
48 Principal–agent analysis

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The contractual network in the arts sector

Various flows of exchange occur in the arts sector. Some of them are monetary, some real, a few are mixed, and many are quite difficult to measure. This is due both to the relevance of metaeconomic aspects (aesthetic, cultural, informational and so on) in the determination of their value, and to the need to be based upon subjective evaluations whose reliability is not necessarily influenced by experience, education or training.

Exchanges in the arts sector form a complex network that can be interpreted as a combination of different principal–agent relationships. Creative artists exchange their works with producers and dealers, they exchange these art objects and activities with single purchasers or large audiences, central and local governments exchange grants or in-kind services with creators (seldom), producers (normally) and sellers (frequently), private corporations exchange funds with artists and institutions, individual donors exchange their contributions with theatres and museums.

Tracking the flows that constitute a whole exchange route is important in order to interpret the outcome of each production as resulting from the combination of contractual power of each agent and of the system of incentives (both legislative and conventional) exerting an impact upon their strategies and choices.

Frameworks of exchange flows can take a recurring form in each sub-sector of the wider arts system. For example, common agency is typical of the performing arts market, in which the agent who sells live performances to the audience receives funds from two principals, the public sector giving grants of various forms, and the private sector giving sponsorships and donations. More complex is the framework of exchange flows in the visual arts sector, where artist, dealer, collector, critic and expert contribute to determine the value of some painting through a system of cross-evaluation and certification.

Each exchange occurring between agents in the arts sector is normally characterized by difference and conflict of goals. Goals are often determined in a generic way, such as diffusion of culture, artistic education of the new generations, preservation of cultural heritage and protection of local/national repertoire in the performing arts. Nevertheless, they can prove reciprocally conflicting: in many cases there is a trade-off between

preservation of and access to heritage, between innovation and access in the performing arts, between the appreciation of regular consumers and the expectations of occasional ones.

The distribution of information among agents

Heterogeneity of the relevant information, and its different level of objectivity, makes it the fundamental factor in conditioning the relationships between principals and agents in the arts sector. This depends upon various elements. First, there is a problem of certification of authenticity, which appears to be quite strong in the visual arts, although it is not irrelevant in the performing arts. Second, evaluation of quality – which is a multidimensional factor covering technical, aesthetic, cultural and social aspects – can prove quite controversial: evaluations of the same arts product can differ strongly from each other or appear incompatible with each other, according to the prevailing goal or group of goals taken into account.

Third, consumer choice is based upon largely insufficient information: household production implies originality and uniqueness in each bundle of goods and services created by consumers, therefore *ex ante* information on quality and likely appreciation is almost impossible to attain, and *ex post* information is subject to a high degree of variability according to the dimensions of the informational stock previously accumulated by each consumer.

Agents endowed with private information find it convenient to produce self-assessment of the relevant aspects such as quality of art products. A wide proportion of the value relevant in each exchange is usually generated by information created, processed and diffused by the agent (artist, museum curator, theatre director and so on). Being related to metaeconomic aspects and subjective assessments, such information is not easily monitored by the principal, who finds it difficult to transform it into objective data.

The problems of adverse selection and moral hazard generated by asymmetrical distribution of information are partially faced thanks to a system of third party assessment of quality and other relevant characteristics of each arts product. Experts and critics produce a great deal of information about authenticity, quality and reliability of paintings, monuments, operas, plays and concerts, as well as the different forms of reproduction (records, pictures, books, videos and so on) whose complex and indefinite set provides art consumers with additional information able to increase the level of utility derived from direct consumption.

Information and evaluations coming from these third parties can be variously reliable, according to the different degree of substantial independence enjoyed by critics and experts in relation to the main exchange flow. In fact, they are often former artists or producers, therefore their judgement

is likely influenced by past experience, with a high degree of subjectivity due to the past active involvement in the economic life of the art sector. Moreover, given the relevance of their evaluations for the determination of the economic value of art products, collusion between agents and critics/experts can occur, strengthening agents' contractual power against principals, and introducing a further bias in the outcome of such complex exchanges.

In some exchanges, such as those occurring between the public sector and theatres or museums, opinion polls can also exert some influence upon principals' choices; on the other hand, they appear to provide agents with useful information if they intend to tune their own strategies and decisions to market trends.

Objectives, strategies and constraints

As we noted before, the strategic choices adopted by both principals and agents depend upon their goals and orientation. Statutes, constitutions and mission statements usually contain long and heterogeneous lists of objectives. These refer to various aspects of art production, and are characterized by an inevitably low degree of precision. This extends to the description of tools and actions to which each principal or agent formally commits in order to pursue his goals. In this respect, strong and sound principles often support weak and uncertain strategies.

