What determines the price of art and is this determination different in fundamental ways from the pricing of goods and services generally?

A. Definition

The price for art, like goods and services generally, is emerged from the intersection of Supply and Demand in the market. That being said we should first classify the object of study, what is meant by art. Here we can cite art being what Scitovsky 1976 would call "creative" versus "defensive" consumption. Art is creative consumption, the demand for which goes up with income, as income increases beyond meeting the necessities of life. Throsby 1994 (*JEL*) finds that as income increases consumption preferences adjust and the demand for art shifts-out relative to defensive consumption. Hutter 1996 (*JCE*) believes that art has intrinsic non-exchange values (Adam Smith's 'contemplation of the Divine'). It is these intrinsic values which help to create the demand for art and which link the demand for art with modern price theory. It is the non-exchange value of art which helps determine the preferences for value as realized in exchange.

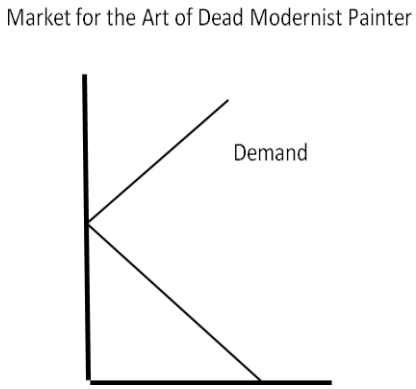
It should also be noted that one heterodox view of art consumption is not that demand shifts-out with income as the constraint, but with time and knowledge as the constraint (art being an experience good). Another heterodox view is that art as an experience good actually means that there is increasing marginal utility to art consumption, something completely at odds with the marginalism as found in modern price theory.

B. Markets

Throsby 1994 describes how the supply of art is greater than demand. Only around 25% of those 'who are willing to sell the product of their labor in the art market' supply labor only to art-production, in other words, 75% of artists must do something besides art-production to make a living. However art is an experience good and so there is asymmetric information involved. The potential art consumer is oftentimes dependent upon 'experts', 'gatekeepers' and/or 'networks' to determine which of the over-supply of art has scarcity (economic) value. We can therefore perhaps say that art is more socially-constructed than are other goods and services, especially that of defensive consumption.

An extreme example of socially-created demand for art would be a conspicuous consumption Veblen good. If we want to impress our friends at home or in the corporate world at our international headquarters we might actually find that

demand increases with price giving an inverted Demand curve at a certain price point.



Because of this "over-production" of art we can say that the pricing of art is very far removed from the world of Walrasian General Equilibrium theory. It is not scarcity values which are a main determinant of the value of art at 'equilibrium', it may be some-type of intrinsic 'social value' which creates demand in the market. However, like J.S. Mill said economic "laws" are really tendencies, and we can see from the example above, that the demand for art from a famous (again socially-constructed) dead artist is indeed based on scarcity. The heterogeneous character of "art" (especially the authenticity value of painting and sculpture) makes for market behavior which differs from that of 'commodities'.

C. A Note on Art as an Investment

Most empirical studies have shown that the market for fine art (as described in the accepted test-of-time canon) is more volatile and with less long-term returns than are financial assets. The difference in these returns is described by cultural economists as 'psychic income' (extreme utilitarians actually believe an art buyer factors-in how often she would look at a piece of art in determining investment behavior). Relatedly, many cultural economists believe that the consumption of creative, experience, goods *adds to* human capital accumulation, something which cannot be said of defensive goods which are used-up in consumption. It is for this reason too that art is seen to have some properties of public goods and might help explain why most if not all *polis* subsidize the arts (despite as stated the 'over-supply' of art as is).

Discuss the argument for and against government funding for the arts. Explain why the issue goes beyond the simple public goods argument of neoclassical economics.

A. Merit Goods

Here we shall classify the "arts" as the high arts such as the performing arts (theatre, ballet, symphony, opera) and cultural heritage (intangible – such as native craft techniques, and tangible - such as monumental architecture or painting).

If we define public goods as something of value to society which cannot be provided in the market due to non-rivalry and non-excludability in consumption, then according to Baumol 2003 most cultural economists do not use the public goods argument at all for justifying governmental subsidies to the arts. Baumol believes that most cultural economists rely on Musgrave's notion of a "merit good" to justify intervention. A merit good is something which the 'public' does not consume enough of due to lack of education, therefore it is up to the State to encourage consumption of this good, simply because it is "good".

It should be noted that in Buchanan and Musgrave 1999, the latter said that he had changed his mind and believes that a merit good is not attached to a personal consumption preference but rather is a good which makes up a person's social and cultural heritage. This may indeed drive us back to the public goods argument. However, art has non-exchange value which does not need to be realized in use-value as it might be argued do public goods. For example, Hutter 1996 gives these values, 1) an individual might value knowing that her community's museum contains the works of a well-known local painter, just knowing that this work is there, eventhough not directly 'consumed' brings the painting's "option value" to the individual, and 2) again eventhough this painting is not directly consumed by the individual, knowing that this painting's cultural value will be passed along to future generations brings the "bequest value" of the painting to the individual.

