

The Nature and Effects of Government Support for Non-Profit Arts Organizations: Strategic Management and Marketing Implications

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Abstract

This research proposal evaluates the literature on the effects of government support for the arts and suggests empirical opportunities to research and analyze the effects of that support on non-profit arts organizations. The analysis draws on the literature to outline the nature of the arts industry, the framework of cultural economics, the role of government support for the arts, the expectations of governments for that support, and recent comparative research. The study then examines government support trends and alternative funding sources for non-profit arts organizations, along with the emerging role of marketing in the context of government support. Based on the literature, a set of two theoretical models is presented, and ten related research propositions are posited for empirical testing. The study presents a preliminary methodological proposal for operationalization of the various construct variables, data gathering, and empirical analysis. Finally, implications of the analysis and opportunities for future research are discussed.

Keywords

Non-profit arts organizations, government support, cultural economics, strategic management, marketing

Introduction

Government support is essential for the long-term survival and health of the non-profit arts organizations of a nation due to the inherent economic nature of the industry (Gainer 1989). Government subsidies contribute a large percentage of the annual budgets of performing arts organizations, although, in recent years, governments generally have provided less support for the arts, in terms of total contribution to the performing arts segment and/or to individual performing arts organizations. National governments, faced with other spending priorities, are increasingly stressing the importance of private cultural funding and creating incentives for individual and corporate support of the arts (Brooks 2003). The decline in government subsidies has had a direct negative impact on the income of arts organizations in general (Skolnik 1992). In most Western countries, governments recognize the need for arts organizations to develop their own income generation and asset building strategies. Government support now typically comes with strings attached, often requiring evidence of financial health, strategic and operational planning, and outcome evaluation for funding (McDonald & Harrison, 2002).

The study of government support for the arts is based on the relatively recent emergence of the field of cultural economics. Unlike other types of organizations, arts organizations face rising resource and operating costs but are unable to achieve productivity gains. Arts organizations typically cannot operate on earned income (e.g. ticket sales) alone and therefore rely on both public and private donations (Laczniak and Murphy 1977). Consumer behavior typically is not the driving force in terms of demand, since an arts organization's program revenue rarely can cover operating costs (Schulze and Ursprung 2000). This instance of market failure requires a degree of government intervention for survivability, and most Western countries recognize the desirability of that intervention for the public good (Frey 1994).

Research published in major academic journals on the effects of government support is grounded in the relatively immature field of cultural economics. Definitions and fundamental concepts are not yet well developed and are still being explored and debated (Peacock 2000). Although individual nations produce statistics on government support of the arts, that data is not comparable across countries without significant adjustment and explanation (Fillis 2002, Arnold and Tapp 2003). Empirical academic research tends to concentrate on studies of single organizations or groups of organizations within a single geographic area. While the quality of that research is improving, much of the research prior to the mid-1990s is qualitative in nature and/or incompletely developed. Until a 2003 pioneer study by Garcia et al., no significant academic project had researched and empirically analyzed the cultural sector at a national or international level. This research proposal analyzes the literature on the nature and effects of government support for the arts, suggests two theoretical models and ten related research propositions for empirical testing suggested by that literature, and proposes opportunities for empirical testing of those propositions.

The Nature of the Arts Industry

Defining the arts presents problems for researchers. A review of the literature shows that national cultures and sub-cultures often do not define the term or define it differently. Peacock (2000) questioned what should be included in the category of the arts but avoided a direct answer, noting that a definition of the arts is susceptible to frequent change, reflecting the influence of arts stakeholders and funding. Baumol and Bowen (1966) defined the arts as "creative arts and their performance / presentation." Peacock (2000) noted that this relatively narrow definition of the arts increasingly is expanded into the wider scope of culture, largely due to the evolution of individual government funding priorities, decisions and support. Scheff and Kotler (1966) examined the combination of arts and education, noting that governments tend to support both efforts separately, and arts education can be funded from either perspective (Cowen 1999). From an economic standpoint, the arts can be categorized into two types: for-profit and not-for-profit. The not-for-profit category includes the majority of arts organizations and is the focus of government support and this analysis (Baumol and Bowen 1966).

