Introduction
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Over the last 50 years, cultural economics has established itself as a field of study that is relevant to arts organizations, creative industries, cultural policy and, increasingly, to economic policy for growth and development. It began modestly in the 1960s with an interest in the economic analysis of the finance of museums and the live performing arts, and has spread and evolved into a broader analysis of the cultural or creative industries and their role in the creative economy. This 'new' economy is dominated by the digital revolution in the use of knowledge and information and its distribution via the Internet; it is shaped by the need to foster creativity and to understand the production and consumption of creative goods and services. While most economists hold that the new economy does not call for a new kind of economics, nevertheless new concepts have been adopted. Cultural economics has long wrestled with topics to which 'ordinary' economics did not seem fully applicable (for instance, understanding economic incentives for artists and other creators) and has accordingly developed an understanding of public policy issues concerning the development and support of the creative industries. Cultural economics now offers expertise in the analysis of markets for a wide range of creative products, ranging from art to digital television, and that is reflected in the topics covered in the second edition of this *Handbook*.

That said, a substantial part of this book reflects subjects that have been studied in cultural economics for many years, often under the heading 'economics of the arts'. Research on the economic characteristics of production and consumption of the performing arts, museums and built heritage on topics such as demand, elasticity, pricing, costs, market structure, finance and regulation continue to attract cultural economists. Some of these art forms – even the most traditional such as opera and museums – have been able to embrace new technologies, not so much on the production side (though that too) as in facilitating their ability to reach wider audiences. In addition, there has been an increase in economic research on the cultural industries (broadcasting, film, publishing and sound recording) and on the impact of the creative industries on economic development in cities and districts, including through festivals and cultural tourism. Besides the public finance of the arts, regulation by governments continues to play an important role in the creative economy in relation to heritage and the media, and through copyright law and artists' rights legislation. This book covers all these topics.

Economic characteristics of cultural goods and services

What all creative goods and services have in common is that they contain a creative or artistic element. Cultural goods may be capital or durable consumer goods – a picture in a museum, a DVD (digital video disk) – and they yield a flow of services over their lifetime; others, especially the performing arts, exist for only a particular time span. Cultural goods are tangible objects, like an artwork or a book; others are intangible services, like a musical performance or a visit to a museum. Some are final goods and services 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 (compact disk) may be sold to the consumer, played on the radio as an input to a broadcast, played in a shopping mall or sports hall or split into tracks and downloaded on to an iPlayer or mobile phone.

Besides this cultural element, what creative 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 (entrepreneurship and human capital). These resources have other uses and therefore have an opportunity cost and a price. Even when they are supplied for free, the costs producing them have to be borne by someone: museum entry may be free for the visitor but the cost of the visit is paid by the funding organization – the state or other sponsor. When cultural products are supplied or financed by the government they are paid for out of taxes that are levied on all taxpayers, not just on those who visit cultural facilities, and therefore there is a redistribution of income from non-participants to those who participate (who are typically better off). Increasingly, services such as television and radio programmes and music are supplied for free to listeners and, as they are financed by advertising, they are ultimately paid for by sales to consumers who buy the advertised goods and services. These are the so-called 'two-sided' markets in which private for-profit firms finance the supply of creative services. This differs from sponsorship, where the firm finances a specific arts organization or project, often to publicize its brand name.

One more characteristic of cultural goods and services is that they typically require considerable investment in the fixed cost of producing the first unit, while the marginal cost of producing further units is relatively low. The ratio of fixed to marginal costs varies, however: in the performing arts, there is a high fixed cost of preparing and rehearsing a performance but then each live performance also requires the presence of the performers and back-stage support staff, thus making the marginal cost relatively. By contrast, if the performance is recorded, copies can be distributed for very little cost. In the case of digitally produced material, fixed costs are lower and distribution costs are virtually zero.

Economic theory and cultural economics

Cultural economics uses economic theory and empirical testing in order to explain these many aspects of the creative economy. Microeconomics, welfare economics, public choice economics and macroeconomics may be used and economists choose one or another of these bodies of theory as appropriate to analyse the topics they seek to explain. Sometimes this can seem confusing but in fact it is not inconsistent and the theories are not incompatible – they just tackle things in different ways. Microeconomics, as its name suggests, is concerned with individual decisions concerning the consumption and production of specific goods and services, and deals with their supply, demand and pricing at the level of the individual firm. So, for example, microeconomics can be applied to understanding how theatregoers respond to changes in prices.

