

Role of Government Panel: The Culture Industry

A. Abigail Payne\*

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\*Canada Research Chair in Public Economics, Associate Professor, Department of Economics, McMaster University, Hamilton, Ontario L8S 4M4, (905)525-9140, ext 23814; [paynea@mcmaster.ca](mailto:paynea@mcmaster.ca)

## Executive Summary

For many decades, economic growth has provided all Canadians with a greater means for the practice and enjoyment of the arts. While the foundations of Canada's cultural identity are with the traditions of native Canadians, the influx of immigrants from many countries has increased both the audience and the pool of available talent in the arts. Art helps us to interpret the world from a Canadian perspective and provide a forum for Canadian views. It is the diversity of Canada's heritage that makes Canadian culture unique.

This report focuses on the economic issues that justify provincial support of culture. We discuss the issues associated with defining "culture" as well as the issues with analyzing the culture industry. This report explores the various the economic justifications for government support. There are two justifications that most clearly support some type of government intervention in the provision of cultural goods. The first justification is that there are potential positive externalities associated with cultural goods. For example, cultural goods are included in the types of amenities that have been found to be positively correlated with the relocation of businesses and individuals, thereby promoting economic development. The second justification concerns the fact that some cultural goods share characteristics of a quasi-public good, especially with respect to having to incur substantial sunk costs which would not be recoverable in private market. Under this justification, the government can help provide the funding necessary to support these sunk costs.

This report provides an overview of the different types of support provided by the Ontario provincial government. It also discusses potential issues associated with providing direct and indirect support of culture.

There are five key recommendations made in this report. These are:

- (1) Require a stronger economic justification for government funding and other programs in support of culture.
- (2) Restructure funding programs and tax incentives to focus on specific types of cultural activities and/or processes involved in the production of culture.
- (3) Implement a more rigorous procedure in evaluating the merits of grant applications.
- (4) Explore which types of cultural activities promote individual and business relocation, especially for the relocations that promote economic development.
- (5) Evaluate the importance of promoting "Canadian culture" and/or multicultural activities.

In making these recommendations, it is important to note that little economic research has been conducted using data on the Ontario culture industry. As such, it is important to consider ways in which to create measures and to systematically evaluate the impact of government funding and other subsidies on this industry.

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## **I. Introduction**

For many decades, economic growth has provided all Canadians with a greater means for the practice and enjoyment of the arts. While the foundations of Canada's cultural identity are with the traditions of native Canadians, the influx of immigrants from many countries has increased both the audience and the pool of available talent in the arts. Art helps us to interpret the world from a Canadian perspective and provide a forum for Canadian views. It is the diversity of Canada's heritage that makes Canadian culture unique.

Ontario has been the birthplace and/or home of many artists. The list of internationally recognized artists with roots in Ontario include: Tom Thompson, Lawren Harris, Margaret Atwood, Robertson Davies, Michael Ondaatje, Glenn Gould, cGordon Lightfoot, Joni Mitchell, Neil Young, Don Mckeller, the Tragically Hip, and Bare Naked Ladies. These artists have not only helped to develop a Canadian culture, they have helped to promote an international reputation for Canada. Thus, within the greater context of promoting Canadian artists and culture, Ontario plays a vital role.

The culture industry covers many activities that are both government and privately provided. In 1996, a total of \$22.48 billion was spent on non- and for-profit cultural activities across Canada, representing approximately 3.1 percent of Canada's GDP. Total employment in the cultural sector was approximately 640,726, representing approximately 4.8 percent of total employment in Canada.<sup>1</sup>

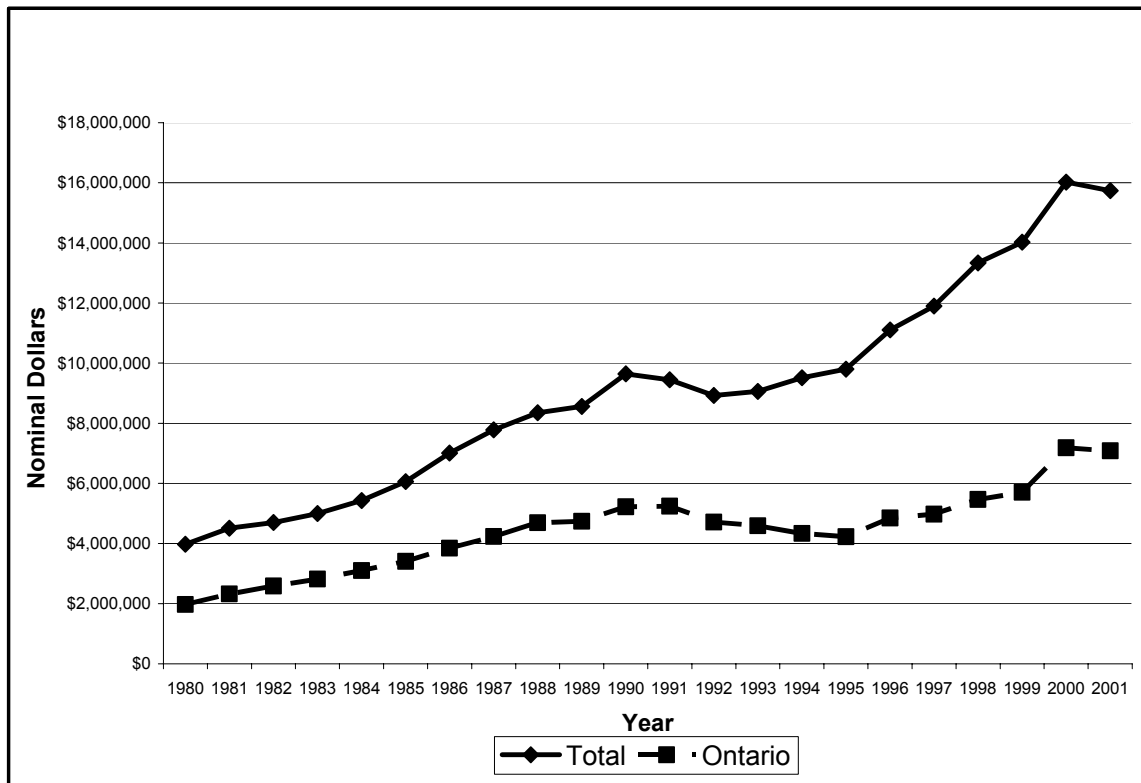
As measured by tourism dollars, more than \$190 million was spent in 2001 on tourism activities by all residents of and visitors to Ontario. The biggest share went to

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<sup>1</sup> In Ontario, statistics suggests that the non-profit culture sector contributes approximately \$1.8 billion annually, accounting for 87,000 jobs.

Toronto, 28%, with Ottawa, the Niagara region, and Peel region each getting between 8 and 9 percent of the total revenue. Figure 1 depicts the total nominal dollars spent on tourism, overall and by Ontarians, from 1980 to 2001. Ontario has seen a growth in tourism from non-residents since the late 1980s. By 2001, non-Ontario residents accounted for 55% of the total dollars spent on tourism. Approximately 32 percent of tourism is accounted from travel by Americans. Overseas visitors account for 15 percent of the revenues and Canadians from other provinces account for 8 percent of the revenues. Culture represents just one of many types of expenditures in the tourism industry. Figure 1, however, illustrates the potential importance of culture and tourism to Ontario

**Figure 1: Annual Tourism Expenditures**



Note: Figure one depicts total expenditures by all tourists and by Ontario residents for the period 1980 to 2001. Data were obtained from the Ontario Ministry of Tourism.

In most developed countries government support of culture is provided by federal, provincial, and municipal governments. Assistance comes in many forms: direct provision, government grants to organizations and individuals, tax credits or deductions, tax exemption, regulation, and advertisement and provision of information to the public. Depending on how one defines culture, government support of culture in Canada falls in the middle of all developed countries.

This report focuses on the economic issues that justify provincial support of culture. We will discuss the issues associated with defining “culture” as well as the issues with analyzing the culture industry. With this in mind, the report will then discuss three issues. First, we will identify the economic justifications for government support, discussing whether these justifications are supported by empirical evidence. Second, we will provide an overview of the different types of support provided by the Ontario provincial government. Third, we will discuss the issues associated with using these different types of support.

There are many issues that could be covered by this report. The starting point for this report is the recognition that supporting the promotion of Canadian culture is important. This report will focus on the types of economic issues that affect most directly the provincial support of culture. This report will not cover issues associated with the regulation of culture (e.g. copyright protection, trade protection), the labour market for artists, or the organizational structure of cultural organizations (e.g. not for profit or corporate status). In addition, the report will not discuss support and/or inducements

provided by federal or municipal governments or the relationship between the different layers of government support.<sup>2</sup>

## **II. Defining and Studying the Culture Industry**

How should one define culture? Historically, culture included only such things as performing arts, visual arts, and heritage. The definition of culture, however, could also include such things as photography, design, architecture, sport, and film. Less clear is how to treat the media (e.g. Television Ontario), festivals (e.g. Caribana, Gay Pride Week, Bloor West Village's Ukrainian Festival), botanical gardens, planetariums, historical sites (e.g. Fort York), and archeological sites. In determining what types of goods and services are included as culture, should the process involved in providing the goods or services matter? For example, creation, production, preservation, manufacturing, distribution, and consumption are several of the processes involved in the provision of culture. Given these processes differ from each other, the way we think about them can affect the degree to which government support is justified.