B. “Mixed Goods”

The performing arts are seen as “mixed goods” which contain elements of both public and private goods. For example a public performance of a respected playwright is a non-rivalrous public good up to the point that the house (or a decent view in a public park) is to capacity. At this point it becomes a private good. The public goods nature of the art can be used as a reason for subsidy.

C. Baumol’s “cost disease”

The cost disease describes the performing arts sector as non-progressive in technology due to the labor-intensive nature of the art. A Shostakovich Quartet took four players 7 minutes and eighteen seconds to perform in 1960 just like it does in 2013. This is juxtaposed with the “progressive” sectors in the economy which have increased efficiency due to investment in labor-saving technology. This means that performing arts organizations are required to raise their ticket prices at a higher rate relative to the general rate of inflation, reducing demand for these tickets and creating an “earnings gap” which needs to be filled through subsidy (or philanthropy). If these unearned revenues are not realized there will result an “artistic deficit” of *good* art.

D. Arguments against subsidy

Cultural economists are not in agreement on the cost disease. In the first instance it is unclear whether there is a positive income elasticity of demand for the arts. If so then the economic growth afforded by the progressive sectors would mean that increasing performing art ticket prices would not diminish demand and create the “earnings gap”. Second it has been argued that labor markets are not integrated and that this is shown in that incomes in the arts do not keep-up with incomes in the rest of the economy. This too coincides with Towse’s 2001 meta-analysis on the supply and demand for artistic labor where she finds that artists are willing to accept lower remuneration in order to pursue their preference for artistic endeavors.

Grampp 1989 (both in his book *Pricing the Priceless* and in his article in *Public Choice*) is the well-known American anti-subsidy cultural economist. Grampp declares normatively that he is against subsidy for the arts and that he is unconvinced by cultural economists' positive models for subsidy (grants and tax-abatements). Grampp frames his anti-subsidy argument in terms of rent-seeking which he defines as using government policy to benefit oneself at the expense of others.

Grampp finds that unlike other industries (he names housing and agriculture as the largest offenders) rent-seeking in the arts is conducted by the demand-side. The largest rent-seeking in the arts occurs by not-for-profit administrators (museums who purchase art and performing arts organizations who purchase art-labor) and consumers of the arts (who tend to be better educated and thus wealthier than non-consumers of arts). Grampp declares that this rent-seeking is self-evident due to the "self-righteousness" of those who rent-seek. The rent-seekers believe that those who are against subsidy to the arts are philistines or barbarous.

Grampp believes that rent-seeking and subsidy to the arts continues because it is "invisible" despite there being more than 400 organizations or programs supporting the arts at the federal level. He tells the story of when during the budget cuts during the Reagan Administration it was proposed that funding to the NEA (which is less than 1% of the federal budget) be halved. "Big Oil" lobbied strongly and successfully to keep the NEA funding because of the positive spillovers that these subsidies add to their own corporate reputations for funding the arts.

Grampp makes two final points. The first is that non-exchange value (or intrinsic, aesthetic, and authenticity value and/or utility) is realized in the market. Grampp calls these "priceless" values, note the quotes. He believes that priceless values are indeed captured in the market and gives the example that when the attribution of a painting is changed (for example a painting turns out to be a fraud or painted by an apprentice) the price of that painting also changes. Finally Grampp argues against subsidy because polls consistently show that less than 50% of the general public support government funding of the arts.

Is creativity the result of supply-side or a demand-side forces? Discuss

When we speak of supply-side and demand-side forces we speak of human exchange in the market. Boldrin and Levine 2008 make the analogy of a Chairman Mao quotation, "revolution is not a gala dinner". B & L state the same about the human instinct for competition in the market. Capitalist competition also is not a gala dinner, but, following Adam Smith, B & L argue it is one of the greatest of human instincts. So we shall argue that the market for creativity too is one of competition, with the intersection of human behavior on both the supply- and demand-sides.

A. Supply-side forces

Throsby 1994 (*JEL*) and others have shown that the number of those who call themselves artists has been steadily increasing since demographic statistics have been kept in "democratic" countries. Throsby also shows that the earnings of art-labor (the supply-side) have not kept up with the rest of the economy. Artists exercise a preference to create which is not strictly based on pecuniary incentives. Towse 2001 uses the term "psychic income" to describe the approbation from other artists and from those who appreciate an artist's work without necessarily purchasing this creativity.

Further Throsby finds that around 75% of artists need work outside of their chosen creative field in order to earn a living. Thus Towse 2001 makes the case that there is an "over-supply of artists", this "over-supply" necessitates artists competing with one-another for both approbational and pecuniarial reward.

It should be noted definitionally that there is a difference between fine or high art and commercial art. Someone considering herself a fine artist (a novelist for example) might have to engage in the more commercial "cultural industries" such as in this example writing advertizing copy in order to subsidize their fine-art. Both of these activities can be creative production but offer differing degrees of incentive. The fine artist will only work in the cultural industry to the point where they can substitute their time for the creation of fine-art.

