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IT Depends: The Maturity of Cultural Economics and Its Public Policy Debates

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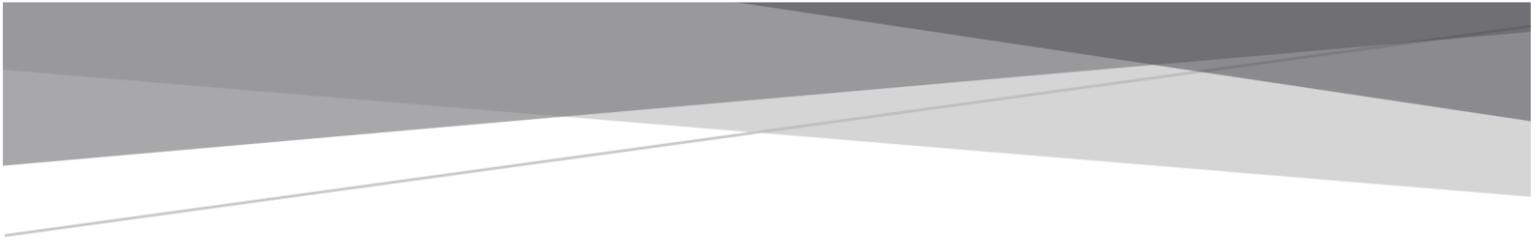
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IT DEPENDS: THE MATURITY OF CULTURAL ECONOMICS AND ITS PUBLIC POLICY DEBATES

This thesis is submitted in partial fulfillment of the requirements for the course Senior Seminar (EC 375), during the Spring Semester of 2019

Abstract

This paper explores a few core cultural economic theories such as Baumol's Cost Disease and Crowding out/Crowding in effects, and it delves in the why, the how, and the how much of the public subsidy debate within economics. It assesses all of these topics using an academic life cycle framework to determine if the field of cultural economics is mature enough to truly be giving recommendations to government. The author finds that there is conflict in terms of policy implication and a lack of data. Leading to the discovery that the field of Cultural Economics is not mature enough to be used in public policy debates.

While writing this thesis, I have not witnessed any wrongdoing, nor have I personally violated any conditions of the Skidmore College Honor Code.

Terence Durrant II

I. Introduction

The field of cultural economics has been around since 1982. Before that, cultural economics was known as the economics of arts and culture. Research has been done in the field since the 1960s, but according to David Throsby 1982, “it was not until around 1975 that serious research in the area became well established” (Throsby 1982, p.242). Moreover, the field has its own well-established journal that started publication in 1976. Despite the field being around for over 30 years, it still remains one of the more hotly contested fields of economic study alongside sports economics and the economics of health and healthcare.

The field of cultural economics has many areas of discussion such as, artists labor markets, Baumol’s Cost Disease, crowding out/crowding in, demand and supply, donor governance, industrial organization, taste formation, and the art market. Many discoveries have been made and expanded upon in the field. This paper will cover Baumol’s cost disease, the crowding out/crowding in discussion, and the overarching discussion behind public subsidies in the arts in terms of the why, the how, and the how much. One of the most common applications of these theories are their policy implications for public goods, specifically nonprofits. The paper will look to delve into the policy implications of these various topics within cultural economics.

The paper will specifically answer the question: Have the public policy theories in cultural economics reached the appropriate phase in the academic life cycle to be accurately applied in practice? The paper will look to update the progress that has been made in each of the respective areas. Furthermore, it will look to examine if cultural economics has truly reached all of the phases of the academic life cycle, as well as examining if cultural economics has embraced modern economic theories and applied them to their expansion of the field. The rest of the paper will be as follows: Section II is the Framework, Section III is on Baumol’s cost disease, Section IV is Public subsidy for the Nonprofit arts beginning with the Why? (Theoretical Arguments) followed by the How Much? Then ending with the How? A means to an End, then Section V is Crowding Effects, Section VI is Results, Section VII is Implications, and Section VIII Conclusion.

II. Framework

The Framework that will be used in this paper was created by cultural economist Bruce A. Seaman (2009). The schema has not been explored in many other papers, so it is fairly challenging to expand upon. His Schema was the first one to examine the field of Cultural Economics in this manner. It used examples from adjacent fields in economics such as Industrial Organization and Sports Economics. Seaman explains how the framework fits in these other realms and then applies it to Cultural Economics. With each comparison, he further engages the reader in the definitions within the framework. Based on

his comparisons to other fields and applications of the framework, he finds that there was fragmentation and consolidation phases within the field which causes there to be a diversion in the literature that eventually comes back together in the final backlash stage. This framework is incredibly subjective and can be applied to multiple sub-disciplines within the field of Cultural Economics. Seaman applies the framework to Cultural Economics as a whole but does not go in depth within subfields of Cultural Economics. This paper extends the literature by using the framework and applying it to the previous research within the specific subfields. It then continues to apply the framework to the greater field of Cultural Economics.

Seaman titled the first stage “Foundation,” which is fitting because this stage lays the groundwork for all the future research to be built upon it. This stage is all about the basics and fundamental theories that spur disciplines. The key factor in this stage is that the framework is compelling but limited. It allows other economists to expand upon it due to their passions. This initial stage can have some empirical evidence supporting it but is not a requirement.

The next stage was called “Maturation,” because the theory from the previous stage is expanded upon. The research goes beyond the limits of the previous theory and economists can use their passion to add new nuances to the original theory. In this stage the original framework may be questioned a little bit, so it leads researchers to utilize tools from other realms of economics and apply it to this field. The emphasis in this stage is the use of rigorous analytical frameworks to evaluate the efficacy of the original theories. After this in-depth analysis, the results are used to influence policy decisions.

The third stage is the “Reevaluation” stage where everything is questioned. By this point, the theories from previous stages are known by most practicing researchers. This is the stage for all the skeptics who question whether the theory is actually an accurate depiction of what is going on in society. In addition, the skeptics may question whether the empirical findings are actually capturing the correct variables and answering the correct questions. Moreover, researchers begin to question if these results are then being applied correctly in terms of policy implications. The reevaluation stage allows there to be doubt in the field which causes the original theorists to answer a few lingering questions.

