Economists' Arguments for Government Arts Subsidies

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Introduction

Due to controversy over various grants by the National Endowment for the Arts (NEA), Congress amended the law in 1990 to require the NEA to take standards of decency into account when issuing grants.[1] Following that amendment, there has been much discussion about the tension, created by government arts funding, between recognizing the values of taxpayers who fund the NEA and the First Amendment rights of the artists receiving the grants.[2] Missing from the debate, however, is discussion whether there are any economic reasons justifying such government funding. Often, the economic case for government arts funding is merely assumed. However, a body of economic literature has been developed that specifically examines whether economic theory justifies government arts funding. Alas, much of this literature is unsatisfactory.

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1. Department of the Interior and Related Agencies Appropriations Act, 1991, Pub. L. No. 101-512, § 103(d), 104 Stat. 1915, 1963 (1990).

2. *See, e.g.*, Symposium *Art, Distribution & the State: Perspectives on the National Endowment for the Arts*, 17 Cardozo Arts & Ent. L.J. 705 (1999) (discussing the impact of the *NEA v. Finley* decision, which instructed the NEA to take into account standards of decency and respect when promulgating regulations on granting funds).

The economics of the arts, or what has been termed *cultural economics*, has been a growing area of interest within the profession since 1966 when William Baumol and William Bowen published their book, *Performing Arts - The Economic Dilemma*.[3] Since then, more economists have been writing in the area, and a professional organization that publishes a professional journal has appeared.[4] Perhaps not by chance, this area has grown only since the advent of the NEA in 1965.[5]

Economists have offered several arguments in favor of government subsidies for the creation and distribution of art, many of which rely on allegations of market failure. In this paper, these arguments are reviewed and critiqued, and the author concludes that no satisfactory economic justification for government arts funding has yet been offered.

I. Ethical Arguments for Government Subsidies

The several arguments brought forth by those that consider themselves cultural economists can, for our purposes, be classified into two general groups. The first contains arguments that are unrelated to economic efficiency and tend to be generally ethical in nature. The second larger set includes those who argue that a free market will fail, for one reason or another, to provide an efficient quantity of artistic goods.

Statistics on audience member income have prompted more than one economist to argue for government arts subsidies on the basis of income inequalities.[6] Because the arts are perceived as luxury goods, individuals with relatively lower incomes are less able to experience the joys of the arts, so the argument goes.[7] It is undoubtedly true that the majority of those individuals who appreciate the arts are indeed on the

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3. William J. Baumol & William G. Bowen, Performing Arts – The Economic Dilemma (1966); *see* James Heilbrun & Charles M. Gray, The Economics of Art and Culture 5–6 (2d ed. 2001).

4. The Association for Cultural Economics International publishes the Journal of Cultural Economics. *Journal of Cultural Economics*, ACEI, http://www.culturaleconomics.org/journal.html (last visited Apr. 11, 2011).

5. *See* Heilbrun & Gray, *supra* note 3, at 5–6.

6. Baumol & Bowen, *supra* note 3, at 378–79; Thomas Gale Moore, The Economics of the American Theater 119 (1968).

7. *See* Moore, *supra* note 6, at 119.

upper end of the income distribution.[8] However, this is more of a description of reality than it is a point of logic.

Income inequality as an economic justification for government arts subsidies fails for two reasons. First, a statistical correlation between art consumption and income should not be assumed to be a causal relationship.[9] An increase in income will not necessarily have a large effect on an individual's arts demand if art is already low on his preference ranking.[10] Moreover, a person's education, upbringing, and occupation also act to shape his demand for artistic experiences.[11] However, not only will they affect a person's demand for art, but they will also affect his income over time.[12]

Additionally, a person's income, education, occupation, and taste for art may be predicated by his time preference.[13] Richard Weaver has postulated that as time preferences become higher, the level of culture demanded declines.[14] Hence, the direct effect of income level on arts demand is much more complicated than merely identifying a statistical correlation.[15] Statistics do show that those who demand arts tend to have incomes in the upper end of the distribution.[16] However, some early studies also found that when education and occupation are taken into account, they become significant predictors of arts attendance, and income does not.[17] Other studies controlling for the effect of education, occupa-

8. *See* J. MARK DAVIDSON SCHUSTER, THE AUDIENCE FOR AMERICAN ART MUSEUMS 5 (1991).

9. *See* PAUL DIMAGGIO ET AL., NEA RESEARCH DIV. REPORT NO. 9, AUDIENCE STUDIES OF THE PERFORMING ARTS AND MUSEUMS: A CRITICAL REVIEW 2 (1978).

10. *See* WILLIAM D. GRAMPP, PRICING THE PRICELESS: ART, ARTISTS, AND ECONOMICS 65 (1989).

11. DIMAGGIO ET AL., *supra* note 9, at 2; SCHUSTER, *supra* note 8, at 27–28.

12. *See* SCHUSTER, *supra* note 8, at 28; Martha S. Hill & Greg J. Duncan, *Parental Family Income and the Socioeconomic Attainment of Children*, 16 SOC. SCI. RES. 39, 43–46 (1987).

13. "Time preference" is a principle of economics recognizing the people prefer to have their ends satisfied sooner than later. *See* LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 480–81 (Henry Regenery Co., 3d rev. ed. 1966) (1949).

14. *See* RICHARD M. WEAVER, IDEAS HAVE CONSEQUENCES 78–91 (1948).

15. *See* DIMAGGIO ET AL., *supra* note 9, at 2.

16. *See* SCHUSTER, *supra* note 8, at 5.