The Framework of Cultural Economics

The rationale for government support for the arts can be derived from the framework of cultural economics, which has developed over the last forty years. Frey (1994) defined cultural economics as the discipline of economics that applies economic thinking to the arts. Baumol and Bowen (1966) wrote the seminal work on cultural economics, concentrating on government support for the arts in the U.S. Peacock (1969) conducted similar research on the economics of

art and culture, examining government support for the arts in Great Britain. Netzer's (1978) study, "The Subsidized Muse," reviewed the first two decades of cultural policy and is regarded as the seminal work on neo-classical justifications for government support of the arts and the first explicit study of cultural public policy. Netzer (1978) proposed that cultural public policy is based on two factors: classic market failure (ameliorated by positive externalities) and social / cultural equality. His research concentrated on direct government subsidy of the arts. Schuster (1985) developed the first in-depth work on comparative government expenditures, in the form of a study of six European countries, the U. S., and Canada.

Cultural economics holds that the arts, as an industry, are subject to market failure, which is defined as a situation in which the market mechanism fails to allocate resources efficiently (Zimmer and Toepler (1999). Welfare economics involves a specific instance of market failure that provides a rationale for the amount and form of public expenditure (Baumol and Bowen 1966). Productivity that is not subject to improvement over time is the key reason for inherent market failure in the case of the arts industry. Stone (1995) points out that the performing arts actually are replicated museum pieces. An example is that of a Mozart quartet, which required four musicians and three man-hours to perform when it was first written, in the late eighteenth century and requires the same staffing and elapsed time to perform today. Baumol (1995) termed this productivity inflexibility a "cost disease," noting that the arts involve handicraft services that are difficult to automate.

The "cost disease" problem is compounded by the factor of inflation, which has risen more rapidly for the arts than for other industries. The arts typically increase at two percent per year higher than the rate of inflation, with a rise of over seven hundred percent higher than the rate of inflation since World War II (Baumol 1995). Peacock (2000) noted that John Maynard Keynes once predicted that government funding could be gradually reduced as the change in individual tastes for the arts moves demand curves to the right. It is now generally accepted that government support is required for the survival of arts organizations. Without government support, there may be less art, and the nature of arts may change, with potential regression of a professional organization to an amateur level in terms of quality and variety (Baumol 1995). Stone (1995) suggested that another "cost disease" issue involves artistic community perception that "the bigger the debt, the more visible our symbol about commitment to the art," manifested by the tendency of arts organizations to hover at near-bankruptcy.

Welfare economics as a discipline also addresses the basic need for social and cultural equality (Zimmer and Toepler 1999). The economic rationale for government support includes the desirability of subsidizing merit goods, defined as "services that we wish to support because we consider it a higher virtue" by Baumol (1995). A public good can make the economy more productive with indirect benefits, such as spillovers to externalities, such as business and society, that appear in a simple supply-demand equation (Fullerton 1991). There is debate over the current usefulness of welfare economics in explaining current government support in terms of cultural equality, since that concept is diminishing in priority, but it can be used to explain the original growth of the cultural equality factor from the 1960s to the 1980s.

The Role and Recipients of Government Support

Governments support the arts with subsidies in order to mitigate the market failure inherent in the arts industry (Zimmer and Toepler 1999). A second reason involves a value judgment by governments, and indirectly by their citizens, that the arts provide an increase in individual welfare. As Baumol (1995) pointed out, governments perceive that "cultured individuals make

better citizens” and therefore desire to enable wide access to the arts. A third rationale for government arts support involves spillover benefits, which are perceived to preserve and further civilized values (Gainer 1989). Peacock (2000) analyzed spillover benefits to other producers (e.g. the arts as a loss leader for tourism). Arts support also is provided, from a long-term perspective, to ensure quality of choices for future citizens (Baumol 1995). A fourth purpose of government support for the arts is to ensure a “healthy artistic diversity” of artistic choices, although ensuring that diversity could have the effect of censorship (O'Brien 1992, Post 1996). There is a tendency, across nations, for those in political power to perceive the need to trust the government, rather than the market, to provide that artistic diversity and quality present and future generations (Gainer 1989, Fullerton 1991).

