# Economics of the arts and literature

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**Abstract**

**Economics of the arts and literature** or **cultural economics** (used below for convenience) is a branch of economics that studies the economics of creation, distribution, and the consumption of works of art and literature. For a long time the arts were confined to visual and performing arts in the Anglo-Saxon tradition. Usage has widened since the beginning of the 1980s with the study of cultural industry (cinema and music publishing), and the economy of cultural institutions (museums, libraries, historic buildings).

**Contents**

## Introduction

Cultural economics is concerned with arts in a broad sense. The goods considered have creative content, but that is not enough to qualify as a cultural good. Designer goods are not considered to be works of art or culture. Cultural goods are those with a value determined by symbolic content rather than physical characteristics. (For further considerations, see also Cultural Institutions Studies).Economic thinking has been applied in ever more areas in the last decennia, including pollution, corruption and education. Works of art and culture have a specific quality, which is their uniqueness. There just aren't two Nighthawks. As there is no equivalent item for each, classical economist Adam Smith held it was impossible to value them. Alfred Marshall noted that the demand for a certain kind of cultural good can depend on its consumption: The more you have listened to a particular kind of music, the more you appreciate. In his economic framework, these goods do not have the usual decreasing marginal utility. Key works in the cultural economics as such were those of Baumol and Bowen (Performing Arts, The Economic Dilemma, 1966), of Gary Becker on addictive goods, and of Alan Peacock (Public Choice).

This summary has been divided into sections on the economic study of the performing arts, on the market of individual pieces of art, the art market in cultural industries, the economics of cultural heritage and the labor market in the art sector.

## Performing arts: Baumol and cultural economics

The seminal paper by William Baumol and Bowen introduced the term cost disease for a relative cost growth of live performances. This cost growth explains the increasing dependency of this kind of art on state subsidies. It occurs when the consumable good is labour itself. To understand this phenomenon, compare the change in the cost of performing the Molière play "Tartuffe" in 1664 and in 2007 with the change in cost of calculating a large number of sums from an accounting ledger. In 1664, you needed two hours and twelve actors to perform Molière's play, and it would take, say, twelve accountants working for two hours to add up all the sums in an accounting ledger. In 2007, a single accountant with a $10 calculator can add the sums in 20 minutes, but you still need two hours and twelve actors for the Molière play.

Now, the artist trade needs a considerable investment in human capital, and needs to be paid accordingly. The artists' pay need to rise along with that of the population in general. As the latter is following the general productivity in the economy, the cost of a play will rise with general productivity, while the actors' productivity does not rise.

There are two lines of thought in subsequent literature on the economics of the performing arts:

- The first concentrates on the existence of productivity growth in some areas of production, thus contradicting the relevance of cost disease. Staying with the "Tartuffe" example, the same performance can be viewed by an ever larger audience by improvements in the design of theatres, and by the introduction of microphones, television and recording.
- The second is concerned with the allocation of subsidies to the cultural sector. While these should be in the general public interest, they may have an income distribution effect, e.g. if they reduce cost to the relatively well-off part of society. This is the case when the well-off are overrepresented in the audiences of subsidized plays, or when subsidies go to a small elitist group of artists.

**3.The market for artworks**

Two segments of the market in the visual arts can be distinguished: works of art that are familiar and have a history, and contemporary works that are more easily influenced by fashion and new discoveries. Both markets, however, are oligopolistic, i.e., there are limited numbers of sellers and buyers (oligopsony). Two central questions on the working of the markets are: How are prices determined, and what is the return on artworks, compared to the return on financial assets ?

**Price determination**

Components of a work of art, like stone or paint, in general have a value much lower than the finished product. Also, the amount of labour needed to produce an item does not explain the big price differences between works of art. It seems that the value is much more dependent on potential buyers', and experts' perception of it. This perception has three elements: First, social value, which is the social status the buyer has by owning it. The artist thus has an "artistic capital". Second, the artistic value, compared to contemporary works, or as importance to later generations. Third, the price history of the item, if a buyer uses this for his expectation of a future price at which he might sell the item again (given the oligopolistic market structure).

Three kinds of economic agents determine these values:

Specific experts like gallery owners or museum directors, the first. Experts like art historians, the second. Buyers who buy works of art as an investment, the third.

**Art market and investment**

Some major financial institutions, banks and insurance companies, have had considerable return rates on investments in art works in the 1990s. These rates haven't slowed down at the same time as the rates on stock exchanges, in the early 90's. This may indicate a diversification opportunity. Apart from this evidence of successful investment, the amount of data available has stimulated study of the market. Many works are sold on auctions. These transactions are thus very transparent. This has made it possible to establish price databases, with prices of some items going back to 1652.

Empirical studies have shown that, on average, the return on works of art has been lower than that on equity, with a volatility that is at least as high. An intangible gain in terms of pleasure of having a work of art could explain this partly. However, before interpreting the figures, it should be born in mind that art is often exempt of many kinds of taxes. In 1986, Baumol made an estimate of an average yearly rate of return of 0.55 percent for works of art, against a rate of return of 2.5 percent for financial assets, over a 20-year period.