17. DIMAGGIO ET AL., *supra* note 9, at 2.

tion, and upbringing have only rarely found high incomes to be statistically significant in predicting arts attendance.[18]

Regardless of income's effect on arts demand, an unequal income distribution is not a sufficient condition for a market inefficiency to exist, and therefore does not, in any way, justify the government's granting subsidies. Not everyone can afford a Lexus either. The fact that not everyone can afford to buy (chooses not to buy is a better way of putting it) a particular good is not an economic justification for government intervention into the market for art or automobiles or any other good. However, it is argued that art is not just another market good.[19] That leads to the next proposed justification.

The advent of public finance as a discipline brought the *merit good* into the economist's vocabulary.[20] When "individuals, as members of the community, accept certain community values or preferences, even though their personal preferences might differ. . . . Such acceptance . . . may affect one's choice of private goods or lead to budgetary support of public goods even though [one's] own preferences speak otherwise."[21] These public goods have been called merit goods by Richard Musgrave.[22] He and others have argued for arts funding, asserting that the arts is a merit good.[23] Note, however, that this is also not an economic justification for government subsidies but is simply a way of arguing that the arts are special. The arts have special merit so that, even though individuals may not be willing to fund them on their own, those same individuals will recognize that the community should fund them.[24] What they mean is that someone else should fund them. Nothing in economics would suggest that the free market needs the visible hand of the govern-

18. *See, e.g.*, SCHUSTER, *supra* note 8, at 18–28 (studying the effects of income level and education on museum attendance while controlling for third variables).

19. BAUMOL & BOWEN, *supra* note 3, at 380.

20. Richard A. Musgrave, *Merit Goods*, *in* 3 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 452, 452 (John Eatwell et al. eds., 1998).

21. *Id.*

22. *Id.*

23. *See id.*; DICK NETZER, THE SUBSIDIZED MUSE: PUBLIC SUPPORT FOR THE ARTS IN THE UNITED STATES 26–27 (Gregg Revivals 1993) (1978); W.J. Baumol & W.G. Bowen, *On the Performing Arts: The Anatomy of Their Economic Problems*, 55 AM. ECON. REV. 495, 502 (1965).

24. *See* Musgrave, *supra* note 20, at 452.

ment to make sure that the arts are funded no matter how much merit certain people think they have.

Another ethical argument used by lobbyists to justify government arts subsidies draws upon what is now known as Baumol's *cost disease*,[25] perhaps the most useful original contribution to the cultural economics literature thus far. First laid out in *Performing Arts - the Economic Dilemma*, the cost disease is a product of unbalanced growth due to the nature of different sectors in the economy.[26] The performing arts are labor-intensive by nature and have little capacity for increasing the productivity of their inputs.[27] One cannot increase a string quartet's productivity simply by telling it to play Beethoven's Opus 18, Number 1 faster. As the whole economy grows due to productivity gains, wages will increase economy wide, including those in the arts, if arts employers are to stay competitive.[28] However, the increases in the performing artist's wages without an increase in productivity means that the relative cost of a performance must increase over time.[29] Consequently, either admission prices must rise (shutting out even more individuals on the lower end of the income distribution) or marginal performing arts organizations will go out of business.

The argument that has often been advanced is that this problem can be ameliorated with government subsidies.[30] This is, in a sense, trivially true. Government subsidies do ameliorate cost problems for the recipients.[31]

However, several criticisms can be made regarding this proposed subsidy justification. One is that the cost disease may not be as chronic as Baumol and Bowen indicate.[32]

25. DAVID THROSBY, ECONOMICS AND CULTURE 118–19 (2001).

26. BAUMOL & BOWEN, *supra* note 3, at 163–67.

27. *Id.* at 164–65.

28. *See id.* at 167–68.

29. *See id.* at 168–69.

30. *See, e.g., id.* at 385–86 (arguing for arts subsidies on the basis that arts are public goods); NETZER, *supra* note 23, at 28–32 (suggesting that arts subsidies would overcome the income barrier, allowing more individuals to partake in the arts).

31. *See* GRAMPP, *supra* note 10, at 10–11.

32. *See* William Barnett II & Walter Block, *Spreading the Benefits of Productivity Increases: Price Increases, Decreases, or Both? A Critique of Baumol on Subsidies to the Arts*, 4 DIALOG ISKUSSTV 38, 39–40 (2006) (Russ.), *available at* http://www.uni-svishtov.bg/dialog/2006/4.06.WB.pdf.

There are substitutes for many of the laborers involved in putting on a production.[33] One can downsize productions, although this undoubtedly has a limit.[34] William Grampp has noted that the bulk of the literature growing from this theory has consisted of empirical studies centering on whether the cost disease is, in fact, active.[35] In doing so, he reminds us that, as a justification for government subsidies, whether the cost disease exists is beside the point.[36] Using the cost disease to justify intervention assumes that the value of the arts is greater than that which the market places on them.[37] In fact, nothing in economics tells us that an increase in relative cost of production is a *de facto* reason for government subsidies.[38] If demand does not increase enough to offset higher costs, it could simply mean that actors in the marketplace have decided that resources previously used in the production of the arts are more valuable if used elsewhere. Upon close inspection, the income inequality, merit good, and cost disease arguments, are not, strictly speaking, economic arguments at all. They are ethical arguments. The income inequality and costs disease theories include a description of what the economists believe to be the reality of the situations.[39] However, what moves the policy advisor from that reality to the plea for government funding is purely normative.[40] They are held because those advocating such positions believe that art is a special good: the arts hold intrinsic value,[41] and the government is justified in taking money from some people and giving it to others because of that intrinsic value.[42] Economics *qua* economics provides no justification for such arguments.

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33. GRAMPP, *supra* note 10, at 262.

34. BAUMOL & BOWEN, *supra* note 3, at 175.

35. GRAMPP, *supra* note 10, at 262.

36. *Id.* at 262–63.

