Upstream agglomeration effects**

The clustering of upstream supply activities linked to high-end has been widely documented. These **clustering effects, which are driven by knowledge spillovers, have an important role in stimulating regional development.** This is partly because of labour market “matching” effects that are similar to the ones discussed earlier in this section. By increasing the stock of skills in a region, high-end activities make it more attractive to invest in that region.

A further channel is the fact that the supply chains associated with high-end activities connect these regions to the global economy. This is particularly important given the difficulties SMEs usually encounter in accessing global markets. The European Commission’s work on the performance of SMEs found that belonging to a cluster improved prospects of accessing global markets.<sup>34</sup> This effect can play out through formal means. For example, being part of a supply chain network can ease constraints relating to access to credit. It can also play out through informal means, such as the diffusion of knowledge about entry into foreign markets.

The automotive sector – which, as reported in section 3.1.1 is the largest by value of the high-end cultural and creative sectors – is well known for its clustering effects.<sup>35</sup> Two examples of high-end clusters are those located in Oxfordshire (UK) and the Stuttgart region (Germany). The former includes luxury and specialist manufacturers, including four firms currently involved in formula 1 racing. More broadly, “Motor Sport Valley”, which extends from Buckinghamshire to Northamptonshire, features a network of around 3,500 businesses employing around 40,000 people, and which accounts for an estimated 80% of the world’s high performance engineers.<sup>36</sup> The industry is a key component of the region’s knowledge-based growth strategy.<sup>37</sup> The region around Stuttgart is dominated by two high-end producers, supported by a dense network of SME’s. Around 222 businesses employ over 134,000 people.<sup>38</sup>

34 European Commission (2014), *Supporting the Internationalisation of SMEs*.

35 European Commission (2013), *Innovation Clusters in Europe – A Statistical Analysis and Overview of Current Policy Support*.

36 See Britain’s Motorsport Valley – The Home of Formula 1. <http://www.bbc.com/sport/0/formula1/23048643>

37 Oxford Strategic Partnership (2013), *Oxford Economic Growth Strategy*.

38 Gerrit Stratman and Gergana Dimitrova (2008), *Automotive Clustering in Europe – Case Studies*, pp 18-19.

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Other examples of clusters are set out in the table below

**TABLE 6: Examples of high-end clusters**

REGION	ACTIVITY/ SECTOR
Smaland, Sweden Bohemia, Czech Republic	Glass
Turku (Finland) Vienna (Austria) Brianza (Italy)	Industrial design and furniture
Glasshutte, Germany	Watches
Grasse, France	Scents and tastes
Florence, Italy Brenta, Italy	Shoes and leather goods
Modena, Italy Bologna, Italy	Cars and motorcycles

**4.2.3 Public goods related to the value of place**

The importance of these public goods was already discussed in relation to tourism activities and agglomeration effects. Independently of these, improvements to the attractiveness of a particular location are likely to be valued, in and of themselves, by residents.

Evidence of this can be found in data from surveys of public opinion in Europe regarding the impact of high-end cultural and creative industries. Data from 2013 suggest that 77% of surveyed respondents thought that luxury cultural and creative industries made an important contribution to the prestige and appeal of city centres. This figure does not vary materially from that reported in 2009, pointing to the stability of this perception.<sup>39</sup>

39 Data based on research conducted for ECCIA by TNS Sofres, see TNS (2013), *European Citizens' Perception of the High-end Cultural and Creative Industries*.

### 4.3 Conclusions on wider effects and implications for policy

The central message of this section is that **high-end cultural and creative industries are associated with several categories of non-market measures that enhance their economic contribution**. In particular, spillover and agglomeration effects are significant. They represent genuine multiplier effects in the sense that the size of the European economy would be smaller if the activities of high-end cultural and creative industries were reduced and these spillovers were also reduced. By contrast, factors that enhance the activity of high-end cultural and creative industries will increase the size of these spillovers, all else being equal, and thus increase overall economic activity.

