Public Private Partnerships in the Arts in the United States

The public policy of support for the arts.

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Good afternoon and thank you Diane and Charlene for the hospitality and the invitation to visit your program again   It already has been a productive day; I met with an old friend, Ken Fisher director of your spectacular arts center, with the head of the museum management program and had lunch with a Leeor Coehn, the second board fellow to work with me at Dieu Donne Paper Mill in NYC. I am also grateful for the diversion to visit the welcoming climes of Ann Arbor after two days of 75 degree temperature in Orlando.

Seriously, I enjoy preparing for talks such as these because they give me the opportunity to speak about ideas I have shared by my many talented clients and to reflect on my experiences working in both the United States and Germany, two countries with completely different public arts policies. Though these remarks are written, consider them a “draft” of my ideas that, I hope, will be challenged and refined during our conversation afterward.

Today I will explore the partnership of the nonprofit arts and government sectors in the United States and describe why this form of public policy is beneficial to the arts organizations and to the general population. And how, this public policy engages the non-arts patrons and the commercial sector to create a sophisticated and very robust "arts ecosystem."

One of my assumptions is that all forms of government funding represent an implicit public policy. The first section of this presentation will describe the three forms of government support; direct, indirect and in-kind. In this section I will give a brief overview of the economics of the nonprofit arts sector. Throughout I will make some references to approaches of government support of the arts employed in Germany as an informative and useful comparison. In this section I will offer some observations on why the US domestic public policy toward the arts contributes to a healthier artistic product and to a nonprofit arts sector that is less elitist and more responsive to its citizens. Finally, I will raise some caution on recent changes in arts public policies.

Designated Arts Funding only tells a small part of the story

For years I have been writing and speaking about the differences between government funding of the arts in Europe (and specifically Germany) and that of the United States. If one compares published data about the government funding of the arts in Berlin, arguably Germany's cultural capital with a critical mass of arts organizations and over 4 million residence, with New York City, our cultural capital, we discover a meaningful disparity.

On average, more than 80% of the income of the typical Berlin arts organizations is provided by the government through direct grants. In New York City, the average is below 5%. For a typical theater company in Berlin with a budget of 20 million euros, more than 16 million euros are provided directly by the city through the office of the minister for culture, science, education and historic monuments. An arts organization in NYC with a comparable budget of approximately $16 million, will receive on average $500,000 to $800,000 of city funding. Stated another way, the per capita government contribution to the arts in Berlin is approximately $2.65 compared to less than $1.50 in New York City.

Since the time of the relocation of the federal capital of Germany from Bonn to Berlin, there has been an infusion of arts funding by the lande or federal government to Berlin arts organizations. Because of a severe deficit in the city of Berlin, city arts funding has been cut. But even with declines in city funding, the overall governmental funding has grown. Continuing the comparison, if we add the National Endowment for the Arts (NEA) and the New York State Council on the Arts grants to NYC arts organizations' city funding, there is almost no change in percentage or per capita funds because those sources of funding are inconsequential.

I have just described some of the often cited benchmarks that lead to the conclusion that public policy toward the arts is much more favorable and enlightened in Germany (and most of Europe) than in the United States. I would now like to describe a broader notion of our domestic public policy toward the arts.

A MORE COMPREHENSIVE LOOK AT FEDERAL ARTS FUNDING

In the mid-nineties the federal arts policy was identified by the National Endowment for the Arts (the NEA) which became a lightning rod for controversy. Its very existence was debated, over issues of censorship and pornography, even though the federal government appropriation to the NEA is minimal (less than $100 million in the late nineties). Compared to other federal programs and even the appropriation for military bands, the NEA budget is inconsequential.

The NEA today continues to search for a meaningful purpose because its public policy is actually defined by a formula that distributes appropriation among all fifty states and territories, to city and rural arts organizations, to individual artists, to high art and community arts organizations, and to state arts councils that then redistribute those funds in a similar "democratic" fashion. It is my personal belief that the NEA is a distraction and a represents a distortion of our public arts policy. I have advocated for the total elimination of the NEA (perhaps we could discuss this after my formal remarks).