While the long-standing debate over how to define culture will not be resolved by this report, it is important to recognize that depending on how culture is defined, the economic concepts may apply differently. In some cases, a given concept is applicable to a particular type of cultural good (or process). Throughout this report, we will try to identify the differences in the concepts based on differences in the types of cultural goods and services.

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<sup>2</sup> DiMaggio (1991) suggests it is important for there to be federal, provincial, and municipal support of artists and organizations. The basis of the argument is that different layers of government can pool their risks associated with a government program given there are political environment under which federal and provincial governments operate differ. Given this difference in political environments, by pooling the risks across governments, the costs associated with making a wrong decision in providing government support are decreased.

Another issue that makes the analysis of culture complicated is the difficulty associated with collecting appropriate measures for a robust empirical analysis of the different justifications for government support. For example, some of the issues concern the effect of culture on promoting other industries such as tourism. Measuring the number of non-resident visitors to museums, non-resident attendance at performances, etc., is very difficult. While some proxies can be used such as hotel occupancy rates, such a proxy would exclude tourists who are visiting a particular destination for a day, or are staying with friends or relatives.

Even if it is possible to measure such things as ticket sales, measuring such things as consumption value is difficult (Seaman, 2003). While we can measure ticket sales, it is impossible to measure consumer surplus and other types of expenditures associated with consumption of the cultural good. It is also difficult to measure the long term effects of culture.

Also of interest is to understand how the exposure to culture affects such things as one's appreciation for culture and/or the benefits to society (e.g. educational attainment, civic participation). For example, does exposure to different societal cultures make one more tolerant of these cultures? On a related matter, to what extent does the promotion of Canadian culture help to sustain a unique identity for Canadian arts? Measuring exposure to culture as well identifying the impact of such an exposure is very difficult.

Throughout the report, we will discuss empirical studies that examine the effect of culture and the role played by the government in the provision of culture. It is important to remember, however, that these studies may not be as robust as studies of other industries. The placement of most of these studies in academic journals is one indicator

of their flaws. For the most part, these studies do not end up in the best academic journals.

In addition, some of the analyses discussed come from commissioned reports. Depending on the type of funding used to support these reports or the organization issuing the reports, the analyses may be biased. As such, it is important to be aware of that the analyses may not represent objective evaluations of a particular question.

### **III. Economic Justifications for Government Support**

Baumol (2003) provides a good categorization of the various economic justifications for government involvement in the provision of culture. There are five basic justifications that are outlined in Table 1. First, there is the argument that there are positive externalities associated with culture. Under standard economic theory, if an activity generates a benefit to more than just the consumer of the activity, the activity will be underprovided because the consumer is only willing to pay to the extent that she benefits from the activity. If culture provides a positive externality, the government can potentially increase the provision of culture, thereby allowing for society to reap the benefits of the positive externality.

Second, there is the argument that some cultural goods and services may be treated as a public good. A public good is a good that possesses several characteristics. First, more than one person can consume the same good (e.g. a park). Second, the additional cost (“marginal cost”) associated with providing the good to another person is zero. And, third, it is prohibitively expensive to exclude individuals from consuming the good. For cultural goods such as attending a performance, watching a movie, or visiting a museum, the first two characteristics are satisfied. For things such as a public statue or

sculpture, all three characteristics are satisfied. For these goods, while the marginal cost is zero, there is a substantial sunk cost to provide the good. Because pricing in a competitive market is based on marginal costs, not sunk costs, there is little incentive to provide the public good privately as the sunk costs would not be recovered by the private producer. Thus, there is the potential for government involvement with respect to cultural goods that satisfy the definition of a public good with respect to supporting these sunk costs.

Third, there is an argument that some cultural goods are “significantly worthy” goods. Tied into this argument is that some cultural goods require people to be exposed to them before they will acquire a taste for the good. Thus, demand for such goods does not exist until one acquires a taste for the good. The government may play a role under this argument to the extent that it can provide a vehicle by which to encourage exposure of cultural goods to consumers who are not likely to be exposed to such a good.

Fourth, there is an argument that some cultural goods are not accessible to all members of society if they are privately provided. As such, there is a question of whether the government can play a role in terms providing greater access to these goods to individuals that may not otherwise be able to afford them. This argument is particularly strong if combined with the third argument that for some goods, one must acquire a taste for the good.

Finally, there is an argument that some cultural goods should be treated as an “infant industry.” To the extent that some goods represent new art forms or there are new organizations, the government could be involved at the early stages to support the existence of these new art forms and/or organizations.

Table 1 provides a brief summary of these justifications for government support. Each of these arguments is discussed fully below. For each of the arguments, there may or may not be sufficient evidence to warrant government intervention through grants, subsidies, tax breaks and/or regulation. Moreover, for each argument the type of intervention as well as the type of goods that would justify intervention varies.

**Table 1: Summary of Economic Justifications**

Economic Justification	Sub-Category	Definition	Applications
Positive Externalities	Demand Side	Consumers only take into account the personal value of a good/service; failure to take into account the value to other consumers results in a demand for the good/service that is less than socially optimal	Participation in the production of a cultural good; observing a final good; preservation of historical buildings, communities; impact on future generations
	Supply Side	Producers do not take into account benefits in production that would allow for the production of more goods (or a better quality of good)	Artists exposed to other artists provides inspiration and facilitates higher quality goods (peer effects); economic development (e.g. tourism)
Public Good		A good/service can be enjoyed by many consumers; the marginal cost of providing the good is zero; it is very expensive to exclude others from using the good. If this latter qualification is not met, the good can be considered a quasi-public good.	Statues in Parks, Street Festivals, Theatrical Performances, Museums, Sporting Events, Television Broadcasting, Film Showings
Good is Significantly Worthy or Requires Exposure		A good/service provides some societal benefit that requires government support above and beyond the type of support that would be provided for other goods that do not provide the societal benefit; alternatively, to acquire a taste for a cultural good, one must first be exposed to the good/service	Finished cultural goods/services
Equality of Exposure		Private provision of goods/services results in only certain economic groups from enjoying the good	Finished cultural goods/services
Infant Industry		New types of cultural goods and/or new cultural organizations are highly susceptible to failure, suggesting that for the new cultural good (or organization) to survive, government support is needed	New forms of cultural goods/services and/or new organizations that support a process involved in the provision of cultural goods/services

a. **Positive Externalities**

A positive externality is one in which more than one consumer of a good or service benefits from the consumption of the good. In the standard supply and demand model, consumer's demand is based on individual preferences and the individual's budget constraint. Given this, the demand curve maps for each price the maximum amount consumers are willing to buy given their individual preferences. If individuals took into account the additional value associated with other consumers benefiting from their purchase of the good, the demand curve, at any given price would result in more goods being purchased. Because consumers do not take into account the benefits of the good to other consumers, the good is underprovided. As such, public support of cultural activities will produce more of these activities and enhance public welfare (Baumol, 2003, and Frey, 2003).

A positive externality can also be associated with the production of culture. The supply curve represents a mapping of the quantities of a cultural good that suppliers are willing to produce for a set of given prices. For each price and quantity combination, the supplier has taken into account the costs of labour, materials, and other supplies needed to produce the good. If the supplier does not take into account benefits in production that would allow her to produce more goods at a given price, the supplier will be under producing the cultural good. As such, public support of the production of culture can increase the supply of these goods.

Identifying the externalities associated with culture is difficult. We discuss below the four primary types of externalities that advocates of government support have asserted.

- (1) Peer Effects: One type of artistic undertaking will inspire others and facilitate the creation of other activities.

This asserted externality concerns the supply of culture. Examples would include such things as the potential benefits associated with artists working together. For example, two artists working together may learn to improve their technique, allowing them to produce a higher quality or different type of good. Support of culture under this reasoning would also help to promote the creation and promotion of Canadian-bred culture.

This externality would apply most directly to the creation of culture such as the visual arts, music composition, choreography, and writing. It would have limited application to such things as the production of existing work.

There is little research to support the notion that one type of artistic undertaking will inspire others and facilitate the creation of other activities. The asserted externality would have the most justification under the notion that there are potentially positive peer effects among groups of artists. While there is no research on whether there are peer effects in culture, research has been done on other types of peer effects. Sacerdote (2001) confirms that student performance is, in part, a function of the student's peers. Guryan (2001) also finds that peer effects play a role in the drop out rates of black students. Gius (1999) suggests that peer effects impact one's decision to commit a crime.