37. *Id.* at 262.

38. *Id.*

39. *See* MOORE, *supra* note 6, at 119; BAUMOL & BOWEN, *supra* note 3, at 378–79.

40. *See* NETZER, *supra* note 23, at 16–18; C.D. THROSBY & G.A. WITHERS, THE ECONOMICS OF THE PERFORMING ARTS 195 (1979).

41. *See* NETZER, *supra* note 23, at 18–19; THROSBY & WITHERS, *supra* note 40, at 192–93.

42. *See* NETZER, *supra* note 23, at 18–19; THROSBY & WITHERS, *supra* note 40, at 195–96.

II. Efficiency Arguments for Government Subsidies

The largest set of reasons given by economists in favor of government arts funding can be gathered under the classification of market failure.[43] Conventional Marshallian welfare theory tells us that a free, perfectly competitive market without external spillovers will achieve *Pareto optimality*, the welfare criteria of which most economists are most accepting.[44] Optimal efficiency is reached at competitive equilibrium.[45] No one could be made better off without taking something away from someone else, hence, welfare is maximized.[46]

Cultural economists, however, are fond of pointing out that welfare maximization is assured only if the free market is also perfectly competitive in structure.[47] When the conditions of pure competition are removed, they argue, the market fails.[48]

There are a number of problems with such welfare economics. In the first place, acting man never exchanges in a perfectly competitive market. In fact, it has been cogently observed that such a conception of market activity is highly artificial and ultimately unhelpful in analyzing economic policy.[49] In the real economy, unrealized gains from trade are commonplace, however, it is just these potential gains that stimulate and indeed are reduced by voluntary exchange. The potential output for the real economy is not given but can expand as people create and take advantage of new opportunities. Consequently, the existence of perfect efficiency is a myth.[50]

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43. Heilbrun & Gray, *supra* note 3, at 208, 210–12; *see also* Netzer, *supra* note 23, at 20–21.

44. Jeffrey M. Herbener, *The Pareto Rule and Welfare Economics*, 10 Rev. of Austrian Econ. 79, 82 (1997); Barry P. Brownstein, *Pareto Optimality, External Benefits and Public Goods: A Subjectivist Approach*, 4 J. Libertarian Stud. 93, 104–05 (1980).

45. *See* Herbener, *supra* note 44, at 97–98, 100, 106; Meir Kohn, *Value and Exchange*, 24 Cato J. 303, 320–24, 331–33 (2004).

46. *See* Kohn, *supra* note 45, at 320; Murray N. Rothbard, The Logic of Action I: Money, Method and the Austrian School 243–44 (1997).

47. *See* Throsby & Withers, *supra* note 40, at 172.

48. *Id.*

49. Kohn, *supra* note 45, at 324–25, 328.

50. Rothbard, *supra* note 46, at 266–68, 371.

There are many other problems with the standard conception of Pareto optimality.[51] For example, it is possible for there to be many states defined as Pareto optimal.[52] There is no presumption that any particular optimum is preferable to any other optimum.[53] Optimality changes over time as economic realities change. Warren Nutter rightly states, "What makes sense as a policy today, viewed in terms of the 'Paretian' standard, will make no sense tomorrow."[54]

When analyzing public policy and its effect on social welfare, it makes more sense to use the concept of demonstrated preference, which treats human values only as revealed through action actually undertaken.[55] Because the voluntary exchange that takes place in a free market is mutually beneficial, we can conclude that the free market is beneficial to all of its participants. The institution of the free market results in gains to social welfare.[56] State wealth transfers, such as government arts subsidies, are very different. They involuntarily take from some and give to others.[57] Because value is subjective, so that it can be neither measured nor compared between individuals, there is no scientific way to conclude that government arts subsidies will increase social welfare.[58] The free market consists entirely of Pareto-superior moves. Thus, every government acquisition of property via intervention in the economy, including income taken to redistribute as arts subsidies, is Pareto-inferior.[59]

Additionally, one should also note that while efficiency and Pareto optimality may seem to most economists as worthwhile goals, using the Pareto criteria as a policy rule is just as much an ethical appeal as the argument from income ine-

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51. Leland B. Yeager, *Pareto Optimality in Policy Espousal*, 2 J. LIBERTARIAN STUD. 199, 199–200 (1978).

52. *Id.* at 199; Burton A. Weisbrod, *Comparing Utility Functions in Efficiency Terms or, What Kind of Utility Functions Do We Want?* 67 AM. ECON. REV. 991, 995 (1977).

53. Yeager, *supra* note 51, at 199.

54. G. Warren Nutter, *Economic Welfare and Welfare Economics*, 2 J. ECON. ISSUES 166, 167 (1968).

55. ROTHBARD, *supra* note 46, at 212.

56. *Id.* at 240.

57. *Id.* at 243–44.

58. *Id.* at 211–12, 243–44.

59. Herbener, *supra* note 44, at 94, 106.

quality, merit goods theory, and the cost disease.[60] However, this does not mean that market failure arguments for government arts subsidies should not be addressed by good economists. The rest of the Article identifies various suggested market failure arguments and assesses their validity.

Supposed economies of scale in symphonies, dramas, and art museums have been put forth as examples of market failure in need of fixing by government funding.[61] Museums and symphonies are believed to operate with relatively large fixed costs while the marginal costs are next to zero.[62] If the price is set at the efficient price which is equal to marginal cost, the price will be below the firm's average total cost causing the arts organization to incur a loss.[63] Thus, the only way for the institution to avoid a loss is to charge a price at least as high as the average total cost which is above marginal cost and hence inefficient.[64] The free market fails to provide the efficient price and quantity.[65]

However, closer inspection of this argument reveals that no economies of scale of production are occurring. This confusion is due to misidentifying the unit of output. A typical definition of arts output is given by Dick Netzer, who stated, "In the arts, the unit of output may be a consumer visit to a museum or an individual's attendance at a performance."[66] If this is taken as the definition of output, then economies of scale seem entirely plausible. It costs no more to perform *Hamlet* to an audience of 851 than it does to 850 as long as the theater's capacity has not been reached. The marginal cost of performing for one additional audience member is effectively zero.