We must examine the full extent of the federal governments' funding to arts organizations to discover the implicit federal arts public policy: Direct federal funding appropriation includes support of The Smithsonian Institution (which alone receives some $600 million), Wolf Trap, The National Gallery and The Kennedy Center. With few exceptions, these appropriations are directed to organizations with private advisory boards and independent paid management. We may summarize the Federal public policy toward arts and culture as **directly legislated but not interfering and as one of significant support of large, national, mostly Washington-based institutions**.

Likewise, in many states there are geographically specific government funding programs that support a critical mass of substantial arts institutions, usually in the most prominent city of the state. Some examples of this are in St. Louis where a designated county millage supports the St. Louis Zoo, Art Museum, the History Museum, the St. Louis Science Center and the Missouri Botanical Gardens or similar legislation in Denver that, when enacted, created a renaissance in the Denver based science center, art museum, zoo, and performing arts center. The City Council, through the Grant Park district in Chicago, provides direct support to the major cultural institutions - Chicago Art Institute, the Shedd Aquarium, the Field Museum and others. In each of these cities, arts funding is in addition to minimal arts council funding, and is directed toward support of the large, premier institutions. In each of these cases, rank and file legislators, with the approval of the executive branch, direct substantial support to critical mass of the largest and most important arts organizations in the jurisdiction while entrusting the management of these institutions to private boards and management..

In some cases, states and cities impose special designated taxes to support the arts: in

Louisville there is a bed tax that is dedicated to funding the arts. In the State of New Jersey, the governor has just proposed a similar lodging tax that will guarantee funding the state's arts organizations outside of the arts council budget.

While these public policies of arts funding can be interpreted as examples of enlightened government, there are other non-arts, economic, self-interests that motivate this policy. Cities believe that a way to attract new businesses and therefore more jobs is by providing cultural activities. In a study commissioned by the Humana Corporation in Louisville, "access to cultural activities" was cited as an important reason for businesses to relocate to that city.

A major city in Florida has recently lost a bank call center business (and over 1,000 jobs) and lost its bid to lure a major publishing company to relocate. In both cases, city officials believe the reason was the absence of a strong arts and cultural community.

Chicago and Denver for example, see a healthy arts community as key to corporate relocation and retention, to attracting executive talent and also as a means of supporting their tourism business. New York City created what is called the Cultural Institutions Group (or CIG), composed of the most prominent arts institutions located on city land (and some other institutions included for purely political reasons) that receive substantial support from the city. According to a recent Theater Communications Group study, every dollar spent on a theater ticket generates between $3 and $7 in additional spending (on restaurants, hotels, transportation, etc.) While outside the scope of this paper, it should be noted that public investments in the arts creates a far better ROI than investments in major league sports facilities.

Dangers of Direct Government Funding

The above describe a public policy that is mutually beneficial for both the arts organization and the government (and therefore, the general population within that jurisdiction). This policy of public support does have an inherent danger. The debacles of both the Robert Mapplethorpe photo exhibition and the Karen Finnely performance art project funded by the NEA notwithstanding, there have been some troubling cases of government intervention on the artistic product – in a sense, a form of censorship.

The clearest and perhaps most amusing example is the “Sensation Exhibition” at the Brooklyn Museum. This exhibition had been well attended and received positive reviews in its prior two venues, at the Royal Academy of the Arts in London and the Hamburg Bannhoff in Berlin, but was reviled by the Mayor of New York City before it opened. Citing the inclusion of morally offensive and sacrilegious works– the exhibit included a depiction of the Virgin Mary “painted” with elephant dung- the Mayor threatened to cut all of the city’s funding of the Brooklyn Museum (a member of the CIG group) if the exhibition opened as planned. Because New York City supports a significant portion of the Brooklyn Museum’s operating budget (approximately 43% at that time, an anomaly among New York City arts organizations) Mayor Giuliani’s action could have stopped the exhibition and could have forced the closure of the entire museum. The Mayor chose to attempt to exercise this form of censorship because of the significant New York City funding of the museum and because the funding came from the city budget. As a post-script - the Brooklyn Museum sued the Mayor who lost the case in appellate court on first amendment grounds, the exhibition opened and it received much greater attendance then it merited (in my opinion) because of the public controversy surrounding it. I will return to this incident later as we examine the indirect government funding of the arts.