Further Bryant and Throsby 2006 (Ginsburgh and Throsby, eds.) believe that "creativity is a basic human trait" be it problem-solving or "the production of art". B & T build a formal model showing that an artist is endowed with talent (T) and faces a trade-off between applying T for purely "creative" endeavors appealing to

the “artworld” or purely “commercial” endeavors appealing to the market, or, some combination of both depending on an individual artist’s circumstance and preference.

B. Demand-side forces

First it is self-evident and as expressed in Maslow’s hierarchy of needs that human beings are first concerned about self-preservation, what Scitovsky 1976 calls “defensive” consumption. Then applying this concept to economics, beyond this lower level as incomes rise we become more and more concerned with family, community, and social identity and then self-actualization. Scitovsky 1976 believes that self-actualization (or perhaps Aristotle’s ‘flourishing’) is realized through what he calls “novelty, flow, and destiny”. We need new things to stimulate our sense of adventure or curiosity, we need to have activities we enjoy so much that we lose ourselves (realize the sublime) while engaged in them, and we need to know that we have a sense of control over the direction of our lives.

Again in the economic sphere, and as we move-up the hierarchy of needs as we live beyond subsistence level, our consumption then becomes more “creative” and less “defensive”. Thus it is generally seen by cultural economists that creative goods are “luxury goods”, the demand for which is positively correlated with income.

However as stated there are two general categories of cultural goods; “high” or “fine” art versus the “cultural industries” or commercial goods. An example of this would be the demand for the consumption of jazz versus that of popular music. While both of these demand preferences fall into the luxury good category, the preference for jazz is seen to be an addictive or experience good, or what Scitovsky calls a novelty good. The more high art like jazz one consumes the more one comes to appreciate it, so consumption of these goods actually leads to human capital creation. There is a risk to experiencing the new and many cultural economists agree that thus there is a public goods role for education in the arts in order to reduce the perceived risk of the ‘common person’ in consuming these ‘finer things in life’, the consumption of which can lead to greater life-time utility.

Denis Dutton in *Art Instinct* (2009) writes that human beings are born with the capacity to appreciate the aesthetic (meaning to find pleasure through the beauty of art) and it is only through lack of quotidian experience that many are unable to

exercise this preference, despite having the income to do so. This is the main thesis of Scitovsky 1976, that in general we consume too much for comfort (or defense) and not enough for novelty. We can further say that the "cultural industries" – a category which some cultural economists, Michael Hutter for example, disdain and believe do not properly fall under the realm of "art" economics – can be seen as comfort preference rather than novelty preference. Whatever creative output is socially-created and "popular" at given moment in time does not necessarily mean that that it is "creative" consumption.

However this of course is a matter of subjective judgment. Someone dedicating their leisure time to the creative good of a computer game may indeed find "novelty, flow and destiny" in doing-so.

C. Where supply-forces meet demand-forces

When we speak of creative goods, which by definition are heterogeneous in quality relative to comfort goods, we find that there is asymmetrical information between the buyers and sellers of these goods (see e.g. Karpik 2010). This is where we find that the "market forces" for creative goods differ from that of other markets. Because as stated there is an "over-supply" of creative goods there are intermediate forces which create the economic scarcity necessary to call a creative good an economic good.

These intermediate forces in the market for creative output include education, experts, cultural gatekeepers and networks. The creation of *demand* for one's art includes competition in these social spheres. The creation of *supply* for an economically "valuable" creative good is also realized through competition in these social spheres. Therefore we can say that creativity is the result of both supply- and demand- forces, however the market where these forces are realized through interaction is different than non-creative market forces. The market for works of art sold through fine-art galleries is one example. The artist supply-forces interact with the gallery-owner as gatekeeper. It is the gatekeeper's reputation in the networked market for fine-art which creates the demand-forces and economic scarcity for creative goods which are by-definition in over-supply.

Is creativity the result of supply-side or a demand-side forces? Discuss

Discussion on demand-pull and supply-push theories of technological change.

Here when we discuss "creativity" it is related to theories of technological innovation and change, as found most generally in the economic growth and history of technological change literatures. In this short essay I will attempt to summarize the main differences between demand-pull and supply-push while noting that the literature on growth theory is voluminous. Also of note is that Keely 2002 makes the case that Schmookler's demand-pull theory is under-represented in the literature and that Schmookler in fact believed that it was both supply- and demand-side forces which are needed to explain creativity as it relates to technological change. Supply- and demand-forces are "complimentary".

Schumpeter 1934's theory on supply-side innovation is that entrepreneurs seeking above-normal profits propagate creative technological change through several channels. These supply-side, technological-push, innovations include the introduction of new and/or improved products, the introduction of new production methods, the opening of new markets, new supplies and/or uses for raw materials, and new organization within an industry. This supply-side innovation can lead to creative destruction within an industry.

> Now comes the second act in our drama. The spell is broken and new businesses are continually arising under the impulse of alluring profit. A complete re-organization of the industry occurs, with its increases in production, its competitive struggle, its supersession of absolete businesses, its possible dismissal of workers, and so forth (p. 131.)

Baumol 1990 extended Schumpeter's theory by factoring-in the institutional incentives faced by entrepreneurs. Given that entrepreneurs are constantly trading-off risk-reward opportunities, supply-side activities do not always match private and social rewards. For example not all talented people will attempt to produce for the market in voluntary exchange. There may be institutional incentives attracting talent which result in what Baumol determines are socially-

harmful outcomes such as rent-seeking, religion, crime and the military. In growth theory we now find that "institutions matter".