The existence of these non-market effects opens the scope for appropriate policy responses, since in the absence of such a policy framework some of the benefits identified in sections 4.1 and 4.2 are likely to be underprovided. This explains why, for instance, authorities have sought to follow policies that enable spillover effects to be better coordinated or to encourage the formation of clusters and networks. At the very least, authorities should take steps to ensure that the efficient operation of high-end cultural and creative industries is not impeded through the lack of an effective enabling policy framework.

Some of the elements of this enabling framework are quite general including, for example, appropriate support for research and development, support for firms that invest in skills development, and efforts to facilitate the operation of labour markets to help match skills with the requirements of firms.

Others are more specific to high-end cultural and creative industries and are linked to the way they operate and their concerns as globalised activities. We consider four important issues in the following section.

## 5 Implications for policy

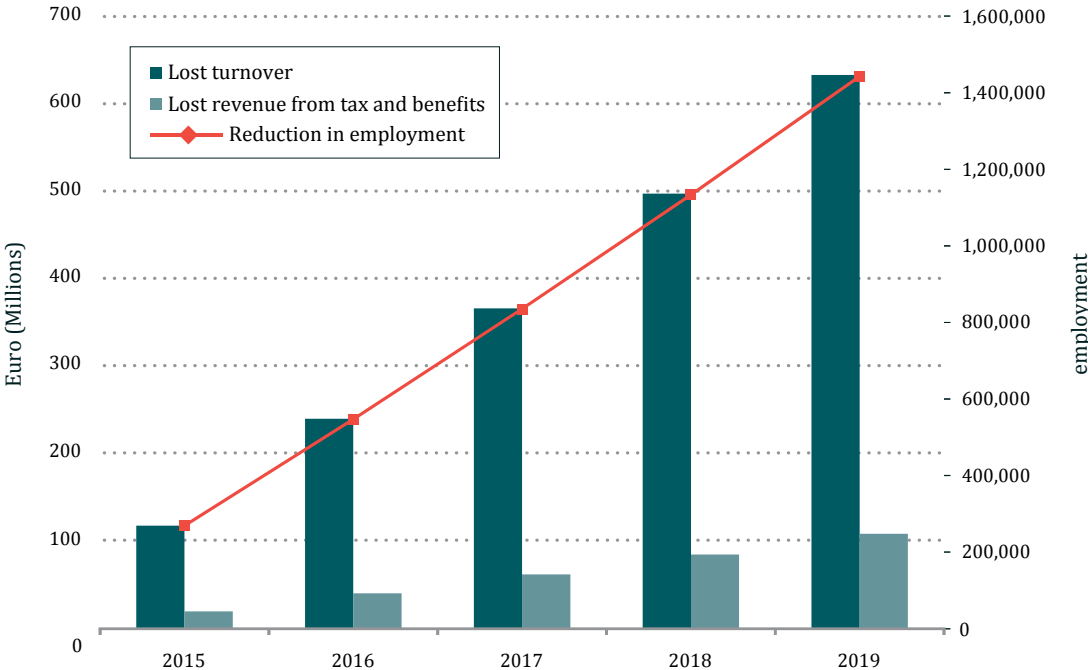
### 5.1 Intellectual property

The protection of intellectual property (IP) continues to represent an issue of critical importance for the luxury cultural and creative industries. As already observed in section 2.1.3, IP rights support the ability of these industries to differentiate their products and represent their ability to innovate and invest in upstream linkages.

The simulations presented in this report illustrate the magnitude of costs associated with the erosion of IP protection. In particular, the results point to the **substantial foregone output and employment that has resulted from counterfeiting activities to date**, indicating notably that **the number of jobs created by the high-end cultural and creative industries between 2010 and 2013 may have been double of that what was actually created**. The number of lost days of output can be interpreted as a measure of the deadweight loss to society arising from counterfeiting activities.

Figure 5 provides projections for cumulative losses for a five-year period (2015-2019) if IP infringements were to continue unabated as under the “high-impact” scenario described in section 3.2.1. The numbers represent foregone opportunities i.e. turnover foregone, revenues foregone and extra benefit-spending, and foregone employment creation.