A more serious example of government censorship is the Enola Gay exhibition at the Smithsonian Air and Space Museum. The Enola Gay is the name of the United States air craft that dropped the first atomic bomb on Japan at the end of World War II. The curator of the exhibition chose to tell the story of the Enola Gay from many points of view. Apparently, one of those points of view was interpreted as un-American by a powerful federal legislator who threatened to eliminate all federal funding to the Smithsonian Institution. In this case, the exhibition content was modified – an event that marked one of the darker days of public/arts partnerships.

I mention these two cases as exceptions to the accepted public policy toward the arts. There is a tradition in the United States, likely supported by the Constitution, that protects the artistic content from government intervention even while government is providing direct subsidy

Ironically, European arts managers whose organizations who are supported by a public arts policy of almost exclusive government funding, do not fear the inherent threat of government censorship and almost never experience it. And while it is true that European government officials seem much more liberal than their US counterparts, I will argue later in this talk; that over reliance on direct government funding could lead to more negative and less vibrant arts climate. [Here tell the story of the Volksbuner theater and Rudzinsky]

I will now speak about what I call INDIRECT OR PASSIVE ARTS FUNDING provided by a PUBLIC TAX POLICY

Before that however, I would like to spend the next few minutes discussing the economics of nonprofit arts organizations and the interrelationships between the health of the general economy and that of arts organizations.

Nonprofit arts organizations have two broad sources of income; usually referred to as earned and unearned. The earned income is comprised of elements such as ticket sales, gift shop and restaurant income, parking fees, rent of facilities and interest from endowments. The unearned income includes special event fundraisers, contributions from individuals, corporate sponsorship, foundation and government grants and planned giving. Depending on the art form, and factors such as size of theater, amount of debt and depreciation, and even quality of the work, arts organizations operate with an earned income of between 35% and 80%. To illustrate this point, healthy, successful symphony orchestras operated within a range of 45to 50% earned income; performing arts centers in the 40 to 80% range, and art museums in the 20 to 40% range. In other words, for every dollar spent, an art museum earns say 40 cents and loses 60 cents that must be supplemented by unearned income. No arts organizations in the United States earns a profit (or as I tell my prospective clients intent on building a profitable performing arts center) "you may build a profitable performing arts center but it will be the only profitable performing arts center in the United States." Allow me another diversion at this point – some of you may question this last statement, particularly when considering the for-profit Broadway play. And it is true that a musical like "The Producers" is earning profits for its producers and that "Chicago" or "Cabaret" have generated terrific returns for the plays investors. However, if we look at the totality of Broadway plays, produced over any time period (this past year, the last five years, the last fifty years), we discover that commercial theater is also nonprofit and requires subsidy. Most Broadway bound plays (commercial productions) never make it to Broadway (the entire investment is lost) and among those that do, most do not generate enough profits to repay the initial investors. I suggest that the data exist for a detailed study of this nature, and that someday some enterprising graduate student should write his or her thesis on this that will either prove or disprove my thesis.

But returning to the nonprofit business model we see immediately its strengths and some of its weaknesses. The strength is that the income streams are diversified – the weakness is that almost all of the elements of both earned and unearned income are vulnerable to outside economic forces.

This vulnerability was dramatically illustrated during over the last two years, as arts organizations experienced what some called the "perfect storm." The elements that came together were all related to the economy: corporate losses which led to layoffs and higher unemployment and a drop in the market value of public companies. This in turn led to a drop in corporate arts sponsorship. Uncertainty over the economy and unemployment led to a diminution in individual philanthropy and individuals' discretionary purchases of cultural events tickets. Since arts organizations benefit from appreciated stock contributions, this source evaporated as individual portfolios nosedived. And because corporate and individual income taxes are the major source of state income, most US states experienced deficits that resulted in, among other things, significant reductions in state arts funding (as you know, here in Michigan, the state arts council funding was significantly reduced).

Foundations, whose assets consisted of investments in the stock market, lost asset value (the assets of the Ford Foundation fell from approximately $15 billion to just over $10 billion between 2001 and 2003) which, because of the rules governing foundation distributions, greatly reduced foundation contributions.