Recipients of direct government support include arts organizations and individual artists. Individual donors and corporate donors share in government support to the degree that they receive tax breaks for contributions to the arts. Communities also receive induced government support to the extent that members receive indirect spillover benefits from direct or indirect government support of the arts (Heaney and Heaney 2003). Stakeholders in government support of the arts include the arts organizations, individual artists, individual and corporate donors, and communities discussed above, and also include foundations, society as a whole, and the government itself (Radbourn 1998, Gainer 1989). A principal-agent problem applies in the case of government support, which involves the issue of how to get a recipient to act in the best interests of the principal – in this case the government, or, indirectly, the citizen. There is an inherent lack of control in funding without retaining power to approve how the funds are used, as well as issues of potential informational disadvantage and divergent interests (Schulze and Ursprung 2000).

Types, Levels, and Agencies of Government Support

Government support for the arts is comprised of three types: direct, indirect, and induced subsidy. Direct support takes the form of currency contributions to arts organizations (Netzer 1978). Indirect subsidy generally involves foregone taxes in the form of tax incentives and government spending on professional training in the arts, mainstream arts education in schools, and administration of arts and culture (Vandell and O'Hare 1979, Feist et al. 1998). Schuster (1999) examined tax-based indirect aid to the arts, focusing on diverse examples of indirect aid mechanisms. Induced subsidy can be described in terms of the spillover benefits discussed earlier (Heaney and Heaney 2003). Government support of the arts across Western countries generally is granted at three levels of government: (1) national / federal, (2) provincial / state, and (3) local / municipal (Gainer 1989).

Western countries have a long history of subsidizing the arts, but the development of clearly defined policies for that support, and the establishment of national agencies to administer them, are a relatively recent phenomenon. France was the first to implement a formal cultural policy, establishing the Ministry of Culture in 1959. In 1965, the U.S. formed the National Endowment for the Arts (NEA), Great Britain established the precursor of the Department of Culture, Media and Sport (DCMS), and the Netherlands formed the Ministry of Culture, Recreation, and Social Work. In 1974, Sweden established its National Cultural Council, and Germany's highest court established protection and freedom for artists, leading to formation of the Deutscher Bühnenverein (Zimmer and Toepler 1999, Schulze and Ursprung 2000).

The premise for these and other Western arts administrative agencies stems from the cultural economics principles outlined earlier. France, Sweden, and Germany place a significant

emphasis on public entities that administer arts organizations. The U.S., however, considers the arts as a private rather than a public responsibility, with a resulting emphasis on non-profit rather than public organizations (Zimmer and Toepler 1999). Despite the implication of its name, the NEA lacks permanent funds and operates using funds appropriated by Congress for each fiscal year (Dorf 1993). Its program grants often require matching funds from private support sources (Hughes and Luksetich 1999). Great Britain's DCMS falls between the limited direct funding perspective of the U.S. and the high levels of government support for culture in France and Germany. It fosters arm's length funding, with funds typically transferred to intermediate bodies, although its national museums and galleries are directly funded (Peacock 2000). artistic programming decisions, which often are affected by what government wants and will fund, and by special interests (e.g. lobbyists and unions) which can affect cultural decisions and processes (Bennett and DiLorenzo 1987). Involvement in arts administration and repertoire / content decisions varies by country. The U.S. tends to take a laissez faire approach, while Germany and France operate arts organizations directly (Schulze and Ursprung 2000). In most countries, there is some controversy among constituents over the nature and amount of government funding for the arts. Heritage preservation and public broadcasting can be controversial, since they are perceived as focal points for the identity and culture of nations, and views of them by citizens vary (Peacock 2000).