**FIGURE 5: Cumulative impact of 15% infringement scenario**



In particular, the projections suggest that cumulative losses in the value of production would amount to around 600 billion Euros, and that close to 1.5 million new jobs in the sector would be foregone.

Taken together, the findings of this report help to emphasise that IP infringements – and counterfeiting in particular – act as an implicit tax on the high-end cultural and creative industries. The effects are likely to be more far-reaching than those quantified through the modelling. Other reports provide a further exploration of economic costs, including adverse effects on innovation and growth, and social costs, in particular those relating to criminality.<sup>40</sup>

## 5.2 Selective distribution

The European Commission has broadly accepted the principle of selective distribution as an arrangement between upstream producers and downstream distributors that is aimed at creating incentives for the latter to take into account (“internalise”) the effects on the former of their investment in sales and promotional effort, including customer care and the quality of shops and infrastructure. As part of these arrangements, the EU has also accepted that producers should be free to require that distributors have a certain number of conventional (“brick and mortar”) points of presence. However, EU law also prescribes “hardcore” restrictions such as restrictions on the volume and value of sales by a distributor through on-line means, or differential pricing of goods by producers as a function of whether sales by distributors are made online or through physical outlets.<sup>41</sup>

As reported in section 2.1.4, **high-end cultural and creative industries’ strategy towards distribution is geared towards maintaining the aura of their product**, and reflects the fact that consumers purchase a bundle of services, including the retail experience, when purchasing a high-end product. The legal arrangements referred to above, and known as **Verticals Restraints Block Exemptions**, are due to run from 2010 to 2022. **The arrangements have provided high-end cultural and creative industries with the scope to manage the distribution of their products in a manner that supports their commercial considerations**, while also balancing concerns over effective competition and consumer welfare. The importance of distribution arrangements to the commercial operation of luxury cultural and creative industries, and their impact through market and non-market effects, together provide support for the continuation of these arrangements.

## 5.3 Consumers trust online

The increased digitalisation of our economy creates unprecedented development opportunities for European industries. **The use of responsible online marketing practices**, such as the controlled use of consumer data and the development of virtuous retargeting (qualitative whitelisting of acceptable websites, quality standards for creative art work, and caps on consumer exposure) **are a clear differentiating factor for the sector from the mass market and core to maintaining the aura and feel of their brands online**. Such practices, when managed responsibly, add value to the online customer experience.

At the same time, **these advantages can be undermined by weaknesses in the governance framework for digital activity**, since such weaknesses can lead to the proliferation of illicit activity, particular trade in counterfeit goods. Weaknesses in digital governance also undermine selective distribution by allowing parties to circumvent selective distribution requirements set out by high-end producers.

Because the adverse impacts of digital governance are played out through IP infringements and effects on selective distribution, the modelling conducted under these two headings provides an indication of the associated costs to high- end cultural and creative industries.

<sup>40</sup> See for example Frontier Economics (2011), Estimating the Global Economic and Social Impacts from Piracy and Counterfeiting; and OECD (2008), *The Economic Impact of Counterfeiting and Piracy*.

<sup>41</sup> See EC (2010), Antitrust: Commission adopts revised competition rules for vertical agreements: frequently asked questions, Press Release, 20 April 2010.

## > Implications for policy

In order to address decreasing consumer trust online due to a lack of protection for consumers facing illicit behaviours online, **high-end cultural and creative industries have promoted the concept of a Duty of Care**, on the part of Online Service Providers (OSPs) in the context of an economic activity. The concept of duty of care can be defined in terms of brand protection, the integrity of e-commerce transactions, reputation and consumer protection. This is based on 4 key pillars:

1. Respect of access to information and freedom of speech in the digital environment.
2. A general Duty of Care should apply to all Online Service Providers (OSPs), in the framework of online and offline commercial activities.
3. The scope of the Duty of Care imposed on a service provider must be assessed on a case-by-case basis, as it depends of the nature of the activity performed by the service provider, the predictability of the risk created by this activity, and the reasonable means that can be used by the service provider to avoid the damage.
4. The reasonable measures expected from OSPs will depend on the level of cooperation and information provided by rights owners.

