Introduction

The term ‘cultural economics’ is to some extent a misnomer. It has come to be used by omission rather than by commission because it is hard to think of another term that easily covers the creative and performing arts and heritage as well as the cultural industries. The earlier name for the subject was ‘economics of the arts’ and a few books in the field still are published with that title. However, the problem with ‘the arts’ is that it is more specific and narrow than the subject matter included in cultural economics; it tends to apply to ‘high’ culture (sometimes even only to the live arts) – the activities that are supported by the National Endowment for the Arts in the USA or the Arts Council(s) in the UK and by similar parastatal organizations in other countries. Heritage (built heritage, museums and art galleries) often falls under a different administration and the cultural industries (film, music, publishing, broadcasting and so on) – ‘low’ culture – mostly receive little public support. Economists studying all these parts of the cultural sector see common characteristics and problems and so have settled for the term ‘cultural economics’. Ministries of Culture have responsibility for policy over the whole cultural sector and cultural economists follow suit. Cultural economics, therefore, is the application of economics to the production, distribution and consumption of all cultural goods and services.

From the professional point of view, cultural economics is recognized as a growing field of economics. The Journal of Cultural Economics is the specialist international journal in the field and articles are listed under the Journal of Economic Literature’s classification Z1 ‘Cultural Economics’ with Z10 ‘Economics of the Arts’ as a sub-field. The Association for Cultural Economics International, whose membership consists of academics and others with a professional interest in the field, holds regular conferences. Courses in cultural economics and in cultural management are increasingly being adopted, particularly at the graduate level. There are several textbooks and readers in cultural economics and two literature surveys have been published in the last few years (Throsby, 1994; Blaug, 2001).

What is it, then, that the field of cultural economics has to offer? The Contents of this Handbook lists the range of topics included in the subject; some are familiar, others probably less so and a few are about closely related disciplines. The titles of the entries have been kept simple to make the book easy to use. Entries are cross-referenced to guide the reader to related
Economic characteristics of cultural goods

What all cultural goods and services have in common is that they contain a creative or artistic element. Cultural goods are tangible objects, such as an artwork or a book; others are intangible services, like a musical performance or a visit to a museum. Some are final goods that are supplied to consumers; others are intermediate goods and services that go into the production of other cultural products or into non-cultural output: a CD may be sold to the consumer, played on the radio as an input to a broadcast or played in a shop or sports hall. Some cultural goods are capital or durable consumer goods – a picture in a museum, a video – and they yield a flow of services over their lifetime; others, especially the performing arts, exist only for a particular time span.

Besides this common cultural element, what cultural goods have in common with all other goods and services is that their production utilizes resources of land, labour and capital and other inputs, particularly human ingenuity. These resources have other uses and therefore have an opportunity cost and a price. That is not to say that all cultural goods and services are sold on the market, though many are, as are the labour services of artists and other creative workers. As we see in the discussion of cultural policy later on, some cultural products are supplied by the government and may be provided free of charge, being financed out of taxes. That is a policy decision, not an economic one; most cultural goods are not pure public goods. However, most cultural economists believe that cultural goods and services have an element of public goods characteristics about them that markets cannot fully take into account through prices.

An important question in cultural economics has been whether the allocation of resources via the price mechanism can produce the socially desirable output of cultural goods and services. The general consensus is that it cannot, for a variety of reasons. One reason is that, by their very nature, cultural goods have some of the qualities of public goods. Depending upon the extent of external benefits, the greater the degree of ‘publicness’, the more likely it is that the state will intervene in markets either to provide the good directly, to subsidize it, or to control its production or distribution by regulation. A second (and related) argument is that consumer demand does not reflect the full value of these goods because they are experience goods; therefore, all consumers’ tastes are not fully formed and they cannot have
full information about cultural goods. Information problems mean that expert judgement has to be relied on to ensure quality and that leads to what is called supplier-induced demand. This easily results in the domination of expert opinion, often supported by state finance, with the consumer/taxpayer being unable to assert her preferences. An alternative but similar concept that is used to justify replacing market decision making with collective provision is that of ‘merit’ goods, the term used by economists for goods that are held, usually by experts, to have inherent value for society. It is worth noting that the above arguments for government intervention are not confined to the arts but are made also in relation to health and education.