Identifying the production costs with the cost of serving one more consumer, however, is incorrect.[67] Throsby and Withers at least recognize the potential for confusion when defining the output, and hence costs, of performing arts pro-

60. Yeager, *supra* note 51, at 204–06.
61. *See* GRAMPP, *supra* note 10, at 260–61.
62. *See* NETZER, *supra* note 23, at 25; HEILBRUN & GRAY, *supra* note 3, at 196.
63. NETZER, *supra* note 23, at 25.
64. *Id.*
65. HEILBRUN & GRAY, *supra* note 3, at 196.
66. NETZER, *supra* note 23, at 25.
67. *See* THROSBY & WITHERS, *supra* note 40, at 11–12.

ducers.[68] Unfortunately, they also misdefine output as the number of tickets actually sold, which is equivalent to describing General Motors' output as only those cars that were indeed sold.[69] Any cars that remain unsold on the lot would not count as being produced. Even economists who argue against the claim of scale economies in the case of arts institutions are not immune from this confusion.[70]

In order to get the analysis straight, the economist should always be careful in identifying the correct marginal unit. The marginal unit is best defined as the unit relevant for action.[71] The relevant marginal unit, therefore, will depend on whose actions one is examining.[72] If searching for economies of scale in producing an artistic experience, the relevant marginal unit is the unit that enters into the decision calculus *from the point of view of the producer*.[73] It is the producer's costs that are being analyzed. The relevant marginal unit for a museum is not one more visitor but one more day's (or hour's) operation. Likewise, the relevant marginal unit for a symphony orchestra or drama company is not one more audience member but an additional performance.

In addition, economic costs are not merely the dollar amounts listed on the accounting expense sheet but are foregone opportunities which are subjective to the chooser.[74] When deciding whether to produce a play or symphony concert, the entrepreneur weighs the opportunity cost and the expected benefits.[75] If a performance is produced, all of the relevant economic costs have already been calculated by the

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68. *Id.*

69. *Id.*

70. *See, e.g.*, GRAMPP, *supra* note 10, at 260–61 (arguing against the declining average cost theory as applied to museums and art performances while retaining the incorrect assumption that the unit of output is the sale of a ticket).

71. SHAWN RITENOUR, FOUNDATIONS OF ECONOMICS 40–41 (2010).

72. *Id.*

73. *See Id.* at 40.

74. *See* HEILBRUN & GRAY, *supra* note 3, at 109–10; *see generally* G.F. Thirlby, *The Subjective Theory of Value and Accounting "Cost,"* 13 ECONOMICA 32, 34–35 (1946) (noting that the "cost" of adopting an alternative is simply the relinquishing of another alternative, with the reward and sacrifice measured by the market participant).

75. *See* HEILBRUN & GRAY, *supra* note 3, at 109 ("The true (or 'real') cost of any endeavor, according to economists, is measured by the value of the resources used up to carry it out."); *see generally* THROSBY & WITHERS, *supra* note 40, at 10 (explaining

producer regardless of how many people are in the theater.[76] If the expected total revenues at least cover all of the economic costs, then the performance was desirable to produce no matter how many seats are filled.[77]

Another source of alleged market failure is imperfect information on the part of some individuals in the marketplace. One of the assumptions of the perfectly competitive model that yields efficient results is that all market participants possess full and complete information regarding all relevant economic variables. If this condition does not occur, then the free operation of the market will not guarantee a Pareto optimal solution.[78]

Cultural economists who argue for public subsidies on the grounds of imperfect information are usually speaking of the information possessed by consumers.[79] John Stuart Mill reasoned that the uncultivated poor did not know which education would best suit them and argued on that basis for public education alternatives to the private education market.[80] Contemporary cultural economists have used similar reasoning to justify public subsidies in the arts market. Because the arts are an acquired taste, some economists have argued that government subsidies are necessary for more people to get a first-hand experience with them in order for them to make better informed choices.[81]

It is tempting to include such arguments with the ethical justifications examined in the previous section because, as applied to arts consumption, they allow normative distinc-

that arts suppliers provide their goods or services to a performing company because they receive accepted pay).

76. *See generally* BAUMOL & BOWEN, *supra* note 3, at 21 (explaining that each artistic production is treated by the producer as its own economic enterprise, even though some matters are beyond the producer's direct control); MOORE, *supra* note 6, at 41–58 (explaining that a performance's actual production costs include all disbursements required to raise the curtain, the operating expenses during the show's run, and set removal costs).

77. *See* MISES, *supra* note 13, at 286–88; RITENOUR, *supra* note 71, at 209–11.

78. HEILBRUN & GRAY, *supra* note 3, at 236–37.

79. NETZER, *supra* note 23, at 25–26; HEILBRUN & GRAY, *supra* note 3, at 236–37.

80. JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 108–09 (W.J. Ashley ed., Augustus M. Kelley 1965) (1848).

81. *See* HEILBRUN & GRAY, *supra* note 3, at 236–37; NETZER, *supra* note 23, at 25–26; THROSBY, *supra* note 25, at 140–41.

tions into the analysis.[82] To say that art is more important than other goods or that some art is better than others is to make a value judgment. People, of course, are free to make such statements from the point of view of aesthetics, ethics, or theology; but economics, as a value-free science, cannot make such interpersonal utility comparisons. Nevertheless, imperfect information arguments are here grouped with other forms of alleged market failures because imperfect information is usually considered a cause of market failure.