Snowden and Vane, eds. 2005 state that Paul Romer's economic growth theory with endogenous technological change is "neo-Schumpeterian" and that this has led to research into the "economics of ideas" with under-performing countries having an "idea gap". The institutional settings of these countries do not allow for creative people to innovate for productive activities. This departs from neoclassical growth theory which predicts convergence based on accumulated capital with a diminishing marginal productivity aggregate production function. The neoclassical model is based on exogenous capital accumulation as opposed to endogenous idea-creation leading towards growth. The neoclassical model thus explains lagging growth as an "object gap", not an "idea gap".

Supply-side forces can be juxtaposed with Schmookler's demand-pull theory. Here it is not the supply-side entrepreneur opening new markets, rather it is new ideas applied to existing problems and existing patterns of demand which determine and sustain creative innovation. It is the *usefulness* of the ideas at solving existing problems which determines technological advance, not the *cost* of technologies as represented in the production function. It is new ideas which constitute creativity and innovation, not necessarily building upon past ideas alone.

Keely 2002 gives two examples of demand-pull historically. Printing was invented in China in the ninth century but because there was not demand for the result of this technological advance, the output of books was not significant. It was only the "pent-up" demand for books during the middle ages on behalf of the clergy and the nascent government administrative bureaucracies did Gutenberg's printing technology then led to the rapid advances in book publishing at the given time and place. The next example is that of textile production and the spinning wheel in Britain during the industrial revolution. The technology of the spinning of textiles had been known for millennia, it was only the demand for this technology by the producers of textiles in Britain at that time which led to the rapid advancement in spinning technology. For Schmookler then it is relatively faster-growing industries which demand innovation, both at the firm level and by independent inventors.

Nicholas Kaldor also has a demand-side explanation for technological creativity, given his well-known heuristic of the "idealized facts" of economic growth. Economic growth itself is what triggers investment in labor-saving technologies and economic growth is continual. The output per person is continually increasing due to increasing capital-labor ratios, while returns to capital, the capital-output ratio, and the capital and labor shares of GDP remain constant. Kaldor rejects the neoclassical notion of steady-rates of growth under equilibrium and necessarily has a cumulative causation model.

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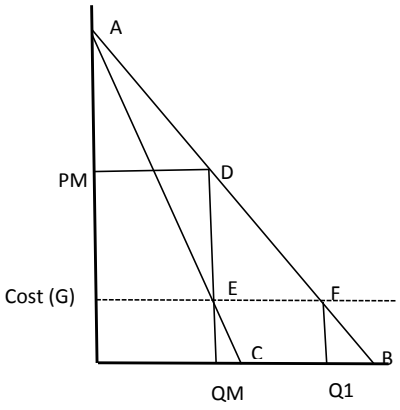
Present a formal model of the role of intellectual property protection in innovation. Present the argument against a strict intellectual property protection regime in the realm of culture and design.

In cultural economics "innovation" is the production of creative goods, which includes cultural/artist output and design. Towse 2008 in her ACEI Presidential Address stated that copyright protection addresses a market failure. Some cultural production (including some design and works of art, music and literature) are reproduced without economic profit accruing to the producer of the work, and therefore the market itself does not create enough of this cultural production. Stoneman 2010 describes creative output as "soft innovation" and lists two major categories of Intellectual Property Rights (IPR) created for encouraging this soft innovation, 1) copyrights (the expression of an original idea) and 2) patents (for the technical and functional aspects of products and processes). Below I will present first a model of the role for *patent* in cultural production, then, a model on the role for *copyright* in the 'new economy' of the internet.

A. A patent model for IPR in cultural/creative production



Stoneman bases the above model on Arrow 1962, however instead of a patent granting a time-limited monopoly based on a process innovation, the patent is for an idea which leads to a product innovation.

AB is the Demand curve

AC is the Marginal Revenue curve

The dotted Cost line represents the cost of production of the good (and due to scale economies, C = MC = AC)

Without IPR, Q1 is the market-clearing quantity and G is the market-clearing cost. This gives social surplus of triangle AFG. However note that all of the social surplus goes to the consumer. Thus there is no incentive for creator/producer innovation.

With the patent, the monopoly output is QM and price PM. The producer now has a surplus, square PM-D-E-G, and the new, lower, consumer surplus, A-D-PM. The social cost of the innovation is the deadweight loss (DWL), D-F-E. The cost of innovation, it is argued, is this DWL. Once the patent expires competition ensues and the full non-IPR surplus is realized. With the patent regime, there is incentive again for additional creative product/design innovation.

B. A copyright model for the new economy

Varian 2005 creates a formal model which shows the relationship between copyright and creative product innovation. We assume that there is a pool of K people who can either each individually purchase the copyrighted product or they can share the product without purchase. Each person values the product at a level of utility "v". There is a transaction cost (waiting in-line, inferior duplication) to sharing, "t". The person with the copyright to the product is a temporary monopolist who sets a price, "p", for her product. Herewith we shall class this monopolist the artist.

