34 International trade
Günther G. Schulze

Introduction

The market for cultural goods is arguably one of the most internationalized. Van Gogh's paintings can be admired in New York, a large collection of Egyptian art is on display in Berlin, Isabel Allende's and Thomas Mann's books are popular in Europe and the Americas alike, the Beatles' and Madonna's CDs are sold throughout the world, and Hollywood movies have global coverage. Yet this phenomenon is not uniform: the market share of American films in Europe is much higher than that of European films in the USA and it is fair to say that Pop-Art had a larger influence on the European culture than traditional Javanese paintings. Why is that? What determines the pattern of trade in cultural goods?

Trade theory explains why sellers (mostly producers) of certain goods reside in different jurisdictions from the buyers/consumers of these products. In order to understand the trade pattern we need to know what determines the demand for foreign art and its supply; that is, what determines consumption of foreign art and under which conditions the respective cultural goods are produced. In both dimensions cultural goods are distinctively different from most other goods.[1]

The demand for cultural goods in the international market

The demand for cultural goods is characterized by the positive addiction in consumption of cultural goods. The idea goes back to Alfred Marshall, who wrote 'It is therefore no exception to the law [of diminishing marginal utility] that the more good music a man hears, the stronger is his taste for it likely to become' (Marshall, 1962, p.94). Marginal utility from cultural consumption increases with the ability to appreciate (a particular form of) cultural goods, which is a function of past consumption (Stigler and Becker, 1977). In the course of consuming cultural goods, such as enjoying Flemish painters or French *films noirs*, art-specific 'consumption capital' is built up. Marginal utility from cultural consumption increases with the accumulation of consumption capital and therefore rises over time. This leads to an actual shift in the demand for the specific cultural goods without a change in prices or income. Empirical evidence for such an addictive effect of art consumption is ample (for example, Smith, 1998). Becker (1996) distinguishes two components of consumption capital: personal capital, which is formed out of past consumption and other relevant individual experience,[2] and social capital, which represents the influence of others on a person's utility, namely the influence of peers or relevant others. Social capital can be influenced by the individuals, only to a limited degree, by the choice of the social milieu they live in. Part of social capital is cultural capital (see Throsby, 1999) which is given for the individual.

In the international context, this notion of positive addiction has two implications. First, people value cultural goods from abroad less as long as they have not accumulated enough personal consumption capital for this unfamiliar art; social capital is likewise underdeveloped as their peers have not accumulated consumption capital for this art either. This *cultural discount vis-à-vis* domestic art limits the degree of trade: the closer (national) cultures are, the smaller the difference in the relevant consumption capital and, thus, the larger the bilateral trade in art. This cultural discount can be asymmetric; one country can accumulate consumption capital for the other country's culture, but the opposite need not be true. There is no clear theory of how social and individual cultural consumption capital is built up, but it is clear that this happens. The more consumption capital is built up, the easier its further accumulation, until foreign-origin cultural goods become part of the national culture. Trade levels go up and remain high. This describes the second effect, hysteresis, in trade in cultural goods. These arguments imply that trade in art is a positive function of cultural proximity and that current trade is a positive function of past trade. Still, this does not predict the pattern of trade in art; we need to look also at the supply side in the international market for cultural goods.

The supply of cultural goods: a classification

Cultural goods comprise very heterogeneous products such as sculptures and statues, original paintings, CDs and DVDs, books, films for cinema and TV, prints and so on. From an economic perspective, they fall into two categories:[3] unique cultural goods (such as original paintings and sculptures, antiques) and reproducible cultural goods (recorded music and films, literature and so on).

Reproducible cultural goods are produced in two steps, the creative step in which the artist creates the blueprint (that is, the manuscript, the original recording, the master copy of the film) and the reproduction step in which the master copy is industrially copied under strongly increasing returns to scale, and marketed.[4] This makes the final products relatively cheap and thus (international) trade takes place predominantly between producers and consumers ('primary market').[5] Note that artists (bands, authors and so on) and the companies that reproduce the original work (labels, publishers) need not reside in the same country, so that there may be a second international transaction, an international art service which is paid for in royalties. Trade can thus be explained by a Dixit–Stiglitz-type monopolistic competition model of international trade in differentiated products (see Wong, 1995, ch. 6).

In contrast, original paintings, sculptures, drawings and so on are produced in a single – creative – step without scale economies. They are unique and highly durable and thus precious, which makes them a storage of value and creates a strong 'secondary market', that is a market between former and future consumers. The observable substantial price increases for these goods demonstrate that additions of the primary market to the secondary market's stock are insufficient to satisfy rising demand for these collectors' items and thus the secondary market dominates the primary market, partly also because of low substitutability between the stock of old art objects and the new products. This makes international trade in works of art demand-determined, as both sellers and buyers are consumers, and thereby distinguishes it from trade in most other products.

Before we turn to the characteristics of trade in these two types of cultural goods, a remark on the magnitude of international trade in cultural goods is in order. It is very hard to measure the actual trade in cultural goods and services, not only because these groups are not easily defined, but also because many of the international transactions are reflected in transborder royalty payments, for which consistent data are hard to find, and not in crossborder movements of physical goods.[6] Table 1 shows the average trade for 1990–94 for 154 countries and selected categories of cultural goods.