Under this more narrow justification, potential government involvement would be limited to finding ways to bringing artists and other individuals in the cultural sector together. This could be done through the education system, through the support of non-governmental organizations designed to promote the development of artists, and/or through the establishment of communities of artists. For example, Providence, Rhode

Island combined its interest in redeveloping a blighted community with providing a community of artists (Schuster, 1999). The state gave an income tax exemption to writers, composers, and artists who resided within the area. It also created a sales tax exemption for writers, authors, and composers who resided and did business within the blighted community.

An example of the government building a community of artists in Ontario is the Gooderham and Worts complex in Toronto. A group of developers preserved and redeveloped the complex for residential and commercial use. As part of this development, Toronto Artscape (a non-profit organization whose goal is to create art space and redeveloping communities) secured a 20 year lease at below market rates for two buildings. These buildings were redeveloped for the use of artist studios and galleries. Funding for the redevelopment came from government and private sources.

While programs have been adopted in various localities to support artist communities, there is no rigorous quantitative research to measure the impact of these communities on the production of artistic goods.

- (2) Societal Benefits: Members of society with an interest in culture are better members of society and their influence benefits others.

Whether members of society that are exposed to and consume cultural goods and services are better and have a positive influence on other members of society is yet another very difficult question to answer. This asserted externality concerns the demand side of cultural goods. If individuals do not take into account how their actions will affect society, they will not reflect the potential benefits from participating in a cultural activity in constructing their demand for the activity. This is another justification that can be used to promote Canadian culture.

Many types of activities would be covered by this type of externality. The activities would include taking an art class, participating in a festival, volunteering in a museum, and observing a final production. If culture is a critical component in a program of education, then to the extent that education benefits economic development and society, exposure to culture would also benefit economic development and society. Williams (1997) in a commissioned work has suggested that culture projects create a greater understanding of different cultures which leads to stronger skills in community leadership and management. The evidence to back this suggestion, however, is lacking.<sup>3</sup>

The justification for providing government support under this argument would be most relevant for the following examples. Museums that focus on the historical and cultural components of society would be justified if the exhibits help individuals to gain a better understanding and respect of different cultures. Historical sites that document the life and culture of the communities affiliated with the site would also be justified under this argument. Festivals that commemorate aspects of a group's culture that would help individuals understand and appreciate different ways of life would also be supported under this argument. Also, education programs designed to introduce individuals to different cultures could also be supported under this argument.

(3) Economic development.

This asserted externality could affect the demand or the supply of culture. There are three key ways that culture potentially can contribute to economic development. First, culture, in and of itself may generate positive economic activity. Second, culture may promote specific types of complementary goods and services, such as tourism and

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<sup>3</sup> A potentially analogous issue is whether educational attainment is linked to civic engagement by individuals. Dee's (2003) empirical analysis suggests there are large positive effects between educational attainment and voter participation.

other service industries. Third, culture enhances the amenities provided in a given community, thereby encouraging individuals and businesses to relocate to the community.

(a) Role of culture in promoting economic activity

Does culture generate positive economic activity in and of itself? It is unlikely that cultural organizations generate enough revenue or hire enough employees to impact significantly a given community, especially in bigger communities.

The only exhaustive analysis that has been done to explore this issue is with respect to bringing a professional sports team to a community. Siegfried and Zimbalist (2000) have summarized the research on the economic impact of sports teams. Despite consultant reports that may assert otherwise, academic research has consistently found that professional sports team have a negative or no impact on a community's economic development. These studies include Baade (1994) which found no significant difference in personal income growth from 1958 to 1987 in 36 metropolitan areas that hosted a professional sports team. In addition, Baade and Sanderson (1997) found no perceptible net increase in economic activity or employment in 10 cities that acquired a new sports team between 1958 and 1993.

The key reasons for why a professional sports team is unlikely to have an effect on a community's economic development are as follows. First, to the extent that a sporting event is a type of leisure and most consumers have a fixed amount of time for leisure, the sporting event is a substitute for other forms of leisure that existed prior to the establishment of the sports team in the community. Second, although the owners and the players may earn big salaries, if the owners and players do not reside in the community in

which the sports team is located, the impact of these salaries on the local community will be small. Third, most major sports teams can generate a “monopoly” status within a local community. Given this, it is easy for the team to negotiate good deals from the community’s government in order to locate in the community. As such, the local government must then raise the necessary funding to cover the cost of bringing the team to the community, offsetting any benefit from the acquisition of the sports team.

While these arguments explain why having a sports team may not promote economic development, they do not necessarily apply to other types of cultural goods. A performing arts center and a local museum are not likely to exhibit monopoly power within a community. As such, these venues will not be able to extract rents from local governments.

In addition, the performers and other workers in these venues are likely to reside within the community in which the organization is located. To this extent, the incomes earned by the performers and other workers will flow back into the local economy.

Finally, while a small percentage of sports spectators come from out of town, consumers of an arts performance or a museum could very well come from out of town. And to this extent, the out of town spectators are not substituting their leisure time from one local good to another.<sup>4</sup>

Given all of this, the degree to which a given museum or arts group can impact the local economy is likely to depend on the extent to which culture represents a major industry within the community. In Toronto, for example, while there are numerous cultural organizations, in total they still represent a small portion of the local economy.

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<sup>4</sup> To the extent that museums and other cultural venues keep track of the postal code of its visitors, one could measure the importance of the venue to out-of-town visitors.

In Stratford or in Niagara-On-The-Lake, however, cultural organizations represent a much bigger portion of the local economy. In smaller communities, however, whether cultural organizations can become a big portion of the local economy is a function of the next issue, whether these cultural organizations can promote complementary economic activities, specifically tourism.

(b) Role of culture in promoting complementary goods and services

Does culture promote complementary economic activities such as tourism and other service industries? A potential problem with relying on the role of complementary economic activities that are based on such things as tourism, hotels, and restaurants, is that this market is highly competitive. In addition, the businesses that are in this industry have a high failure rate and the labour market for these industries is very different from the labour market for other industries (Lundberg, Krishnamoorthy, and Stavenga, 1995). The labour market tends to be a more transient and young labour force (Shaw and Williams, 1994).

Creating a sustainable community that relies on culture and tourism can be quite difficult. To the extent that government support relies on a justification that culture is important to the local economy of the community, it is important to analyze carefully the sustainability of both the culture and tourism within the community.

(c) Role of culture in promoting business and/or individual relocation

Does culture encourage the relocation of businesses and individuals because it adds to the amenities provided within a community? Many articles have demonstrated that human capital is positively correlated with economic development.<sup>5</sup> Thus, to promote economic development, an unanswered question is what affects an individual's

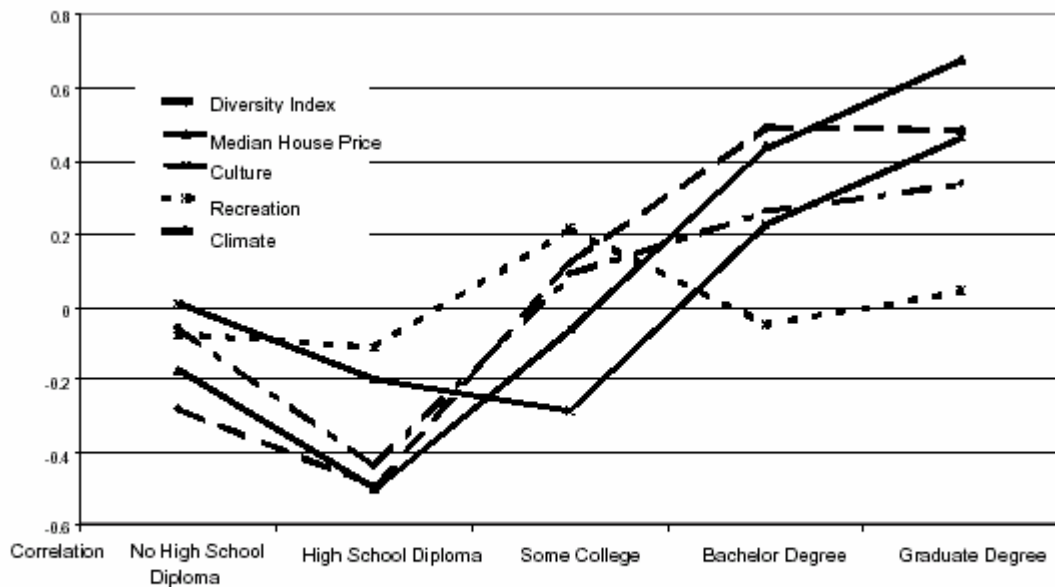
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<sup>5</sup> Florida (2002) discusses the key research in this area.

decision to locate to a particular area. Economic theory suggests that individuals choose their residential location based on the types of local public goods and services available to a community (Tiebout, 1956). To the extent that individuals are mobile, they have the capacity to move with their feet. Thus, to the extent that culture is treated as local public good (discussed below), it will impact on one's choice of residential location.