Cultural policy
There have been changes to cultural policy in many countries over the last 30 years or so that have affected cultural economics. Cultural policy, once concerned only with ‘high culture’ arts and heritage, has broadened out to include crafts, cultural industries, community arts, minority arts and such-like and that has been mirrored by an increasing interest in cultural economics in these areas. In some countries there have been policies of ‘privatization’ or ‘déétatisation’ – the withdrawal of state ownership and control of cultural facilities and organizations. That has necessarily taken place in the former soviet-type economies of Eastern Europe, but other countries in Europe, pressed by the European Monetary Union to reduce the size of the public sector, have followed similar policies; for example, opera houses in Italy have become private non-profit organizations. These changes have implications for the use of public funds and, in some countries, accountability has become more important, with issues like performance indicators now being seriously considered.

Another trend in cultural policy has been a changing balance between central, regional and local government, especially with respect to the finance of culture. All of these changes are important for cultural economists analysing cultural policy.

As with other areas of public policy, economists do not see themselves as having professional competence in the realm of policy formation; their role is rather to provide analysis that can assist in making choices between policies or policy tools. An important contribution by economists to cultural policy making has been the recognition that it often seeks to achieve multiple objectives that are in conflict (for example, raising quality and spreading access) and that require different policy measures and incentive structures. This is the case not only at the macro level but also at the level of individual arts organizations; a museum, for example is a multi-product firm, offering research and conservation services as well as education and
entertainment for visitors. Lump sum grants, therefore, may not secure desired policy outcomes. Another point to note is that almost all cultural policy relates to the supply side: the main exception to this is arts education in schools that develops future consumers’ tastes. There has been some limited experimentation with voucher schemes on the demand side but otherwise the focus is entirely on the supply of cultural goods and services by public and private organizations.

A basic distinction can be made between those cultural facilities and organizations that are publicly owned and those that are private and, within the latter group, those that are non-profit-making concerns. Public ownership could mean national, regional or local authority ownership. It is also, of course, important to distinguish between ownership and control: private organizations may be controlled by financial or legal means, and publicly owned ones may be expected to mimic market forces (for example, quasi-markets in state-owned health or educational provision attempt to give efficiency incentives equivalent to the profit motive; likewise, publicly owned museums are increasingly expected to run shops). State-owned heritage and performing organizations in some countries are managed by civil servants and their revenues and costs absorbed by the state (or local authority); they may not even have their own budget. In other countries, cultural organizations are privately owned, self-managing, free-standing, non-profit enterprises, which receive state subsidy. Later we discuss the finance of culture in more detail. Suffice it to say that throughout the world there are many possible permutations and combinations of public and private ownership and control in the arts and cultural industries.

A classification of cultural policy tools is also useful. As suggested above, one policy choice for public authorities is whether to own and/or manage cultural organizations or to subsidize them. Subsidization is a policy tool. Subsidy may be direct or indirect. Direct subsidies may be lump sum grants or used to achieve some specific policy outcome, such as increased public participation. Indirect subsidies include waiving taxes for arts and heritage organizations and using tax breaks to encourage private giving. The government may also exert control by regulation. By and large, the privately owned cultural industries receive little state subsidy but are subject to laws, rules and conventions including self-regulation: laws include copyright law; rules include such things as varied as content restrictions in broadcasting, the fixed book price in publishing and heritage-listing regulations. While cultural economics has had quite a lot to say about financial tools of cultural policy, regulation has until recently attracted much less attention, though it can strongly influence the market for cultural goods.

Cultural policy, therefore, has economic dimensions: on the one hand, market outcomes are intentionally altered by state intervention and, on the
other, the success of cultural policy depends upon financial incentives and regulatory measures to deliver the desired outcome.

**Finance of culture**

The range of ownership models in the cultural sector interacts with the finance of culture. Organizations and facilities that are publicly owned or subsidized receive funds raised from taxes from central and local government bodies. Public finance can also be indirect through tax expenditures. Finance may come from private sources even for state-owned institutions; consumer purchases of tickets are an obvious source but sponsorship, donations of money, goods and volunteer labour can be significant sources of support. Inter-country comparisons of cultural finance are notoriously difficult, not only because of the lack of comparable statistics but also because policies and practices differ. Nevertheless, we can make the general observation that the balance of public and private financing varies a lot between different countries: by and large, the proportion of private finance of culture is greater in the USA, Japan and the UK than in other European countries, Canada and Australia. What also differs between countries is the role of non-profit organizations and their relative importance in the cultural sector; that is typically lower in continental Europe than elsewhere. Finally, there are the private for-profit organizations (such as the cultural industries and Broadway and West End theatre) that are financed from private capital and from sales revenues.