While it may be true that taste in art is something that develops over time via experience, to argue on that basis that a free arts market fails is equivalent to arguing that every free market fails everywhere all the time. No one has perfect information about all relevant variables concerning any economic goods—human beings are not omniscient.

Regarding consumer information, art is no different than any other good. If consumers face a dearth of information concerning particular goods, entrepreneurs will find it profitable to offer this information to the public.[83] Subscribers to periodicals such as *American Record Guide*, *Gramophone*, and *Fanfare* are continually instructed in taste elevation and are provided much information about things such as what are the best recordings of Beethoven's *Symphony No. 5* to buy and which city's symphony would be worth paying the admission price to hear.[84] The imperfect information argument for public subsidies also rests on the questionable assumption that the government's money will be put to the best use, allowing the ignorant consumer to be exposed to only the best works.[85] Subsidies that merely lower admission prices to performances will not help consumers decide which performances will be worth attending. If the subsidies are used in education to solve the information problem, the state-funded teachers would have to know which works of art are the most important and which ones to leave out, which schools are

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82. *See* THROSBY, *supra* note 25, at 140–41.

83. *See generally* MISES, *supra* note 13, at 664–65 (showing the reasons why people provide products and services).

84. *See, e.g.*, Susan Brodie, *On Tour in New York & Eastern Canada*, AM. REC. GUIDE, May/June 2010, at 10–11 (reviewing several performances in rich detail).

85. *See* HEILBRUN & GRAY, *supra* note 3, at 236–37.

worth examining and which ones are not.[86] State bureaucrats would also have to know which educational programs are worth funding and which ones would be a waste. If consumers spending their own money do not have enough knowledge to choose wisely, nothing in economic theory or in experience indicates that state controllers, spending other people's money, are any more knowledgeable.[87] Hence, the argument for government arts funding in the face of imperfect consumer information fails.

A more popular market failure argument for government arts funding is found in *public goods theory*.[88] A public good is one in which there is jointness in consumption (meaning that one individual can consume a good without infringing on another's consumption) and for which the costs of excluding consumers is prohibitive.[89] In other words, if a good can be provided in the same amount to all of the affected consumers, it is a public good.[90] Paul Samuelson argued that, given certain assumptions, the free market will not provide for the optimal production and distribution of public goods; specifically, the market will not provide enough.[91] While his discussion has not been without criticism,[92] and arguments have been made showing that exclusion is almost always possible,[93] the fact remains that, given the standard neoclassical assumptions put forth by Samuelson, his conclusions necessarily follow.

Several cultural economists have latched onto this line of thought and have sought to demonstrate that art can be viewed as a public good. Therefore, public funding is not only

86. *Cf.* THROSBY & WITHERS, *supra* note 40, at 245–47 (noting the relatively small number teachers in public education with the requisite knowledge or interest in the arts).

87. *See generally* ROTHBARD, *supra* note 46, at 122–26, 136 (discussing the imperfect knowledge of consumers in general and central planners in particular).

88. *See* NETZER, *supra* note 23, at 21–23; HEILBRUN & GRAY, *supra* note 3, at 230–31.

89. GRAMPP, *supra* note 10, at 240.

90. HAL R. VARIAN, MICROECONOMIC ANALYSIS 414 (3d ed. 1992).

91. Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 388–89 (1954).

92. Stephen Enke, *More on the Misuse of Mathematics in Economics: A Rejoinder*, 37 REV. ECON. & STAT. 131, 132–33 (1955).

93. Robert B. Ekelund, Jr., *The Fragile Nature of Public Goods Equilibria*, 35 REV. SOC. ECON. 204, 206 (1977).

justified, it is necessary if society is to produce and consume the optimal amount.[94] However, this appeal to public goods theory is often made with rather fuzzy logic and blurry distinctions. While using public goods terminology, cultural economists are forced to acknowledge that the arts are surely not a pure public good as defined above.[95]

They have attempted to carry on by asserting that art has public-like characteristics, namely jointness in consumption.[96] Everyone in a theater consumes the same play, and the individual audience member's consumption does not infringe on the utility gained by other audience members (assuming, of course, that audience members do not cough, snore, make other unwanted noises, have body odor, put on too much perfume, or wear obstructive hats). The arts on television are seen to more closely approximate a public good as do large works of visual arts such as mural paintings.[97] The need to fall back to weaker classifications, such as public-like, is due to the fact that it *is* possible to exclude individuals from theater performances and television viewing.[98] If exclusion is possible, then it can be shown that even with jointness in consumption, an efficient outcome will occur.[99] In addition, jointness in consuming a mural becomes a problem as crowding increases. The breakdown of pure jointness in consumption and the possibility of excluding unwelcome parties, by definition, rules out the pure public goods argument for government arts subsidies.

When cultural economists cite public-like characteristics in arts production or consumption, they are really referring to the most popular economic argument used to justify taxpayer

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94. *See* NETZER, *supra* note 23, at 21; HEILBRUN & GRAY, *supra* note 3, at 225–26.

95. NETZER, *supra* note 23, at 21.

96. *Id.* at 21–22.

97. *Id.*

98. *Id.* at 21.

