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# Chapter 1

## Art: The Economic Point of View

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### I. Pitfalls and Possibilities

Whenever economists study areas outside their traditional field, the economy, they run the danger of misperceiving what contribution they are able to make. Only if the choice of which aspects to study is carried out carefully can a useful and novel contribution on the part of economics be expected.

The danger indicated is particularly great in the case of the arts. One reason is that no consensus as to the definition of the arts exists among experts or the public. Another reason is that the scholars engaged in art economics invariably are art lovers, and sometimes art practitioners, so that they risk being carried away by their emotions instead of taking the same sober and rationalistic attitude as when they deal with their traditional area.

The area of the 'economics of art' can be determined from two different points of view which are discussed in section II. It is argued that the second point of view is preferable, and that the economics of art are not restricted to the (narrow) economic, material or monetary aspects of the arts. The following section III looks at the economic concept of art from the demand side (from the consumers of art) and from the supply side (from the producers of art). Section IV suggests that the disequilibrium between the demand for, and supply of, art helps us to understand better what 'art' is from the economic point of view. Section IV offers concluding remarks.

### II. Two Views of the Economics of Art

'Economics' and 'art' can be combined in two quite different ways:

- (1) as the analysis of economic or material aspects of artistic activities, and in the extreme as monetary dealings in art;
- (2) the application of the 'economic', or rather, the 'rational choice' methodology to art.

These two points will subsequently be discussed.<sup>1</sup>

#### 1. *Economic Aspects of Art*

The arts need an economic base to flourish. Think, for example, of the dominant role of subsidies to the performing arts and to museums in Europe, which, in America, are substituted by tax exemptions for donations; the prices in, and profitability of, the market for paintings, antiques and

other art objects; international trade in art; or the income of individual artists. To some extent, cultural activities also influence the economy as, for example, when a festival such as Salzburg or Verona attracts many additional visitors to the city.

Such connections between economics and art are rather obvious and well visible, and need not be further commented on here.

## 2. *The Economic Approach to Art*

Over the last few years, the typical way of economic thinking has been applied to many different areas. Economic methodology in the form of the rational choice approach has become a general social science paradigm extending to all areas of human behaviour.<sup>2</sup>

The economic approach is characterised by four features with respect to human behaviour:

- (i) Individuals, but not groups, states or society as a whole, are the acting units (methodological individualism), but this does not mean that individuals act in isolation, rather they constantly interact with each other;
- (ii) behaviour depends on individual preferences as well as on the constraints in terms of resources (income), time or norms an individual is subject to;
- (iii) individuals are, on average and most of the time, pursuing their own interest; their behaviour is determined by incentives;
- (iv) changes in behaviour are as far as possible attributed to changes in constraints, because the latter are better observable. This strategy allows to derive empirically testable propositions.

The second cornerstone of the economic approach is the importance attached to institutions which shape the environment within which individuals act. Institutions may take the form of decision-making systems; of norms, traditions and rules as well as of organisations. They act as the constraints on human behaviour and thus determine an individual's possibility set. Modern economists look at institutions from a comparative perspective, i.e. they study the effects of different institutional settings on the demand and supply of art. Thus interest attaches not to how a theatre produces a Pareto-optimal amount and quality of performances, but to how the number of plays and their quality are affected if the theatre acts in a competitive market or as a monopolistic supplier; whether it receives subsidies from the government or gains its revenues by own productive efforts; whether the subsidies received are unconditional or conditional on

the number of tickets sold, etc. As a result, the comparative institutional approach is directly related to relevant policy questions.

The rational choice approach today is not restricted to economics, but has been taken up by sociologists, political scientists, lawyers and historians, but not by traditional art scholars. It has been successfully applied in a great many different areas such as the natural environment (Environmental Economics), politics (New Political Economy, Economic Theory of Politics, or Public Choice), international relations (International Political Economics), conflict (Economics of War and Peace), education, health, the family, and sports.