Even in countries that spend relatively large amounts on public provision or subsidy of culture, the cultural budget is only a small proportion of government spending, often less than one per cent of the government budget. The study of cultural economics is not motivated by the size of the cultural sector, nor is it important because of the amount of public money involved. However, cultural policy and public expenditure on culture are often controversial, attracting attention that is disproportionate to the amount of money involved. Moreover, the arts and culture attract more attention in some countries than in others. Who is to be appointed Director of the Vienna State Opera is widely discussed in Austria; in the UK, only a handful of people could even say who is the Director of the Royal Opera Covent Garden. Yet probably more or less the same (small) proportion of the population attends the opera in either country.

The distribution of public finance between different parts of the cultural sector is often uneven. The performing arts tend to be more heavily supported by public subsidy than heritage, literature or the visual arts. Within the performing arts sector, opera and ballet take a larger proportion than orchestras and theatre.

Another universal observation of the public finance of culture is that the
bulk of public funds are directed to organizations rather than to individuals. This is no doubt because of issues such as public accountability and moral hazard. It is also argued that organizations can offer individual artists more effective opportunities for exhibiting their work. There are some notable exceptions; for example, The Netherlands has policies of supporting visual artists. In general, though, it is organizations rather than individual artists that receive the greatest amount of direct and indirect public support and the better established and larger the organization, the more subsidy it is likely to get, which, of course, enables it to increase its status. This can easily militate against artistic innovation, especially when the organization is publicly owned and staffed by state employees who favour old routines. The durability and size of the organization also determines the amount of attention it receives and the political pressure it can deploy when threatened with a reduction in public subsidy. One can think of this as a version of Say’s Law applied to arts subsidy – supply creates its own demand for public funds; the bigger and the better funded an organization is, the more support it demands.

The regional or geographical distribution of publicly funded cultural organizations is also controversial in many countries. The UK is an example of a country where cultural policy is centralized and the amount of public support (direct and indirect subsidy and expenditure) per head of population varies considerably by area. It is far higher in London than elsewhere in the country, despite the fact that around half the public budget for culture (arts and heritage) is provided by local authorities. And that is the case even though policy on the bodies responsible for distributing public funds has alternated over the last 50 years between centre and regions. The same policy issue is present in many countries.

One reason why problems arise in the public finance of the cultural sector is that data collection and analysis are still far from satisfactory even in countries where cultural policy is well developed. Data on the use of subsidy are needed for answering questions about the equity as well as the efficiency of cultural policies. Both topics have been the subject of analysis by cultural economists. Participation in the arts and heritage – who benefits from cultural policy and finance – has long been studied, as have the relative merits of direct and indirect subvention and private provision. Lately, public choice theory with its focus on rent seeking as well as principal–agent analysis and the economics of regulation have come to be applied to cultural policy and the public finance of culture. Institutional economics is also gaining increasing attention. In their different ways, these economic approaches all emphasize the role of incentives. What incentives do specific policy measures offer and do they achieve their objectives? Thus cultural economics is concerned with the connection between cultural policy and
the finance of culture. Some call this ‘political economy’ to emphasize the policy orientation. That, however, has always been a main theme of cultural economics. What is still lacking, though, is the detailed study of the effects of policy measures on the supply and demand for cultural goods and services to see if they achieve their stated objectives.

Analytical approaches to cultural economics
So far, we have made the point that cultural economics is concerned with broad aspects of cultural production and with cultural policy. It was also said that economists approach these matters from different points of view. In this section, the analytical approaches that have been taken by cultural economists are identified and explained. They are microeconomic price theory, welfare economics, macroeconomic growth theory, property rights economics, institutional economics, public choice and political economy. Finally, the section briefly considers the relation of cultural economics to other disciplines.