99. *See* William Mark Crain & Robert B. Ekelund, Jr., *Chadwick and Demsetz on Competition and Regulation*, 19 J.L. & ECON. 149 (1976); Harold Demstez, *Joint Supply and Price Discrimination*, 16 J.L. & ECON. 389, 401, 403 (1973); Robert B. Ekelund, Jr., & Joe R. Hulett, *Joint Supply, the Taussig-Pigou Controversy, and the Competitive Provision of Public Goods*, 16 J.L. & ECON. 369, 381–83 (1973); Harold Demstez, *The Private Production of Public Goods*, 13 J.L. & ECON. 293, 301–03 (1970).

funding of the arts—*external benefits*.[100] The conditions necessary for the existence of an externality are fewer and weaker than those characterizing a pure public good.[101] For externalities to arise, all that is necessary is for some individuals besides the producer or consumer to bear some of the costs or reap some of the benefits associated with the production or consumption of a good.[102] It has been shown that, given the standard neoclassical assumptions, when external benefits arise from the consumption of a certain good, the free market will not produce the Pareto optimal amount of that good.[103]

Cultural economists have produced several variations on the external benefits theme, arguing for the necessity of public subsidies for arts production and consumption.[104] One of the more popular variations is the *arts impact study*.[105] The basis for such studies is the common sense claim that spending by arts organizations in particular locales generate substantial incomes for many people.[106] Some advocates of arts subsidies have taken such empirical realities and developed Keynesian explanations attempting to show how much government money spent on the arts in a certain locale will increase the economic activity in that area. They argue that this occurs due to spillover effects as concert and theatergoers also buy food and drink, take taxis and subways, and

100. NETZER, *supra* note 23, at 22–23.

101. *Id.* at 22–24.

102. *See id.* at 22.

103. *See* Edgar O. Olsen, *The Simple Analytics of External Effects*, 45 S. ECON. J. 847, 852–53 (1979); *see generally* Francis M. Bator, *The Anatomy of Market Failure*, 72 Q.J. ECON. 351, 370–71 (1958) (nothing that, given standard neoclassical assumptions, in a free market, externalities will always result in market failure).

104. THROSBY, *supra* note 25, at 140.

105. *See, e.g.*, Harry Hillman-Chartrand, *Introduction: The Value of Economic Reasoning and the Arts*, *in* ECONOMIC IMPACT OF THE ARTS: A SOURCEBOOK 2–3 (A.J. Radich & Sharon Schwock eds., 1987) (noting the increasing use of the economic impact study).

106. *See* Rosemary Scanlon & Robert Longley, *The Arts as an Industry: Their Economic Importance to the New York-New Jersey Metropolitan Region*, *in* ECONOMICS OF CULTURAL INDUSTRIES 93, 94–98 (William S. Hendon et al. eds., 1984); Geoffrey Wall & Colleen Roberts, *The Economic Impact of the Tutankhamun and Van Gogh Exhibitions*, *in* ECONOMICS OF CULTURAL INDUSTRIES, *supra*, at 66, 73–76.

stay at area hotels and motels.[107] Pecuniary externalities such as these, however, have been shown in general to not cause any inefficiency.[108] In fact, from this point of view, the arts subsidy is simply a transfer of wealth from one group of individuals to another. In the particular case of the *arts multiplier*, it was pointed out in the Nineteenth century that

> it is clear that the taxpayer, who has contributed one franc [to pay for arts subsidies], will no longer have this franc at his own disposal. It is clear that he will be deprived of some gratification to the amount of one franc; and that the workman, whoever he may be, who would have received it from him, will be deprived of a benefit to that amount.[109]

This same point is echoed more recently by Bruce Seaman[110] and Tyler Cowen.[111] Studies on the economic impact of the arts consistently incorrectly estimate the real economic impact because of the faulty use of Keynesian multiplier equations.[112] Consequently, these studies take little account of the substitution of resources indicated by Bastiat. Money spent on art is money *not* spent elsewhere. The arts multiplier is, at best, reduced due to crowding out.[113] From a national standpoint, subsidizing the arts is a zero-sum game.[114] One city's gain is another's loss. It is clear that appealing to pecuniary external spillover effects will not do for justifying arts subsidies.

Cultural economists have not, however, constrained themselves to arguing for government subsidies on the basis of

107. AM. FOR THE ARTS, ARTS AND ECONOMIC PROSPERITY III: THE ECONOMIC IMPACT OF NONPROFIT ARTS AND CULTURE ORGANIZATION AND THEIR AUDIENCES 9–10 (2008).

108. Peter Bohm, *External Economies*, *in* 2 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS, 261–63 (John Eatwell et al. eds., 1987).

109. FREDERIC BASTIAT, *That Which Is Seen and That Which Is Not Seen*, *in* 1 THE BASTIAT COLLECTION 15 (2007).

110. Bruce A. Seaman, *Arts Impact Studies: A Fashionable Excess*, *in* ECONOMIC IMPACT OF THE ARTS: A SOURCEBOOK, *supra* note 105, at 43, 49–55.

111. TYLER COWEN, GOOD AND PLENTY: THE CREATIVE SUCCESSES OF AMERICAN ARTS FUNDING 14–16 (2006).

112. *See, e.g.*, AM. FOR THE ARTS, *supra* note 107, at 1–13 (using Keynesian principles to evaluate economic impact of nonprofit art in America); *see also* HEILBRUN & GRAY, *supra* note 3, at 344–47 (explaining how the multiplier effect of art on local communities is calculated).

113. *See* Seaman, *supra* note 110, at 52–53, 55.

114. *See id.* at 57–60.

mere pecuniary externalities but have provided stronger arguments showing technological and consumption external economies. It is argued, for example, that some art forms are interdependent.[115] Music forms, for example, sometimes support one another. If one is an admirer of Gershwin's *Rhapsody in Blue* or Aaron Copland's *Concerto for Piano and Orchestra*, one has benefited from the jazz idiom from which these composers drew, even if the listener cannot stand jazz and thinks it vulgar. Composers from different schools draw material from each other, and musicians' involvement with performance institutions provide the opportunity to share training and expand employment possibilities.[116] Some artists may learn from other's failures. Subsidies, consequently, should help artistic risk takers.