The final stage is called “Backlash,” which is simply the answer to the “Reevaluation stage.” The believers of the “Foundation” or “Maturation” stages will have to answer the questions presented in the “Reevaluation” stage to maintain the validity of their research. More often than not, the “Backlash” stage questions whether the added sophistication in the “Reevaluation” phase makes the model less realistic for society. The defendants may also wonder whether these questions are substantive and furthering the field (Seaman 2009)

III. Baumol’s Cost Disease

In the “Foundation” stage, William Baumol and William Bowen describe what they call a disease in their seminal paper. Some claim their paper is the foundation stage of Cultural economics as a whole, as it was the first paper to discuss the topic, and therefore has become the main foundation of the theory itself. They begin to explain that there is a special attribute of the arts cost structure. They call this phenomenon the “cost disease,” which is where the cost of live performances continues to rise faster than the cost of a typical manufactured good. (Baumol and Bowen 1966) In the paper Baumol and Bowen continue to explain that over the years cost structure of nonprofit arts organizations has not improved because they have not gained any real benefits from technology due to labor saving innovation. This is because it still takes the same number of man hours and people power to write and play a piece by Purcell or Beethoven. This fact still rings true today, for when you go to your local orchestra you will still see the same number of players as you would have seen 100 years before. Furthermore, performers still have to work the same number of hours to learn and practice the piece.

During the “Foundation” stage Baumol and Bowen compare the arts market to the watch making industry. Baumol and Bowen would use the example of a modern swiss watchmaker being able to make 1200 watches in the time a watchmaker used to make only 12 due to technological advances. In addition, the costs of watches and other manufactured goods have plummeted while the live arts have become more expensive. One of the key gaps that Baumol and Bowen left out during the “Foundation” stage is the theory that mass media, film, and radio would not incur the same cost disease. Their paper was also a breakthrough for public support for the arts. It gave arts supporters a major argument for incurring federal support. The cost disease shows that the arts should be subsidized due to their cost structure. In addition, the cost disease describes some of the problems that we may be witnessing today in the arts due to underfinancing. This was labeled by W.E. Oats as the “fiscal illusion” and he’s quoted as saying:

Cost Disease implies that cost of performance will rise faster than the general price level.
If government support only increases only marginally faster than the price level
politicians will conclude that the quality the public is receiving is declining.
Mismanagement is likely to be blamed and budgets will be trimmed and that would put
support levels lower than the public’s actual preferences (Baumol 1987, p. 843).

This a noteworthy argument as it is something that the arts industry is currently experiencing.

Government support has been rapidly decreasing over the past few years for the fine arts. More often than not, mismanagement is the usual excuse when a nonprofit goes under. Moreover, nonprofit budgets have also become small and continually focused on cost-cutting, which creates an interesting theoretical observation that we might be witnessing today.

As mentioned earlier, there was a key gap left within the foundational literature because it was assumed that media, film, and radio would not experience the cost disease. It only makes sense that this theory would need to be tested. To kick off the “Maturation” stage of the literature, Hilda and William

Baumol went on to test the original hypothesis in 1984. In the paper, they analyze whether the cost disease can be felt within the mass media industry. The Baumols discovered that the television broadcasting industry has a cost structure that is asymptotically stagnant. According to the theory, the industry begins with an initial decline in costs and then begins to behave like the costs within the performing arts. Hilda and William Baumol include a data table and graph that shows the ticket prices of films, dramas, and musicals from 1948 until 1983. In all of these industries the prices go up, but the film industry's prices are increasing at a much faster rate. When looking at the assumptions of the theory they do make one possibly faulty assumption to allow the theory to work. The Baumols assume that there are two major attributes of the film industry. One of these attributes is completely stagnant, while the other is technologically driven. Baumol assumed that the technology driven input would eventually begin to decrease costs at a decreasing rate. This faulty assumption allows the stagnant attribute to take over and cause the cost disease to take effect. Unfortunately, that is not how innovation works in the real world. Innovation is always at play within industries, and it often will decrease costs at an increasing rate as the industry grows. This would force them to rethink whether or not the cost disease truly applies to the film industry based off of the two inputs. This questioning of assumptions is the basis of many of the papers within the "Reevaluation" stage.

One of the key players in this stage was Tyler Cowen, for he never shied away from explaining the gaps in Baumol's original logic. Cowen brings a nuanced approach to analyzing the cost disease. He breaks down his analysis based off of two key arguments: innovations in process and product innovations. Cowen brings up the fact that the technological advances in recording technology allows thousands of listeners to engage in musical performances. He stated that, "Even if the number of musical performances does not rise, the quantity of performance output, measured in consumption units, has skyrocketed" (Cowen, 1996, p. 208). His argument measures the results of musical performances based on consumption units rather than focusing on the labor and man hours required to put it on. Unfortunately, Cowen's nuanced argument does not address the cost aspects despite being a valid point. He furthers the argument by bringing up the claim that quartet production does not differ from industries because there are some irreducible labor costs in manufacturing. Cowen goes on to say that, "Short of complete automation of the entire firm, including upper level management, all production processes involve some irreducible amount of labor" (Cowen 1996, p. 209). This point addresses the costs in a logical fashion. Every firm experiences some sort of labor costs because many of them are indeed closer to fixed costs. Thus, Cowen's original arguments are not a direct rebuke on the cost disease itself but rather raise philosophical considerations on how we are measuring productivity.

In the area of product innovation Cowen questions Baumol's fundamental assumption of keeping both inputs and outputs fixed. In this example the inputs are four musicians, a quartet, and the output is a

classical music performance. Cowen claims that when doing this, “the postulate comparison eliminates new ideas as a source of productivity improvement. The Mozart example makes the performing arts appear stagnant by treating music creation as fixed, unchanged activity” (Cowen 1996, p.209). This is a valid point because when compared to the automobile industry, it would also appear stagnant when the final product and production process are fixed. He goes on to acknowledge that all industries suffer from time to time with a lack of creative labor. This would show that the arts are not very different from other industries at all because the cost disease does not focus on the value added in productive process. He says that a proper comparison must account for the increasing diversity within the arts. This is an important point because the arts are a creative industry and eliminating that creativity would automatically put it at a disadvantage when compared to other industries. Furthermore, Mozart’s symphonies are not the only pieces of music that are performed because new pieces are continually being created by modern day composers. They include different labor inputs and different instruments. He goes on to make the analogy, “The modern world does not produce the Model-T more cheaply, it produces a better car altogether. If the cost disease is restricted to products of constant quality, it will be largely irrelevant for long term growth, which brings new products in all spheres of life” (Cowen 1996, p. 210). This is another great counterpoint given that orchestras now play what is called “pops” music. Orchestras will play pieces from famous movies, musicals, and even some popular modern music. This would be called a new product in any other industry and would lead to the cost disease to compare apples and oranges. Lastly, Cowen points out that many of these authors focus on high culture when measuring these effects. When looking at more popular, modern music, you would possibly see different results. In addition, the data indicates that the number of high culture organizations, whether opera companies or symphony orchestras, have all increased from 1965 to 1990. The industry is clearly growing for some reason and increasing costs in an industry would not lead to so many new entrants.