### 3. *Comparison between the Two Views of Art*

It is useful to look at the economics of art in terms of content or in terms of approach. Nevertheless it is argued here that the guiding principle should be to look at the economics of art as a methodological approach. The reason is that the material or monetary aspects of art can be treated also by other social sciences. This has, for instance, been shown in an exemplary way for sociology by Hauser (1953) in his monumental *Sozialgeschichte der Kunst und Literatur* or, more recently, by Foster and Blau (1989). The distinguishing characteristics of an economics of the arts would be lost if restricted to the interrelationship of economy and art. What makes the economics of art different from other approaches is its outlook shaped by the assumption of individuals' rational behaviour and the comparative view of institutions. It may, of course, be argued that economists have a relative advantage in looking at material or monetary aspects of art. This may be true but it should not be overlooked that many practitioners have an excellent knowledge of such aspects (e.g. auctioneers on prices of paintings, or theatre managers on salaries of actors), so that the economist's relative advantage again consists in the particular way such facts and figures are analysed.

## III. The Economic Concept of Art

### 1. *Consequences of Individualism*

The concept of art as understood by economists starts from the preferences or values of the individual. This distinguishes the economic concept of art fundamentally from other definitions of art which derive from quite different principles, e.g. from a notion of aesthetic beauty based on deeper philosophical grounds. It also strongly differs from the concept of art defined by art experts (art historians, museum people, art critics and journalists, gallery owners and artists themselves) who have a superior professional knowledge of the various aspects of artistic activities and derive therefrom the authority to pass judgment on what art is. According to the economic approach the individual preferences for art are recorded, but no normative judgment about it is given: art in this sense is what people

think art is.<sup>3</sup> Economists cannot, and do not want to say what is 'good' or 'bad' art; this is not the realm of their professional competence, but should be left to those sciences (such as philosophy) which have a theory appropriate for dealing with the question of art quality.

A case in point are 'authentic' reproductions of paintings which have been suggested to be put into museums to overcome the scarcity of originals (see Banfield, 1984, based on the much earlier idea by André Malraux in his 'Musée Imaginaire', 1947). Economists are neutral as to whether such copies represent art. They rely on the judgment of the (majority of the) people. Other sciences concerned with art do, in contrast, deal with the question of whether reproductions constitute art. Thus, philosophers of aesthetics tend to argue that copies do not have the special 'aura' of the original. Art lawyers, for instance, would also claim differences because the rights of the creator of the original art work may be affected. While economists in their professional capacity do not engage in the debate of whether copies are art, they have much to say about the consequences on demand and supply of producing perfect reproductions. Presumably, if the originals are no longer distinguishable from the copies, their price tends to fall. Museum managers would find themselves in a drastically different situation because they now could afford to exhibit any painting they care to, and protection and preservation costs would strongly fall. But would art lovers still visit such museums? Or would new groups of the population be attracted? It would indeed be fascinating to analyse the many different consequences by using the tools of the economics of art.

Two different kinds of individuals' preferences for art need to be distinguished. The basic preferences referring to the fundamental wishes of people are taken as exogenously determined; they are not the subject of economic analysis, but are left to other sciences better equipped to deal with them. Economists have limited knowledge about the factors affecting human preferences (see e.g. recently Becker, 1992), in particular how experts' opinions influence what ordinary people think about art - if they are influenced at all. It is often useful, especially when deriving testable propositions, to assume that these basic preferences do not change over time and do not in general differ widely between individuals. Revealed preferences, on the other hand, are not only shaped by the (constant) basic preferences but also by the constraints with which individuals are confronted. The difference between basic and revealed preferences can be demonstrated by considering the preferences for visiting the opera. A person may have a deep love for the opera. Despite these marked basic preferences for this form of art, he or she may reveal low preferences for the opera when one looks at his or her behaviour. Perhaps the opera lover is poor and cannot afford to buy a ticket (income constraint), or he/she is very much taken up by his/her profession (time constraint), or cannot find a babysitter (social constraint), or the next opera house is located too far away

