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THE ECONOMICS OF PUBLIC SUPPORT FOR THE ARTS

By Jim Marshall

Introduction

There is continuing discussion about whether and to what extent there should be public support for artists and the arts¹ they produce. From time to time, some seek an economic rationale for public support, trying to illustrate that government support for the arts has an “economic value” or is “good for the economy”.

More often than not, this approach focuses on an attempt to show that funding for the arts increases the overall level of economic activity, especially as measured by its impact on the financial well-being of artists. Unfortunately, increased income for a few does not prove an increase in societal well-being, especially when the funds used to raise that income are derived by reducing the income of others. In effect, the measured microeconomic impact of such programs on the primary beneficiaries does not represent the overall impact on the whole of society and should not be assumed to represent the macroeconomic impact.

While it is difficult to argue that efforts to raise the well-being of artists is of benefit to the larger society from a purely financial perspective, there are an abundance of other arguments in favour of a positive economic impact from public support for the arts. Most of these arguments are based in a field of economics called “public finance”.

Public Goods

From the perspective of economists, most goods and services² are exchanged in transactions between producers and final consumers³. In these exchanges, producers carry the awareness of the effort that has gone into the production of the goods, often viewed as the “cost of production”. They know what has been required to produce the good in terms of inputs and effort and are conscious of what they need to receive in payment to justify continued production of the good.

On the other hand, final consumers have an awareness of what specific goods will provide them in terms of satisfaction or utility. They bring a valuation of the worth of goods to the bargaining process.

Through a process of bargaining and negotiation, producers and consumers manage to establish a rate of exchange for goods, a price, at which they are both comfortable. The price paid by consumers will move to a level which is acceptable to producers and/or the price charged by producers will settle at a level which is acceptable to consumers.

Not everyone will be happy with this rate of exchange. Some people will find the prices to be too high for their liking and they will

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choose to not consume the good in question. Some producers will find they cannot justify continued production at the established price, especially if they face unusual costs, and they will choose to quit production and do something else. But, for those who remain in the exchange agreement, there is a voluntary solution to the fundamental questions of economics: what to produce, how much to produce, how to produce it and for whom to produce it.

These are the fundamentals of Adam Smith's "invisible hand" argument that suggests that, by merely bringing to the table their own awareness of the resources required in production and the "value" of the goods produced, producers and consumers can work out a transaction in which the price paid is reflective of both the value of the good to society and the costs of the resources required to produce the good.

In a broader sense, with these transactions occurring over and over, billions of times a day involving billions of different goods, the resolution of the exchange rates will ensure that for every good, the price reflects its costs in terms of resources consumed in production and, in competing for those resources, will ensure that the resources available to society are employed first and foremost in the production of the goods which society values the most, in declining order of value until all the resources are fully employed in production, and the goods produced will accurately reflect the valuation of the individuals who receive them and therefore the valuation of society at large.

There are many factors that can disrupt the smooth working of this exchange process, however. Among those factors are those that reflect goods which have certain characteristics that prevent negotiations between consumers and producers from reflecting their true value to society as a whole. Economists have termed these goods "public goods", as distinct from "private goods". There are several important characteristics which are used to identify which goods are public goods and which goods are private goods.⁴

Exclusion

From many goods, the consumer is able to derive the sole benefit of consumption. When one person consumes such goods, it is of little or no benefit to anyone else. This is the characteristic of exclusion: in consumption, it is easy to

prevent others from deriving any benefit from the good. But, there are other goods, the consumption of which provides benefits to some other than the individual who consumes the good and, more to the point, in which there is no practical way to prevent those others from benefiting from that good.

An example often used to illustrate the distinction is the provision of national defence. One could not conceive of a convenient way to exclude anyone within a nation's borders from benefiting from national defence effort. Once one defines the protected area, all who are within that corridor will be protected, regardless of their involvement in the overall activity.