Microeconomic analysis
Cultural economists have used neoclassical price theory in the study of the costs of production, revenues and pricing policy (including price discrimination and studies of the elasticity of demand and supply) of cultural organizations. Traditionally neoclassical analysis has assumed that firms maximize profits; however, microeconomic analysis is also applied to non-profit organizations (which may maximize sales or attendances or membership). Studies of demand and supply of a whole range of arts and heritage organizations and of markets for cultural goods as well as of artists’ labour markets have been undertaken. This type of analysis is positive economics and increasingly uses econometric analysis, particularly in the study of the art market.

Welfare economics
Welfare economics with its derivatives, such as cost–benefit analysis and contingent valuation, is probably the most widely used approach in cultural economics (as well as in many other policy-oriented areas, such as environmental economics). Welfare economics analyses the conditions for achieving maximum efficiency of the use of resources. The Pareto optimality rule, that social welfare is necessarily increased if one member of a society is made better off by a policy without it making anyone else worse off, has been elaborated by the distinction between actual and potential Pareto improvements, the latter being measures where some people would be made worse off but accept a financial payment to compensate them for their loss (the so-called ‘Hicks–Kaldor’ compensation test). The conditions for
maximizing efficiency for the whole of society are highly restrictive and unlikely (if not impossible) to exist in the real world since general equilibrium in all markets is required. However, following Pigou, rules for maximizing social efficiency in individual markets by equating marginal social costs and benefits to determine optimal price and output in the presence of external effects have become widely used for policy purposes (road pricing is a familiar example).

Applications of welfare economics are varied and range from cost–benefit analysis (CBA) to pricing rules for regulated natural monopolies. CBA of long-term investments – say a theatre or museum – uses information about expected costs and revenues over the lifetime of the installation (private costs and benefits) and the external effects to the locality that cannot be captured in admission prices (the social costs and benefits) to calculate the social rate of return on the investment. Comparing that to the social discount rate enables the policy maker to weigh the proposed project against other public investment and leads to the well-known trade-off argument of kidney machines versus theatres. CBA is a widely used and accepted method of decision making; regulatory pricing, by contrast, has so far little application in cultural economics. However, the growth of interest in information economics, digitalization, the Internet and the regulation of copyright collecting societies is likely to change that.

Closely related to CBA are economic impact studies, which in addition to measuring the social costs and benefits of a cultural installation, or even the whole cultural sector in a city or region, apply macroeconomic techniques (see below). They are being replaced in cultural economics by a recent and fast growing literature on contingent valuation analysis, also firmly rooted in welfare economics, which uses surveys of people’s subjective estimates to directly calculate society’s valuation of public goods or quasi-public goods.

These methods of decision taking attempt to provide ‘positive’ empirical evidence of economic and cultural variables. Their acceptance, however, implies that the underlying conditions of welfare economics are met, and that is a tall order. In addition, critics question welfare economics itself as normative, on two counts: first, that it takes as given the underlying distribution of income and thus ignores public concerns about equity, though in practice much government intervention is motivated by a desire for greater equality. Welfare economics therefore over-emphasizes efficiency at the expense of equity. Secondly, it justifies government intervention through use of taxes and subsidies but ignores possible institutional changes (for example, to property rights) and bargaining by private parties that could eliminate apparent external effects and public goods and so obviate the need for state intervention.
As in other areas of applied economics, it seems unlikely that the criticisms of welfare economics will prevent its use or, rather, the use of techniques and concepts that essentially rest on it. It has led to powerful insights and effective policy applications. But its somewhat dubious foundations mean that we should be especially careful in applying it and that we should search for alternative underpinnings for the economic analysis of the cultural sector; ideas such as cultural value and sustainable cultural development are attempts to overcome these problems. The search for improved methods and alternative means continues.

Macroeconomic growth theory
Economic impact studies of the arts have been criticized not so much on the grounds of their welfare economics foundations but more because estimates of externalities (social benefits) are embellished and magnified by the use of spuriously high multipliers. The Keynesian multiplier, whether applied at the local or national level, is a macroeconomic concept and its use requires an understanding of fundamental economic concepts like national income accounting, the measurement of value-added and the aggregation problem. Few of the many economic impact studies that have been done have paid sufficient attention to these issues (and nowadays we see the same thing happening with measures of the size and so-called ‘economic importance’ of the cultural industries and of copyright). Economic impact measurement is also vulnerable to the size of the area being considered. Ignoring these problems has led to exaggerated claims for the growth and employment possibilities of the development of cultural facilities, for example for improving the economic conditions of the inner city.