While single goals can conflict with each other within the strategy of each single agent, his main orientation appears to be crucial in determining the likely outcome of each principal-agent exchange. The heterogeneous nature of activities, the range of material and financial dimensions, the different extent of regional competence and other factors generate a variety of institutional structures in the arts sector.

From a juridical perspective, organizational forms can arise from various causes; they normally share the non-profit constraint, but can adopt the formal label of foundations, institutions or corporations, with a series of specifications and definitions (such as the newly born 'participation foundation' and 'cultural society' that enrich the Italian institutional landscape).

In order for their organizational orientation to be identified, the formal label does not necessarily prove useful, though a few characteristics can be analysed, such as the goals of price policy, the selection of inputs or the length and breadth of product life. In the case of art producers, orientation normally lies between the extremes of altruistic mission and revenue maximization; a role is played by the proportion of utility derived by 'immaterial' satisfaction, that is, utility related to the activity *per se* rather than to its monetary or material implications and effects.

In this regard, public institutions belonging to central and local government can be either oriented towards social goals such as the diffusion of the arts and culture or equality of access to the arts, on the one hand, or towards typically bureaucratic goals such as consensus or rents (or some mix of both) on the other. For their part, private companies give funds to the arts either in search for a distinguished reputation or – at the opposite extreme – in order to diffuse their brand name through indirect publicity.

There are cases in which the network of exchanges among the various agents operating in the arts sector is more complex, and in which agents of an exchange act as principals in another one, forming a sort of principal–agent chain (as in the visual arts market); this makes the analysis of the whole picture more difficult owing to the reciprocal impact exerted by the actual orientation of each agent.

Also limiting our view to the simple case of a theatre or a museum, we often face a common agency relationship, in which two principals give funds to the arts institution (their common agent) in exchange for activities whose real nature and cultural value are completely known and evaluated by the agent who receives the funds. The agent has therefore the possibility to provide each of his principals with a false report about the goals actually pursued (and the impact actually exerted). The choice actually to hide some information from one or both principals depends upon how one party's orientation combines with the others'.

If the agent is revenue-oriented and the principals respectively pursue social goals (public sector) and reputation (private sector), there is the strongest incentive for the agent to cheat, overstating the characteristics of his supply which appear to be consistent with these generical and unmeasurable goals. The most efficient response on the part of each principal is then to replace monetary grants with in-kind subsidies: since monitoring of output appears to be ineffective, the stage of control is 'shifted back' to inputs.

This can contribute to the selection of mission-oriented producers who are specifically interested, not in receiving grants, but in having a real opportunity to produce, since in-kind subsidies actually reduce their production costs.

The existing framework of incentives

An adequate system of incentives can substantially reduce – if not offset – the advantages currently enjoyed by cultural institutions in this complex principal–agent network. Unlike the case in manufacturing, incentives in the arts sector cannot focus upon the price level or other monetary parameters, also owing to the controversial measurability of value, and to the existence of many (often infinite) alternative combinations of inputs, in order to produce the artistic outcome.

Incentives appear to be weak in most (national and local) cultural policies throughout the world. This is certainly due to bureaucratic resistance, and to the evident convenience for the art institutions to be included on a list of recipients, which in some way guarantees the reception of public grants year by year. But a stronger reason for this lack of effective incentives is the perception that any mechanism activating monitoring and the consequential sanction risks impinging upon creative, artistic or cultural freedom. Such a perception is shared by both art institutions and public regulators, and assisted by a very strong and explicit moral sanction.

A closer look at art production should make it clear that cultural choices and managerial strategies can be separately considered, analysed and evaluated. Of course there may be a 'grey area' in between, but certainly many decisions and actions taken by art institutions can be the object of monitoring and evaluation, according to the prevailing goals of the principal.

In fact, while the choice of inputs in a performance or in an exhibition are certainly related to artistic and cultural choices – and therefore respond to subjective and 'untouchable' criteria – there are many other aspects of art production that can be measured through rather precise parameters: the diffusion in a certain area or the length of production, the policy aimed at guaranteeing equality of access and its outcomes, the educational impact, and the variety and quality of informational side-products are all parts of art production whose monitoring does not exert any negative impact upon the artistic and cultural choices.

The level and composition of grants can therefore be tailored to the level and composition of art production according to a specified hierarchy of goals and performance indicators. In such a way public grants could abandon the uncomfortable role of financial lifebelt, becoming instead the explicit reward for the attainment of specific goals.

An effective system of incentives could finally move art production from the false market of grant maximization to its proper market, in which various and heterogeneous principals 'buy' different parts (or effects) of the agent's effort, each according to his goals, values and orientation; this would strengthen the importance of consumer choice and expectations, and re-equilibrate the contractual power of principals and agents.

See also:

Chapter 49: Public choice; Chapter 52: Regulation.

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