Empirically, it would be quite difficult to measure the effect of culture on one's residential location decisions. The difficulty lies in discerning the effect of culture from other related goods (such as public services, educational opportunities, etc.). Gabriel and Rosenthal (1999) have demonstrated that local amenities have a significant impact on wage rates as well as on worker skill levels, suggesting that amenities do impact residential location decisions.

**Figure 2: Amenities and Education Level**



Source: Gates, Arora, Florida, and Kamlet, "Amenities and the Location of Knowledge Workers" (Carnegie Mellon University, H. John Heinz III School of Public Policy and Management, January 2000)

Figure 2 depicts a graph of the relationship between different types of amenities and the educational level of U.S. workers. This is based on the research of Gates, Arora, Florida, and Kamlet (2000). To construct this figure, the researchers examined 115 industries in 67 metropolitan areas with populations of 500,000 or greater. The research suggests that high skill workers are more likely to relocate in high amenity areas. Figure 2 shows how the relationship between educational level and amenities are positively correlated. Using regression analysis, the authors also find a positive correlation between relocation and culture.<sup>6</sup>

Does culture encourage the relocation of businesses? Siegfried and Zimbalist (2000) suggest sound businesses that move search for a more qualified or less expensive labour force. In addition, these businesses look for a convenient location for their inputs or sales, a good infrastructure, a sound fiscal environment, attractive government services, and appealing cultural opportunities. If there are two locations with a similar labour force structure, cultural amenities may become the deciding factor. Thus, for businesses, the first priority is based on the economics of the location as it relates to the operation of the business. A subsequent consideration involves the existence of cultural and other amenities.

Cultural and other amenities may have an indirect effect on the underlying economic justification for a business' location decision. As discussed above, cultural amenities are expected to affect residential preferences. If these amenities affect sectors of the labour force population differently, then the labour force composition of a community will be based, in part on the types of amenities provided in the community.

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<sup>6</sup> Florida (2002) also finds a positive correlation between “coolness” and location of highly educated individuals. Coolness is defined to include such things as outdoor dining, active outdoor recreation, a thriving music scene, active nightlife, and bustling street scene.

As such, different types of businesses will be attracted to the community based on the labour force of that community. Given the research of Florida (2002) and others, there is some evidence to suggest that more highly educated individuals value amenities that include culture.<sup>7</sup> Thus, indirectly, cultural amenities may affect the economic justification for a business' relocation.

More generally, Pereira (1999) studies the effect of public capital accumulation on private sector performance. To the extent that government support of culture can be treated as a component of public capital accumulation, this is another way of testing whether private sector performance relies on the cultural sector. In his analysis, Pereira (1999) recognizes that there is a bi-directional impact of public capital and private sector performance insofar as both components can affect each other.<sup>8</sup> Pereira (1999) finds that public capital positively affects the accumulation of private capital. Public capital, however, has a small and marginally significant effect on private sector employment. This research suggests that businesses may be more reactive to changes in government policy than residents are, at least in the short run. Thus, to the extent that culture is a component of a community's public infrastructure, it could impact the growth of businesses within the community. This is an issue, however, that would require further research.

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<sup>7</sup> At the same time, one should not take this argument too far. In examining the high-technology industry, Florida (2000) failed to find a clear relationship between arts and culture and high technology regions.

<sup>8</sup> Empirically this is done by utilizing a vector auto-regression technique. Provided there are exogenous factors that apply to each measure (public capital and private sector activity) independently, one can allow for each measure to affect the other.

(4) Culture for tomorrow: Culture today promotes more culture for future generations

The impact of culture today on future generations is a type of externality if the recipients of the culture today do not take into account the appreciation of the culture by future generations. Under this hypothesis, demand for the culture will be less than is socially beneficial. This type of externality concerns primarily activities such as the creation and/or preservation of culture. It is less concerned with the production of culture. Given the potential impact of today's cultural activities on future generations, this type of justification is important with respect to the promotion of Canadian culture.

Given this last argument concerns how decisions today affect choices tomorrow, measuring such an impact of these decisions on future generations is extremely difficult. One way of looking at this problem is to focus on the role of historic preservation of buildings in a community. Given these buildings have economic value, we can compare how the value of these buildings changes over time relative to buildings that do not have a historic association.

Designation of historic districts has been used as a tool to revive or halt the deterioration of central-city neighborhoods. Thus, the value placed on these buildings by existing residents was low. If it was lower than would be optimal given the potential for greater appreciation by future generations, then we should see that the government intervention through the preservation of the communities has an impact on property values. But for the preservation to be worthwhile (from a future generation standpoint), the increase in the property values should be greater than any increase in property values in communities where there is no historic preservation.

In analyzing the impact of historic preservation on property values, it is important to compare similarly situated communities. Thus, if historic preservation is used in a deteriorating neighborhood, this factor must be controlled for in any analysis.

In any given neighborhood, an historic designation can be value enhancing or value-detracting. The argument that the designation is value enhancing is based on the assumption that the designation provides a form of insurance of future neighborhood quality (Leighenko, Coulson, and Listokin, 2001). In addition, it is believed that the designation will have positive spillover effects on neighboring areas. In contrast, the historic designation may impose restrictions on alterations and demolition that may be costly and inefficient (Leighenko, Coulson, and Listokin, 2001).

In comparing the average growth rate in property values in historic areas with those in non-historic areas, the research is mixed as to whether historic preservation results in higher property values by homes in historic areas. Leighenko, Coulson, and Listokin (2001) use data that identify specific houses for a group of nine cities in Texas to study the issue of whether historic designation benefits the property values of these houses. In this study, the authors find a positive effect from the historic designation for seven of the nine cities. To the extent that historic preservation is one way of promoting culture for future generation, the stronger empirical evidence suggests there is a potential benefit given to future generations.

It is difficult to assess the impact of today's culture on future generations. The importance of this justification for government support, however, should not be easily dismissed. To the extent that government support helps to create and define a distinct

“Canadian culture,” the impact of this type of support is likely to have a positive influence on future generations.

**b. Public Good**

A good is considered a public good if more than one consumer can enjoy the same good (e.g. a park, theatrical performance). To be a pure public good, two conditions must be met. First, the additional cost associated with one more person enjoying a good or service must be zero (or close to zero). Second, excluding individuals from using the good or service must be prohibitively expensive. With respect to pure public goods, the easiest examples of these goods would be things in public spaces such as statues, sculptures, and paintings on the sides of buildings. Radio and television broadcasting are other examples where there is no practical limit to the number of listeners/viewers who can be served without the depletion of supply to others (Baumol, 2003 and Frey, 2003). For these types of goods, the key problem is how one collects the revenues necessary to produce the pure public good. If consumers can access the good for free (or nominal cost), then they have the incentive to “free-ride” and not pay anything for the good. And to this extent, suppliers of these goods have no incentive to produce the good as there are sunk costs associated with the provision of the good.

Most cultural goods, however, do not exhibit the properties of a pure public good insofar as only one of the two conditions is met. It is easy to exclude consumers from attending a performance if a ticket is not purchased. In most productions, the additional cost associated with one more person enjoying a good or service is often close to zero. Thus, the public goods concept applies most easily to the production phase of culture. Examples include theatres, stadiums, and museums. A theatre is designed to hold a fixed

number of patrons. Once a performance is set, the cost of providing the performance to one patron is close to the same cost as providing the performance to many patrons because these patrons are able to see the performance simultaneously. Similarly, once a museum creates a display, many patrons can view the display at the same time.

The economic problem which can result in government intervention is that to create an exhibition or to set a performance, there are large sunk costs. In economics, goods are priced on marginal costs (the additional cost associated with providing one more unit of the good), not on sunk costs. In the production of culture, sunk costs are incurred repeatedly. For example, once a theatre is built, the theatre owners must still incur the costs of set design, hiring actors, directors, etc. for each production performed within the theatre.

Given these sunk costs can be substantial and they are incurred again and again, it is important to figure out a means by which to pay for them. The role of sunk costs in culture production provides some justification for allowing for price discrimination among the patrons of the performances. The different prices that may be charged can be based on age, number of performances attending, number of individuals in a group, etc. Baumol (2003) presents a theoretical argument for allowing price discrimination for a cultural organization to remain solvent. Throsby (2003) suggests that sunk costs play an important role with respect to the entry of organizations in the culture market and this, in turn, affects the role of culture in developing the local economy and generating tourism.

Another problem associated with the production of live performances is that known as “Baumol’s Cost Disease” (Baumol and Bowen, 1966). Culture, unlike most industries suffers from what is known as a “productivity lag.” For a given production of

live theatre, the same types of technology and labour effort are typically required. For example, to perform a symphony, one continues to need a conductor and musicians. The number of musicians needed for the symphony does not change over time and so any given musician cannot increase her productivity with respect to performing the symphony. In contrast, most industries experience an increase in productivity over time because of increased capital per worker, improved technology, increased labour skill, better management, and/or economies of scale as output rises. Given in culture it is impossible to increase productivity based on any of these reasons, the costs of many of the inputs used in the culture industry will inevitably rise given the productivity increases in other industries, thus explaining the notion of Baumol's cost disease. Given that all industries compete to hire workers, artists' wages must rise over time by the same proportion as wages in the general economy if the arts industry expects to hire the workers it needs for a performance. As such, if there are limited productivity gains in the culture industry, the costs of a performance will increase over time (Heilbrun, 2003).