Macroeconomics also provides the theoretical background for Baumol's cost disease, which is due to the unbalanced growth of different sectors of the economy, causing the one growing the slowest to lag behind; hence another name for it – the productivity lag in the arts. Incorporated into Baumol and Bowen’s (1966) book, *Performing Arts: the Economic Dilemma*, the model of unbalanced growth assumes a dynamic sector, with growth propelled by technological progress raising labour productivity, and a stagnant sector, with lower growth and little scope for factor substitution. Labour-intensive service industries, including the arts among others (hairdressing, health, education), lag behind in the growth of labour productivity and, with economy-wide wage rates driven up by the dynamic sector’s productivity, the service industries experience relatively higher labour costs and hence must raise prices above the average. Thus the arts and similar inflation-prone industries are predicted to become increasingly less able to compete for consumer spending and so are at risk from market forces that would eventually lead to their demise. Historically, that is a typical outcome
of dynamic growth with technical progress and it has displaced industries and occupations from scribes and handloom weavers to station porters. Their passing is considered a normal part of economic development and growth and is often compensated by new products coming on the market that replace the old. This is not accepted or acceptable, however, where merit goods are concerned, such as the arts, heritage, education and so on. Protection by the state is therefore called for if existence of such goods (for whatever reason) is to be guaranteed. The alternative is that they absorb an increasing proportion of national income (which is growing as a result of productivity increases in the dynamic sectors) and that may also be a socially acceptable outcome.

The theory of growth underlying the Baumol model is one of exogenous technical progress absorbed via capital investment with an aggregate production function that raises labour productivity as capital is added. Modern growth theory postulates endogenous technical progress that is embodied in human capital through education and skills acquisition. This is the new endogenous growth theory and its practitioners emphasize cultural factors as inputs into the production function. However, this is ‘culture’ in its wider anthropological rather than its narrower artistic sense.

Property rights economics
Following criticisms of welfare economics and its justification of government intervention, particularly by Coase, the property rights approach and transaction cost economics have become increasingly important in economic thinking. The property rights approach throws the onus of dealing with ‘external’ effects back on to the market in which property rights can be traded and allocated to those who can make the most efficient (that is, profitable) use of them. The Coase theorem that, in the absence of transaction costs, the initial distribution of property rights does not affect the market outcome demonstrated that transaction costs must be incorporated alongside property rights. This approach, now standard in Law and Economics, is employed in cultural economics in analysing artists’ rights and copyright and also for considering policy issues such as auctions for broadcasting licences. It is applied as well to regulation of built heritage in private ownership.

Institutional economics
The term ‘institutional economics’ may be defined in several ways to cover, in the narrower sense, the study of the organizations in the cultural sector or, in a broader sense, all institutions in society, such as laws, social, political and cultural norms, and organization and, of course, the market as an institution itself. Moreover, institutional arrangements themselves are the outcome of political and economic choices by a society.
The incentive structures within organizations and those they offer to their trading partners form part of this study. Thus the way public subsidy to the arts and heritage is organized and the type of subsidies offered fall under this heading, as do laws and regulations controlling broadcasting and the press.

There is considerable variation in institutional organization and structures between countries and they influence societal values and attitudes to the role of the arts and culture and how they should be financed and supported. For example, the high levels of subsidy to the arts in many European countries are due not only to their specific historical development but also to the role they play in society, what one might call the ‘culture of cultural provision’.

**Public choice theory**

Public choice theory adopts an economic approach to political decision making. It concentrates on the incentives that influence the choice of policies: for example, why politicians support the arts and how they use the arts to gain political support for themselves, on the one hand, and, on the other, how cultural lobbyists influence arts policy. Principal–agent analysis is relevant here; what kind of policies or incentive structures can the principal, for example, the grant giver, offer the agent, the arts organization in receipt of the grant, to fulfil the principal’s intentions? Regulation and public choice theory develop this approach, considering such problems of rent seeking in the arts – the pursuit of unearned rewards via political lobbying.

This approach has not been much used in cultural economics, though the subject clearly lends itself to it; an exception is its application to heritage regulation.