By contrast, macroeconomics analyses broad aggregates at the level of the whole economy, looking at employment, economic growth and development: examples are the impact of a new cultural facility on a city or the contribution to national or regional income generated by the creative industries. Cultural economists also analyse the economics of sub-sectors of the creative economy and the term 'creative industries' is now widely used to cover the whole arts and cultural sector (the performing arts, including live music, theatre, opera and dance; heritage, including museums and built heritage; the cultural and media industries, including sound recording, film, software and games, publishing and broadcasting) as well as industries, such as fashion and advertising, that have not so far been part of the subject matter of cultural economics.

Welfare economics takes as its theme the economic well-being of a whole society and it offers an analytical framework for assessing the effect of changes due to technological developments, social attitudes on welfare and policy measures. It lays down theoretical criteria for increased social efficiency and it forms the basis for applying cost–benefit analysis, which is widely used by government to evaluate new projects. Although welfare economics looks at aggregate welfare, its analytical methods are founded in microeconomics. Cultural economics has made great use of welfare economics in evaluating government policies for financing and regulating cultural institutions. Less use has so far been made of public choice theory, which applies economic analysis to political decision-making and takes into account the self-interest of policy-makers and administrators.

Another area of economics that is widely used in cultural economics is public finance. Public finance is the term used for the study of taxation and expenditure at the national, regional and local levels of government. It analyses the efficiency and equity effects of taxes and subsidies: the former is concerned with incentives to consumers and taxpayers, and the latter deals with topics such as the redistribution of income and 'fairness'. Public finance is closely connected to government policy; however, although economists are frequently involved in the positive aspects of policy-making, for instance, estimating the costs and benefits of a particular programme or project, they have little professional competence in the normative side of policy formation. An important contribution by economists in analysing 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 to the arts and heritage) 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. A lump-sum grant would not distinguish priorities of government policy, for instance, if a publicly funded museum is expected to target participation by new audiences, and such a grant, therefore, would not necessarily provide the right incentive to achieve the desired policy outcome. As almost all subsidy to the arts and heritage is channelled via the supply side, public expenditure given to arts organizations needs to be targeted and its success in achieving policy objectives monitored. There has been some limited experimentation with voucher schemes on the demand side but otherwise the focus of public finance is almost entirely on the supply of cultural goods and services by public and private organizations.

Applying the theories

An example of how different theories and economic research can be used in combination is presented by the well-known economic analysis of the performing arts by Baumol and Bowen (1966). Initially, the authors gathered a mass of microeconomic data on theatre, opera, ballet and orchestras on employment, prices, revenues and audiences in the USA and UK, and looked at trends over a period of time. They developed the theory that is now called Baumol's cost disease, using a macroeconomic framework to compare growth in two 'sectors' in the economy, manufacturing (the dynamic sector) and the performing arts (the stagnant sector) to explain why costs and prices were rising faster in the performing arts than in the manufacturing sector. They then employed microeconomic thinking about consumers' responses to price rises and predicted the possible consequences for arts organizations of a financial deficit. Evoking so-called 'market failure' arguments from welfare economics, they argued that external and unpriced benefits would be lost if the performing arts were left to market forces alone and that the presence of these externalities and spillover effects made the case for welfare-improving government intervention via direct subsidy or tax breaks.

In methodological terms, it can be seen that the cost disease theory is a mixture of positive and normative approaches: data gathering and analysis is a 'positive' research activity; measures of labour productivity and cost inflation utilize standard macroeconomic tools and are objective, while welfare economics is 'normative' in that it seeks to achieve the norm of social welfare improvement.

Positive and normative economics

The distinction between positive and normative is very important in economics because it is a way of legitimizing the scientific contribution of economic thinking and distinguishing it from controversial opinion and belief. This distinction does not always hold water and there is even danger in being over-confident about the power of the distinction, but for economists, it is important to try to be objective and to respect individual choice. Thus to return to the example of Baumol's cost disease: establishing the 'real' increase in prices and costs (that is, increases after allowing for inflation) and audience figures is not controversial, although there may be some statistical errors in predicting future revenues. But we cannot go from those facts to argue that the government *ought* to subsidize the arts without making normative claims. That case had to be made in terms of the policy goal of maintaining a certain level of arts provision by showing that without financial support from other sources, revenues from ticket sales would be unlikely to cover costs of producing the same level and quality of performing arts, and those levels of output could not be achieved. Baumol and Bowen were very clear on this distinction.