The existence of "Baumol's cost disease" does not mean that government intervention is needed. As the general economy develops, real wages will increase. As such, the public will be more willing to pay more for a ticket to a cultural event (Heilbrun, 2003).

Several researchers have studied the issue of "Baumol's cost disease" empirically (Netzer, 1978; Peakcock, Shoesmith, and Millner, 1982; Baumol and Baumol, 1984; Schwarz, 1986). These studies point, in general, to production-side adjustments by performing arts groups over time and have found little evidence of differential rates of inflation in the performing arts sector relative to other sectors of the economy. Baumol

and Baumol (1980) noted there was a relatively slower rate of cost increase in the live arts during periods of high general inflation such as the 1970s. Typically, in times of inflation, there is an erosion in philanthropic support and when combined with a heightened money illusion from the inflation, there is a restraint in rises in ticket prices, forcing performing companies to concede to lower wage increases, reduced labour inputs and other types of cost-reducing strategies. These production adjustments with increased demand tend to counter any rise in deficits by the performing arts. Thus, while this problem is possible, there has been little evidence that the problem results in the dissolution of performing arts companies.

c. **Merit Good/Imperfect Information**

A good is identified as a merit good if some "outside analyst" (e.g. the government) considers the good to be intrinsically desirable, uplifting or socially valuable for other people to consume, independently of the actual desires or preferences of the consumer herself. In the case of such goods, demand will be lower than is socially optimal (Frey, 2003, Montmarquette, 2003). The potential problem with this type of justification for government involvement is that it involves a subjective decision of what is and is not important for consumers.

Alternatively, culture may be considered an industry in which consumers have imperfect information about the quality or importance of the goods and services provided. This may be particularly true with respect to one's initial exposure of culture. Baumol and Bowen (1966) showed that audiences for the arts are skewed to the right in income, age, occupation, and levels of education (see, also, Dobson and West (1988) and Dickenson, 1992). Levy-Barboua and Montmarquette (2003) and Frey (2003) show that

taste for culture is acquired based on one's exposure and that the shadow price (or value) of culture declines over time. O'Hagan (1996) presents evidence of the importance of early arts education in accounting for later participation in arts events that is independent of incomes or attendance costs. In an evaluation of an Arts Awareness Intervention program in Ireland, participants were observed to have experienced a dramatic shift in attitude and appetite for arts education and training and that arts projects had an impact on self-expression, communication, feeling good, working hard, and feeling a part of a team effort (CAFÉ, 1996).

Under the combined notions of imperfect information and merit goods, government support could be justified based on a need to encourage exposure to culture by segments of the population (e.g. by age, income, education, and/or ethnic status). This type of support would be most applicable in the area of supporting the production (and consumption) of existing culture. It is also an important justification for providing government support to the extent that Canadian culture is viewed as an evolving good for which promoting exposure is important.

**d. Equality of Opportunity**

As illustrated above, there are several studies that establish that the income distribution of consumers of culture is skewed to the right (Baumol, 2003; Frey, 2003). This is especially the case for culture that is considered "high culture" such as opera and ballet. The question is whether this is a function of choice or merely the opportunity of exposure. O'Hagan (1996) suggests that participation in culture in one's later years is attributable to early arts education. Gray (1998) examines the impact of early exposure to art on museum attendance as an adult. Using survey data from the United States,

individuals visit one or more museums an average of 3.3 times per year. The survey also suggests that by taking art classes as a child (in school and privately), there is an increase in the probability of one attending an art museum as an adult.

Even if one does not participate in a cultural event, there still may be an interest to support culture. In willingness to pay studies, there is some evidence that individuals who never attend a cultural event are willing pay some taxes to ensure that they do not die out. Morrison and West (1986) show this using Canadian data. Throsby and Withers (1985) show this using Australian data.

**e. Infant Industry**

This argument is limited to new and emerging forms of culture and/or new organizations. Under this concept, because new organizations (or forms of culture) are more susceptible to failure, government support could help these organizations to sustain the pitfalls of early development until the organizations become more mature. This is an argument that has been difficult to justify economically (Baumol, 2003). As with any industry, start-up organizations face a higher risk of failure. But if we rely on this argument alone, then all start-up organizations, regardless of industry, should be given government support.

**f. Using the Economic Justifications**

For any given cultural good or service, to provide government support, it is important first to identify the economic reasoning for why the good or service would not be privately provided. But once a reason is found, this alone may not be sufficient to justify government support. As with any good or service that is supported by the

government, it is important to decide whether a given cultural good or service is worthy of government involvement.

This raises the issue of voters' attitudes towards culture. For this report, we could not identify any information regarding Canadian's views towards culture. In studies using data from the United States, researchers have found that individuals with a high level of education, women, and younger voters tend to support the arts; higher income households only weakly support government subsidies for culture (Pettit and DiMaggio, 1998; Brooks, 2001). There is also some evidence that voters with a more liberal ideology (as measured by U.S. voters) support government involvement in the arts.

Using Australian data, Withers (1979) asserts that the median voter plays an important role in supporting government involvement in the arts. Income levels of voters played a minor role with respect to this type of government support.

#### **IV. Ontario Support of Culture**

Ontario supports culture in four ways. Table 2 provides a summary of Ontario's support of culture. First, there is a provincial charitable donation tax credit. The tax credit is an indirect means of support insofar as the government is forgoing tax revenue that could be used for other purposes. By providing a tax credit to taxpayers, the "price" of the donation is lowered, thereby encouraging a greater donation by the taxpayer. If a culture organization is a registered charity, donations to the organization are eligible for the tax credit. As such, in the cultural sector, donations are collected by non-profit organizations. As a result of the tax credit, non-profit cultural organizations receive more funding from the donation than they otherwise would if no tax credit is given.<sup>9</sup>

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<sup>9</sup> To qualify as a non-profit organization, the organization must receive exemption as a charitable organization under federal tax code.

The tax credit is the same for all types of organizations. Thus, this method of indirect support does not distinguish among organizations based on type of good provided or the process used to produce the good.

Second, Ontario provides grants to organizations and artists through various programs administered by the Ministry of Culture or through arms length agencies of the Ministry. These grants support annual operating expenditures, provide for endowments, and provide for specific programs. Some of the programs that administer the funds are targeted based on form of expenditure or type of good. For the most part, however, the programs are general and do not provide a direct link between the type of funding and economic justification for the funding. Below we identify possible economic justifications for each program.

Provincial grants are administered under the following programs/organizations:

- (1) Ontario Arts Council: an agency of the Ministry of Culture, the Ontario Arts Council provides operating, project, and annual block grants to organizations and artists (in 2001-2002 fiscal year, 829 grants for a total of \$18,551,297 were distributed to organizations; 1229 grants for a total of \$3,862,023 were distributed to individuals). The grants were distributed to theatre groups, dance groups, art fellowships, and book publishers. The economic justification for this fund is unclear.
- (2) Arts Endowment Fund: administered by the Ontario Arts Council for the establishment of endowments for arts organizations. The amount an organization may receive depends on the organization's total operating revenue needs. Some of these funds may be used for operating expenditures. The grants require a matching grant, although some of the matching grants are quite nominal (between 1998 and 2002, 254 grants for a total of \$40,650,582 were distributed). In phase 2 of the program, organizations are expected to demonstrate they have raised an equal amount of funding to be used for endowment purposes from the private sector. The maximum amount provided by the fund is predetermined. Non-profit professional arts organizations that are eligible for funding under the Ontario Arts Council may apply for a grant under the Arts Endowment Fund if they demonstrate that they have been in continuous operation for at least two years and they (a) provide professional artistic

programming, (b) support the creation, production or dissemination of artistic works by professional artists, or (c) support the professional practice of artists (through professional development, career support, promotion of public awareness etc.). Economic justification may be based on the notion that the endowments help to support the sunk costs of the organizations' quasi-public goods. Economic justification may also be based on the notion of positive externalities.