Cowen raises valid points, but Baumol’s Cost Disease is still used to this day as a policy and discussion topic. In the field of welfare and discussion of the role of the state, Baumol’s Cost Disease is found to be robust especially because of how the theory has evolved (Andersen 2017 and Semat 2019). These papers are not focused on the arts at all, but they give insight to the other uses of Baumol’s Cost Disease because there is also a growth component to the theory not discussed in the paper. In terms of direct studies, such as Anne-Kathrin Last (2011), finds that German theaters are directly affected by the Cost Disease. They find that the key driver behind the cost increases is increasing wages as estimated by Baumol. This study is good empirical evidence and proof that despite the holes in the theory, there is clear empirical validity. Additionally, in direct response to Cowen and natural academic evolution, Baumol does evolve the theory over time. One of the major evolutions in the theory was the focus on further defining the stagnant activities. In these activities there are labor inputs that cannot be improved by

technology. Thus, they need a name and definition, or as Paschal Preston calls them creative inputs defined as, “ original ideas, concepts, actions, and inductive solutions to ill-defined problems. Creative inputs are provided by creative labor, which is assumed to be irreplaceable by machinery” (Preston 2009, p. 243). This clarifies that these new product innovations discussed in Cowen’s critique would be considered new products all together. Because the creative inputs that created Mozart are not the exact same creative inputs that went into rock, country, and other types of music. They also go further to acknowledge the fact that the standardization is the process that turns a stagnant good into a progressive good that has the ability to improve with technology and innovation. This additional nuance acknowledges that Cowen is right in how new fields are able to be consumed in different manners. Moreover, the Cost Disease can be used to determine why the number of musical performances does not increase as much as output for other activities (Preston 2009, p.244).

IV. Public Subsidies for the Nonprofit Arts

Public Subsidy for the Arts: Why? Theoretical Arguments

It will be rather challenging to apply the framework to the public subsidy arguments because this section will focus primarily on the theoretical arguments behind why the government should subsidize the arts. The literature discusses many different arguments, but many do not include empirical data backing it.

In the “Foundation” stage, it starts with Baumol’s Cost Disease because, as discussed earlier, it leads to some valuable predictions regarding future subsidy of the arts. The field evolved from there because there are many arguments in support of the arts. One of the big discussions is whether or not the arts are a merit good. If the arts can be qualified as a merit good, then there is a logical reason for the government to support the arts financially. The standard definition of a merit good is: goods which some people believe should be available and whose consumption and allocation are thought to be too important to be left to the private market (Cwi, 1980, p.39). The problem is that the merit good argument is relatively subjective because it is not per say an economic argument. It is a strong value judgement that will depend on a person’s view and level of advocacy of the arts. The value judgement conflict is exactly why it’s difficult to justify this argument as support for public subsidies in the arts. Furthermore, there will always be people that will believe that the arts should be subsidized and believe that the arts should be subsidized more than it already is.

In addition to the merit good argument, authors often discuss the question of whether there is market failure in the arts, which would be another good claim for public subsidy. Unfortunately, there are not many great arguments for market failure proposed in the literature except for one. The best argument for market failure is that the poor cannot afford the arts, so there could be a strong equity argument for the arts. Moreover, this equity argument would raise another issue for the policy discussion because the

equity argument can also be applied to many other fields. In addition, it begs the question of how many people want to use the arts that cannot afford it. Also, how much subsidy would be necessary to incentivize people to consume the arts? In addition, it would open the comparison even further to other goods because what would make the arts so special that the government should subsidize them based on the grounds of equity. The only solution to this problem, that stems from welfare economics, would also be to subsidize the consumer rather than the producer. That would come in the form of vouchers, which has its own extensive literature that will be explored later on in the paper. It is an interesting subsidy dilemma because it leads to many other questions as well, such as who would control them, effectiveness, and how would this be applied. The other problem is that vouchers would only be a short-term equity solution because in the long run you still have to modify people's tastes in order for them to consume more of the arts. The long-term solution is much more difficult because modifying people's tastes are challenging, and it would require there to be more sampling of the arts. These samples would allow people to gain a deeper understanding and desire for the arts which would increase demand in the long run (or at least increase the consumption from people of lower incomes).

There are four externalities that are lauded as benefits the arts can bring to wider society. The first is that they help improve national and local identity or pride. It allows people to be proud of where they are from and what is going on in their community. In addition, there are economic benefits to the community. For example, the audiences that the arts organization brings in bring profits to local business. The arts serve as a tool for educating children, and that allows them to critique culture and educate other people as well. Lastly, art forms are interdependent, so they help each other create new innovative pieces.

Another argument is that the arts must be preserved to help the future generations. Unfortunately, this argument is relatively invalid because of the advent of modern technology the digital preservation of the arts has become much easier, especially in music, dance, and theater. It is an okay argument for visual art, but with digitalization it is quite easy to maintain the existence of these art forms. Furthermore, the skills required to produce the art work is passed down from person to person and that allows the form to be maintained from generation to generation. In addition, the creative nature of the arts truly means it is not like a natural resource because as long as humans have creativity and imagination the arts will be around. That means that the arts will never truly die and will not run out like natural resources.

In addition, other papers question one of the fundamental assumptions of the public subsidy argument. We often assume in the arts that they are being under consumed, but what if they are in fact being consumed at their optimal level? The assumption that the arts was unrealistic in the 1980s because at that time the consumption of the arts had grown drastically, and it did not hold any merit. The literature began to evolve in the "Reevaluation" phase and acknowledged that the past arguments were not valid enough to warrant subsidies in the arts. Another theory to support the arts is that the arts are incredibly

difficult to exclude. In the sense that consumers are able to engage with the arts for free and cannot be kept from it. This is also due to mass consumption and mass reproduction of the arts. In addition, it is hard to keep secrets in the arts because other artists (producers) draw inspiration from each other. In addition, in visual art you can simply copy what the other artist did with acute observation. That means that one of the main reasons why the arts should be subsidized is due to their market structure. (Abbing 1997; Peacock 1991; Fullerton 1990)

Public Subsidy in the Arts: How Much?

Thorsby and Whithers delve into the public support for the arts in their 1985 article *What Price Culture*. In this article, they deep dive into the results of their survey of the arts in Australia. The survey tried to target people in the community that are required to contribute to the arts through taxation. The 1982 survey was a large, randomly selected sample of people over 17 years old. They restricted the survey to Sydney, Australia because of cost. This article is written for people that may not have an extensive economic knowledge, so they focused on the results and their policy implications. Additionally, they left out their econometric analysis and other mathematical formulas because it is highlighted in another paper. From their results, they looked to explain the role and nature of the arts in Australia. The paper does this by focusing on two specific areas, the community involvement in the arts and the willingness to subsidize the arts.