Table 1 Average trade in selected groups of cultural goods as defined by SITC, 1990–94

	Works of art (SITC 8960)	Sound recordings (SITC 8983)	Books etc. (SITC 8921)	Total manufacturing trade
Volume of trade (billion US$)	10.569	18.27	8.441	3586.802
Percentage of total trade in manufactures	0.30	0.51	0.24	100

Note: The data exclude transborder royalty payments.

Source: Schulze (1999).

Trade in unique art

Trade in unique art is demand-driven and this demand in turn is a function of the income level as works of art are luxury goods. Demand also depends on cultural proximity, which should have a substantially stronger impact on the trade of works in art than on total trade. Schulze (2002) compares the pattern of trade in works of art with the total manufacturing trade pattern in a gravity model which links gross bilateral trade flows to the country sizes of both countries as measured by GDP, the geographical distance between the two countries, the income levels (GPD per capita) and dummies for a common border, a common language and for countries that are members of the same trade bloc.

The findings are consistent with the theoretical predictions: the effect of GDP per capita of the importing country is significantly stronger for works of art than for total trade, pointing towards a higher income elasticity of demand. Also the variables that capture cultural proximity – distance and a common language – exert a much stronger influence on trade in unique art than on total trade. People have closer ties to and have built up more consumption capital for nearby cultures; likewise, a common language not only facilitates cultural exchange but often is tied to a common (mostly colonial) history. It turns out that people trade five times as much in works of art if they have a language in common, which is 2.5 times the factor for total trade.[7]

Trade in reproducible cultural goods

While trade in unique art establishes a particularity not only because of the special demand characteristics and therefore the importance of cultural proximity, but also because works of art are the only group of products where the secondary market dominates the primary one,[8] the latter does not apply for reproducible art. For these goods cultural discounts are likewise important and this relates to the different cultures of the artists (first production step) and the consumers, not the country of reproduction. Reproduction is characterized by strong scale economies: once a manuscript is written, it is cheap to reproduce additional copies of the book. This explains why (re)production of a particular cultural good is concentrated in one location. At the same time, production of many cultural goods is characterized by strong economies of scope at the firm level as a substantial part of fixed costs are not tied to the production process of one particular product (a certain CD) only, but to producing similar products (CDs in general). Production facilities (CD production plants) and distribution networks are efficiently used only if used for many similar products. This explains the existence of labels, film studios and publishing houses. In addition there may be economies of scale at the industry level, which may be local, national or international, depending on the industry.

The movie industry may serve as an important example (see Frank, 1993). Obviously, *re*production is characterized by economies of scale as it is easy to copy film rolls. Production and marketing are characterized by scope economies as studios, marketing departments and distribution networks can serve for production and especially financing and sale of many films at rapidly decreasing unit cost. Another reason is the high risk involved in film making: studios pool the risk and thus serve as an insurance device, a function which capital markets may not fulfil equally well as knowledge is highly industry-specific. This explains the existence of the big studios. The making of the film itself requires highly specialized labour – actors, stuntmen, cameramen, stylists and so on – for a very limited period of time who make a living by working consecutively or even simultaneously in many movie productions, also for different studios. As flexibility and short-term availability are important, this creates a specialized localized labour market and thus local economies of scale at the industry level. This explains the existence of Hollywood or 'Bollywood' (Bombay), the concentration of the movies industry in one place in a country.

The dominance of American films in the Western world is explained by the concurrence of scale economies in supply and the demand characteristics for cultural goods. Since initially the cultural discount works both ways, and domestic films are preferred to foreign films, the film industry in the larger home market will have larger total sales as it faces cultural discounts in the demand for its films for a smaller portion of the world market (Wildman and Siwek, 1988; Frank, 1993). Given strong scale economies in film production, this effect allows the larger country's film industry to lower its prices or to increase its fixed (production) costs and thereby to try to enhance the quality of its products. Either way, it gains a competitive edge and enjoys a higher market penetration in the foreign countries than foreign films in its home country. Market penetration in foreign markets will build up consumption capital and reduce the cultural discount until eventually American films have become part of European culture. The opposite does not hold to the same extent – trade in films may become a one-way street.

Although this phenomenon is not uniform for all countries, empirical evidence is consistent with this theory. In 1999, the market shares for domestic films were 92 per cent in the USA, 14 per cent in Germany, 17 per cent in the UK, 32 per cent in France and 0.5 per cent in Belgium. The market sizes in terms of movie attendances were 1480m. for the USA, compared to 880m. for the EU (Germany 149m., UK 140m., France 154m., Belgium 22m. and so on). This explains the film trade pattern, for instance, for Germany: Germany paid DM 1327m. in royalties for imported films, 71 per cent of which to the USA, and earned only DM 74m. in royalties from exported films (11 per cent of which from the USA).[9]