(physical constraint). In the same way, an economist would, as a working hypothesis, not assume that the Japanese have an intrinsic or even genetically given preference for buying European Impressionists (Renoirs, van Goghs).<sup>4</sup> Rather, an economist would study to what extent the differences in the constraints between Japanese on the one hand, and American and European collectors on the other hand, influence the preferences revealed by their behaviour. Relevant factors to look at would be the differential growth in income, relative price changes (in particular of the exchange rate between the dollar and the yen), the availability of different sorts of paintings at auctions, the difference in the 'use' to which the paintings are put, differences in tax treatments, but also the differences in familiarity and in cultural education (impressionist paintings seem to be more similar to classical Japanese art), which can be studied by human capital theory (see Stigler and Becker, 1977).

These two examples serving to illustrate methodological individualism in general, and basic and revealed preferences in particular, refer to the demand side but equally apply to the supply side. The production of art in all its forms is (in principle) traced back to individual behaviour. The subject of study is how, and to what extent, incentives and constraints induce people to create art.

The economic approach to art focuses on the fact that scarcity exists with respect to resources (capital and labour, natural resources and the environment), time and the physical as well as psychic<sup>5</sup> potential of persons. This again distinguishes the economics of art fundamentally from other studies of art (such as aesthetics, and of most art history), which are not concerned with scarcity and therefore do not deal with the problems and aspects alluded to above.

The economic approach outlined has the following consequences for the concept, and definition, of art:

- What is 'art' is defined by individual actors and not by exogenous considerations or art experts;
- there is no 'good' or 'bad' art;
- what is considered 'art' changes over time and differs between persons as a result of changing constraints, i.e. it is a dynamic concept;
- different institutional conditions affect individuals' constraints and therewith the concept of art.

The following two subsections discuss particular aspects of the economic approach - the demand for, and supply of, art.

## 2. *The Demand for Art*

An individual experiences utility from enjoying (consuming) what he or she considers to be art. The economist is able to measure this demand in the form of the 'marginal willingness to pay'. For the various art objects and artistic activities, different sizes of the willingness to pay will be observed, but it would be ridiculous to ascribe any intrinsic 'artistic' value to such measurement. If individuals are prepared to pay twice as much to see a film than to see a theatre play (or vice versa), this does, of course, not mean that the film is twice as 'good' as the play - economists refrain from normative statements and simply register that the individuals in question are ready to pay twice as much according to their own evaluation.

The willingness to pay by individuals is often directly visible in the price paid for art objects paid (e.g. at auctions for paintings), or the entry fee paid for attending a cultural event. In other cases it must be measured empirically for which purpose there are many different methods (for an extensive discussion see Pommerehne, 1987). They range from direct methods via sample surveys and budget games (where the persons are subject to an income constraint), to indirect methods such as travel costs (measuring how much people are willing to spend in money and time to see an artistic event), or market evaluations (where the willingness to pay for art is reflected in higher house and land values, all other things being kept constant). While these methods are sometimes not easy to apply, they nevertheless provide a useful quantitative picture of what the individuals composing society consider to be art.

It should be noted that such estimates are not democratic in the sense that the majority of citizens decide what art is. Rather, every person decides for herself or himself; a willingness to pay is recorded even if it refers only to a very small minority in the population. Indeed, it is quite possible that a few persons make up the bulk of a society's aggregate willingness to pay for a specific art form, i.e. even rare preferences for art can be expressed. Thus, it is not at all true that the economic approach to the art implies a decision, or a support, for 'popular' forms of art.