When the utility from sharing is greater than that of purchase, sharing occurs,

$(v- p/K – t) > (v – p)$, resulting in,

$v > Kt/(K-1)$

Therefore sharing is more likely to occur when there is a large number in the pool and/or if it is not costly to duplicate.

Varian highlights the "perverse dynamics" of this relationship. If the artist sets the price slightly below "v" then sharing occurs and the resulting equilibrium is inferior products for the sharers with the artist receiving (v-t) from any sales.

Therefore in order to prevent sharing the artist uses the "limit price".

$(v- p/K – t) = 0$, which in turn means $p = Kt / (K-1)$,

Where the artist receives $t/(K-1)$ for each unit sold. We note as well that therefore the higher the value of "t", the higher the price to the artist. If we look at "t" as copyright protection, we can see the relationship between IP protection and art and design production (creative innovation). The stronger the copyright protection the higher the price for art and design and a greater incentive for the supply of this production.

C. Argument against IP protection

i. Freely-competitive sectors and the "land grab"

Both Boldrin and Levine 2008 and Raustiala and Sprigman 2012 argue that those industries in which IPR is not strictly enforced are more innovative and competitive than those that are. Examples of these competitive industries include fashion design, automobiles, furniture design, advertising and architecture. All of these industries freely imitate each other leading to rapid innovation.

This can be juxtaposed to the rent-seeking in IPR described by Boldrin and Levine 2008 who argue most fully for the removal of IPR. In summary B&L argue that the expression of ideas is not a scarce resource (more than one person can hold the same idea at the same time) and therefore that ideas should not be given temporary monopoly rights under law (here we are speaking of both copyright

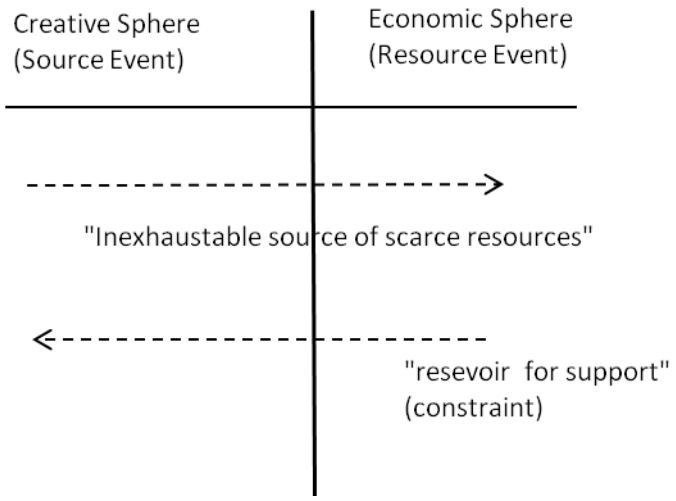
and patents). It is only the tangible, physical, tradable manifestation of an idea which is scarce.

B&L set-up their argument by discussing land. When someone purchases land, they are not buying all the land, just some of it. They are free to improve upon their land as they see fit. Then they discuss someone purchasing for example a copyrighted book. They are not buying all the copies of this book, just the one physical copy. Yet they are not free to improve upon their unique copy of the book.

B&L examine the length of copyright monopoly protection in the USA, which has doubled in the last 100 years (not least due to the 1907 law and the Sonny Bono/Mickey Mouse law of 1998). If copyright protection is seen to be a necessary incentive towards creative production, we should see an increase in the number of books per capita over the last 100 years. The authors show that this is not the case and in fact the number of books released per capita over the last 100 years has not significantly changed. B&L then calls the 1998 law, "the largest land grab in history", one which accrues to the large monopolistic media companies who own these copyrights. They argue that removing the copyright to Mickey Mouse would in fact increase MM's "social value" as more people have more access to the icon, at the cost of the "monopoly rents" accruing to the Disney Corporation. B&L also show that the number of books commercially available in print for which copyright has expired is greater than those still under copyright.

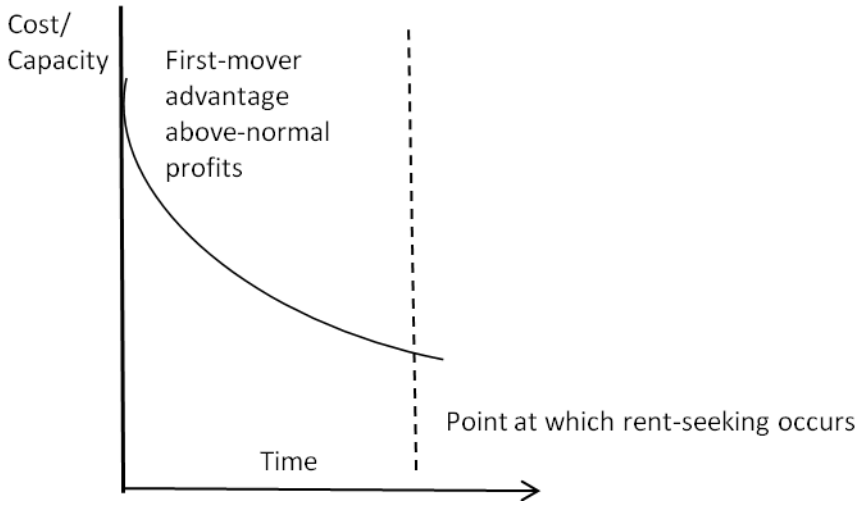
ii. "Source" and "resource" events

The concept of ideas not being scarce is also found in Hutter 1998 (Klamer, ed.) as illustrated below. We can see that for Hutter creative human ingenuity is limitless. It is the interaction between the creative and economic spheres which creates cultural value. Ideas, again, are not scarce, it is the economic (scarcity) manifestation of these ideas which constitute cultural value in the economy.