The legal framework relies mainly on best-endeavours on the part of ISPs, but is evolving. For example, in a decision taken in October 2014, the UK High Court ruled that trademark rights holders were able to issue injunctions to ISP's requiring them to block websites offering counterfeit sales.<sup>42</sup> The ruling extended to trademark protection mechanisms available to copyright holders.

Furthermore, the Duty of Care has also been further developed by recent ECJ case law on data protection and the 'right to be forgotten' that has underlined the duty of OSPs to take responsibility to protect brand owners and consumers alike online<sup>43</sup>.

### 5.4 Market access

The previous report modelled the effects of an adverse market access shock on high-end products, represented as an increase in tariff duties. In practice, increases in duties have been limited, mainly because of legally binding commitments that trading partners have entered into, either through regional or bilateral preferential trade agreements, or multilaterally through the WTO.

At the same time, many high-end products are affected by market access issues. These reflect, amongst other things:

- High ad-valorem tariffs. For example, high-end clothing and leather goods face import duties on average of 15-20% in China, which is more than twice the average duty applied by China on manufactured products generally. In the US, imports of clothing, including fashion-wear, face import duties that are on average around 12%, and may be as high as 32%, compared to an average duty rate of 4% for non-agricultural products more generally. In Japan, duties average around 13% compared to an average of around 3% for non-agricultural products.
- Domestic indirect taxes, that apply equally on local and imported products, on specific goods. In China for example, high-end watches attract an indirect tax of 20%, while cosmetics (other than skin-care products) attract a tax of 30%.

<sup>42</sup> [2014] EWHC 3354 (Ch), *Cartier vs BSKyB*.

<sup>43</sup> Case C-131/12 *Google Spain SL v Agencia Española de Protección de Datos (AEPD)*.

For these reasons, it seemed opportune to model the effects of a reduction in the incidence of duties, especially in the light of free trade negotiations that are either under way (as between the EU and the US, and between the EU and Japan) or that are under consideration. We thus modelled the effects of a cut in customs duties of 5-10 percentage points (see section 3.2). The results highlight the importance to high-end cultural and creative industries of continued efforts to further liberalise trade.

The results are a lower bound on the benefits of trade liberalisation as they do not take into account the question of non-tariff measures, including regulatory measures. These are significant. However, accounting for them within the scope of this study is difficult given how numerous they are, and difficulties in quantifying their effects. Common barriers across all industries include:

- Non-equivalence of regulations and of conformity assessment processes. The latter are significant since they imply that even if regulations in different jurisdictions have similar effects, satisfying the requirements in, say the EU, is not in and of itself sufficient to demonstrating compliance with regulations in export markets. High-end automotive exports to Japan, for example, need to satisfy separate test data requirements, even if standards followed in Japan in respect of environmental and safety requirements are no more stringent than in the EU.
- Restrictions that apply to distribution services, which affect the extent to which firms can enter markets and differentiate their products. This is a key issue for high-end services, given the importance, documented elsewhere in this report, of control over distribution networks.

Finally, an issue that is conceptually similar to market access – in the context of high-end cultural and creative industries – is that of the ease of access for tourists to the European market. The linkages reported in section 4.2.1 between the luxury cultural and creative industries, on one hand, and the tourism and travel industries, on the other, lend further support to initiatives proposed by the European Union to revise the visa code, and the introduction of a touring visa for the Schengen Area. As reported in section 3.2.4, a reduction in the administrative barriers associated with travel can be expected to facilitate the attractiveness of EU wide travel, including access to luxury shopping opportunities.