INDIRECT or PASSIVE GOVERNMENT ARTS FUNDING

I described earlier the various forms of direct government funding of the arts in the United States. While I have discovered no one source of information on total direct government funding for the arts, it is clear that the often quoted sources (the NEA and the state and local arts councils) are only a small percentage of the direct government funding. But the various US governmental entities, through tax policies, contribute a much larger sum to the arts through what may be called indirect or passive contributions. Allow me to explain.

If we compare the tax treatment of nonprofit arts to for profit entities, we discover a large indirect contribution from the government. For example, if someone purchases a ticket to a Detroit Tigers game, the Tigers are compelled to pay sales tax which it passes on to the ticket buyer. Yet, there are no sales taxes for tickets purchased for the Detroit Symphony. Similarly, because of their nonprofit status, arts organizations do not pay sales tax on items they purchase, nor do they pay real estate taxes on property they own. Continuing, we see that arts organizations are not taxed on yearly profits or investment returns of their endowments.

More importantly, through federal (and some state and city) public tax policies, the government shares in the unearned income contributions to cultural organizations. For example, a donor in the 35% tax bracket receives a federal refund of 35 cents for every arts dollar contributed, or stating it another way, the government contribution matches individual contribution almost 1 to 2. By allowing full deductibility of appreciated property, the government provides for significant endowment and capital funding, and provides a great motivation for individuals to contribute works of art and objects, real estate and stocks to US museums. Likewise, corporations who contribute to the arts receive favorable tax treatment. In a sense, the government collaborates with the corporation on its contributions. For corporate sponsorships that are considered advertising, the total profits of the corporation are reduced and therefore it's the tax burden (I mention this here because, in some European countries, for example, corporate contributions were not tax deductible and the arts organization receiving the contribution was taxed on that amount of the sponsorship)..

US foundations also provide significant funding to the arts. Foundations are required to contribute 5% of their assets each year. Those assets usually grow at a higher percentage and the foundations pay no taxes on capital gains, dividends and interest. This special tax policy is an implicit government policy favoring the nonprofit arts.

Taken together, these public policies provide powerful public support for the arts. For example, a few years ago the direct government funding to Carnegie Hall was 4% or income. However, its indirect or passive contribution raised its government funding to over 30%.

While it may be fascinating to identify the many manifestation of the indirect or passive contribution to the arts, the more interesting characteristic of this policy is the implicit rewards that the government provides to well run, responsive and, let us presume, healthy arts organizations. Allow me to explain.

Let us assume that the amount of private contributions (and therefore indirect government contributions) is finite. Therefore individuals, corporations and foundations make choices as to which organizations they fund. Presumably, these choices are based on a combination of factors including the quality and diversity of the art, customer service, the education and entertainment values offered, and other social values that are inherent in cultural events. In other words, the more appealing (or whatever positive value one assigns to an arts experience) the more likely there will be private support and the more the government will indirectly support it.

This policy of indirect public support also rewards cultural institutions that are fiscally healthy and well run. Since profits are not taxed, there is no disincentive to earn a profit and since capital gains, interest and dividend are not taxed, there is no disincentive to increasing assets. Many arts institutions borrow building funds using their endowments as collateral and earn the profit on the float between the interest rate on the loan and the non-taxed appreciation of their endowment. Think of the disincentive to our major cultural institutions if they were either taxed on their profits or, as in many European countries, had their funding reduced by the amount of profits earned.

This is a critical point, particularly when compared to countries where public policy toward arts funding is in the form of almost total direct government funding A few examples are in order. While Berlin arts organizations enjoy the security of receiving 80% of their funding from the government, they are also more vulnerable to government intervention. Two years ago when the deficit in the city of Berlin grew to crisis levels, the Minister of Culture (an appointed official with scant arts experience) single-handedly closed a historic theater and threatened to force the three Berlin opera companies to merge. By contrast, the indirect public funding policy puts the decision making in the hands of the public and creates a healthy competition among the arts organizations to provide quality art and good customer service.