So, if that is the case, you might reasonably ask why some economists did not accept the theory of the cost disease. The reason is that Baumol *assumed* that the arts are a stagnant sector unable to benefit from technological progress, whereas the manufacturing sector does benefit and as a result can produce goods more cheaply; second, he assumed that performing arts organizations, such as theatre companies and orchestras, cannot change their artistic labour component; third, he assumed that rates of pay in the performing arts would rise at the same rate as those in the economy as a whole (that the labour market is 'integrated'). It is these assumptions that have been criticized as unrealistic and incorrect, but not the logic of increasing costs. Moreover, it is not only the cultural sector that is prone to this 'disease': it has manifested itself in a range of public sector services.

Public finance

One of the earliest topics that concerned cultural economists was the case for public finance – either direct finance or subsidy, or tax measures to encourage private donation – of the arts and heritage. The type of intervention adopted varies considerably from country to country, but it is possible to identify broad trends. In mainland Europe, many countries have what are tantamount to state-owned and -managed arts and heritage organizations: central, regional or local government owns the buildings and contents, employs the people working in them and is responsible for managing the organization. Arts organizations are therefore simply part of the public sector and are financed wholly out of taxation; revenues from ticket sales often revert to the government office responsible. At one time, broadcasting was also a state monopoly in most countries. Changes have been made to both ownership and management structures in some countries in all areas of the cultural sector but direct finance is still the norm in many instances. An exception to this model is built heritage, where many significant items are in private ownership and therefore regulation, often combined with subsidy, is used to achieve policy objectives.

By contrast, the model in the USA and other countries, for example Japan, has been of private finance through revenues from ticket sales and other enterprises and state encouragement of private giving through the tax system (such as the use of tax waivers) to privately constituted, typically non-profit, arts and heritage organizations. The 'intermediate' model adopted in the UK, Australia, New Zealand and Ireland, among others, is the so-called 'arm's-length' principle of public finance, whereby private, non-profit organizations (often constituted as charities) are granted sums of money from general taxation for a specific period of time and are expected to raise a considerable proportion of their incomes from sales and donations, increasingly helped to some degree by the tax system. In practice, these models overlap to some extent, but differing attitudes to the responsibility of the state and public finance still frame the debates and practices of cultural policy.

By contrast, the cultural industries are private, for-profit businesses that rarely receive public finance (the exception being public service broadcasting), although they are regulated by the state for monopoly (antitrust) abuses and, more significantly, by copyright and other intellectual property law.

Public goods

The main economic rationale for public finance for the arts is that they have public-good characteristics and so the extent to which that is the case has been debated for a long time in cultural economics. Pure public goods (of which there are almost no real-life examples) have the characteristics of being both non-rival and non-excludable, meaning that one person's consumption of them does not reduce what is available to others and, equally, they are available to all-comers. Over-the-air broadcasting is an example of a service with strong public-good characteristics. There are several implications of these features: an entrepreneur seeking to make a profit or a non-profit organization seeking to cover its costs with revenues from sales would not be able to fully capture those revenues as consumers would probably 'free-ride' on the expenditures of others – once a sufficient amount to get the good or service supplied were raised, everyone could 'cash in' and get access to the good or service. The result is that the good would not be supplied except through some form of collective finance – for instance, taxation – and the allocation of resources via the price mechanism would not produce the socially desirable output of goods and services.

Cultural goods and services vary as to the extent of their public goods characteristics: visits to the theatre or to a museum have a private benefit (utility) to the visitor for which they are prepared to pay and for which entry can be excluded for those who do not pay; however, visiting a beautiful city provides utility for which a price cannot be charged for by entry ticket. Even excludable goods and services may have some external (or 'spillover') benefits; an element of non-rivalry is present since consumption by paying audiences and visitors benefits the public good by reinforcing a sense of national or local identity and by increasing understanding of other people and cultures. The mere existence of a theatre or a museum in a city may also produce social benefits; contingent valuation studies have shown that people who do not participate in the arts and heritage are willing to pay something to provide these facilities either to ensure that they exist for others or as a option for their own future consumption. Markets therefore do not take their full value into account through prices, and this argues for some form of public intervention. A second argument for public finance of the arts and heritage is that consumer demand does not reflect the full value of these goods because they are 'experience' goods; 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 consumers and taxpayers being unable to assert their preferences. An alternative but similar concept that is used to justify replacing consumer sovereignty with collective provision is that of 'merit' goods, the term used by economists for goods that are held, often 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 also made in relation to health and education. The logic of these arguments has, however, not been extended to the creative goods and services produced by the private enterprise cultural industries, the exception being public service broadcasting.