Recent Research – Comparative Government Expenditures

Three recent comparative studies examine government expenditures across Western countries. First, *NEA Note # 74* (2000) summarizes research comparing U.S. government support with that of other countries. Second, UNESCO's (2000) report compiled and analyzed 1980-98 data on quantifiable trade in cultural goods (a broader classification of culture than that used by most national arts organizations) and presented trade statistics based on regional bodies, such as the European Union (EU) and the Asia-Pacific Economic Cooperation (APEC). In 1998, APEC and EU countries accounted for 91 % of all imports and 94% of all exports of cultural goods. The study finds that flows of trade in cultural goods are unbalanced, with many small/developing countries at a disadvantage. Third, an Arts Council of England (ACE) report (Feist et al. 1998) analyzed direct public arts spending data for 11 countries between 1993 and 1996. Per capita arts spending ranged from a high of \$91 in Finland to a low of \$6 in the U.S. Finland had the highest arts spending as a percentage of GDP (2.10%), followed by Germany (1.79%). The U.S., with the highest population (258.2 million) and the highest GDP (\$7,265 billion), recorded the lowest level of arts spending as a percentage of GDP (.13%), with an arts budget which declined by 50% from a high of \$176 million in 1992. This low level of direct government subsidy in the U.S. can only partially be explained by the traditionally small size of its public sector relative to the private sector and the U.S. preference for indirect support through forgone taxes (Schuster 1987, Gainer 1989).

For researchers and those who rely on arts organization and comparative arts program data, the lack of rigorous theoretical and empirical research is a significant issue. Cultural economics lacks a common analytic vocabulary. Definitions of concepts and statistical classifications vary across, and often within, countries. The scope and activities of the arts are perceived differently by different nations and thus are not comparable from an evaluative standpoint. Even within nations, accumulated data often is not policy-relevant (Bradshaw 1996). Structural differences in governments, arts organizations, and data sources make comparative analysis extremely difficult. Secondary data must be examined and adjusted before comparing even basic figures across countries. Surveys tend not to be discriminating, and the accuracy of their results is an issue. Empirical testing has only recently begun to take advantage of decision sciences tools

that can produce powerful analyses of complex models and propositions (Schuster 1987, Feist 1998).

Strategic Management and Marketing in the Context of Government Support

Several opportunities for academic research in the area of arts organization strategic management and marketing emerge from this examination of cultural economics and government support for the arts. Government funding sources have a variety of expectations, which differ among countries, cultures, and levels of governments. They evaluate artistic quality and relevance of artistic products to the market, with organizations often judged by their peers (McDonald and Harrison 2002). Governments increasingly demand some form and level of accountability, increasingly in the form of formal outcome evaluation. Prior to the 1990s, applicants for government support generally needed to account only for outputs and expenditures. Now, they must also prove that programs also make a measurable difference in the lives of people and communities. Key predictors for success include organization culture, technology, management support, and involvement (Poole et al. 2001). Factors suggested by the literature to contribute to increased levels of government funding are depicted in Figure 1. Figure 2 depicts potential effects of publicity of government support on levels of individual contributions, corporate support, and foundation funding. Ten related propositions are outlined below.

As government subsidies remain stagnant or fall, and competition for leisure time increases, the literature indicates that the roles of strategic management and marketing are increasing significantly. Although Western countries administer government support in different ways, several trends appear to span the nations. Government support at all levels has declined, and government funding overall is expected to remain static or decrease (Arnold and Tapp 2003, Skolnik 1992). There is a perceived shift for arts support from national governments to regional and local governments, which appears to have been empirically tested only in Spain; further research could confirm this.