When individuals can benefit from the existence of a good without contributing to the cost of its production (when exclusion cannot be applied), they can become "free riders"; allowing others to purchase goods and pay the costs of their production and deriving satisfaction or benefit at no cost to themselves.

Exclusion is fundamental to the smooth working of the market exchange process discussed above because, for the "market price" to reflect the total valuation of society of the good being exchanged, every person deriving benefit from the good must be involved in and contributing to its valuation. When individuals can benefit from the existence of a good without contributing to the cost of its production (when exclusion cannot be applied), they can become "free riders", allowing others to purchase goods and pay the costs of their production and deriving satisfaction or benefit at no cost to themselves.

When exclusion does not apply, or when goods take on the characteristic of "non-exclusivity", the market clearing mechanism will not result in an exchange value that reflects their total value to society since those who are sitting on the sidelines and deriving benefit will not be involved in the negotiations process that leads to a market price. While some consumers will be directly involved, those that are will not wish to encourage production up to the full level of value to society, but will stop short at encouraging production only up to the value that they derive personally.

While free riders will derive a benefit from the good's production, they will not (by their own choice) be at the table to set the societal valuation of the good. To do so would be to "reveal their preferences" and risk being asked to contribute towards the costs of production of the goods. Since free riders receive the same benefit from goods whether they admit to benefiting or not, they are strategically wise to deny any benefit and the market assessment of the societal value of the good will not include the value derived by free riders.⁵ The good will be "undervalued" in the marketplace and, hence, it will be "under-produced".

The tendency will be for available resources to be fully employed in production somewhere. If the allocation of resources towards the production of non-exclusive goods is inadequate (both absolutely and relatively) due to the tendency to "undervalue" such goods in a market exchange system, it follows that the under-production of non-exclusive goods will be matched by an equal "over-production" of exclusive goods in society, or that the mix of goods produced will not be reflective of society's relative valuation of the goods produced. In other words, the society will not be maximizing its benefit from goods production and a state of economic inefficiency will exist.

So, when there is a condition of non-exclusivity, allowing the choice of "what to produce", "how much to produce", "how to produce it" and "for whom to produce it" to be made purely through negotiations between producers and consumers will result in less non-exclusive goods than would be desirable from a societal perspective (and, by implication, more of other, exclusive goods), and we would end up with much less national defence than we (collectively) "want". These questions cannot be answered by the invisible hand and require a different, collective decision-making process.

Rivalry

In the case of many goods, the consumption by one person precludes the consumption by another. This is a condition of rivalry in that individual consumers become rivals for the consumption of the good. In such case, one consumer's valuation of a good is in contrast or opposed to the valuation by another of the good. Their individual valuations are alternatives and, in general, the consumer with the higher valuation of the good will be the one "to whom" the good is distributed, thereby maximizing

society's overall well-being by ensuring that goods are distributed to those who value them highest, for whatever reason.

But, again, there are goods in which the consumption by one does not preclude the simultaneous and valuable consumption by another. Indeed, there may be goods in which shared consumption may even enhance the value to both consumers.

In the case of many goods, the consumption by one person precludes the consumption by another. This is a condition of rivalry in that individual consumers become rivals for the consumption of the good.

Examples often cited include public highways or public parks. Anyone travelling a lonely Saskatchewan highway in the dead of winter knows and appreciates the presence of other vehicles and the sense of security their presence may offer in the event of a vehicle breakdown. Similarly, a public park may be a more enjoyable place if there are many others around to ensure group and individual security and, perhaps, to provide the potential for social interaction in addition to the appreciation of nature.

When goods are "non-rival", their value to society as a whole is derived not by choosing the highest value placed by the consumers vying for the good, but, rather by adding the valuation of all the consumers who could simultaneously consume the good without detracting from the enjoyment of others.⁶

As with the case of non-exclusivity, non-rivalry will prevent the usual process of negotiation between producers and consumers from yielding an outcome which is truly reflective of overall value to society. The invisible hand will choose one consumer over another in the distribution of goods (or in answering "for whom to produce") when the correct answer is to provide adequate amounts of the good to meet the needs of both consumers, simultaneously consuming the good. The private decision-making process would undervalue non-rival goods relative to other, rival goods and would, therefore, result in an inefficient allocation of resources between the two types of

goods. Like non-exclusive goods, non-rival goods require a collective decision-making model to derive their true societal value and to correctly answer the four fundamental questions of economics.