## 6 Conclusions

- In the two years following the publication of the first Frontier Economics report on the value of the European high-end cultural and creative industries to the European economy (2012), **the European Commission's position has evolved from recognising the specificity of the sector, as part of the European cultural and creative industries, to identifying it as a model for the renaissance of Europe's industry.** The specific attention that the Commission granted to the luxury cultural and creative sector also led to the **recognition, among all EU institutions, of the industries' contribution to the European economy,** which in turn is expected to **ensure continued support for the industries' concerns at the EU level in the upcoming years.**
- **This updated report shows that recognition at the EU level of the specificity of the European luxury cultural and creative industries and role as a key driver of competitiveness, growth and jobs in Europe was justified.** As a matter of fact, the findings show that the sector has enjoyed a **28% growth and created close to 200,000 jobs in just three years,** thereby outperforming most other European industrial sectors. In addition, by substantially increasing their contribution to EU exports, European high-end cultural and creative industries have **reinforced their role as an "Ambassador" of European values** such as culture, creativity, craftsmanship, quality, or excellence on the world stage.
- Besides their contribution to the European economy, **European high-end cultural and creative industries also create positive spillovers on other non-market aspects of the European economy,** such as tourism and agglomeration effects.
- This report has demonstrated that the **European luxury cultural and creative industries' business model, based on production in Europe and strong exports, creates high added-value for the European economy and society at large.**
- The report also serves to highlight the **"value at risk",** in financial and broader economic terms, **related to adverse policy shocks that could undermine the business model followed by high-end cultural and creative industries.** These shocks include IP infringements, the undermining of selective distribution, the undermining of the aura of the products, and reduced access to skilled craftsmanship.
- In this context, **European decision-makers should aim at strengthening the existing legal and policy framework to enable the high-end cultural and creative industries to continue their substantial contribution to competitiveness, growth and jobs in Europe.**

- The key elements of this enabling legal framework are:
  - **Continued efforts to strengthen the framework for protecting intellectual property rights and addressing the problem of counterfeiting activities.** These efforts are consistent with the recognition that the protection and enforcement of intellectual property rights are critical to European competitiveness, as a whole, in global markets. They are also consistent with the recognition of the wider social costs (particularly those related to criminality) associated with counterfeiting activities.
  - **Upholding the scope for selective distribution, as currently enshrined in Vertical Restraints Block Exemptions.** The purpose of these exemptions is to allow practices that are desirable both from the point of view of the industries concerned, and society more generally. The analysis in this report underscores the benefits, both to the high-end cultural and creative industries, and to Europe, that stem from recourse to selective distribution practices.
  - **Strengthen the framework for consumer trust online,** in a manner that reflects the importance of the internet to economic activity, including high-end cultural and creative industries, and addresses the financial and social detriment created by illicit practices. The framework would need to take into account the emerging jurisprudence regarding the concept of a Duty of Care online and offline.
  - **Promote access to global markets.** This requires a multi-pronged strategy that addresses (i) tariff and non-tariff measures in overseas markets through trade negotiations (ii) efforts to facilitate trade by addressing administrative measures within Europe, specifically access by non-European travellers to European tourist markets and destinations.

## 7 ECCIA policy recommendations

The report prepared by Frontier Economics has demonstrated that the European high-end cultural and creative industries' business model, based on the preservation of traditional European *savoir-faire* and strong exports, creates high added-value for the European economy and society at large. In this context, **ECCIA encourages European decision-makers to continue working towards the creation of an appropriate legal framework enabling luxury cultural and creative industries to continue its substantial contribution to competitiveness, growth and jobs in Europe.**

In order to do so, ECCIA recommends the following, based on the findings in the work conducted by Frontier Economics.

### 7.1 Intellectual property

- There is a **need for European decision-makers to establish a strong framework of intellectual property rights protection to safeguard European brands and increase legal certainty for European companies.** Such protection should be **equivalent in the physical and digital economies**, in order to empower European companies to fully exploit the potential of the EU single market.
- To tackle the issue of counterfeiting and further enhance the protection of intellectual property rights (IPR) across Europe as a key driver for growth and innovation, **ECCIA encourages EU decision-makers to adapt the existing legal framework on the enforcement of IPR**, including through the revision of the IPRED Directive, **to tackle infringements, which are increasingly linked with organised crime and terrorism.** The IPRED revision should therefore:
  - Include tougher sanctions (including heavy fines) acting as a real deterrent for counterfeiters
  - Improve the damages and compensations awarded to right holders
  - Urge EU Member States both to create specialised courts and to take concrete action to improve the training of judges in intellectual property, and most importantly
  - Clarify the safe harbor status ensuring the active involvement of Internet intermediaries along the digital value chain, in the prevention and termination of online infringements.
- The findings of this report and other research on the subject suggest that there are substantial benefits, to the EU economy as a whole, of investing in measures that would address the issue of counterfeiting, and more generally strengthen the protection of intellectual property. In this context, **ECCIA strongly recommends that the current proposal on the revision of the EU trade marks system confirms the possibility of seizing infringing goods in transit, without any other obligations or constraints.**