iii. First-mover advantage

Finally B&L make the case that above normal-profits (rents) accrue to new ideas due to the first-mover advantage, not due to patents nor copyright. A new idea is tangibly brought into the market with limited quantity (and thus scarcity value) due to limited initial production capacity. It is this first-mover advantage which allows the creative innovation (be it a copyrighted design or a patented process) to earn above-normal profits. Further, it is only once scale economies level-off does the innovator seek monopolistic anti-competitive rent-seeking through IP protection.



The first-mover advantage allows for the development of a reputation and brand loyalty, something which imitators cannot fully compete-away. Boldrin and Levine 2008 cite a 2000 Carnegie Survey which received responses from around 1,000 firms reporting product innovation and 1,000 firms reporting process innovation. Both types of firms report that gains from innovation were due more to lead-time and secrecy than to patents or other legal protection.

Explain Baumol's cost disease and discuss its relevance to the economics of culture. Review the empirical evidence on the magnitude and importance of Baumol's disease.

A. The "disease"

Baumol's cost disease was introduced with a Baumol and Bowen *AER* paper in 1965, which was expanded to their 1996 book, *Performing Arts – The Economic Dilemma*. Their cost disease thesis is that the performing arts ("arts" herewith) were "non-progressive" relative to the rest of the economy (the "progressive" sectors). The arts are labor-intensive relative to the progressive sectors and therefore, assuming integrated labor markets, experience cost-inflation higher than the economy writ-large because there is a productivity lag in that the arts cannot as rapidly substitute factors of production into labor-saving technological advancement. The *Rite of Spring* ballet takes the same amount of time and players today as it did when first performed 100 years ago, and rehearsal times cannot be reduced without reducing quality.

This productivity lag creates several problems for the economics of the arts. First not-for-profit organizations (who we assume produce the "high art", see Throsby 1994 in *JEL*) need to raise ticket prices at a higher-rate relative to the progressive sectors. This reduces demand and in-turn creates an "income gap" which needs to be filled-by unearned revenues (government subsidy and/or philanthropy). In addition the quality of the art need decrease (a move from "high" art to popular art) in order to create more demand, earned revenues, from the general public (uneducated in the experience good of the "high" arts). This in turn creates an "artistic deficit" in society. B&B didn't normatively call for subsidy but made their case positively.

B. Empirical evidence

Brooks in a meta-analysis of the cost disease in Ginsburgh and Throsby, eds. 2006 finds "mixed support" for the cost disease. Baumol and Bowen 1966 used two main studies to support their thesis. First B&B compared the costs in 1770 of two (now shuttered) theatre companies in London with those of the Royal Shakespeare Theatre in 1964. They found that the theatre production costs increased 14 times (1,400%) between 1770 and 1964 while the "general price index" in England increased 6 times (600%). The second study (seen as more robust) evaluated the New York Philharmonic from 1843 to 1964. B&B showed

that the costs increased for the Philharmonic at an annual average rate of 2.5% while wholesale prices in the US economy increased at an average of 1% per annum.

Brooks 2006 cites other research which supports the cost disease. First we find that unearned revenues in general have been increasing as a percentage of revenues of not-for-profit performing arts organizations in the USA. In addition research shows that the canon of works being presented is becoming more narrow and "popular" with the major performing arts groups programming less 'risky' ("high" art) works.

However there is also counter-evidence against the cost disease. Throsby 1994 and other demographic studies conclude that the number of those who call themselves artists has been steadily increasing (with the cost disease we would expect the opposite as labor shifts to the more progressive sectors). Throsby finds that artists were less than 1% of the work force in 1950 yet around 2% of the workforce in 1990.

In a well-known article in the *Journal of Cultural Economics* Cowen 1996 states "why I don't believe in the cost disease" and discusses the "new [digital] economy" where a single artist can reach millions of consumers through low-cost CD technology (note that today this would be billions through the internet and not least YouTube). So the main argument here is that the new technology has made the transmission of the arts "progressive" counter to the cost disease thesis. It should be noted however that this counter-argument assumes that digital duplicates are a near-perfect substitute for 'live' performances. Some art economists disagree with this and believe that the recorded arts lack the quality of the live arts (not least in inferior aesthetic quality but also in authenticity value).

In addition enlarging the scope of our analysis now from the performing arts to cultural production in general Brooks 2006 notes we are seeing a move away from labor-intensive "unique autographic" works to easily duplicable digital arts. In summary, whether there is a cost disease or not depends, like all positive economics, on how we classify "the market".

