Introduction

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Over the past sixty or so years, cultural economics has established itself as a field of study that is relevant to arts organisations, 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 economy is now 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 some economists hold that the digital economy does not call for a new kind of economics, nevertheless, new concepts have been adopted with the title 'platform economics' and extended universally. 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, which were reflected in the topics covered in the second edition of this *Handbook*. The third edition now takes matters a step further, with a good proportion of the chapters dealing with the economic theory and its application in the digital economy.

However, there are timeless topics in cultural economics. Research on the economic characteristics of production and consumption of the performing arts, museums and built heritage on topics such as 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 increased amount of economic research on the cultural industries (broadcasting, film, publishing and sound recording, and video games) and on the impact of the creative industries on economic development in cities and districts, including through festivals and cultural tourism. In addition to the public finance of the older 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 – and they yield a flow of services over their lifetime; others, especially the performing arts, exist only for a particular time span. Cultural goods are tangible objects, such as an artwork or a book; others are intangible services, such as 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; for example, a sound recording 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 or streamed to an iPlayer or mobile phone.

In addition to this cultural element, what creative goods have in common with all other goods and services is that their production utilises 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 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 for by the funding organisation, that is, 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 those who visit cultural facilities, and therefore there is a redistribution of income from non-participants to those who participate (who are typically financially better off). Increasingly, services such as television and radio programmes and music are supplied 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 two- or multi-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 organisation or project, often to publicise its own 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 creating marginal costs. 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. Even the performing arts, such as opera and ballet, have come to be widely accessible through what has known as event cinema – the showing of live performances broadcast from building-based performance in real time to cinemas large and small.

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 it is not inconsistent and the theories are not incompatible; they just tackle things at different levels. 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. So, for example, microeconomics can be applied to understanding how theatre-goers respond to changes in prices. Microeconomics is also involved in industrial economics – the study of the structure of firms in an industry – and in platform economics, the study of the economic strategies and pricing decisions of online intermediaries resulting from economic interactions between distinct groups of consumers or users who benefit from the resulting network effects.

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. 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, that is, museums and built heritage; and the cultural and media industries, including sound recording, film, software and video games, publishing and broadcasting), and includes industries, such as fashion and advertising, that so far have had little attention in cultural economics. National governments and supra national organisations, such as the European Union, routinely measure the size and growth of the whole creative industries sector. Over the past decade or so, the quality and use of statistics on production and consumption in the creative economy have greatly improved, though labour market data still present problems.

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 in, for example, technological developments, laws and social attitudes on welfare. It lays down theoretical criteria for increased social efficiency and it forms the basis for 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, including in relation to copyright law. Less use has so far been made of the theory of political economy, 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. 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. Performance indicators have been developed and utilised in situations in which financial data cannot be used to evaluate efficiency in the achievement of objectives, whether at the macro level or the micro level. 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. Since almost all subsidy to the arts and heritage is channelled via the supply side, public expenditure given to arts organisations needs to be targeted and its success in achieving policy objectives monitored. The focus of public finance is almost entirely on the supply of goods and services by public and private organisations.

Chapters in this book explain all these topics.

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 then 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 manufacturing. They employed microeconomics to analyse consumers' responses to price rises, and predicted the possible consequences for arts organisations of a financial deficit. Evoking 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 other spillover effects made the case for welfare-improving government intervention via direct subsidy or tax breaks.

In methodological terms, the cost disease theory is a mixture of positive and normative approaches. Data gathering and analysis is a positive research activity in that measures of labour productivity and cost inflation utilise 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 legitimising the scientific contribution of economic thinking and distinguishing it from controversial opinion and belief. This distinction does not always appear sound and there are even dangers from being overconfident in the power of the distinction but, to 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 in audience figures is not controversial, though there may be some statistical errors in predicting future revenues. However, we cannot go from those facts to argue that the government ought to subsidise the arts, without making normative claims. That case had to be made, for 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 the cost of producing the same level and quality of performing arts and that those levels of output could not be achieved. Baumol and Bowen (1966) were very clear on this distinction.