Government intervention in the international trade in cultural goods

The observed trade patterns for both types of cultural goods are also partly a result of various government interventions. For instance, according to Article 36 of the Treaty of Rome, the EU member states have the right to protect their national patrimony through export restrictions for works of art (embargos, export licensing, pre-emptive rights to purchase works of art to be exported) and they are free to define what they regard as their national patrimony. VAT regulations may distort trade as well: within the EU, works of art are taxed at the margin (on the difference between purchasing and selling price) according to the origin principle, which disfavours high VAT countries. On imports of works of art into the EU, the import VAT is levied mostly at reduced rates which differ substantially between countries, favouring low-tax countries such as the UK. The *droit de suite* entitles artists to a fraction of the gross selling price each time their works of art are resold. This right functions like a turnover tax and thus may divert trade away from countries that enforce these resale royalty rights. The EU has decided on introducing a uniform *droit de suite* on a sliding scale with a derogation period between five and ten years for some countries, whereas the important art markets of Switzerland and the USA do not have resale royalty rights. Lastly, direct subsidies to art museums or indirect subsidies to art institutions and private individuals in the form of tax incentives (wealth and inheritance tax exemptions, income tax deductions for donations to art institutions, acceptance of art objects in lieu of tax payments) increase the incentive for residents to acquire or to hold art, and thus distort trade.

Government interventions in the movie industries are also frequent. This refers not only to direct subsidization of the domestic film industry (also in the form of lucrative awards), but also to local content requirements for national TV.[10] These measures increase the supply of and the demand for domestically produced films and therefore reduce imports and increase exports. To what extent government interventions actually distort trade is of course an empirical matter which to date remains largely unresolved.

Notes

1. The following two sections draw on Schulze (1999). For normative issues of trade in cultural goods, see, for example, van Hemel *et al.* (1996) and O'Hagan (1998, ch. 4, 6).
2. This includes the interaction with others. This helps to explain the emergence of superstars. See entry 'Superstars' in this volume.
3. We disregard live performances like concerts, plays and so on which are internationally tradable services if bands or theatre companies tour abroad.
4. The second step can be divided into functionally defined substeps (production, financing, marketing, distribution). See below, 'Trade in reproducible cultural goods'.
5. This does not exclude possible intermediaries such as foreign publishers, so that the international trade can also take place between the producer and the foreign intermediary and the subsequent sale is between this intermediary and a consumer.

6. One example is the case of a domestic publisher who sells the right for a foreign edition of a book to a foreign publisher.
7. The other results are as follows: art trade rises more than proportionally with GDP, a common trade bloc increases trade significantly and a common border does not increase trade in addition to the proximity as measured by geographical distance.
8. The only other exception is antiques and scientific collections, which are in the same SITC category.
9. All data refer to 1999; source: Roth (2001, pp.80–87).
10. For the Canadian case, see Acheson and Maule (1992); for Germany see Perino and Schulze (2003).

See also:

Chapter 21: Cultural statistics; Chapter 31: Globalization; Chapter 54: Superstars.

References

Acheson, Keith and Christopher Maule (1992), 'Canadian Content Rules for Television: Misleading Lessons for Europe', *Journal of Cultural Economics*, 16, 13–23.

Becker, Gary (1996), *Accounting for Tastes*, Cambridge, MA: Harvard University Press.

Frank, Björn (1993), *Zur Ökonomik der Filmindustrie*, Hamburg: Steuer- und Wirtschaftsverlag.

Marshall, Alfred (1891), *Principles of Economics*, London: Macmillan, cit. 8th edn, 1962.

O'Hagan, John (1998), *The State and the Arts*, Cheltenham, UK and Lyme, US: Edward Elgar.

Perino, Grischa and Günther Schulze (2003), 'Competition, Cultural Automony and Global Governance: The Audio–Visual Sector in Germany', mimeo, University of Freiburg.

Roth, Markus (2001), *Filmstatistisches Jahrbuch 2001*, Baden-Baden: Nomos.

Schulze, Günther (1999), 'International Trade in Art', *Journal of Cultural Economics*, 23, 109–136.

Schulze, Günther (2002), 'International Trade in Art – A Tale of Cultural Proximity and Secondary Markets', University of Freiburg, rev. manuscript.

Smith, Thomas (1998), 'The Addiction to Culture', paper presented at the biannual meeting of the Association for Cultural Economics International in Barcelona, 14–17 June 1998; also part of 'Two Essays on the Economics of the Arts: The Demand for Culture and the Occupational Mobility of Artists', unpublished doctoral dissertation, University of Chicago, September 1998.

Stigler, George and Gary Becker (1977), 'De Gustibus Non Est Disputandum', *American Economic Review*, 67, 76–90.

Throsby, David (1999), 'Cultural Capital', *Journal of Cultural Economics*, 23, 3–12.

Van Hemel, Annemoon, Hans Mommaas and Cas Smithuijsen (1996), *Trading Culture*, Amsterdam: Boekman Foundation.

Wildman, Steven and Stephen Siwek (1988), *International Trade in Films and Television Programs*, Cambridge, MA: Ballinger Publishing.

Wong, Kar-yiu (1995), *International Trade in Goods and Factor Mobility*, Cambridge, MA: MIT Press.