## 7.2 Origin marking

- **The current proposal to introduce mandatory origin marking (“made in”) for all products imported in the EU territory, are of crucial importance as they represent an opportunity to strengthen one of the key pillars of their business model.** Furthermore, the positive impact that these legislative measures might have on the European economy at large in terms of competitiveness, growth and job creation, are inversely proportional to the above-mentioned potential negative impact of a decrease in the aura of our products. **ECCIA therefore recommends the introduction of compulsory or mandatory origin marking based on the customs code for all products.**

## 7.3 Selective distribution

- **ECCIA strongly recommends that the existing principles are upheld and not undermined**, as they are at the core of our business model. Indeed, Table 3 of this report shows that reduced control over distribution could create a 20% decline in output, lead to an output loss of €110 billion and the loss of 252,000 jobs.

## 7.4 Consumers trust online

There is a **need to restore consumers trust online and increase legal certainty for European companies engaging in the digital environment.** In order to do so, **ECCIA strongly encourages the implementation at EU level of a principle of Duty of Care, as part of the definition of the rights and duties of online economic actors, in the context of a commercial activity, along the digital value chain.**

On 1 July 2014, the European Commission published an IPR Action Plan entitled “Towards a renewed consensus on the enforcement of Intellectual Property Rights”, in which the Commission committed to evaluate the establishment at EU-level of a due diligence (Duty of Care) principle throughout supply chains as a means to prevent commercial scale IP infringements. ECCIA therefore invites EU decision makers to introduce a concrete proposal for the reaffirmation of the “Duty of care” principle online and offline at EU level, as a priority for 2015.

## 7.5 Market access

ECCIA strongly supports this commitment and further recommends EU stakeholders to:

- Expand FTA negotiations to emerging countries with high-growth potential, such as in particular Indonesia.
- Take into account the specificity of the European high-end cultural and creative industries in trade negotiations - the excellence that is unique to the values shared by our members does not generally face local competition in our export markets.

## > ECCIA policy recommendations

- In addition, on 19 March 2014, the European Commission proposed a joint initiative on visa facilitation, comprising the revision of the EU Visa Code and the introduction of a “touring visa” for the Schengen Area. These changes to the visa policy would directly benefit to the European luxury cultural and creative industries and would have a strong impact for the tourism industry and the European economy at large.
- ECCIA therefore strongly supports the European Commission’s proposal and encourages the new European Commission, Parliament, and Council to adopt a comprehensive and ambitious proposal relating to visa facilitation in order for the EU to fully grasp the potential of its tourism policy, which will create positive spillovers for the entire EU economy.

### 7.6 Skills and vocational training

This report has demonstrated that European **high-end cultural and creative industries represent a source of hope for the younger generations** through their contribution to job creation in Europe: they employ 1.7 million people and created close to 200,000 jobs in Europe over the past three years. Based on production in Europe, they invest over €700 million every year in vocational training, thereby contributing to the preservation of traditional European *savoir-faire*.

Luxury cultural and creative industries rely on a highly-skilled and creative workforce, which constitutes one of the key pillars of their business model. However, there is a **need to address the gap between industry needs and the availability of highly-skilled workforce** at EU level.

European lawmakers have already identified this problem. There is therefore a need to work hand in hand with EU and national stakeholders to:

- **Secure the preservation of traditional European *savoir-faire***
- **Re-valorise vocational training and highly-skilled workforce to attract and create talents**
- **Raise awareness about career opportunities** in manufacturing jobs through awareness campaigns and policies promoting the transmission of knowledge.

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