In economic terminology, these examples amount to technological spillovers.[117] The secret, from a policy perspective, is knowing which industries or firms to subsidize in order to make the most of these spillovers. The empirical record is less than sparkling for the central planner. Studies have shown, for example, that where centrally planned industrial policies have been undertaken in Asia, the economy has not grown as robustly as those of the more free economies and that the central planners generally picked the wrong industries to subsidize.[118] No reason exists to indicate that central planners would be better at choosing the right artist or institution to fund in order to make the most of artistic spillovers, allowing higher levels of artistic growth. Even so-called experts, such as the arts establishment and influential critics, cannot perfectly predict the future. Renoir, Seurat, and Cezanne were all kept out of the officially approved art salons in France.[119]

Another more alluring argument from externality theory is the notion of cultural heritage preservation or option value as

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115. NETZER, *supra* note 23, at 22–23.

116. *Id.*

117. *See* MOORE, *supra* note 6, at 121–22; HEILBRUN & GRAY, *supra* note 3, at 229–30.

118. Robert J. Barro, *Industrial Policy, a Tale of Two Cities*, WALL ST. J. ASIA, Apr. 2, 1992, at 6.

119. *See* H.R. ROOKMAAKER, MODERN ART AND THE DEATH OF A CULTURE 96–97 (Crossway Books 1994) (1970).

it is sometimes termed.[120] If the arts are to be available for providing utility to future generations, they must be supported adequately today.[121] This argument is quite seductive, and indeed Alan Peacock sees this as the strongest of all externality arguments.[122] This theory generally asserts that while a community cares about passing on the arts to future generations for them to enjoy, the free market will not make possible such provision, hence, the government must step in to insure art's survival.[123]

Several cultural economists have also argued that a thriving arts culture provides even those citizens who do not directly consume them with a bit of locational prestige, whether on a city, state, or national level.[124] "The more arts, the more vigorous the arts, the better developed the arts, the more prestige any one country has with the citizens of other countries."[125] Some citizens who do not consume any art, who in fact may hate art, nevertheless benefit from others consuming art.[126] These benefits are external to those reaped by the consumers. Concert and museum goers have no incentive to take into account the national prestige afforded their Philistine fellow citizens; consequently, a free market will not provide the optimum amount of the art.[127]

Both of these arguments suffer from two basic flaws. One boils down to a willingness to pay issue. Professors Peacock,[128] Throsby, Withers,[129] Baumol, and Bowen[130] all assert that the community as a whole recognizes the external benefits provided by the arts and that the community must fund art via the government because individuals will not pay enough for it.

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120. *See* A.T. Peacock, *Welfare Economics and Public Subsidies to the Arts*, 18 J. CULTURAL ECON. 151, 151 (1994).

121. *See id.*

122. *Id.* at 155.

123. *Id.*

124. MOORE, *supra* note 6, at 118.

125. *Id.*

126. *Id.*

127. *See* Baumol & Bowen, *supra* note 23.

128. Peacock, *supra* note 120, at 155.

129. *See* THROSBY & WITHERS, *supra* note 40, at 175.

130. *See* Baumol & Bowen, *supra* note 23.

Such an argument fails to recognize that a community is made up of the same individuals it is alleged will not pay. None of the literature cited above explains why, if the individuals in a particular community really want something (e.g. perpetuation of culture or national prestige), they are not willing to pay for it. The reason, implied in this argument, is that, when external benefits exist, the first order conditions of a constrained optimality problem under standard neoclassical assumptions tell us that consumers will not be willing to pay for enough of the good.[131]

The above argument suffers, however, from what F.A. Hayek termed *scientism*.[132] Economists, in attempting to be scientific, have adopted the method of the engineer.[133] Suppliers and demanders resemble inanimate objects passively reacting to exogenous constraints.[134] In fact, buyers and sellers are humans who act according to their will. Each consumer compares the subjective marginal benefit and subjective marginal cost of each purchase before he acts.[135] If a work of art is not consumed, it is because the costs are too high.[136] If art consumers do not take into account potential external benefits, external beneficiaries can bargain with consumers to compensate them for additional purchases. If they choose not to do so because transactions costs are too high, then they are recognizing something that a lot of economists choose to ignore. Transactions costs are real costs that cannot simply be ignored or eliminated by increased government activity.[137]

Nevertheless, cultural economists have sought to analyze the extent of the so-called *free-rider problem*.[138] Empirical studies have been undertaken to examine whether a free-rider problem does exist and, if so, how economists can ac-

131. *See* Bator, *supra* note 103, at 356–63; *see also* Olsen, *supra* note 103, at 853.

132. F.A. HAYEK, THE COUNTER-REVOLUTION OF SCIENCE: STUDIES ON THE ABUSE OF REASON 24 (Liberty*Press*, 2d ed. 1979).

133. *Id.* at 25.

134. ROTHBARD, *supra* note 46, at 10.

135. Brownstein, *supra* note 44, at 96.

136. *See id.* at 97.

137. *Id.*; THRAINN EGGERTSSON, ECONOMIC BEHAVIOR AND INSTITUTIONS *passim* (1990).