Externalities

In the case of most goods, the benefits of consuming the good accrue only to the person consuming the good. In this case, the valuation of the good by that consumer reflects the total value of benefits to be derived from the consumption of the good.

Examples of negative externalities abound as non-smokers, decidedly negatively affected by the consumption decisions of smokers, increasingly demand a chance to be involved in the decision-making with respect to tobacco products manufacturing and distribution.

But, in some cases, the consumption of a good by one person may affect the well-being of another person either positively or negatively. When one person's consumption leads to the unintended enhancement of the life of another, "positive externalities" are generated. When one person's consumption detracts from the well-being of others, "negative externalities" occur.⁷

Examples of negative externalities abound as non-smokers, decidedly negatively affected by the consumption decisions of smokers, increasingly demand a chance to be involved in the decision-making with respect to tobacco products manufacturing and distribution. Similarly, the impact of agricultural use of phosphates on the condition of fisheries has led to a strong interest among fishers in the technology employed in farming. In each of these cases, the four economic questions referenced above would be incorrectly answered if decisions were left exclusively in the negotiations between producers and final consumers. Outsiders (people who are not involved in the process) have a strong interest in seeing that the goods in question (in this case) are produced and consumed in considerably less quantity than the smokers and tobacco industry or the farmers and the fertilizer industry would choose on their own.

In the context of goods that have negative externalities, a mechanism needs to exist that allows the ill effects on outsiders to be considered as well as the benefit to direct consumers to arrive at a true social value for the goods being consumed. Otherwise, these goods will be over-produced and resources will be over-allocated to their production. Therefore, the mix of goods being produced in society will be inefficient relative to society's true valuation of the goods.

Positive externalities may be more difficult for some to consider but there are also many examples of these in our society. Although one might derive considerable benefit from the cultivation of an attractive ornamental garden in one's front yard, there are additional benefits that accrue to passers-by who inadvertently receive the benefit of the aesthetic without ever being asked an opinion on its value. A classic example also exists in the symbiosis between honey production (and the maintenance of apiaries) and neighbouring orchards engaged in fruit production. Each is assisted positively by an expansion in activity beyond that which either would choose on its own, yet, ordinarily, neither is involved in the decisions about production levels of the other.

In the case of goods which have positive externalities, a mechanism needs to exist that allows the benefits of outsiders to be added to those of direct consumers to arrive at a true societal value for the goods being consumed. Otherwise, these goods will be under-produced and resources will be under-allocated to their production; therefore, the mix of goods being produced in society will be inefficient relative to society's true valuation of goods.

When goods have either positive or negative externalities, the four basic questions of economics must be answered through a process which includes collective decision-making.

Merit Goods

Some references have also been made to a class of goods called "merit goods" which inherently qualify as "public goods". Merit goods are goods which are deemed to be of significant societal value – goods which are important to the whole of society beyond the value they hold to any individual or all individuals collectively.

The concept is used to describe many cultural events and facilities such as museums and orchestras which, it is

argued, help to define and shape the culture even beyond the impact they have on any individual within society. In the case of museums, for example, their true impact may not be clear for many generations as future generations derive the benefit of recent history being preserved to the point that it becomes ancient history in the preservation of the historical record of the society.⁸

In these cases, many of the beneficiaries of the good's production and/or consumption are not involved in current decisions, perhaps because they are not yet born. In these cases, the full value to society would not be reflected in a private exchange process and would have to be reflected through a collective decision-making process.

Art as a Public Good

If art is a public good, it must be a merit good and/or demonstrate at least some of the characteristics discussed above: non-exclusivity, non-rivalry and/or externalities.