If that is the case, you might reasonably ask why some economists did not accept the theory of the cost disease. The reasons are that Baumol made the following assumptions: first, that the arts are a stagnant sector unable to benefit from technological progress, whereas the manufacturing sector does do so and therefore can produce goods more cheaply; secondly, that performing arts organisations, such as theatre companies and orchestras, cannot change their artistic component labour; thirdly, 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 criticised 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. Latterly, Baumol accepted that digital distribution would enable arts organisations to reach far greater audiences at almost zero marginal cost, while maintaining that the fixed cost of creating the good in the first place would remain subject to the same strictures as in the pre-digital economy.

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 state-managed arts and heritage organisations; central, regional or local government owns the buildings and contents, employs the people working in them and is responsible for managing the organisation. That has changed over the years with a move to privatising the management, but much of the finance remains part of the public sector and is provided out of taxation; revenues from ticket sales may 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, at least for museums and the traditional performing arts. 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, one being 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 organisations. The intermediate model adopted in the UK, Australia, New Zealand and Ireland, among others, is the arm's length principle of public finance, whereby private, non-profit organisations (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 extent by the tax system. In practice, these models overlap but differing attitudes about 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), though they are regulated by the state for monopoly (anti-trust) 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-goods characteristics, and so the extent to which that is the case has been debated for a long time in cultural economics. Pure public goods 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 organisation seeking to cover its costs with revenues from sales would not be able to fully capture those revenues as consumers would likely 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. Many goods and services in digital form are effectively public goods, and this has given rise to new business models and a great deal of piracy.

Cultural goods and services vary as to the extent of their public-goods characteristics. For example, 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 welfare by reinforcing a sense of national or local identity and by increasing understanding of other people and cultures. Just the existence of a theatre or a museum may also produce social benefits, and 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 an 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 finance. 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. Moreover, cultural value is elusive and is not fully recognised in price.

Information problems mean that expert judgement has to be relied on to ensure quality and that leads to 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 used to justify replacing consumer sovereignty 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, the environment 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 in the creative or knowledge economy and this, in turn, has led to considerable interest in the creative industries, emphasising 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 third edition of the *Handbook* with both new and some revised chapters demonstrating the significant impact that the digital revolution has had.

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. Digitisation has enabled producers to transform many cultural goods into intangible services for delivery via the Internet and to market other goods that way. It has transformed items that previously would have been classified as goods into services; e-books, newspapers and photographs are some examples. In electronic form, these items can be personalised, 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; instead of buying a good for a fixed amount of money (the price) that you can keep for as long as you like or give away to someone else, when you obtain them now as electronic services you pay a licence fee for a specific selection of services for a specific period of time.

Digitisation 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, digitisation has called into question its ability to enable creators and the creative industries to fully appropriate revenues in these markets. Copyright law protects technological protection measures, and digital rights management is used to prevent unauthorised distribution, but 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 – fundamental to the success of the creative economy.

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 has now changed in part owing 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 third edition of this *Handbook* shows how much the subject has progressed since 2011. As in previous editions, 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 together with suggestions for further reading, which in almost all cases have been provided by the chapter authors. Also as previously, it is assumed that readers have a basic knowledge of economic theory. The books listed at the end of this Introduction explain the theories used in cultural economics.

REFERENCES

Baumol, W.J. and W.G. Bowen (1966), *Performing Arts: The Economic Dilemma*, New York: Twentieth Century Fund.
Caves, R. (2000), *Creative Industries: Contracts Between Art and Commerce*, Cambridge, MA and London: Harvard University Press.
Throsby, D. (2010), *The Economics of Cultural Policy*, Cambridge: Cambridge University Press.
Towse, R. (2019), *A Textbook of Cultural Economics*, 2nd edn, Cambridge: Cambridge University Press.

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. 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. *A Textbook of Cultural Economics* (Towse 2019) provides an introductory account of the whole field of cultural economics along with explanations of the economic theory necessary to understand it, updated to take account of the digital revolution in the creative industries.