There are many areas and instances in which the individuals do not exert their demand for art directly but rather leave the decisions to some representative body. This can be the parliament (which determines the size of the budget allocated to the arts), the public administration (which distributes the funds to the various art institutions and artists), or a group of experts (which may either exert control at 'arms' length' only, or hand out the money in the form of prizes or stipends). In these cases, the individuals' willingness to pay for art is expressed indirectly in the sense that these representative bodies are given the power to decide ultimately about art. Thus, in a democracy, the voters also decide about the general art policy when they elect their parliament and government. In Switzerland, the

citizens can express their preferences about art more directly by means of initiatives and referenda.

### 3. *The Supply of Art*

It is useful to distinguish individuals acting (a) as artists producing independently, and (b) in the framework of an art organisation such as a theatre.

#### a. *Self-employed artists*

In most societies, everyone is free to call him- or herself an 'artist'. This may have been quite different in earlier times, when an artist was a well-defined member of a profession, and had to undergo a specific educational career (mostly as an apprentice) and moreover had to belong to a guild (see e.g. Montias, 1982). It may also be different in more primitive societies, where custom and tradition determine who is an artist. Economic thinking can be applied irrespective of an artist's underlying motivations.

Who is, and who is not, an artist is, however, of crucial relevance to empirical studies on the share of artists in the population, and, more important, on artists' incomes (see e.g. Filer, 1986). If the purely subjective evaluation is used, per capita income tends to be systematically lower than if one takes a more restricted definition such as the membership of a professional association, or the successful completion of a recognised course in art.

#### b. *Artists in organisations*

Most individuals in the performing arts work in a unit such as a theatre company, in a corps de ballet or in a circus. But there are also, of course, independent performers in this area of art. Art organisations are also very important in the case of museums of all sorts. In economics, art organisations are not treated as collective entities with a life and behaviour of their own. Rather they are the result of individual action.

Institutional conditions determine strongly to what extent an organisation is free to call itself 'artistic' or 'cultural'. In Western industrial societies, the use of these expressions is in principle free (e.g. it may be used for purely pornographic performances). However, the government regulates and codifies its use whenever it supports the 'arts' by handing out subsidies or allowing tax exemptions and tax credits. What is 'art' and 'culture' is in this case the outcome of the interactions of a large number of actors in the political sphere. The result heavily depends on the strength of organisations interested in the government support of the arts, in particular the community made up of art experts and devoted art lovers. Established art forms such as theatre, opera and ballet, or museums, have long enjoyed

governmental promotion while newcomers engaged in 'illegitimate' art forms find it much harder to belong to the publicly recognised sector of art and culture.

#### 4. *Equilibrium between Demand and Supply*

The demand and supply sides of art have so far been considered separately. It should be appreciated, however, that the equilibrium between demand and supply determines to a large extent what an artist is from the point of view of economics.

While every supplier is free to call her- or himself an 'artist' in today's society, the term becomes more definite when the interaction with demand is taken into account. While a young lady working as a waitress may want to consider herself an opera singer (even without adequate education), it makes little sense to count her among the artists if the demand for her artistic services is so low that she works zero hours as a singer. The same applies if demand is so low that she receives only a small share of her total income from artistic activities.

In some countries, namely those influenced by German Romanticism, such a view is rejected: there exists a strong tradition suggesting that a 'true artist' is poor.<sup>6</sup> In contrast to what has just been argued, this tradition proposes a negative relationship between the quality of art and its marketability. However, this view is purely idealistic and has little to do with reality. Empirical evidence (see Frey and Pommerehne, 1990, chapter 9) shows that

- certainly not all artists are poor (van Gogh and Gauguin are exceptions and certainly not the rule);
- artists of high income are not necessarily of 'poor' quality (defined according to art historians' evaluations);
- many artists of highest 'quality' have received very high incomes.

Examples for the last two statements are, among painters, Rubens, Titian and Rembrandt,<sup>7</sup> Lebach and Stuck, Picasso and Beuys; among composers Mozart<sup>8</sup> and Beethoven, Verdi and Wagner; among singers Domingo, Pavarotti and Carreras; among writers Shakespeare and Goethe, Dickens, Hauptmann, Brecht and Thomas Mann.