Figure 1

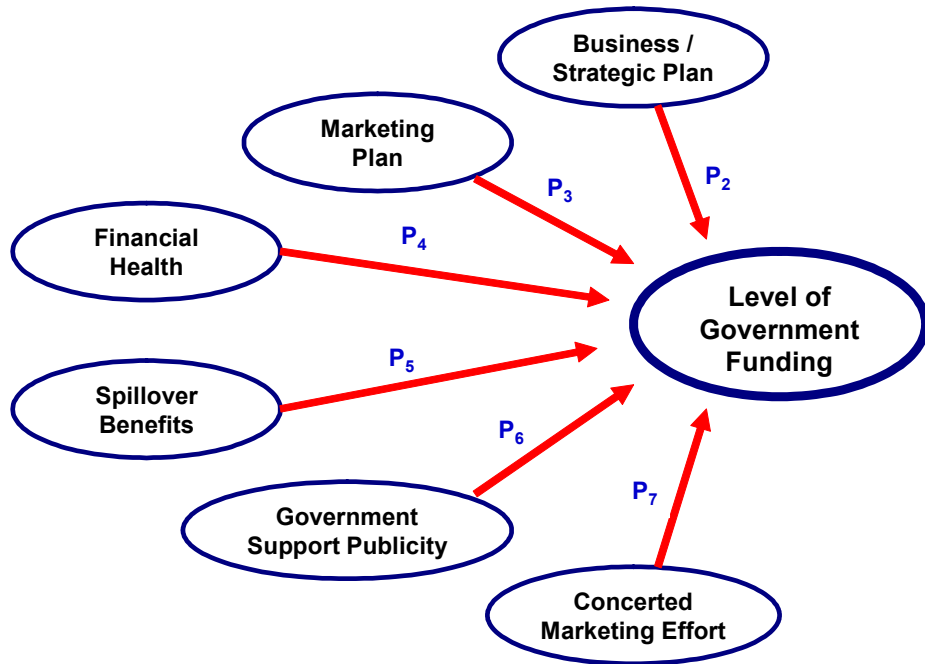
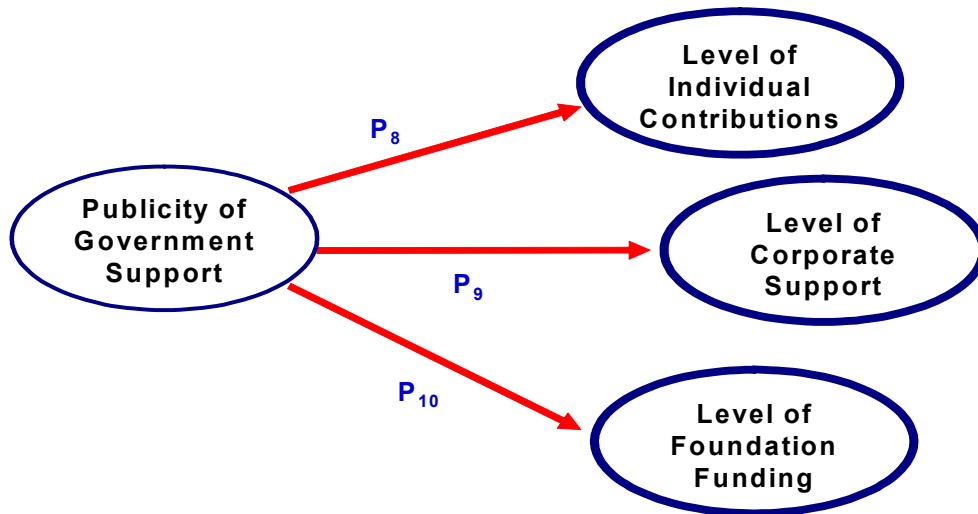


Figure 2



N.B. Proposition 1 can be empirically tested using data gathering and statistical calculations; it is therefore not included in the theoretical models.

Although arts organizations should apply for the range of government subsidy options at all levels, knowledge of trends enables better strategic and operational planning (Garcia 2003). Therefore, the following proposition is posited:

- P₁: Government support management activities and associated budgets for the arts are shifting from national governments to regional and local governments.