Art both defines the culture and has a role in shaping the culture in which society exists. Its effects are pervasive and ubiquitous. As such, the benefits of art accrue to all members of society either directly in the appreciation of art or indirectly in the enhanced quality of life offered by a stable and well-defined culture. Many of the effects of art may be indistinguishable to the majority of people it affects and may be undefined as separate from the many cultural influences that are commonly and collectively experienced on a continuous basis. Since all members of society benefit from this cultural definition in various ways, one could argue that art, or at least the cultural influence it spawns, is a non-exclusive good. No one can be excluded from its influence, so it must be a public good to some extent.

Art can be consumed simultaneously with many other people without detriment to the benefit received by the primary consumer.⁹ While art or cultural events may be enjoyed in private by individuals, in many cases the enjoyment is even enhanced by the presence of others. Art has many of the characteristics of non-rival goods and is, therefore, a public good to some extent.

Positive externalities exist whenever a good, consumed by one person, yields unintended benefits to others. As discussed above, the consumption of art by some yields benefits to many others, even those not directly involved

in the process, either through cultural influence or, more directly, through the positive influence of the experience on the consumer and those around them. There are many direct and indirect benefits of art, as a cultural exercise, which flow to people other than those directly consuming the art. Therefore, art has positive externalities and is, to some extent, a public good.

Similarly, there is a strong case to be made that art is a prime example of a merit good, providing socially and culturally significant benefits from its mere existence. As a reflection and record of current culture, art may provide significant benefit to future generations and, therefore, may have indeterminate intergenerational cultural value. As a clear merit good, art qualifies to some extent as a public good.

The Economics of Art

There can be little doubt that art is a public good and, without the use of a collective decision-making process, there will be a tendency for under-production of art in society. This is simply because the primary consumers of art are receiving only a portion of the total benefit of art and, if its social value is established only by those primary consumers in negotiation with producers, they will choose a consumption level far below that which would be chosen by society as a whole. Consideration of the value that art yields to non-participants in the exchange process can only be added through a process that includes the interests of the society as a whole, not just the individuals directly involved.

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While this role of collective decision-making has recently been fulfilled by government, as a convenient mechanism for assessing social value through the political process, there are many other examples of collective decision-making at work in society, such as social institutions, religious organizations, and cultural organizations. In fact, collective decision-making has occurred locally and

internationally in the past through religious organizations which, not coincidentally, also served as major patrons of the arts.

Since private decision-making processes would result in less than optimal production of art, only through collective decision-making can the production level for art reach its appropriate level, as defined by the social and cultural needs of the greater society. Any other result would represent a sub-optimal distribution of goods and a misallocation of the resources required to produce the goods consumed by society – in short, an economically inefficient solution to the four main questions of economics. Thus, the recognition and treatment of art as a public good and the involvement of collective decision-makers in the process of resource allocation in the production of art is fundamental to ensuring the achievement of an economically efficient use of society's resources.

This is the economics behind government involvement in the arts. Without the government's involvement there would be too little art and too much of other things in both relative and absolute terms.

This analytical approach allows one to turn attention to the fundamental questions of the economy for answers. On the question of "what to produce", it appears that the answer must include some art since art has value to society, and the art that is produced should be that which yields the greatest social benefit. On the question of "how to produce it", the answer, as with all production processes, must focus on production using the most efficient and effective technology there is to produce art. On the matter of "how much art to produce", the answer has to be that art should be produced up to the point where the social value generated by the last work of art produced is equal to the social value of the resources required to produce it. On the question of "for whom should art be produced", it would seem that, at least to some extent, as a public good, art is produced for the masses; whether it is delivered through intermediaries or patrons of the arts, or directly to the public, its effects are society-wide.