Creative industries and the digital revolution

The growth of the service sector and the decline of manufacturing in developed economies have focused interest on the creative or knowledge economy, and this in turn has led to considerable interest in the creative industries, emphasizing their role as the main force for growth in the creative economy. The impact of this 'paradigm change' is reflected in the content of this second edition of the *Handbook*, with both new and some revised chapters demonstrating the significant impact of the digital revolution.

The digital technological revolution has had profound effects on the production, consumption, distribution and marketing of creative goods and services, on their costs and pricing and on their content. Digitalization has enabled producers to convert many cultural goods into intangible services for delivery via the Internet and to market other goods that way. It has transformed items that would have previously been classified as goods into services – books, newspapers and photographs are some examples. In electronic form, these items can be personalized, reused and retransmitted in ways that were not possible in the form of tangible goods. This transformation has meant that pricing policies have changed significantly: now, instead of buying a good that you can keep for as long as you like or give away to someone else for a fixed amount of money (the price), when you obtain them as electronic services, you pay a licence fee for a specific selection of services for a specific period of time and copyright law is likely to prohibit sharing them with others.

Digitalization has also meant that these services become akin to public goods since it is trivially easy to share digital files between users without payment, and that has produced an upheaval in the creative industries that produce digital material – recorded music, games, film and so on. Although copyright law exists to prevent such free-riding, digitalization has called into question its ability to enable creators and the creative industries to fully appropriate revenues in these markets. Although copyright law now includes technological protection measures and digital rights management is used to prevent unauthorized distribution, the scale of copying has made it an insuperable task to enforce it fully. Copyright law has to find a balance between the demands of producers and users in the digital world; this is fundamental to the success of the creative economy but, so far, the subject has attracted little interest in cultural economics, perhaps because it is too specialized a topic.

Empirical research on the creative industries

One of the main contributions economics can make to all the topics mentioned above is to provide empirical evidence. That can range from the collection of basic data (for example, the value-added of the creative industries) to testing theories of incentives. In the past, lack of data, especially of official statistics on the cultural sector, has been a barrier to good empirical research, but that is now changing in part due to the emphasis on the economic role of the creative industries in the creative economy as well as to past efforts by cultural economists. As with other branches of economics, good statistical analysis and theoretical development are vital to the success of cultural economics.

About this edition

This introduction has shown that cultural economics has a body of knowledge that provides common approaches to production and consumption in all the creative industries. The second edition of the *Handbook* shows how much the subject has progressed since 2003. As in the first edition, the titles of the chapters have been kept short to make the book easy to use, and chapters are cross-referenced to guide the reader to related topics and, as before, it is assumed that readers have a basic knowledge of economic theory. Several books listed at the end of this introduction explain the theories used in cultural economics. A new feature of this edition is the addition of suggestions for further reading, which in almost all cases have been provided by the chapter authors. Thus this second edition of the *Handbook* is significantly brought up to date and, I believe, improved.

References

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Throsby, David (2010), *The Economics of Cultural Policy*, Cambridge: Cambridge University Press.

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Further reading

Richard Caves's (2000) book is a detailed analysis of the structure of the creative industries based on the contracts between the artist or original creator and the firm; this provides a wealth of material covering the whole cultural sector. Bruno Frey is a leading writer on cultural economics (in addition to many other subjects) and his book *Arts and Economics* (Frey, 2000) contains essays on a range of topics; it has rightly been one of the most popular books on the subject. David Throsby's (2010) book demonstrates the relevance of economics to all aspects of cultural policy for the arts and cultural industries by an author who is one of the best-known cultural economists. My *Textbook of Cultural Economics* (Towse, 2010) provides an introductory account of the whole field of cultural economics, along with explanations of the economic theory necessary to understand it. The first part of the UNCTAD (2008) *Report* offers a brief overview of the concept of the creative economy and the role of the creative industries in economic growth and development.