Many people assume that there is little interest in the arts because many people view it as a high class good. Unfortunately, this view was proven wrong thanks to Thorsby and Whithers' study. They find that 4 out of 5 respondents are interested in at least one kind of art whether it be theater, visual art, classical music, crafts, ballet, or opera. The key part about these results is that this is for people that are interested, so it does not necessarily mean that they participate frequently in the arts. The results are positive because it shows that people still have a broad interest in the arts as a whole. Over half of the respondents claimed to have been to some type of arts performance within the last twelve months, which also a high positive percentage for attendance in the arts. That stats clearly show that the arts are not a "high class" activity or a luxury good because people believe in it and attend it. Lastly, they look at active involvement in the arts. This is for the people that frequently participate in some form of the arts whether it be acting, making crafts, or performing music. They found over a quarter of the population are actively involved in some form of the arts. This number can be considered higher than most people would expect because it would mean that the arts are not as elitist as people would think even when it comes to the people that actively participate.

In the second section they highlight the willingness to subsidize and they find that people acknowledge the importance of the arts to wider culture. A majority of people perceive there to be public benefits from the arts and that those benefits are not solely seen by the rich and wealthy. The community

also recognize the arts' role in helping people understand culture and the wider world as a whole. They believed that the arts can help people evaluate society and help add to a successful democracy. Throsby and Whithers also find that, "the average willingness to pay exceeds current levels of government support in Australia" (Throsby p.18, 1985). The willingness to pay in 1982 is \$20 per person, but the range of their data is anywhere from \$15 to \$200 per person. These are good numbers considering it would be a substantial subsidy for the arts if it were actually employed. Despite their willingness to pay being higher, not everyone supports it. Furthermore, they find that just under three quarters of the respondents favored an increase in governmental support for the arts. The respondents were willing to finance the increase in support by reducing social security spending and defense spending. This is a surprising finding considering the current arts climate. It is interesting to see how this survey would change in 2019 and how it would be different in the United States. These results could be incredibly different, and it would be interesting to see if people still believe in the arts like they once did, especially with the expansion of STEM initiatives. From a cultural perspective, it's not clear that people from the United States would be willing to sacrifice defense spending, especially considering our current political climate. There are many frequent budget disputes during the current administration, and it would appear that it would be hard to pass any legislation even if it is confirmed that people want it.

In further expansion upon their earlier paper, Throsby and Whithers measure the intensity of different forms of bias and free riders to test if their past results can be considered reliable due to human behavior. In total, they find that there is a strong free rider problem in these types of surveys, which makes it incredibly difficult to study willingness to pay. The finding that free rider behavior is random with respect to observable socio-demographic characteristics. That means that many people tend to answer the survey questions differently because they actively want to benefit from other's money. In addition, it does not matter sex, age, birthplace, education, or occupation, people will still free ride. It is interesting that there is no determinant for race or ethnicity, and that is an area that could have led to more meaningful results. In addition, they find that all of the other forms of bias including social choice and information bias are all significant. Since the presence of these multitude of problems they have to correct their estimates for true willingness to pay. Which they find, after correction, to be \$74, which is within the range they gave in their last paper as well.

Morrison and West test the willingness to pay in a similar style survey for Canada. They have a cross section sample with 463 telephone interviews. In the survey, they inform respondents of how much of their taxes goes towards the arts, \$3.35. The results are quite mixed because 39 respondents say it's too little, while 49 believe it's just right. Despite this fact, a majority of the respondents were willing to pay between \$6-\$9 per annum. Of course, this is an interesting argument that further shows how difficult it truly is to decide on how much the arts should be subsidized.

One of the major findings from these early papers is that many find a number on what the willingness to pay could be but cannot be certain because of the survey methods. Also, they find that many results are incredibly mixed because the surveys often show that not every single person within the survey cares about the arts. Many in fact find that the level to which they are supported is more than enough. Moreover, Morrison and West find that their respondents do not perceive many external benefits from the arts. This argument to be quite suitable to compare to the U.S. because it much closer to the U.S. in geographical distance and similar in demographic characteristics. The hard part is that the countries are different politically. Furthermore, with the history of the arts in the U.S. much stronger empirical evidence is needed to convince politicians to increase subsidies for the arts. We will see what the later 2000s papers have to say about the argument.

The “Reevaluation” stage in this subfield is an interesting because David Throsby offers a unique critique to the methods he used in previous papers. In his 2003 piece, he critiques the validity of using contingent valuation methods (CVM), which is how he assessed willingness to pay (WTP) in previous papers. In this paper, he explains what CVM measures, but also what it leaves out. He explains that CVM is only effective when people have proper information regarding the good being assessed. Since we have established multiple times, both in the field and in this paper, that it takes acquired tastes to appreciate the arts it would mean that not all people have full information with regard to the arts. This is especially prevalent because it is not as if we are asking people about national defense or a good which everyone is more familiar with it. Another limitation of the CVM technique is that in the past he used it to ask consumers their WTP, and as consumers it is hard to quantify how much we are willing to pay because we do not know how to represent the value of the good in monetary terms. Since cultural goods are not tradable, it makes it hard to quantify in monetary terms. Those that do have experience in the arts would be able to give a ball park estimate of how much a ticket or event is worth, so it is difficult to agree with this thought process. If this was being used to assess a random pleasure or exchange it would be much more difficult to monetarily quantify that experience. In addition, Throsby explains that it would be challenging to quantify the value of a good that is experienced by a group, such as the worth of Mozart’s music.

The second aspect to Throsby’s paper that is enlightening is the idea of cultural goods having two types of value: an economic value and a cultural value. The cultural value can be, “their aesthetic properties, their spiritual significance, their role as purveyors of symbolic meaning, their historic importance, their significance in influencing artistic trends, their authenticity, their integrity, their uniqueness” (Throsby 2003, p.280). As depicted in the quote, these are all aspects that are not quantifiable and are different from the economic value of a cultural good such as a painting or play. Since these are two different values, Throsby claims CVM studies will always undervalue cultural goods because this

type of analysis can only capture the economic value through the WTP. Furthermore, we have to go beyond the number crunching and find a way that can assess the true value of cultural goods and how we can best help everyone receive that full value. The question is will we be able to improve CVM, or will we need to invent a new type of analysis?

It was very difficult to find a paper that represents the “Backlash” stage, but this paper by David Forrest uses a different type of analysis to assess the levels of subsidies for small repertory theaters. Forrest 2000 does a study on small theaters in the U.K. He finds the current level of subsidies to be satisfactory because small repertory theaters cannot capture consumer surplus via price discrimination. This is not a direct rebuke of the previous literature, but it is a small analysis using a robust regression analysis in a small area of the arts. The result cannot be used as justification for maintaining subsidies across the arts, but it can be a stepping stone for other researchers to use regressions to analyze the validity of subsidies, rather than trying to assess willingness to pay.