OTHER NOTABLE PARTNERSHIPS WITH PUBLIC FUNDING

We have examined the direct government funding of arts organizations and the indirect or passive funding. There is a third form of a government partnership with arts organizations that has less to do with government largess or tax policy and more to due with a confluence of interests. Here there are less sweeping public policy issues and more examples of enlightened government, but they are notable and, in some cases, quite substantial. I will try to give some examples:

In the City of Newark, an innovative deal was struck between the arts center and the city where the arts center build a police substation across from its entrance plaza in return for extraordinary police presence during performances. Before and after performances, there are dozens of Newark Police officers on duty, directing traffic at significant cost to the City. In New York City, developers are given building variances if they include arts facilities in their overall design. A facility was built by the developer for a nonprofit theater company on Union Square in Manhattan as part of that developer's variance to build an apartment complex higher than the local code.

There are hundreds of other examples of mutually beneficial public policies, where enlightened city officials and savvy arts leaders arrive at innovative actions involving zoning, in-kind service that directly benefit arts patrons to tax incremental financing zones.

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I will conclude with some comments on the trend in public policy toward the arts. While this will sound like a political diatribe against the current administration, that is not my intention. However,

I believe the administration's tax policies and other domestic policies will have a negative effect on the arts.

As I described above, it is the governments' indirect contribution to the arts, through tax incentives, that not only fund the arts but make arts organizations more responsive to its stakeholders. The recent tax cuts will reverse this policy. As individual and corporate tax rates are lowered, the government's indirect contribution is also lowered. Therefore, that differential will require additional individual and corporate contributions. The same is true for the reduction in the capital gains tax, probably the single most significant tax incentive provided to individuals.

Arts leaders I speak with cannot conclusively deduce that individual giving is motivated by tax incentives. Philanthropy is driven by more factors than just economics. However, there is some indisputable evidence of the effect of tax policy on philanthropy. In 1985, the tax treatment of contributions of assets was changed from the present value to the original value. A work of art of Picasso purchased during the artist' lifetime for $100 that was then appraised for $1 million would no longer provide the donor with a $1 million contribution, rather the contribution would be valued at $100. Likewise with appreciated stock and other property. This change was to come into effect in 1986. The amount of capital giving in 1985 reached its all-time high and was followed by a precipitous drop in 1986. The amount of capital spending on building in the arts spiked in 1985 and during that year Carter Brown, then the Director of the National Gallery of Art leveraged the impending tax change to significantly augment the collections.

This time the significant tax change, one I believe that will have a direct impact on philanthropy, is the elimination of the estate tax. Wealthy individuals have been motivated by the estate taxes (or the death tax as the republicans like to say) to use estate planning as a means of contributing to the arts and securing a legacy in perpetuity. Many museum wings have been named and built through substantial gifts from individuals who preferred to create an arts legacy than to pay an estate tax. While it is too early to calibrate the effect of the elimination of the estate tax, we can conclude that the indirect government support provided through present estate planning will no longer exist.

There are other public policies that have the potential of harming the arts. For example, HR 7 is a bill currently under discussion in Congress that will change accounting rules regarding foundations. Essentially, the bill will require foundations to donate 5% of their assets not including administrative costs. (Typically, foundation administrative costs are less that 1% of assets after a 2% excise tax). Although this seems like it would benefit the arts by forcing more contributions, over the long term in will reduce the assets of foundations. .

The federal government's policy of shifting what was once federal obligations to states has exacerbated state deficits and led to further cuts in state arts council budgets. For example, heightened federal terrorist alerts required cities to expend additional funds on police and other security. One Los Angeles city council member wrote in the NY Times that the recent federal state of orange alert cost the city of Los Angeles $2 million in extra security.

The last example is the state department's current tightening of visitor visas. This has led to unpredictable and long delays for foreign artists obtaining visas which has wreaked havoc with many international touring presentations in the United States.

So, we see a shift in the public policy toward the arts. Since, as I have demonstrated throughout, most of the public support for the arts is indirect, other public policies are having a less apparent effect on the arts. The current administration, for example, has increased the appropriation to the NEA reversing a decade long trend.

This increase is far outweighed by the indirect decreases resulting from the changes in public policy. The strength of the arts sector in the US is attributable to this public policy system of indirect government support of unearned income and rewards for good management through tax relief on profits. This change of policy, combined with the fragile US economy, could lead to a difficult time for the arts in the United States.