**Political economy**

The political economy approach is concerned with broad questions of the choice of policy. The relation between central and local government financing is an obvious example of an issue in political economy. Whether subsidies should be given by an arm’s-length body or directly by the public authority that raises the taxes is another. However, one could say that questions like the use of performance indicators to assess efficiency also come under this heading because they are devices that bring the values of the market place into the assessment of whether subsidy is achieving its policy objectives. The political economy approach is obviously very close both to institutional economics and to public choice theory.

The term ‘political economy’ is also used by non-economists to highlight the effect of ownership patterns on social and political outcomes.
The relation of cultural economics to other disciplines

Cultural economics does not have a monopoly on the study of economic phenomena in the cultural sector. Other disciplines study the cultural sector from other points of view. Cultural sociology or sociology of the arts is a well-developed sub-discipline of sociology, possibly far better recognized within the sociology profession than cultural economics is by the economics profession. Cultural sociologists study some of the same topics as do cultural economists. It can fairly be said that they have displayed far more interest in the cultural industries than have economists. Sociologists have also studied artists’ labour markets and art markets and participation in the arts. Because of their different intellectual backgrounds, economists and sociologists may draw different wider implications from their research; for example, the study of artists’ career development relates to the role of professionalism in sociology, whereas the economist might relate it to the study of incentive structures in labour economics. There are some people trained in both cultural economics and sociology who take what might be termed a ‘joint’ approach, for example, to art prices.

Arts management has emerged as a specialist subject over the last ten years, studying the internal management of individual arts organizations and their environment. Some topics, such as agency theory and performance indicators, bring cultural economics and arts management close together; within arts management, marketing the arts relates to a joint interest in participation in the arts and in taste formation. The latter topic can be studied by psychologists and also by cultural anthropologists who ‘observe’ cultural habits and acquisitions.

Geographers and urban planners are interested in the location of cultural facilities and in the distribution of employment. The role of the arts in urban development and in inner cities has long been studied; this comes close to work on economic impact in cultural economics. A current idea that attracts attention in that world is ‘cultural clusters’, the view that economic development can be stimulated in urban areas by locational clustering of arts organizations and cultural industries. This is very similar to the urban economist’s concept of agglomeration economies. On a global level, the cultural sector is viewed, for example by the World Bank, as a means of economic development in South countries, not only for its tourist potential but also because cultural industries are regarded as dynamic and important sources of economic growth.

Summary

What is the significance of all these different approaches to cultural economics and its relation to other disciplines? One response to this question is to say that, like other branches of applied economics, it feeds from and
is nourished by the body of analysis we call economics. To work in cultural economics, you need a grasp of economic theory and to do seminal work in the field you need to understand its nooks and crannies. Caves’ (2000) book, for example, very well demonstrates the strength of applying an economic approach, in his case contract theory, to the creative industries. The reverse has not yet happened, that a concept developed in cultural economics revolutionizes the wider discipline of economics. However, Baumol’s cost disease is a powerful idea developed in relation to the arts that has had widespread implications (Baumol, 1996).

Another response to the question is to say that economics is a ‘house with many mansions’. Not all the connections between branches of economics are that obvious to the insider, let alone to the outsider. Moreover, the economics profession harbours quite a few dissidents within it, economists who reject the dominant professional ideology and hegemony, particularly the emphasis on mathematical modelling with little concern for the real world. The view ‘let many flowers bloom’ is a congenial one that respects the breadth of approaches in economics and the contribution of other disciplines.

‘Is cultural economics a separate discipline?’ is a question that is also often asked. I think it is so just as are health economics, labour economics, environmental economics or any of the other categories that make up applied economics. One cannot be expert in economics of the electricity industry without knowing something about the generation of electricity, nor can you be a cultural economist without having an understanding of the arts and culture. As to its insights, let the reader decide.

A final question is whether cultural economics has made progress as a discipline. In his survey of the subject, Blaug (2001) offers two methodological criteria of progress: analytical and empirical progress. He concludes that cultural economics has made little analytical progress in the 35 years since the publication of Baumol and Bowen’s seminal book (1966) but that it has made empirical progress. It is my belief that, as cultural economics broadens out to embrace new problems facing the arts and cultural industries from so-called ‘Information Age’ technologies, on the one hand, and, on the other hand, responds to the demand that economists take culture in its wider sense into account, it will make analytical progress.

Note
1. Towse (1997) reprints a selection of work in cultural economics and provides an overview of the subject.

References