Public Subsidy for the Arts: How? Means to Achieve the Ends?

Professor West argues heavily for the use of a voucher system in order to subsidize the less well-off consumer. It is an interesting argument because it goes against the grain in the means to an end argument. Many people solely focus on supply side measures, such as different methods of subsidizing the suppliers (producers) of the arts. In this newspaper article, he brings up the great point that the primary beneficiaries of the current arts subsidies are the well-educated well-off consumer. He asks, why not subsidize the less well-off consumer, and put the power in their hands?

He quickly admits that the main reason why this idea of subsidy is often fought is because of bureaucracy. Many of the people in charge of arts organizations will quickly become hostile and upset because they enjoy having the power in their hands and being able to receive their grants as usual. West argues that the government can use this program to focus on the daily non-user of the arts, who is typically from a lower income household or still in school (West 1986, p.9). This idea would be good because it would help bring in more users that do not often engage in the arts. It would be a strong way to help fix long term tastes, and thus fix the taste formation problem with the demand for the arts. Furthermore, it would also help maintain a balance of benefits so that middle-and lower-class individuals can also gain the benefits of the arts. This would only be useful if politicians view the purpose of subsidies as to help with income inequality. This of course would only be a useful argument if it had ever been applied.

West educates the reader on the British voucher experiment that started in September of 1968. They kept the program running for 13 years and then mysteriously shut it down. The best part is that by 1979 the ticket scheme was associated with 125,000 admissions per year. In addition, the costs to administer the plan was 840 pounds for printing, 720 pounds for postage, and some secretarial time. This

is not expensive for such a program. Northern Arts, the Arts Council subsidiary running the program, did a survey between April and November of 1979-1980 to try and find out the usefulness of the vouchers. Participating organizations were upset because it was an inappropriate time to survey ticket usage since the organization was closed. Therefore, there was no use for the vouchers. In addition, a couple of theaters saw increase in usage among young people and claim that they work, but that did not stop Northern Arts from shutting down the program. West points out it is hard not to conclude that the program was shut down because of public arts bureaucracy that was acting in its own interest that prefers policies that subsidize the producers rather than the consumers of the arts (West, 1986, p.10).

Similarly to Britain, there was a voucher experiment started in New York in 1972 by the Theatre Development Fund (TDF). William Baumol completed a survey of the coupon audience in 1974, and found that the scheme was quite successful, especially in bringing in new audiences from different ethnic groups. African-Americans and Hispanics were the two ethnicities that benefitted from the vouchers. In addition, his survey showed that 9% of the coupon users were over the age of 60, which compared to 5% of normal theater audiences. Overall, it showed that it was great for getting diversified audiences within the theater. "By the end of its first season coupons had brought income to over 80 'off-off-Broadway' groups. In the next Season it had reached 127 groups (West 1986, p.11). These are nice numbers because they show that the effects are helping smaller theater organizations and growing in its effects. These are all positive signs for theater within the U.S. It also allows for these smaller theaters to survive and grow rather than relying solely on the bigger Broadway theaters.

The only problem with this argument is this type of service would not work with all views of the arts. If people believe that consumers do not know what is truly good for them, then the voucher system would not be effective. In terms of the "merit good" argument, it would be effective because it would allow consumers to go to the organizations that they value, and it would mean that unpopular organizations simply wouldn't be used. That means the ones that people do not like would go out of business. The U.S. program spread from New York, Buffalo, and Chicago, so it would be interesting to see where it is now.

In a counter-critic, William Grampp points out that the arts should not be subsidized at all. This is because of the vast debate cited from the why section that it depends on your evidence. West cites it being a merit good and because of positive externalities argument, which was discussed as not being strong arguments. Furthermore, West cited a source that yielded mixed results. There were many positive aspects to the program, but the most popular theaters that specialized in classics are the ones that received most of the vouchers.

In addition, Grampp goes further to say why would you solely give the vouchers to the poor? Why not subsidize everyone if the good is indeed a merit good? The assumption of a merit good is that

everyone is under consuming the good, so why not subsidize everyone not just the poor. Also, the poor would probably prefer to receive something much more beneficial to them than tickets to a culture event. That means they are more likely to sell the vouchers to gain their true desire, money. If that is indeed the case, why not just give the poor money? This argument is backed by the fact that other studies have shown that not everyone is into the arts, so it does not make sense to give out vouchers when some people would not spend money on the arts even if they were free.

Grampp points out that when you look at the averages of the Baumol survey that not much changed, which is not an encouraging sign for the usefulness of the vouchers. Moreover, the increase in older people were not new consumers of the arts. They were simply older people whose retirement income no longer allowed for them to attend the theater like they used to. In addition, there had to be a special rule implemented just to allow Blacks and Hispanics to enjoy the use of the program. He concludes by saying that as long as the arts are private, the people that want it should be the ones to pay for it (Grampp (1986/7)).

Ruth Towse enhances the literature by pointing out that the various arguments for why the arts should be subsidized, as each require a different type of subsidy. This is because all the reasons have different restrictions, so the method of subsidy would have to be different in order to have the desired impact. She claims that the word subsidy does not matter because it can take many different forms such as: a lump sum payments through a grant, an exclusion from taxation for companies or donors, or it could be incremental payments. According to Towse, the national prestige argument means that subsidies can only go to large firms that help enhance the nation and culture as a whole. These types of subsidies would be detrimental for the smaller firms in the arts because it would discourage them from doing daring and creative production. It would encourage art that is all similar or the classics, and it will cause many financial troubles for the smaller organizations. The risk and uncertainty argument would imply that subsidies should only go to smaller firms to help build audience attendance to help the future generations. In order to monitor this objective, the government would need exact stat tracking to ensure that these relevant goals are being met.

Many people believe that the subsidies should indeed be used to increase access, but Towse finds the same as many others in the past. The subsidies often increase attendance among the more well off, and people are not bothered by increased prices. That means that the real conflict is the goal of the means. Should it be efficiency or equity? In the end, it is hard to determine what the focus should be on. Economics is good at telling policy makers why or how to subsidize the arts, but how much is a different task. It is hard to give a definitive answer because we have only asked consumers their willingness to pay and their willingness to increase taxes. Moreover, there will never be enough funding for the arts because demand will always be higher than the supply. This is because supply seems to be creating demand. That

means that further empirical research will need to be done in order to help figure out how many people want the arts. In addition, we need to know how people would be willing to pay for the arts and if it should be done at all. Assuming that we should, we will next examine how the current set up for public funding affects arts organization through the examining of the crowding effects. (Towse 1994)