- (3) Ontario Cultural Attractions Fund: An independent, not-for-profit corporation, established to administer funds on behalf of the government. The Board of Directors of the corporation is composed of community leaders from the arts, culture and heritage sectors. The corporation helps organizations with new programming ventures by providing partially repayable loans (between 1999 and July of 2003, 65 grants for a total of \$12,135,209 were distributed). Large and small organizations are eligible for the fund. Funding proposals require a sound business case for the project that reflects a measurable contribution to the profile and revenue capacity of the organization, as well as the ability of the organization to repay a portion of the fund's investment. At least ten percent of project revenues must come from private-sector sponsorship or donations. Funding has been distributed to such organizations as the Art Gallery of Ontario, Black Creek Pioneer Village, Canadian Opera Company, a small town's concert band, local theatre groups, and film screenings. Economic justification may be based on the infant industry argument, although some of the events funded are organized by well-established organizations. The economic justification is likely to vary based on the project funded.
- (4) Arts Services Organizations Fund: administered by the Ministry of Culture. Grants are provided for operating expenditures to organizations designed to support artists (in 2002-2003 fiscal year, 31 grants for a total \$944,300 were distributed under this fund). The goal is to promote access to the arts, increase the volunteer sector, and the promotion of self-reliance by the funded organization. Organizations receiving funding include the League of Canadian Poets, the Ontario Council of Folk Festivals, the Canadian Music Centre, Women in Film and Television, and the Dance Ontario Association. Economic justification may be based on the notion of positive externalities associated with peer effects.
- (5) Cultural Strategic Investment Fund: administered by the Ministry of Culture and their regional offices. Organizations may receive grants for projects representing up to 50% of the cost of the project (up to 80% in communities with a population of less than 10,000) (in 2002-2003 fiscal year, 35 grants for a total of \$956,317 were distributed under this fund). The projects funded involve two or more partners and require a demonstration that: (a) there are measurable benefits to a sector at the provincial or regional level; (b) the funding will contribute to community

economic activity and/or job creation; (c) the funding will promote sustainable arts, cultural industries, or heritage sectors; (d) the project is innovated and uses the best practices model of operation; (e) other criteria that involves the tracking the effectiveness of the project, and satisfying government priorities. Economic justification may be based on the notion that if the good is a quasi-public good, the funding supports the sunk costs associated with providing the good.

- (6) Ontario Trillium Foundation: using funding from casinos, the foundation funds arts & culture, sports & recreation, environment, and human & social services organizations (the foundation distributes \$100 million per year in grants; only a small portion of this funding goes to cultural organizations). It is unclear what criteria are used for awarding funding under this program to cultural organizations.
- (7) Ontario Media Development Corporation: an agency of the Ministry of Culture. The corporation provides grants to the cultural media industry to build capacity in the industry and to provide opportunities that encourage business alliances across the cultural industries (received \$1,749,000 in 2001-2002 fiscal year from the Ontario government, representing approximately 41 percent of the operating revenue of the corporation). Economic justification may be based on two notions. First, under the theory that if the goods produced by the media industry are quasi-public goods, the funding would support the sunk costs associated with the provision of the good. Second, funding may be provided under the theory of positive externalities. Potential positive externalities would include: spillovers through attracting economic development within the communities in which the media industry locates; peer effects from having several media companies located in the same area.
- (8) SuperBuild Sports, Culture & Tourism Partnerships: an agency of the Ministry of Finance. The agency provides grants for infrastructure projects that focus on sports, culture, and recreational facilities across the province (as of the end of 2002, approximately 59 grants were distributed; these grants were supported using federal and provincial funding; the provincial portion of the grants was \$130,000,000). Funding has been used for such things as community activities centres, long term care facilities, highway expansions, health care facilities, environmental projects, and other things that are indirectly related to culture and tourism. To the extent that these projects are geared towards quasi-public goods, the grants would help support the sunk costs associated with these goods.
- (9) Summer Experience Program: administered by the Management Board Secretariat. The program provides grants to arts service organizations to hire a summer student for seven weeks of work (for the 2002-2003 fiscal year, \$17,108 was spent on this program). The economic justification for

this program would be based on the notion that the student workers are gaining exposure to culture, and, thus, are being given an opportunity to acquire a taste for culture.

- (10) Visiting Programmers/Journalists Program: administered by the Ministry of Culture. The Ministry supports the facilitation of meetings between foreign programmers and industry representatives with Ontario artists, programmers and organizations. The Ministry may also provide a per diem for programmers and journalists. The priorities under this program include: programmers from a festival, venue, or cultural institution with the ability to support an Ontario artist; visits that have articulated results for Ontario arts and culture industries; programmers from regions with which the province has a special relationship; programmers from target markets identified by the Ministry of Economic Development, Trade and Tourism; and journalists affiliated with major daily newspapers, magazines, and trade journals in important markets.
- (11) Trillium Book Awards: administered by the Ministry of Culture and the Ontario Media Development Corporation. The award was established by the Ontario government in 1987 to "recognise excellence, support marketing and to foster increased public awareness of the quality and diversity of Ontario writers and writing." It has since been expanded to include francophone writers and poets. Ontario writers who have lived in Ontario for at least three out of the past five years and who have been published anywhere in the world are eligible for the awards. The awards range from \$10,000 to \$20,000 depending on the type of writing and include a nominal award to the publisher.

Third, Ontario directly supports several museums and foundations. These organizations were established as corporations without share capital (non-profit or charitable organizations). As a group these organizations received more than \$61 million in funding from Ontario. The provincial support represents between 30 and 56 percent of total revenue for these organizations. Most of these organizations deliver goods or services that could be characterized as quasi-public goods. As such, without support through government grants and/or private donations, the goods or services are likely to be under-provided. As raised in the next section, whether the provision of support should be

direct (e.g. through a government allocation of funding) or indirect (e.g. through the support of private donations) is an area that requires further investigation.

- (1) Royal Ontario Museum: established to showcase art, archaeology, and science; it is the largest museum in Canada to explore both the natural world and humankind's cultural past (in 2001-2002 fiscal year, the museum received \$19,024,000 from the province, representing 36% of total revenue)
- (2) Ontario Science Centre: established to open minds to science and technology (in 2001-2002 fiscal year, \$16,140,000 from the province, representing 56% of total revenue)
- (3) Art Gallery of Ontario: established to cultivate and advance the cause of the visual arts in Ontario, to offer programs on the origin, development, appreciation, and techniques of the visual arts, and to collect and exhibit art and displays (in 2001-2002 fiscal year, the gallery received \$11,994,000 from the province, representing 35% of the total revenue of the gallery)
- (4) McMichael Canadian Art Collection: established to acquire art works, objects, and documentary material for the collection and to conduct activities that enhance and complement the collection (in 2001-2002 fiscal year, this organization received \$3,959,688 from the province, representing 53% of total revenue)
- (5) Ontario Heritage Foundation: established to advise the Ministry on the conservation, protection, and preservation of the heritage of Ontario; receives and acquires property in trust and also preserves, maintains, and reconstructs property of historical architectural, archeological, and/or recreational interest (received \$3935,000 from the province in 2001-2002 fiscal year, representing 41% of total revenues)
- (6) Science North: established to educate the public about the origins, development and progress of science and technology and their relationship to society (in 2001-2002 fiscal year, this organization received \$3,410,137 from the province, representing 30% of total revenues)
- (7) Royal Botanical Gardens: established for the collection, research, exhibition, and interpretation of the plant world (in 2001-2002 fiscal year the gardens received \$2,710,950 from the province, representing 37% of total revenue)

Finally, the province supports culture through a series of tax credits. These tax credits are administered through the Ministry of Culture, Ministry of Finance, and the Ontario Media Development Corporation.

- (1) Ontario Film and Television Tax Credit: The tax credit is designed to promote film and television production activity in Ontario. It is available to qualifying production companies for producing eligible film and television productions in Ontario. The credit is available for the lesser of Ontario Labour Expenditures and 48% of eligible production costs. This credit is similar to that provided under federal legislation. The credit is expected to amount to \$40 million per year.
- (2) Ontario Computer Animation and Special Effects Tax Credit: This refundable tax credit is provided to Ontario-based companies that perform eligible computer and special effects activities for commercial film or television production. The credit is calculated at a rate of 20% of qualifying labour expenditures and has a cap of \$500,000 per associated group of corporations
- (3) Ontario Production Services Tax Credit: This is an 11 percent refundable tax credit on qualifying labour expenditures to foreign and non-Canadian companies producing film and television productions in Ontario. The credit is harmonized with the federal film or video production services tax credit.
- (4) Ontario Book Publishers Tax Credit: This refundable tax credit is for Canadian-controlled, Ontario-based book publishing companies. It applies to works by first-time Canadian authors. Qualifying expenditures for the credit includes 100% of pre-press and promotional costs and 50% of costs related to production, with a maximum credit of \$30,000 per book (the maximum credit was \$10,000 prior to 2000).
- (5) Ontario Sound Recording Tax Credit: This 20 percent refundable tax credit is for certain expenditures incurred by a qualifying corporation in the production of “eligible Canadian sound recordings” by “emerging Canadian artists or groups.”
- (6) Ontario Interactive Digital Media Tax Credit: This is a 20 percent refundable tax credit for Ontario labour expenditures incurred to develop interactive digital media products for commercial exploitation in Ontario.