**Cultural industries**

Some artwork is not reproducible, but there are many cultural goods whose value does not depend on the individual copy. Books, recordings, movies get some of their value from the existence of many copies of the original. These are the products of cultural industries. These markets are characterized by:

- Uncertainty on value. The demand for a good (success) is hard to predict. This is a characteristic of an experience good.
- Infinite variety. You can differentiate between products, e.g. a car, on basis of its characteristics. Many products allow classification on a relatively small number of such characteristics. Cultural goods, however, have a very high number of them, which, on top of that, often are subjective. This makes them hard to compare.
- High concentration in traded products. A major part of sales is in best-sellers or block-busters.
- Short life cycle. Most items are sold shortly after introduction.
- High fixed cost. There is high cost before introduction. Making a movie is much more expensive than producing another copy.

**Market structure**

The important cultural industries have an oligopolistic market structure. The market is dominated by a few major companies, the rest of the market consisting of a big number of small companies. The latter may act as a filter for the artistic supply: A small company with a successful artist can be bought by one of the majors. Big conglomerates, pooling TV and film production, have existed since the 1920s. The 1990s have seen some mergers extending beyond the industry as such, and mergers of hardware producers with content providers. Anticipated gains from synergy and market power have not been realised, and from the early 2000s there has been a trend towards organisation along sector lines.

**Economics of cultural heritage**

Cultural heritage is reflected in goods and real estate. Management and regulation of museums has come under study in this area.

**Museums**

Museums, which have a conservatory role, and provide exhibitions to the general public, can be commercial, or on a non-profit base. In the second case, as they provide apublic good, they pose the problems related to these goods: should they be self-financing, or be subsidized ? One of the specific issues is the imbalance between the huge value of the collections in museums, and their budgets. Also, they are often located in places (city centres) where the cost of land is high, which limits their expansion possibilities.

American museums exhibit only about half of their collection. Some museums in Europe, like the Pompidou Centre in France, show less than 5 percent of their collection. Apart from providing exhibitions, museums get proceeds from derived products, like catalogues and reproductions. They also produce at a more intangible level: They make collections. Out of so many pieces in the public domain, they make a selection based on their expertise, thus adding value to the mere existence of the items.The dual goal of conservation and providing exhibitions obviously presents a choice. On the one hand the museum has, for conservation reasons, an interest in exhibiting as few items as possible, and it would select lesser known works and a specialized audience, to promote knowledge and research. On the other hand, the exhibition argument requires showing the major pieces from different cultures, to satisfy the demands from the public and to attract a large audience. When a government has made a choice about this, application of economic contract theory will help to implement this choice by showing how to use incentives to different managers (on the financial, conservatory side) to obtain the required result.

**Real estate**

Many countries have systems that protect buildings and structures they consider to be of cultural interest. Owners get tax deductions or subsidies for restoration, in return for which they accept restrictions on modifications to the buildings or provide public access. Such a system poses the same choice problems as museums do. There has been little study of this issue.

**6. The artists' labor market**

The labour market for artists is characterized by four things in particular:

- There is an extremely unequal income distribution within the market segment. A very small group of people earn a high proportion of the total income. There is a structural excess supply of labour. There are always more people who like to earn their income as an artist than there is demand for them.There are intangible returns to labour, so that people accept lower wages than their qualifications would earn in a different market.Non-separation of artist and work. The image their product gives them, is important to artists.

**The star system**

The term "star system", coined by S. Rosen, is used for the phenomenon that a handful of the artists in the market, earn a major part of total earnings in a sector. Rosen's 1981 paper examined the economics of superstars to determine why "relatively small numbers of people earn enormous amounts of money and seem to dominate the fields in which they engage." Rosen argues that in superstar markets, "small differences in talent at the top of the distribution will translate into large differences in revenue." Rosen points out that "...sellers of higher talent charge only slightly higher prices than those of lower talent, but sell much larger quantities; their greater earnings come overwhelmingly from selling larger quantities than from charging higher prices".

In cultural industries, the uncertainty about the quality of a product plays a role in this. The consumer does not really know how good the product is, until he has consumed it (think of a movie), and the producer is confronted with the typical uncertainty in a cultural industry. The consumer looks for guidance in the price, reputation, or a famous name on the cover or poster. As the producer understands this affects demand, he is prepared to pay a lot for a name considered a sign of quality (a star). Indeed, authors like Adler and Ginsburgh have given evidence that star status is determined by chance: in a musical contest, results were highly correlated with the order of performance.

**Production structure**

A case has been made for the existence of a different structure in the production of cultural goods. (See Cultural Institutions Studies.) An artist often considers a product to be an expression of him, while the ordinary craftsman is only concerned with his product, as far as it has an impact on his pay or salary. The artist may thus want restrict the use of his product.

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