138. C.D. Throsby, *The Measurement of Willingness-to-Pay for Mixed Goods*, 46 OXFORD BULL. ECON. & STAT. 279, 285 (1984).

count for it in survey results.[139] These studies use a method that allegedly takes into account the bias of the respondent according to whether he is expecting to be taxed or not be taxed for more art.[140] The studies provide an upper and lower boundary of average willingness to pay on the part of the participants. Using this data, cultural economists have claimed that a free-rider problem does exist, affirming that the free market really does not provide enough art to attain the optimal levels of external benefit from art for which people are willing to be taxed.[141]

Such studies, however, are unconvincing. The authors of these studies place a lot of emphasis on whether the respondents are telling the truth. While this is, of course, an important issue, even more important is that no matter whether respondents are giving honest answers, their response is irrelevant to the issue at hand. Participants simply do not know what quantity they will demand in the future given future circumstances. All surveys of this type are locationally and historically bound. To answer willingness to pay questions, participants must construct some hypothetical environment they can imagine and then decide how much under these circumstances would they be willing to pay for.[142] It is obvious that the imagined circumstances will most probably never come into being. Conclusions based on these questionnaires must consequently be very qualified.

If people are willing to pay for art to add to national prestige or cultural perpetuation, why do they not do so? As William Grampp points out, "When the public is asked to contribute voluntarily to the arts, it reveals it holds them in less esteem than when it simply is asked its opinion of them."[143] To argue that individuals are, in fact, willing to pay for something, while economists do not actually *see* them paying for it,

139. *Id.* (studying the willingness to pay for arts and the free-rider problem in Sydney, Australia); *see also* C.D. Throsby & Glenn A. Withers, *Strategic Bias and Demand for Public Goods: Theory and an Application to the Arts,* 31 J. PUB. ECON. 307, 317 (1986); William G. Morrison & Edwin G. West, *Subsidies for the Performing Arts: Evidence on Voter Preference*, 15 J. BEHAV. ECON. 57, 59 (1986).

140. *E.g.*, Throsby, *supra* note 138, at 284.

141. *See id.* at 287.

142. *See id.* at 284.

143. William D. Grampp, *Rent-Seeking in Arts Policy,* 60 PUB. CHOICE 113, 115 (1989).

requires much fortitude. To argue that the market does not account for external benefits from art, and that consequently a private market will not supply an adequate amount, seems to ignore the fact that a multitude of arts institutions are nonprofit organizations existing as a result of voluntary contributions.[144] Voluntary nonprofit institutions are a market response to individuals desiring to pursue certain ends, such as art production (in part for national prestige and cultural heritage reasons) and are willing to donate money to see that this demand is met.[145] Burton Weisbrod has compellingly argued that nonprofit organizations tend to produce goods and services that are perceived to provide for external benefits.[146] To argue that a free society is incapable of providing those goods yielding an external benefit is to ignore a large section of the fine arts industry, and it removes charitable acts from the category of economic goods.[147]

The second main flaw in the cultural preservation and national prestige externality arguments is that they incorrectly assume that the arts is a fund of creative stuff consisting of homogeneous units.[148] If the perpetuation of culture or national prestige is a service provided via current art consumption, then artworks and arts institutions can be seen as capital goods used in the production of these external goods. As is true with all capital goods, the arts is not a homogeneous blob of higher order good with a capital *A* stamped on it.[149] The heterogeneity of capital goods in general has been ably demonstrated.[150] Capital goods are not useful for the desired task simply because they are something called capital. As Ludwig von Mises put it, "Capital is always in the form of definite capital goods. These capital goods are better utilizable for some purposes, less utilizable for others,

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144. *See* BURTON A. WEISBROD, THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS 1 (1977).

145. Murray N. Rothbard, *The Myth of Neutral Taxation*, 1 CATO J. 519, 523 (1981).

146. WEISBROD, *supra* note 144, at 1, 59–60.

147. *See id.* at 1.

148. *See* F.A. Hayek, *The Mythology of Capital*, 50 Q.J. ECON. 199, 214 (1936).

149. *See id.*

150. *See id.* at 219–20.

and absolutely useless for still other purposes."[151] Using certain higher order goods becomes profitable only when they are mixed appropriately with other goods to most efficiently produce the end product desired.[152]

What is true with capital in general is even truer in the case of art that produces national prestige and future utility. Not all artists, art works, and institutions are alike. Indeed, art, by its nature, is the best example of a highly differentiated product.[153] Mises again, when speaking of what he terms the *creative genius* states, "It is, furthermore, impossible to substitute other people's work for that of the creators. If Dante and Beethoven had not existed, one would not have been in a position to produce the *Divina Commedia* or the Ninth Symphony by assigning other men to these tasks."[154]

The implication of the above is that some art will work to increase the level of future culture and national prestige, but some will not. In fact, some art may even work against it. While many citizens think consumption of works by Maplethorpe, Karen Finley, and Serrano contributes to a thriving and daring artistic culture, many also see their work as leading to external bads.[155] Several citizens consider them contributing to reducing the level of future culture and a source of national shame.[156] Because interpersonal utility comparisons are not possible, economic science is unable to conclude that government bureaucrats will be able to determine who are more deserving of subsidies and which artists, works, or institutions will be able to provide the optimal level of cultural heritage or national prestige.

CONCLUSION

As the above discussion demonstrates, cultural economists use economic arguments in vain when trying to successfully justify government intervention into the market for art and

151. MISES, *supra* note 13, at 503.

152. *See id.*

153. *See id.* at 139–40.

154. *Id.* at 140.

155. NATIONAL ENDOWMENT FOR THE ARTS: A HISTORY 1965–2008, at 89–95, 98 (Mark Bauerlein & Ellen Grantham eds., 2009).

156. *See id.* at 92.

artists. Some arguments that initially appear to be primarily economic turn out to be purely ethical. Market failure arguments fail themselves when brought under the scrutiny of sound economic analysis. Appeals to the public-like characteristics of certain facets of the arts do not warrant the provision of state arts subsidies. Those looking to the economics literature for valid scientific justifications of government arts subsidies search in vain.