These answers may not be of the nature that one expects from "economics" but they are nevertheless economic answers. Put another way, the answers must be derived through a collective decision-making process and, for the sake of convenience, have generally been resolved through political processes. In short, the arts require government

involvement to generate an economically efficient level of production. The right level of production depends on the outcome of the political process. While this may lack the mathematical rigour normally associated with economics, that is because it is a matter of attaching social value to art, a task only achievable by those empowered, through whatever means, to represent social values in collective decision-making. In any event, these answers should be acceptable to those in the arts community, as they carry at least as much rigour as is employed in the definition of art itself.

Policy Implications

There are a number of important implications to the consideration of art as a public good. From an economics perspective, some of those are discussed above.

From a policy perspective, there are other considerations. Governments become involved in influencing the level of production of art to ensure that more art is created than would be the case if they were not involved. It is a valid argument to suggest that the level of art creation may be currently lower than is required to meet society's needs and, therefore, more encouragement is needed to produce more art. This same argument may be used to suggest that more effective means of intervention may be required to ensure that the current effort results in more art, however.

Government supports artists to get more art and, especially, the less tangible social benefits derived from art, not because there is inherent value in the artistic existence, necessarily.

So, one might argue that we need more art and that will require more artists or more artistic effort and that will require more government assistance. This should not be confused with an argument that more assistance will enhance the well-being of artists. Government supports artists to get more art and, especially, the less tangible social benefits derived from art, not because there is inherent value in the artistic existence, necessarily. While there is a valid economic argument in favour of greater support if it is clear that there is an inadequate production of art, there is no economic validity in suggesting that more government support will generate more income for

artists. The artists are the means to the end (the contribution of art to society) not the objective of government policy.

So, to demonstrate a need for greater government support for the production of the public good art, one has to demonstrate that there is currently an inadequate supply of art; that the current means of producing art is the most effective; that the art currently being produced is of the greatest possible social value; and, that providing more assistance will be effective in generating more art and, thereby, more social benefit.

Endnotes

1. In this context, I will use the term “arts” to indicate any product or activity which is considered to be of “cultural significance”. While this may be controversial to some and indicative of insensitivity towards the true purpose and significance of the arts, this debate is not one an economist is equipped to resolve. Readers are invited to insert any definition of “arts” they wish as it will not affect the following argument.

2. Hereinafter simplified as “goods”.

3. While there may be a long chain of transactions on both the supply side and the demand side, including manufacturers, shippers, wholesalers, retailers, purchasers and donors, for simplicity, it is assumed that the supply chain represents “producers” and the demand chain represents “final consumers”.

4. There are very few goods which are strictly “public goods”, or “pure public goods”, or which are strictly “private goods”, or “pure private goods”. It may be best to consider all goods as existing on a continuum between the two extremes.

5. To an economist, this strategic positioning has important implications for the use of polling as a means of deriving information on matters of public policy, but this can wait for another essay.

6. Non-rivalry is usually restricted by the point at which “congestion” occurs. Highway users benefit from the presence of others until the roads become clogged with motorists, at which point rivalry is reintroduced.

7. The term “externality” is used to indicate that there are impacts on people other than those making the private

decisions on consumption, persons who are “external” to the decision-making process.

8. It may be that “merit goods” are just specific instances of “positive externalities” perhaps in cases where the beneficiaries are not aware of the benefit they derive (because it is subtle or long-term in nature) or where their benefit is positive but uncertain due to factors such as the fact they are not born yet.

9. Again, this is subject to congestion limitations.

Author Bio

Jim Marshall is the Chief Economist at the Saskatchewan Institute of Public Policy. In his 29 years of government service, Jim Marshall has held many positions, such as Assistant Deputy Minister, Economic and Resource Policy Saskatchewan Industry and Resources; Senior Project Manager, Crown Investments Corporation of Saskatchewan; Executive Director, Economic and Fiscal Policy Branch, Department of Finance; and, Senior Economist, Taxation and Economic Policy Branch, Department of Finance.

After finishing his Masters of Arts (Economics) at the University of Calgary, Jim Marshall taught at the Department of Economics, Brandon University, Manitoba and conducted research for the Library of Parliament in Ottawa before starting with the Government of Saskatchewan.

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