**Table 2: Summary of Provincial Support of Culture**

Type of Support	Targeted Recipient	Name	Description
Tax Credit	Given to donors to non-profit cultural organizations		Applies to all types of organizations, regardless of good provided or stage of production of the cultural good
Provincial Grants	Given to organizations (occasionally to individuals)		Typically applies to many types of cultural goods. Little is done to link the type of grant to the economic justification for the grant
		Ontario Arts Council	Provides operating and project grants to organizations. The primary economic justification for this type of funding is unclear.
		Arts Endowment Fund	To help establish endowments for arts organizations. Economic justification may be based on notion that if goods provided by organizations are quasi-public goods, the endowments help to cover the sunk costs associated with the provision of the goods.
		Ontario Cultural Attractions Fund	Supports new programming ventures by providing partially repayable loans. Economic justification may be based on the infant industry notion but grants are given to established organizations.
		Art Services Organization Fund	Grants for annual operating expenditures to organizations designed to support artists. Economic justification may be based on the potential peer effects associated with artists working together.
		Cultural Strategic Investment Fund	Grants for up to 50% of project cost. Economic justification may be based on supporting the sunk costs associated with quasi-public goods.
		Ontario Trillium Foundation	Funding that supports arts, culture, and other types of non-cultural organizations. It is unclear what may be the primary economic justification for this type of funding.
		Ontario Media Development Corporation	Grants to cultural media industry to build capacity in the industry and to provide business alliance opportunities. Economic justification may be based on notion of externalities.
		SuperBuild Sports, Culture & Tourism Partnerships	Grants for infrastructure projects that focus on sports, culture, and recreational facilities. Economic justification may be based on supporting the sunk costs associated with quasi-public goods.
		Summer Experience Program	Provides grants to allow for the hiring of students during the summer months. Economic justification may be based on providing exposure to culture, promoting the cultivation of an appreciation for culture.
		Visiting Programmers/Journalists Program	Provides funding to allow programmers from venues, festivals, and organizations and journalists to visit Ontario. Economic justification may be based on the notion of positive externalities and on the role played by promoting awareness of culture in Ontario.
		Trillium Book Award	Provides awards to Ontario authors and their publishers for several types of writing. Economic justification may be based on the potential peer effects from the recognition of Ontario writers.

**Table 2 continued**

Type of Support	Targeted Recipient	Name	Description
Direct Support of Organizations		Royal Ontario Museum	museum for art, archeology, and science; receives approximately 36% of total revenue from the province
		Ontario Science Centre	museum of science and technology; receives approximately 56% of total revenue from the province
		Art Gallery of Ontario	museum of visual arts; receives approximately 35% of total revenue from the province
		McMichael Canadian Art Collection	museum of visual arts; receives approximately 53% of total revenue from the province
		Ontario Heritage Foundation	advises the Ministry of Culture on the preservation, conservation, and protection of the heritage of Ontario; receives approximately 41% of total revenue from the province
		Science North	museum of science and technology; receives approximately 30% of total revenue from the province
		Royal Botanical Gardens	plant conservatory; receives approximately 27% of total revenue from the province
Tax Credits			
		Ontario Film and Television Tax Credit	covers labour expenditures and production costs of film and television production activity conducted in Ontario
		Ontario Computer Animation and Special Effects Tax Credit	covers computer and special effects activities used in film and television production
		Ontario Production Services Tax Credit	covers labour expenditures for film and television activities conducted in Ontario
		Ontario Book Publishers Tax Credit	covers works by first time authors published by Canadian book publishers
		Ontario Sound Recording Tax Credit	covers Canadian sound recordings by emerging Canadian artists
		Ontario Interactive Digital Media Tax Credit	covers labour expenditures for interactive digital media products used for commercial exploitation

## V. **Economic Issues Underlying Different Forms of Support**

In section II, we discussed the various justifications for providing government support for culture. Given that some of the justifications are valid, the next question is in what form should the support take? The options range from directly providing a good (e.g. such as the establishment of museums and heritage foundations as has already been done), to providing ways to encourage support by private individuals and corporations. In this section, we discuss a few of the economic issues associated with different types of government support.

It is important to recognize there are many types of cultural goods provided and processes involved in the provision of these goods. This variation suggests the need to focus on the reason for wanting to provide government support and the method that will be most effective in promoting the cultural good under study given government resources and the political economy under which the government operates.

### a. **Individual Giving**

Gifts by individuals can be ideal, primarily for the reason that a given donor is able to choose where and when to give. To the extent the government wants to support culture, encouraging private donations is one way of giving the most freedom to individuals. On the other hand, however, it also limits the government directions of such support insofar as some type of goods may receive more support than other types of goods. Analogously, depending on the underlying motivation for the gift, a private donor may not fully internalize all relevant social externalities associated with the provision of culture.

One means by which to induce individuals to give is through an income tax credit or deduction. The federal and provincial governments provide a tax credit for charitable donations in Ontario. In providing a tax credit, the government gives up revenue it would otherwise collect and allows individuals to choose which charities should receive the funding. A credit effectively lowers the price an individual must pay to provide a donation. And with lower prices, donors should be expected to give more. If the tax credit is accompanied by a change in overall tax rates, then there is also an income effect which can also lead to a change in the amount of a donation by an individual. The income effect provides the individual with less (or more depending on the direction of the change in tax rates) income, forcing the individual to choose how to spend her money not only on charitable goods but on other types of goods. Thus, the income effect results in an individual making a substitution among several goods.

In addition, a tax credit would have both a temporary and a permanent effect on charitable giving. Using data on U.S. taxpayers, Auten, Sieg, and Clotfelter (2002) find strong permanent effects from changes in tax rates on charitable giving and, by lowering the price of giving, one should expect to find an increase in that giving. Thus, in considering ways in which to encourage private donations to cultural goods, one must take into account the potential tax implications of changes in the level of donations.

With any tax incentive scheme, policy makers must be careful (Schuster, 1999). Tax incentives can be difficult to implement and, once implemented, they can be difficult to change given that different political actors are involved in the process of implementing and monitoring tax incentives. Also, tax incentives tend to be broad based; they need not be, however. Finally, unless a cap is placed on the incentive, it could be used more than

anticipated, causing a greater burden on the government because for each dollar of tax credit the government has lost a dollar of revenue.

**b. Corporate Giving**

There are two key types of corporate giving, sponsorship and donation. Under sponsorship, a corporation is likely to become involved for one of four key reasons: the promotion of the corporate name or image, because the cultural good is directly linked to the types of goods/services produced by the corporation, to lobby or influence key policy makers, and non-monetary benefits to the managers or owners of the corporation (O'Hagan and Harvey, 2000).

With respect to corporate giving, Young and Burlingame (1996) identify four main concepts that motivate such giving. First, giving contributes to a firm's ability to make a profit. For example, donating computers to a school promotes use of and allegiance to the corporation's computers. Donations also promote a good feeling among workers within the donating company, potentially resulting in greater loyalty and/or productivity by the workers. Second, community culture may drive the firm to be socially responsible and ethical. Under this type of reasoning, a firm will donate out of duty. Third, a firm may be driven by politics to donate. If a firm is interested in preserving corporate power and autonomy and minimizing government interference, it may see private donations as a means by which to minimize the role of government involvement in the provision of culture. Fourth, given that firms are complex structures, philanthropy by the firm may help it to manage the various stakeholder groups with which it must deal.<sup>10</sup>

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<sup>10</sup> Other reasons that have been asserted for giving: rivalry within specific industries (Johnson, 1996; Whitehead, 1976); enlightened self-interest (Useem, 1984; Galaskiewicz, 1985);

Fully understanding corporate motivations for giving is difficult given there has been limited research on this topic (LeClair and Gordon, 2000). Johnson (1996) examined the role of industry structure and performance on corporate donations. He found that pre-tax profits were the primary determinant of a firm's decision to donate. Useem's (1987, 1987a) research suggests that corporate giving is a function of the business cycle; on average one percent of a firm's income is used for corporate giving. Kirchberg (1995) found that community characteristics such as the education level of the population and the importance of services in the economic base also play a role in corporate giving.

c. **Government Grants**

Ontario relies substantially on government grants as a vehicle for supporting culture. There is little research that explores the impact of government grants on the activities of an organization. Netzer (1992), using a survey methodology, demonstrates that subsidies to the arts lowered ticket prices, increased attendance, and increased artists' salaries. The subsidies did not impact access to the arts by individuals that might not otherwise attend such events. Given the research was based on a single survey, however, the research may not fully reflect the potential long-term benefits of government subsidies.

In thinking about government grants, it is important to consider whether there are differences in the incentives provided based on whether a cultural organization is directly or indirectly subsidized by the government. Should a government base its policies on the

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advertisement/marketing (LeClair and Gordon, 2000); Schwartz, 1968; Levy and Shatto, 1979; Turgeon and Colbert, 1992; Fry Keim and Meiners, 1982); corporate size, interest of top management and the firm's position within the community (Useem, 1988, 1989; Kushner, 1996).

sustainability of the organizations? Also, is there a conflict between quality and satisfying the majority of the population?