V. Crowding Effects

The effects of crowding are a debate that has long been argued since the inception of economics. Another name for the argument is whether government funding and private donation are complements or substitutes. In the nonprofit realm it is just called crowding in or crowding out. The public economics literature began in the 60's and 70's. The more relevant theories stemmed from neoclassical economics. In the "Foundation" stage of the crowding argument, everyone fully believed that there was what some would call, "complete crowding." This is based off of the, "pure altruism." The fundamental assumption in this model is that private charity is motivated by altruism. This altruism would lead to dollar-for-dollar crowding of private charity by public transfers. In these earlier arguments, they also focus on charity as a whole and have not yet focused in on any specific types of nonprofits, thus the models created are based on the aggregates. The paper also uses microeconomic modeling to theoretically prove the model and look at aggregate data from various sources to prove their point. Based on the government's actions creation of more initiatives to help the poor in the 1930s, they saw that many nonprofits and altruists payed less attention to the poor causes. Roberts specifically claims, "As government takes over this task our compassion turns to imperfect substitutes: counseling services, alleviating the diseases that afflict children, and helping the less fortunate of other nations" (Roberts 1984 p. 146). It naturally makes sense that nonprofits would shift their attentions to other causes because they cannot provide the help that government agencies can. That is strictly because of funding alone, and in a world with limited resources, most nonprofits are better off using their resources for a cause that is not being served.

It is interesting to discuss the maturation stage, because in the crowding argument many of the advancements are not in chronological order. In addition, the original discovery during the "Foundation" stage acknowledges the fact that there is a possibility of a spectrum. In James Andreoni's 1990 paper, he actively questions the validity of the pure altruism model. He advocates for the idea that some people give because of the prestige, respect, and "warm glow" gained from giving. The impure altruism model changes the simplifying assumptions of the previous model. As Andreoni says, "Impure altruism, however, assumes that people are not indifferent between these alternatives: all else equal, they prefer the bundle with the most warm glow" (Andreoni 1990 p.468). This varies from the original assumption of the previous model because previously people were assumed to be indifferent of whether the dollar goes to the poor via their hands or from their pocket through taxes. This paper still fails to use econometric

methods to prove its point. It uses heavy theoretical calculus to prove their point via estimating the relative income and price elasticities. They do find that the impure altruism model leads to results that are drastically different from the previous model. They also lead to more intuitively logical results, such as partial crowding effects rather than a dollar for dollar crowding. When you consider the logic behind it, dollar-for-dollar crowding wouldn't make sense because in the real world there are organizations that have respectable levels of both public and private donation. As is textbook for the "Maturation" stage, it expands upon the original theory, and modifies the assumptions to allow for further discovery.

One of the papers that bridges the "Foundation" and "Maturation" stage, that is also highly cited, tries to find out if the dollar-for-dollar crowding is applicable on a specific type of nonprofit rather than looking at aggregate measures. In the paper Kingma focuses on public radio because it receives federal funds, state funds, and private funding, so it allowed him to look at varying effects at different levels. He uses a cross-sectional data set with 63 different radio stations and 3,541 individual observations. His initial summary statistics lead to the discovery that contributors to public radio, on average, have higher incomes and are better educated. From his Tobit model he finds:

That a \$10,000 increase in government funds for public radio results in a \$0.15 decrease in an agent's contribution. Given that the average public radio station has 9,000 members, this implies a total crowd out of \$1,350, or an \$8,650 net increase in funding. Since this level of crowd-out is significantly less than dollar for dollar, the pure public good model of charity is not appropriate in this case (Kingma 1989, p. 1203).

This is one of the most interesting findings of this paper, because Kingma proves that the impure altruist model is more accurate. It empirically negates the idea of the dollar-for-dollar crowd out. Furthermore, he hints at the argument that the overall effects of crowding out may be negligible, so does it really matter? Unfortunately, he does not delve further into this implication in the paper but is something that will be discussed in the policy implication section.

Payne chooses to focus her research on the crowding effects of shelters, human services, crime, and other types of nonprofits. She takes a varied approach to Kingma and looks at IRS tax return data from 1982-1992. She creates an unbalanced panel with nonprofits that have at least four years of IRS tax returns. Payne expects there to be altruistic behavior because of the firms that she chose. She finds via a two staged least squares that the crowding out exists, but the effects are only partial. Additionally, she finds that donors from more liberal states are more likely will donate unlike donors in states with conservative sentiment. It is an interesting finding to consider because this could have some large policy implications, because she only measured this based on the state's governor. It would be interesting to expand upon this argument via looking at the current president. Also possibly consider including a variable for political affiliation and see if there is a direct correlation to the amount that they donate. It opens to door for political economists to include other areas of institutional economics regarding political

cycles as well. This is a potential area of expansion within the field because not many other papers comment on the effect that political cycles or political affiliation has on private donation.

The next stage (Reevaluation) flips the argument on its head, literally and figuratively. Brooks tries to be the first paper to finally explore the possibility that you can experience both crowding out and crowding in. He elaborates that you cannot have the goal of increasing both private and public donation, because they are competing goals, and it can lead to a “subsidy trap.” As the first paper to claim that crowding and leveraging are not mutually exclusive, it requires him to use a different model to test the effects. Brooks is the first to imply that the curve for crowding effects could be hyperbolic and concave down. That indicates that you could experience crowding in of private giving from public subsidies upwards to a maximum point. After that maximum has been surpassed, you will begin to experience crowding out. Unfortunately, the maximum point for total revenues is at a different point than the maximum for private revenues. That follows the economic logic because total revenues would be comprised of both public and private donation, and there is a point to maximize total revenues with a little bit of public funding. These relationships are depicted in Graph 1.

The data used to test his hypothesis came from 253 American symphony orchestras. The final data set had 40 observations for eight different years and is regressed using generalized least squares (GLS). Brooks finds, “According to this model, the average group 3 orchestra will, *ceteris paribus*, tend to experience a leveraging effect up to about \$8,200 in government support per concert; after this point, private support will begin to be crowded out” (Brooks 2000, p.458). He finds that one of his groups (the middle group with budgets between \$1.8M-\$5M) of orchestras can leverage up to \$8,200 in government support per concert before crowding out occurs (which is much higher than I anticipated). It again raises the question of how relevant is crowding out if it takes that long for it to begin. Another policy implication on top of the fact that it is indeed a parabolic function. Furthermore, he finds that the crowding effect is different for different groups, so that means that the crowding argument will affect different sized nonprofits in various ways. Most of them experience crowding in, but one group does experience crowding out. The group that experienced crowding in was the largest level of nonprofits, and it appears that, due to their size, they do not benefit from increased public donation. This would fit the prestige argument because too much public donation for them would indicate bad financial health, thus decreasing their public donation. It is unfortunate that Brooks does not discuss this further in his analysis, but it is clear that it is a large implication for artistic directors or development directors of large organizations. It would indicate that it would be in their best interest to focus primarily on private donation and maintaining their own financial health.