C. A note on Income effects

Finally, there is unresolved debate on the Income effects of the demand for high art. In theory the demand for Scitovsky's "creative" consumption should increase relative to the "defensive" consumption of necessities as the progressive sectors increase real income. Others disagree (e.g., Frank 2005) and believe that increasing incomes mean that the cost of leisure (assuming the consumption of the arts "costs" leisure time) increases as well negating income effects on demand. Therefore the unresolved debate here is around the income elasticities of the demand for art and as framed in B&B's "progressive" and "non-progressive" thesis.

Explain the concept of positional goods. Compare them to Veblen and other types of good in terms of supply, demand and price.

A. “Normal” and “public” goods

First I will explain “normal” economic goods in order to lay a foundation to discuss positional and Veblen goods. A good has economic value due to material scarcity. In the neo-classical economic model a normal economic good is traded privately in the market where demand- and supply-forces meet to create an emerged price and quantity exchanged without externalities. The demand-preference for the good increases with income. The supply-preference increases when the cost of production is reduced, usually due to technological advance. All costs and benefits are captured in the voluntary exchange in the market. This private market exchange maximizes consumer and producer surplus through the most-efficient allocation of society’s scarce economic resources.

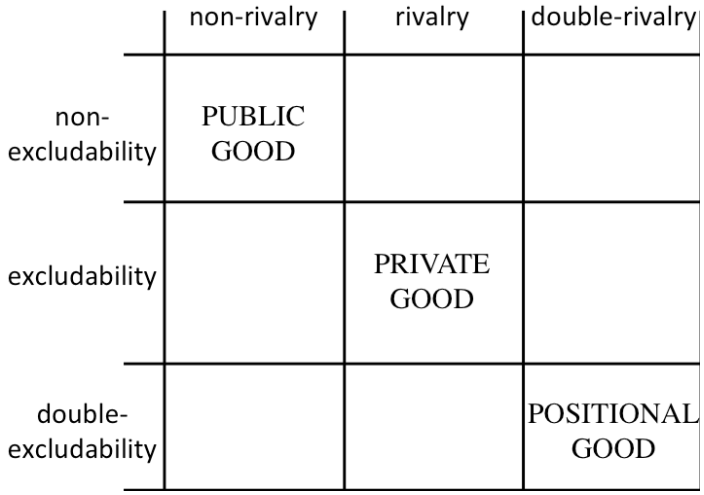
Public goods are goods deemed to bring social value which cannot be brought to bear through private market exchange due to non-rivalry and non-excludability. The most common example is national defense. Nobody within the *polis* can be excluded from the ‘consumption’ of national defense and defense is not rivalrous as all within the *polis* enjoy its benefits equally all at the same time. There is a role for the State’s provision of public goods, using its power to tax.

B. The Tower analogy

Positional goods introduce social scarcity to material scarcity where the consumption of a positional good is used to signal superior social-status in society. Vatiero 2011 uses an Italian village and tower-building as an example. Families in the village compete for social status by building the highest tower. Having the highest tower in the village brings social prestige to a family, and there can only be one tallest tower in the village at a given time. Thus positional goods are few in number by definition. Towers do not share common walls so that others cannot benefit from the construction of the towers. This means that the towers are more costly to produce. Thus higher prices coincide with positional goods.

C. The “Goods Triad”

Vatiero 2011 presents the “goods triad” to differentiate positional goods from private and public goods. Paraphrasing Hirsch 1976 who coined the term “positional goods”, Vatiero states in summary that the theory of positional goods is that, “If you go up, I go down”. The theory of positional goods assumes that utility functions are interdependent due to social-formation of consumption preferences, unlike the more common public and private goods where preferences are not socially-formed. I will use the Goods Triad below to further illustrate.



Positional goods contain the properties of “double-rivalry” and “double-excludability” due to both material and social scarcity. Double-rivalry means that a positional good contains the rivalry in consumption of a private (“normal”) good as well the social rivalry of utility interdependence. There can only be the one tallest tower at a given time, thus tower-building is socially rivalrous.

Double-excludability means that positional goods have the excludability of private goods, as well as the excludability of social scarcity. The person who has the tallest tower gains the concomitant social-status benefits of owning (producing and consuming) the tallest tower, and, the Other who does not have the tallest

tower loses welfare from not having the tallest tower. The double-excludability of positional goods means that the consumption of positional goods in society is a zero-sum game, where the consumer of the positional good gains the same welfare that the socially-excluded Other loses.

Vatiero further illustrates using the "*n*-context of consumption".

The welfare of private goods consumption is additive:

1) $X_1 + X_2 + \ldots + X_n = \mathbf{X}$

All share the same welfare for the consumption of public goods:

2) $Y_1 = Y_2 = \ldots = Y_n = \mathbf{Y}$

The consumption of positional goods is a zero-sum game:

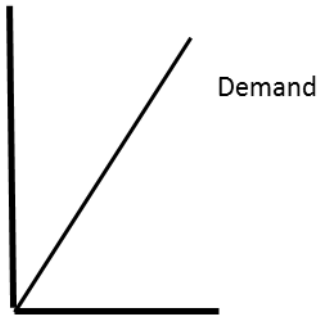
3) $Z_1 = Z_2 = \ldots = Z_n = \mathbf{0}$

Therefore we can see (e.g., Bagwell & Bernheim 1996 and Frank 2005) why some analysts believe that the production and consumption of positional goods are wasteful and inefficient in that there is no positive social welfare.