One issue that inevitably rises with government grants, especially during times of fiscal austerity, is whether these government grants are a substitute for private donations. Under traditional economic theory with strong assumptions, government grants and private donations represent a dollar for dollar trade-off. Empirically, however, few researchers have found this dollar for dollar trade-off (see, Steinberg (1991), Payne (1998)).

With respect to culture, there are several reasons why one should expect there not to be a dollar for dollar trade-off between government grants and private donations. Under the theory set forth by Andreoni (1990), donors may receive a warm-glow from their donation. If there is a warm-glow associated with a donation, government grants are not merely substitutes for private donations. A change in government funding will result in a less than dollar for dollar tradeoff in private donations. Under some restrictive conditions, there could even be a positive relationship between government funding and private donations under the warm-glow theory.

There are also other hypotheses that would support a positive relationship between government grants and private donations. Payne (2001) explores the relationship between government funding and private donations at research universities and finds a positive relationship between government funding and private donations. With respect to universities, given the complexities of university activities, some donors may look to government funding (especially with respect to research) as a signal of quality. If so, this would explain a positive relationship between private and public

grants to universities. Similarly, for some types of culture, donors may look to the government for a signal of quality and, therefore, increase their donations with an increase in government funding.

In addition to private donors reacting to changes in government funding, organizations may react to changes in government funding. For most organizations, private donations do not magically drop from the sky. Instead, these organizations must employ fundraisers and host fundraising functions to encourage private donations. Given that organizations are not passive in their collection of donations, if an organization receives government funding, this may make the organization less eager to collect private donations. Andreoni and Payne (2003) explore this issue and find, indeed, for a group of arts organizations in the U.S., fundraising expenditures fall when government funding increases. Whether this change in fundraising efforts is socially desirable is not clear. Regardless, if there is a decrease in fundraising efforts by an organization, then one can expect private donations will also decline. Thus, in addition to having a direct effect on the decisions of private donations, government funding may also have an indirect effect on these decisions as a result of its effect on the fundraising efforts of the organizations receiving the government funding.

Given a relationship among private giving, fundraising efforts, and government funding, in adopting policies towards government funding, one should reflect on how these policies would affect other revenue sources of the affected organizations. This is certainly an issue that requires further study.<sup>11</sup>

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<sup>11</sup> To the extent that the government provides grants to cultural organizations, another important issue concerns the mechanism used to distribute these grants. Currently, the province provides two broad types of grants, grants that are distributed among several organizations using a competitive process and grants that distributed to specific organizations that are considered to be

**d. Tax Credits for Suppliers**

For organizations in the film or publishing industries, Ontario has provided several types of tax credits. This is the only type of support provided to for-profit cultural organizations. In many respects, the use of tax exemptions in the cultural industry represents the most innovative type of government intervention. As with any tax incentives, these tax credits can be difficult to implement or change because different governmental agencies are involved (Schuster, 1999). For example, the Ministries of Culture and Finance and the Ontario Media Corporation are involved in the administration of tax credits to organizations in the film or publishing industries.

For these types of tax credits to be effective, a given organization must have net of cost revenues against which the tax credit can be used. Focusing on the film industry, it is not clear that Canadian films, especially those that may be considered more valuable from an artistic perspective are profitable. Many Canadian films, for example, only obtain a three percent share of domestic box office receipts (Finn, Hoskins, and McFadyen, 1996). Moreover, many do not achieve theatrical distribution, and when they do, the box office receipts are often disappointing.

To the extent that tax credits emphasize the film industry, it is important to consider the potential contribution of the film industry to a local community. With respect to the types of workers employed in the film industry, some may be considered to be transient and, therefore, will not contribute as much to the local community as workers in other types of industries.

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a part of the Ministry of Culture (e.g. Art Gallery of Ontario, Royal Ontario Museum). There has been little research to evaluate the effectiveness of these two different mechanisms for distributing research.

e. **Treatment of Non-Profit Charitable Organizations**

Non-profit cultural organizations are eligible to receive donations from individuals and corporations. Tax credits for these donations encourage organizations to adopt a non-profit organizational structure (Hansmann, 1981). Thus, it is important to evaluate the economic justifications for allowing an organization to adopt a non-profit structure.

A policy issue related to granting non-profit status is how the government should treat activities by these organizations that are similar to activities performed by for-profit organizations. For example, if a museum has a gift shop, should the proceeds of the gift shop be treated as taxable income despite the museum having a non-profit status? While this may seem at first glance to be a relatively minor issue, tax-exempt organizations have become increasingly involved in the provision of commercial activities (Cain and Meritt, Jr., 1998).

Does tax-exempt status provide an economic advantage regarding commercial activity? If tax-exempt status means that the proceeds from the commercial activities are not taxed, then the tax-exempt organization will be able to charge different prices than a for-profit organization. This issue, however, is not necessarily black and white. As Cordes and Weisbrod (1998) point out, potentially the motivation for engaging in commercial activity is different in the tax-exempt setting insofar as the primary activity of a tax-exempt organization is to provide the good or service for which the charitable status is given. If this is the case, if the commercial activity is taxed the same regardless of the tax-exempt status of the organization engaging in the commercial activity, the tax-exempt organization will not engage in the commercial activity. If, however, there is

differential taxation based on the tax-exempt status of the organization, there is an opportunity for the tax-exempt organization to earn above-normal returns on its commercial ventures. If these above-normal returns are used to support the primary good of the tax-exempt organization, this is another means by which the organization can sustain its operations.

## **VI. Conclusion**

Given the potential justifications for government support and the issues associated with different types of support, how should Ontario address the support and funding of culture? The strongest economic arguments that would justify government involvement in culture are the ones based on externalities and/or public goods. To some extent the importance of providing exposure to culture in order for one to acquire a taste for culture also provides a justification for government support.

Government support is provided indirectly through tax credits to individuals and businesses. Support is also provided directly through the use of government grants and tax credits to certain types of for-profit organizations. Some of the government support is targeted to particular types of organizations or to particular types of activities. But other types of government support are more broadly defined. This raises the question of what types of economic justifications underlie the funding. One area that should be explored further is that concerning the effectiveness of the different funding programs with respect to the possible economic justifications that could be used to support the programs.

Given many of the programs supporting culture are broadly defined and not based on a set of economic justifications, the government could restructure these funding

opportunities to be focused and aimed at specific cultural industries. Although this has been done recently with respect to the media industry, most of the other types of cultural activities are lumped together. Similarly, the different processes involved in the production of culture (e.g. creation, development, final production, distribution, consumption) are also lumped together in many of the funding opportunities. Given each phase of the cultural production process can involve different types of individuals and organizations, another way cultural funding could be restructured would be based on which phase of production funding is being provided.

Overall, it is unclear how the various grants are awarded. In the area of research and development, proposals are often subject to a rigorous peer-reviewed, competitive process. More exploration is needed to assess whether the funding process in the cultural industries would be well-suited to a more rigorous evaluation of the projects for which funding is sought.

Another relatively under explored area, especially in Canada, is the various implications of the different methods of government support of culture and their relationship with other forms of support. More research should be done to explore such questions as whether private donations are a substitute for or complement to government grants and the effectiveness of tax credits to for-profit cultural organizations.

Tourism is often a cited reason for supporting culture. Given this, a study to explore the role of culture on promoting tourism as well as a study on the effects of tourism on a local economy's economic development would be useful. Related to this issue is the role of cultural amenities in promoting business and individual relation to Ontario. To the extent that cultural amenities are a factor in relation, it is important to

understand which types of cultural amenities have the biggest effect. As discussed above, there is limited evidence to suggest that amenities such as music venues and more pop-culture types of activities may be more important than more traditional forms of cultural activities.

A missing component in provincial support of culture is the subsidization or promotion of the consumption of culture. To the extent there is subsidization, it is indirect, through the support of the other processes involved in culture production. Resources for such things as education are limited, and therefore, may restrict the ability of other government supported organizations to promote the exposure of culture to children and other unexposed groups. The government should, therefore, consider providing direct funding and incentives to promote increased exposure to cultural activities for currently underserved populations.

Finally, Ontario, especially the cities in Ontario, is home to individuals from many cultures. It would be useful to understand better the role that cultural organizations, museums, and other activities such as ethnic festivals play in promoting tolerance and understanding of these different cultures. Given the importance of having a defined “Canadian culture,” it is important to understand the role played by multi-cultural activities and how these activities affect the development of Canadian culture.

Briefly summarizing our recommendations, the government should consider the following actions:

- (6) Require a stronger economic justification for government funding and other programs in support of culture.
- (7) Restructure funding programs and tax incentives to focus on specific types of cultural activities and/or processes involved in the production of culture.

- (8) Implement a more rigorous procedure in evaluating the merits of grant applications.
- (9) Explore which types of cultural activities promote individual and business relocation, especially for the relocations that promote economic development.
- (10) Evaluate the importance of promoting “Canadian culture” and/or multicultural activities.

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