The third and other major finding from this paper and during this stage was problem that occurs depending on being long term or short term focused. The short-term effects have been discussed in the

previous section. In the long run, just as any other microeconomics concept, is comprised of all the maximums of the short run. The implication it has for manager is:

trouble with liquidity or a misunderstanding of the subsidy-donation tradeoff could lead to the consumption of a suboptimally high level of subsidies by some firms in the long run, which in turn could trap them at levels of total unearned revenues below the maximum. Thus, the inability or unwillingness to forego a relatively small amount of public funds in the current period (in order to stimulate even more in private donations) could represent a significant long-term sacrifice (Brooks 2000 p. 462)

This is an unfortunate situation that managers could find themselves in. It would mean that some companies would have to risk taking on fewer public funds and risk possibly running a short-term deficit to try and recover long term profits. That is a difficult idea to propose to board members. Despite it being a nonprofit, it would still be a hard sell.

The challenge in defining the Backlash Stage in the Crowding effects argument is that when you explore the modern literature, there is no backlash. You actively find that Brook's parabolic suggestion is widely accepted, for it follows strong economic logic. The rest of the field has expanded from there to branch off in various directions. Rather than try to go through every single detail of every paper or go into one specifically, this section will give a broad overview as to where the field has gone since Brook's discovery and some of the key data and implications.

There have been multiple studies that have evolved and used Brook's methodology to confirm his research and the effects of crowding in until large sums appear. One of the most interesting branches has been the analysis of the National Endowment of the Arts' (NEA) specific effect on the crowding argument. Smith 2003 finds that the NEA provides leveraging effects for dance organization. Finally confirming the thought that a NEA grants acts as a prestigious item and helps to bring in more donations. He also highlights the need for these dance companies to continue to evolve their program service revenue because it has the opportunity to lead to more donations as well. This would also imply that the government should continue to fund the NEA, because their funds are important for some arts organizations across the US. Unfortunately, that has not been the case; the US has slowly been decreasing funding to the NEA. In Dokko 2009 she analyzes the effects of the cut in NEA funding on nonprofit arts organizations. She finds that private donations increased about 60 cents for every dollar reduction in NEA funding, which gives us another reason to wonder what the true effects are. It implies that research is never over, because the effects could be different depending on the art discipline chosen. Moreover, it provides to rationalize the governmental decision to cut funding for the arts. The paper also indicates that both fundraising staff and the private sector pick up the slack in order to take care of these arts organizations. To further complicate the expansion, there is a paper that finally breaks down the effects that state, local, and federal funding has while also accounting for individual, corporations, trustees, and

foundations on the private side. They find that organization characteristics matter when nonprofits are trying to attract more charitable revenue. Since the paper entails a more complete model, it means the crowding effects of the various areas are small; moreover, it tells arts managers not to focus on one single revenue stream. They encourage diversified revenue streams, similar to corporate businesses. This was one of the first studies of its kind, so the results will be questioned and contested as the field continues to grow (Krawczyk et. al 2017). The only thing that can be said definitively is that this discussion will continue evolve for decades.

VI. Results

The analytical framework is supposed to function as a strong analysis framework for assessing the age and maturity of the economic theories driving public policy. It is similar to the industry or product life cycle in business which tells us where the future of the field is going, and if there is still room for the company to grow. This framework is supposed to help assess the growth potential of this subsection of Cultural Economics. Furthermore, it would allow me to come up with where the literature is lacking and how it could be improved upon.

The framework requires you to pay close attention to the arguments being made in every single article read, because you have to figure out where specific articles belong in the life cycle. It is effective because it allows you to categorize articles much more easily and pair authors together on which sides of the arguments they take. In addition, it helps create a mental timeline of how the arguments have progressed throughout the years. The framework is helpful in organizing the history and the progression of economic thought, but it does not add any knowledge to the issue. It allows for a more linear progression in the argument. The idea of the framework is linear in its progression, and that linear nature is not overly compatible with the nature of research. Throughout many of the sections I have found that research and economic thought is not linear in terms of the chronological order. A major assumption was that papers in chronological order would follow the model of the framework. Unfortunately, just because papers followed each other in chronological order, it does not mean that they follow each other in the progression of economic thought. After the field had progressed to the third phase, a new paper that is 10 or 20 years after the seminal piece brings it right back to the first phase. It makes it complicated to put it in the framework. In addition, because years are such a major factor, it makes it hard to assess the boundaries of every single phase because papers from across decades discuss various economic concepts. As has been pointed out that economics does not always follow a perfectly linear process.

In addition, the application of this framework is rather arbitrary. The definition of every single phase is arbitrary and can always be up to interpretation. This limitation becomes especially apparent when trying to define the “Backlash” stage. It raises the question of can a field be in backlash for more

than 10 years? If the field started in the 1970s, but you have backlash starting in the 2000s, it does not quite make sense that the field has had 19 years of backlash. At times it also felt that due to the definitions of the stages it requires you to fit papers to definition that they do not necessarily fit. From a theoretical perspective how do we truly know where an economic concept is when we do not know what we do not know? Because I am assessing the progress of thought it will be incredibly subjective and can always be argued due to the lack of empirical evidence to back it up.

Overall, the framework is not useful in assessing these very specific subfields that are more theoretical in nature. I have not found many other frameworks that have been used to analyze the progress of economic thought. It seems that most people prefer to just do survey papers in a standard format that covers the sections they are interested in. This analytical framework adds a level of complication for writing a survey paper that most authors would not want to embark upon. Moreover, you can still gain the same knowledge without this framework in place. It would follow the structure of an extra-long literature review.

VII. Implications

As alluded to throughout the paper this the various topics address many possible implications whether it be for managers of nonprofits or public policy. Due to the contested nature of the literature, the biggest implication is for nonprofit arts managers. This comes from a paper that could not be put within the framework because it was a perfect example of how not all papers can fit in to the framework. Brooks 1999 finds, “a 10% increase in advertising and promotion expenditures was associated with 19.4% increase in private donations and a 26.2% increase in public subsidies” (Brooks 1999, p.40). This paper did not fit into the lifecycle per say because it did not find any crowding effects after the Kingma paper. However, they found that focusing on advertising could increase all types of donation. This is such an interesting finding, because few nonprofits will spend money on advertising. Most nonprofits try to cur most operational expenses that they view as unnecessary. This clearly shows a gap in the operation of nonprofits that could be increasing their funding overall. The other problem would be that executive directors would also have to convince the board that this will be a worthwhile expense that will help the organization. It would be well worth it for nonprofits to try this focus because the results could be fruitful. Furthermore, nonprofit arts organizations should clearly focus on diversified streams of revenue as indicated in the Crowding Effects section, because that is the only true way to survive. That is especially important because this implies that nonprofits can try to be run more like for profit corporations because at the moment they are not. From a management perspective they should not be run differently, so it will cause mangers to reassess how they are financing their organization.