For the purpose of practical analysis, economists often follow the common distinctions between 'creative art', 'performing art' and 'cultural heritage'. Thus, for instance Baumol and Bowen's (1966) or Throsby and Withers' (1979) books are devoted to the performing arts only, while Wagenführ's (1965), or Feldstein's (1991) books deal with creative art in the sense of paintings and museums, only. Such differentiation makes sense in so far as

the demand and supply processes, and therefore the equilibrium attained, deviate systematically from each other.

#### IV. Dynamic Aspects

The reactions to disequilibrium situations when either supply exceeds demand (excess supply) or demand exceeds supply (excess demand) allow us draw important conclusions about the concept of art in society, and should therefore be carefully studied.

##### 1. Excess Supply of Art

Consider a theatre company which plays to an almost empty house. What does this situation reveal about the economic concept of art? The economist need not jump to the conclusion that the lack of demand for the performance reveals that no art is involved. Rather, the analysis of this disequilibrium situation leads him or her to concentrate on the process of art in society.

A lack of demand to the extent stated in our example leads to a commercial loss for the theatre company. This disequilibrium situation cannot be maintained over an extended period. Three solutions are possible:

- (i) The company does not survive. In this case, 'art' indeed disappears, it is no longer produced;
- (ii) the theatre company is reorganised so that costs are reduced and/or demand is increased. If this permits avoidance of a loss, we have an example of market-produced art;
- (iii) the company covers its losses from producing the play by outside funding. Private sources may directly sponsor the activity usually benefiting from tax exemptions: A change in tax laws in this case has a strong impact on whether such privately subsidised art is able to survive.<sup>9</sup> The loss may also be covered by the government. What type of art survives, and therefore what culture is, in that case, politically determined by what parties are in the government and parliament, how well the cultural interests are organised compared to other pressure groups, what art experts' influence is, and how good the budget situation is. The government's behaviour with respect to art funding is analysed within Political Economy (see e.g. Mueller, 1989).

As has become clear, different factors are responsible, and are studied by art economists, depending on which of the three adjustment processes take to equilibrate the excess supply of art.

## 2. *Excess Demand for Art*

Consider again an extreme example, namely that there exists a demand for a particular artistic activity but that the supply is not forthcoming. The analysis of this disequilibrium again draws the attention on factors relevant to understand art in society.

In the example given, artistic activity has not taken place and cannot be measured as part of society's output (e.g. as part of national product). However, the pertinent question is why the 'profit' opportunities given by existing demand are not exploited by offering the corresponding supply of artistic activities. Three major reasons for a disequilibrium can be analysed:

- (i) The production of the artistic output is not feasible because costs exceed the stated willingness to pay. The question then arises whether individuals' demand captures all the benefits produced by the artistic activity, or, in other words, whether there exist any (relevant, i.e. marginal) externalities. The literature based on economic welfare theory has identified important public good effects of art (see e.g. Throsby and Withers, 1979 for Australia), the most important being the option value, the existence value, the prestige value, the education value and the bequest value. Depending on the size of these external effects, it may normatively be argued that the corresponding artistic activities should exist, and economists can suggest political measures which reflect individuals' true marginal willingness to pay.
- (ii) The artistic activity is not forthcoming because its supply is forbidden or at least hindered. Political restrictions on the supply of art do not only exist in authoritarian regimes and dictatorships, but also in democracies, especially when sexual matters are involved;<sup>10</sup>
- (iii) Supply is not adjusted to demand in order to maintain or willingly produce a queue which the consumers interpret as an indication of good quality (see Becker, 1991, for the case of restaurant queues). Such behaviour is rational for the suppliers also when they are able to appropriate (part of) the rents arising from the artificially created scarcity. In many public theatres, opera houses and festivals, the managers raise their power, prestige and directly or indirectly their income by allowing a black market for tickets (for an extensive discussion for the case of the Salzburg Festival see Frey and Pommerehne, 1989, ch. 4).