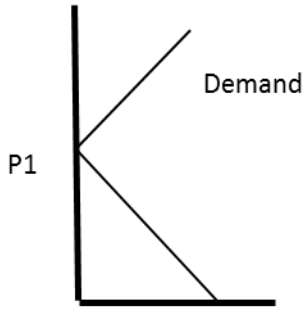
D. Veblen goods

The most commonly-accepted definition of a Veblen good (from Bagwell and Bernheim 1996) is that there is willingness to purchase "a functionally equivalent good" simply because it has a higher price because it signals the necessary conspicuous consumption of wealth. For example "luxury goods" such as wine and designer clothing are seen to be Veblen goods. Veblen goods also gain their value through scarcity, as is well-known by luxury goods manufacturers. However it can be safely said, from Vatiero's towers, that Veblen goods are not as scarce as positional goods. The demand curve for Veblen goods is usually drawn in one of two ways.

The “pure” Veblen good has an upward sloping demand curve.



Other goods have both Veblen and normal good characteristics, where at a certain price level (P1 below) “Veblen effects” take place and the Demand curve becomes inverted like the pure Veblen good. In this type of good the upward sloping portion of the Demand curve is “snob value”.



In the field of cultural economics, there are very distinct theories of different cultural forms (music, fine arts, etc.). Discuss.

A. “Traditional” cultural economics

I would like to approach this question from a historical perspective. It is seen that the initial publication creating the field of ‘cultural economics’ was Baumol and Bowen 1966 which was specifically about the performing arts; theatre, dance, opera, symphony. The thesis being that the economics of the performing arts are different (technically non-progressive) than the rest of the economy. From here the field continued to focus on “high”, “good” or “fine” arts. A pivotal work here being Scitovsky 1976 on “creative” or “novel”, as opposed to “comfort” or “defensive”, consumption as leading to happiness and utility, again using examples such as fine-art, literature and music. A shared belief of these original art economists is that the finer arts carry some intrinsic social, cultural or spiritual values which extends the modern price theory of exchange-value. Art was seen to have public and/or merit good qualities.

Almost simultaneously and onward, analytical focus began to be on the usually not-for-profit (in the USA) or governmental (Europe and Asia) organizations which provide these goods to the public. Museums, libraries, public broadcasting and other arts organizations were the object. A noted work here is Grampp 1989 who focuses on the economics of the fine-art museum. (Relatedly research was conducted into the returns to art as an investment versus other assets, a robust field through today.) Public policy analysis was, and is, conducted into these organizations’ effect on the local economy, providing justification for subsidy and tax expenditures. (Towse 2010 however states that economic development rationale for funding of the arts – versus say that of sports arenas - is no longer credible due to the absence of counter-factual scenarios and that the use of economic development rationale by cultural economists might discredit the economist and the field.)

Cultural heritage both tangible (such as historic architectural) and intangible (such as local customary practices) were part of the initial wave of cultural economics, bringing-in the use of contingent valuation surveys, as used in environmental economics, to value cultural goods which are non-tradable. Again this culture having public goods characteristics.

B. The “cultural industries” turn

Then according to Towse 2010 the newer, and not universally accepted, category of the “cultural industries” was added to field of cultural economics not least because this category was created by UNESCO in 2000. This sector is commercially-oriented and production is for-profit, and includes most if not all activities which require creative content and oftentimes but not always the output can be protected by copyright. Cultural industries include industrial design, fashion design, internet media, advertising, newspaper publishing, television, radio, film, video and cultural tourism.

Throsby 1994 discusses the industrial organization aspects of these two categories of analysis in cultural economics. Due to the ‘cost disease’ the high-art not-for-profit organizations are dependent upon unearned revenues (subsidies and/or philanthropy). Ticket prices are below marginal cost [P < MC]. In the cultural industries we find that producers have price discrimination (for example the “cheap seats” on Broadway) and we find that prices are higher than marginal cost and that marginal cost approaches average cost due to scale economies [P > (MC =AC)].

C. The ‘new economy’

Lastly we should mention the “new economy” of the internet and digital media. Tyler Cowen in his keynote speech at the Association of Cultural Economics International (ACEI) in 2008 notes that “everything has changed”; the costs of creating, transmitting and/or consuming many cultural goods is approaching near zero marginal cost (note however this view removes one intrinsic value of art which is authenticity value, there is no replacement for viewing the real *Guernica* in Madrid nor listening to a Shostakovich quartet in person). Bianchi 2008 (in Hutter and Throsby, eds.) makes the heterodox point that high-art experience goods are not bound by income and price constraints but rather by time and knowledge constraints. These budget constraints have been dramatically reduced by the internet and digitization making high-art available to almost everyone depending upon individual “differing rates of habituation” for consuming the novel.