VIII. Conclusion

For the field of economics as indicated in Appendix A (a table with the framework application for every section) the field needs more continued data in the public subsidy discussion no matter what question you are answering. As indicated by the framework, it was challenging to find articles that truly fit into the backlash stage, so I cannot say that the field of cultural economics is mature enough to answer the key public policy questions. The major area for future research is furthering the discussion on why we should subsidize the arts. Once that question is answered, we can effectively answer how much to subsidize the arts, and what means we should use to do that. As it stands right now, economists can tell you reasons why the government should subsidize the arts, but they will also conflict each other and say why that's a terrible reason. In addition, we can give you estimates on how much subsidies can be used, but we cannot tell you that they are incredibly accurate. Lastly, we cannot even agree on how they should be subsidized because we have not answered the first two questions. One of the greatest things I have learned throughout all my economics classes is that there is one answer that you can always use in class and never be wrong, and it applies here too. In the case of policy implications for the nonprofit arts organizations, it depends.

Appendix A: Graphs and Tables

Table 1: Explanation of Framework

Foundation	<ul style="list-style-type: none">• Sets the groundwork for future research• It is key that the fundamental framework is limited, but compelling so that it can be expanded upon
Maturation	<ul style="list-style-type: none">• Goes beyond previously stated limitations in order to expand upon the theory in the Foundation Stage• Utilizes tools from other areas of Economics and applies it to Cultural Economics• Also uses rigorous analytical frameworks to assess the efficacy of the original theories
Reevaluation	<ul style="list-style-type: none">• Theories from previous stages are known, and skeptics continually question assumptions, empirical findings, and applications• Poses Questions for original theorists to answer
Backlash	<ul style="list-style-type: none">• Proponents of the foundation or maturation stages will answer the questions presented in the previous stage• Questions whether the added sophistication further advances the field and makes the model realistic for society

Table 2: Framework Application – Baumol’s Cost Disease

Foundation	<ul style="list-style-type: none"> • Basic Theory Summary: the costs of live performance continues to rise due to lack of technological labor innovation • Theorized that the cost disease could not be experienced by radio, film, and mass media
Maturation	<ul style="list-style-type: none"> • Discovery that film experiences the cost disease as well • Uses basic industry data to emphasize this point
Reevaluation	<ul style="list-style-type: none"> • Adds nuance by using a different unit of measurement • Questions Baumol's original assumptions and makes valid points that there needs to be room for product and process innovation
Backlash	<ul style="list-style-type: none"> • Authors acknowledge Cowen's point and include additional nuances to account for the critique • Further uses of the Cost Disease, outside of solely the arts, maintains the validity of the argument

Table 3: Framework Application – Why Public Subsidies?

Foundation	<ul style="list-style-type: none"> • Baumol's Cost Disease • Basic supporting arguments such as: Merit Goods, Market Failure, and Mixed Goods
Maturation	<ul style="list-style-type: none"> • Subsequent papers expand upon the possible Arguments: Externalities, Future Generations, Mass Consumption, and Mass Production
Reevaluation	<ul style="list-style-type: none"> • They find that the past arguments are not valid enough to warrant subsidies
Backlash	<ul style="list-style-type: none"> • N/A

Table 4: Framework Application – How Much?

Foundation	<ul style="list-style-type: none"> • Throsby and Whithers come up with a robust estimate of willingness to pay for the arts based off their survey in Australia
Maturation	<ul style="list-style-type: none"> • Expansion of studies into different countries • Discovery of innefecient survey methods, causing corrected estimates
Reevaluation	<ul style="list-style-type: none"> • The effectiveness of the methodology is questioned due to developments in economic thought
Backlash	<ul style="list-style-type: none"> • Consider other alternative to asking consumers their willingness to pay, such as using regression analysis to assess the validity of subsidies in the arts

Table 5: Framework Application – How? Means to an End

Foundation	<ul style="list-style-type: none"> • Simple subsidy in the form of lump sum payments or grants
Maturation	<ul style="list-style-type: none"> • Evolution of the voucher argument and considering the use of demand side economics
Reevaluation	<ul style="list-style-type: none"> • Adding nuance that the subsidy argument can truly take any form depending on the belived rationale
Backlash	<ul style="list-style-type: none"> • N/A

Table 6: Framework Application – Crowding Effects

Foundation

- Complete crowding where there was dollar for dollar crowding of private donation in the presence of public donation
- Does not use any Econometric Modeling

Maturation

- Expands from the pure altruist model to warm glow or partial crowding effects
- Econometric Models are finally used to prove partial crowding effects

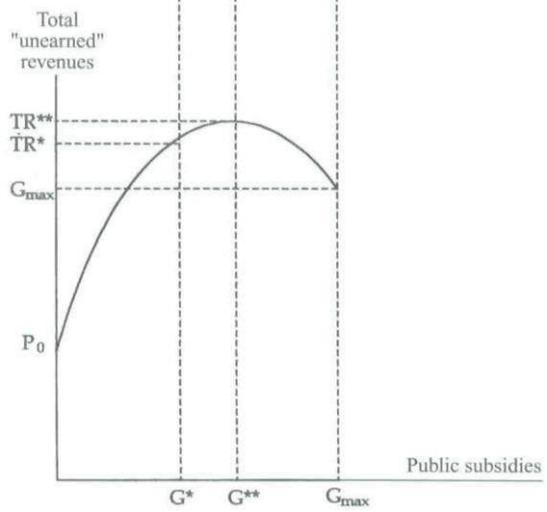
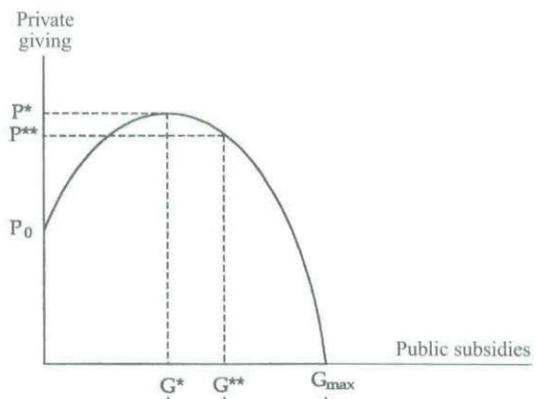
Reevaluation

- Crowding arguments adapts parabolic function for Crowding effects and finds that it is possible to experience both effects at once

Backlash

- Everything from the Reevaluation stage is widely accepted and confirmed as the prominent theory
- The debate evolves to examine these effects in further sub fields

Graph 1: Parabolic Relationship Between Public Subsidies and both Private Giving and Total Revenues



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