Research to confirm whether or not government funders reward arts organizations which meet their expectations would yield important information for both researchers and practitioners. Government funders increasingly specify criteria and have expectations of recipients. The literature suggests that arts organizations should address those criteria and expectations, particularly those that relate to recipient strategic planning and financial health, since there is a growing linkage of funder support to recipient effectiveness and financial viability. Creative application for arts support shows anecdotal effectiveness. Fillis (2002) noted that recent government stakeholder focus has been on the need to develop creative competencies, such as marketing, as part of the growing knowledge economy. Evidence of business and marketing planning is now required by Australia and Canada, and marketing may be done, in some cases largely to please funding bodies and government agencies despite insufficient skills and resources (McDonald and Harrison 2002). An important question for potential research is whether or not the submission of arts organization business and marketing plans and evidence of financial health with funding applications actually translates into increased government support. The following propositions are therefore posited:

- P₂: The level of government funding is positively influenced by the submission of a business / strategic plan or plan summary.
- P₃: The level of government funding is positively influenced by the submission of a marketing plan or plan summary.
- P₄: The level of government funding is positively influenced by the recipient's financial health.

Arts organizations can also explore options for additional government support. Economic impact analyses that show spillover benefits to the community can be used to lobby for additional support to increase those benefits. Governments look for creativity in arts organizations as well as income-building and value-added opportunities for their constituents, so publicity of government support and how it is used to benefit citizens may encourage additional funding. The literature suggests that non-profit arts organizations should market to government funding sources with the same innovative and concentrated effort that they put into marketing to ticket buyers and private sector donors (McDonald and Harrison 2002). The concepts of marketing to government funders and publicizing the benefits of government support have not yet been fully explored, understood, or leveraged. The following propositions are therefore posited:

- P₅: The level of government funding is positively influenced by submission of evidence of spillover benefits.
- P₆: The level of government funding is positively influenced by publicity of government support.

- P₇: The level of government funding is positively influenced by a concerted marketing effort to government funders, designed to maximize government funding.

Governments are asking arts organizations to look for alternate sources of funding and are offering incentives for private sector support. Arts organizations should therefore grow the capability to supplement government funding (McDonald and Harrison 2002, Heaney and Heaney 2003). Additional income options include: (1) earned income, (2) retail sales, (3) fundraising projects, (4) individual donors, (5) corporate donors, (6) foundation support, (7) sponsorships, and (8) joint ventures with corporations and governments. Leveraging these options requires organizations to market their cases for funding to the appropriate income sources. This requires arts organization fundraisers to be creative, persuasive, and communicative (Skolnik 1992). Kotler and Scheff (1997) examine the need to adapt marketing strategies to changing opportunities. Retail sales (e.g. gift shops) are rising as arts organizations market secondary products related to their primary products. Arts organizations have the potential to increase corporate contributions by marketing the case for contributing to executives using mechanisms such as cultural action committees to educate the business community on the role of business in the arts (Steed 1985, Tweedy 1991). Although government support is decreasing, corporate, foundation, and individual support is rising, as these donors and arts organizations leverage creative opportunities and use cause related marketing to support each other for mutual benefit, promotion, and enhanced viability through sponsorships and cooperative or joint licensing ventures (File and Prince 1998, Rentschler and Wood. Foundation support in the U.S., in particular, rose dramatically, and continues to grow, due to the 1976 Tax Reform Act, which requires foundations to disperse 5% of their earnings each year (Harpey 1992).

With a consensus that private sector sponsorship must grow, a need exists to educate the business community on the nature and value of arts support, including the advantages of plural funding, which couples government funding with business sponsorship. A crowding-out effect was observed in the 1980s, when support from one source tended to result in reduced support from others. However, that effect may be countered with effective marketing approaches to both government and donors (Tweedy 1991). More recent research by Brooks (1999) indicates that public funding and private support are independent; they neither crowd each other out nor leverage each other. However, there is evidence of a substantial, positive stimulus of federal funding, which has a powerful positive image, on private contributions (Hughes and Luksetich 1999). Rentschler et al. (2002) presented a model of transactional relationship / loyalty marketing to achieve funder loyalty, and recommended lobbying funding bodies of all types. The literature suggests that arts organizations should leverage government support by publicizing it to potential donors and should stress government-related donor implications (e.g. tax implications and state / local political benefits) to private and corporate donors. Federal funding should therefore be pursued for its own sake and as a way to attract private sector support because of its strong impact (Hughes and Luksetich 1999). Therefore the following propositions are posited:

- P₈: The level of individual contributions is positively influenced by publicity of government support.
- P₉: The level of corporate support is positively influenced by publicity of government support.
- P₁₀: The level of foundation funding is positively influenced by publicity of government support.

Suggestions for Empirical Analysis

Secondary data can be used for empirical analysis of the models and propositions where it exists and can be validated. It is anticipated that proposition 1 can be tested using secondary data alone from national, state / provincial, and local levels of government. The constructs for the models in Figures 1 and 2 must be decomposed into multiple operationalized variables, and specific data sources must be identified. Propositions 2-10 will require both secondary and survey data, which can be gathered either from arts organization surveys or from arts organization annual report information filed with the government, which are available as public record either via Internet or traditional government access. Data from both sources can be verified and augmented with survey information. For all proposition testing, the country of the organization should be captured, using a country code, and used to assess differences in results from a national perspective.

Proposition 1 can be empirically tested using data gathering and statistical calculations. Propositions 2 through 10 should be tested using confirmatory factor analysis using structural equation modeling software, which allows an analysis of the separate effect of each variable by controlling the variance in the other variables. Since each construct should have multiple contributing measurement items, this approach effectively estimates all of the variables and equations in the models simultaneously and is consistent with previous research, such as Gainer and Padanyi's (2002) use of structural equation modeling to assess the effects of marketing activities. The literature indicates that the relationships between level of government support and other variables may be causal ones (Stone 1995), as outlined in the structural models (Figures 1 and 2). Ideally, they should be analyzed with time series analysis on longitudinal data over time (Dawes 2000) to assess any time lag effects. While this approach complicates the data collection and analysis process, it should produce a realistic and accurate test of the hypotheses.

Managerial and Academic Implications of This Analysis

From a managerial perspective, strategic and operational planning are vital to ensure the viability and financial health of arts organizations. Because of the inherent market failure aspects of the non-profit arts industry, arts organizations must optimize their operations and maximize funding from the range of available sources. Creative and effective marketing techniques must be coupled with solid financial management to achieve organizational health.

Several implications for academic research on the arts industry emerge from this analysis. First, more theoretical and empirical work is needed at the macro level of government support research, especially from a comparative perspective, to serve as a foundation for lower level research. Second, government support for the arts at a high level is likely to remain relatively stable (neither increasing nor decreasing dramatically). However arts organizations must have contingency plans to deal with the potential of decreased funding in individual cases. Little, if any, academic research exists in the area of risk management and business continuity for the arts, and that research could be helpful in identifying strategic options for the arts industry.

Suggestions for Future Research

Further theoretical research might address definitional and methodological issues by mapping a common analytical vocabulary for cultural economics which can be used for comparative arts research (Peacock 2000). More detailed and focused empirical cross-institutional and international research might yield both statistical data and theoretical generalizations that could be used to advance the field of cultural economics (Feist 1998).

Future research might also expand the discussion of cultural economics to look at national and international implications of cross-cultural issues and organizational / institutional theories of leadership, strategy, structure, path dependency, motivation, and resource dependence as they pertain to the arts industry and government / private subsidy of it.

Since government support is increasingly based on accountability in terms of financial health, artistic quality and integrity, and organizational viability, future research might also build on previous outcome evaluation work and be used to develop appropriate outcome strategies and measures for the arts industry (Poole 2001).

Finally, there is little academic literature on arts organizations and government subsidy of them in non-Western countries. Future research to examine the cultural economics and arts organizations of Asia, Middle East, South America, and Africa would contribute significantly to both a global-level overview and individual national perspectives of the topic.

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