In order to understand what art is produced under these conditions, it is again necessary to conduct an analysis along the lines of Political Economy. It should be emphasised that the outcome of the political process does not necessarily reflect the normative considerations just discussed. In particular, it may well be that the government does not intervene though there exists

an option or existence value not reflected in the market. At the same time, political forces often induce the government to support art even when no such external effects exist. In contrast to the welfare theoretic approach of conventional economics, the politico-economic analysis allows us to identify the factors which determine the production of culture in these areas, and which indirectly define what 'art' is from the economic point of view.

## V. Concluding Remarks

There are two ways to understand the economics of art: as the economic forces determining art and the economic consequences of art on the one hand, and the application of the economic analysis to the arts on the other hand. It is argued that the latter concept focusing on the methodological approach should be used because only here economists do enjoy a relative advantage. This does not mean, of course, that the former aspects should be neglected, but the economic causes and consequences should be analysed from the rational choice perspective in order to differentiate it from other approaches such as the sociology, the psychology, or the law of art.

The economic approach is characterised by its individualistic focus and its acceptance of individual preferences. 'Art' is defined to be what people think art is, and economists do not judge whether art is 'good' or 'bad'. The concept of 'art' changes over time as a result of changing constraints, which in turn are shaped by the institutional conditions existing on the demand and supply sides of art. In equilibrium, the economic concept of art is defined as the consequences of the preferences and the constraints of all the actors involved.

Disequilibrium situations in which supply exceeds demand, or demand exceeds supply help us to better understand the process by which art is produced and demanded, and therewith how the economist's concept of art evolves.

## Notes

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- 1 The discussion is based on a now abundant literature on the economics of the arts. For monographs in English see e.g. Baumol and Bowen (1966), Netzer (1978), Throsby and Withers (1979), O'Hagan and Duffy (1987), Peacock, Shoesmith and Milner (1983), Grampp (1989), Frey and Pommerehne (1989), Feldstein (1991).
- 2 The main exponent is Becker (1976); see also McKenzie and Tullock (1975) and the survey article by Hirshleifer (1985). A methodologically oriented treatment is

- given in Kirchgässner (1991), and several applications are provided by Frey (1992a).
- 3 While this sounds terribly naive, such a definition of art is indeed supported by some of the most sophisticated artists and art theorists, an example being Joseph Beuys.
  - 4 Remember that several of the highest prices ever paid for a painting are van Gogh's *Portrait du Dr. Gachet* (auctioned for \$82.5m. in 1989), and *Sunflowers* (auctioned for \$39.3m. in 1987), which both went to Japan. There is today considerably less interest in Old Masters by Japanese collectors.
  - 5 The cognitive limitations of human beings have only recently been acknowledged within economics. Pathbreaking is Simon's (1978, 1982) 'bounded rationality', and the discussion of anomalies in human behaviour (Kahneman, Slovic and Tversky, 1982, or for a survey Frey and Eichenberger, 1989). For a discussion of the respective extensions of economics see Frey (1992).
  - 6 Spitzweg's picture *Der arme Poet* (1839) in Munich's Neue Pinakothek well illustrates people's perception of an artist in German speaking countries.
  - 7 Rembrandt earned high fees but he (almost) went broke because of risky speculations with shipping stocks.
  - 8 In contrast to what Miles Forman's film and Peter Shaffer's underlying play *Amadeus* portray, Mozart was well paid for his time, but he lost much of his money gambling (Baumol and Baumol, 1992).
  - 9 For example, recent restrictions in tax exemptions in the United States have resulted in a reduction of private donations to museums of 24% according to some estimates. See Fullerton (1991).
  - 10 A recent example in the United States is Maplethorpe's photographs.

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