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THE NONPROFIT SECTOR AND THE ARTS IN THE UNITED STATES: BRIDGING THE GAP

by

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THE NONPROFIT SECTOR AND THE ARTS IN THE UNITED STATES: BRIDGING THE GAP*

Although the arts and high culture predominantly take the nonprofit form in the United States, there has traditionally been little interest in exploring the consequences of the “nonprofitness” of arts and culture with few exceptions (e.g., DiMaggio 1986). While this is beginning to change, both arts policy analysts as well as arts economists have typically focused on the role of government in financing the arts, leaving the issue of the provision of cultural services largely aside. In part, this might be due to the seemingly clear-cut division of labor between the three sectors in the United States: High culture was the undisputed domain of the nonprofit sector due to market failure and the historical non-existence of government arts institutions, where as the market ruled the production of popular culture. With this role distribution taken for granted, private vs. public or nonprofit vs. for-profit provision of the arts was essentially a non-issue.

However, over recent years, a number of broad institutional changes have taken place that direct more attention to the issue of auspices. Firstly, recent cuts in federal support for the arts have increased attention on private philanthropy (Cobb 1996)—the traditional form of nonprofit finance. Secondly, the arts sector has grown significantly since the 1960s, increasing the complexity of operations and raising the financial stakes. Moreover, the continuing budgetary crisis of the arts has encouraged arts organizations to engage in, or expand, activities that are essentially for-profit in nature, such as the retail operations of museums (Anheier and Toepler 1998). The fundraising and business skills that are increasingly required of arts administrators in this economic climate draw new types of managers from outside the art world to the field with potentially serious ramifications for organizational missions and behavior (Alexander 1996). Thirdly, technological and larger socio-demographic changes open opportunities for for-profits to enter new markets in the arts, heretofore thought of as protected by market failure, or to seek collaboration and cross-fertilization with the nonprofit arts (Cherbo 1999; Pankratz and Gibson 1999).

While there is therefore a heightened interest in various aspects of the “nonprofitness” of the arts, the issue of whether, and if so how, broad trends that affect the nonprofit sector at large (Weisbrod 1997) also have implications for the nonprofit arts remains unexplored. In other words, the question at hand is whether the larger nonprofit policy debate can bring useful, new perspectives to the arts policy debate. In the following, I briefly present one assessment of the overall challenges currently faced by the nonprofit sector and then concentrate more fully on one key trend—growing commercialization and its implications.

* This paper is based on a presentation at the “Organizations and the Future” colloquium sponsored by the National Endowment for the Arts, Washington, D.C., May 14, 1999.

THE CRISES OF THE NONPROFIT SECTOR

A good starting point is the summary analysis and assessment of the state of the nonprofit sector recently developed by Lester Salamon (1997; 1999). Salamon notes a number of trends that are supportive of the future development of the nonprofit sector, including social and demographic trends that will increase demand for services nonprofit organizations typically provide (ranging from the aging of the population to the transformation of the role of women to increased leisure expenditures), increased visibility and professionalization of the sector and the potential of new revenue sources deriving from the expected intergenerational transfer of wealth and new approaches to corporate philanthropy. At the same time, however, Salamon also identifies four major challenges that the nonprofit sector currently faces:

1. **The Fiscal Crisis:** The relatively prominent position that the nonprofit sector occupies in economic, social and political life today is for the most part a post-war phenomenon that is largely based on a “third-party government” approach to addressing public problems by providing public funding for the private provision of services (Salamon, 1995). Like the National Endowment for the Arts (NEA), many of these third-party government programs originated in the Great Society era of the 1960s and strongly fostered the growth of private nonprofit service providers. Beginning with the “Reagan Revolution’s” fiscal retrenchment in the early 1980s, however, the nonprofit sector saw substantial cutbacks in federal support. Fiscal retrenchment in combination with growing demand for services has put the nonprofit sector under considerable financial strains since. In the arts, federal support declined by almost half between 1980 and 1997 and its GDP share in 1997 stood at only 35 percent of the 1980 level (Abramson, Salamon et al. 1999, p.113).
2. **The Economic Crisis:** With private philanthropy unable to fill the gaps left by reduced government support, the nonprofit sector increasingly has relied on fees, charges and other earned income to respond to the growing demand. With the marketization or commercialization of the sector on the rise, since, many nonprofit organizations are running the danger of becoming indistinguishable from for-profit ventures. Moreover, with shifts in the general institutional environments and commercialized nonprofits demonstrating the marketability of their services, the for-profit sector has begun to enter, or even take over, markets that were traditionally served by nonprofits.
3. **The Effectiveness Crisis:** The growth of the sector as well as its more business-like approach to doing charity has also led to a greater professionalization. The highly professionalized provision of services, the replacement of volunteers with on occasion extremely well-paid professionals has brought the modern reality of the sector at odds with traditional popular conceptions of charity. The results are decreasing good will bonuses and greater demands on nonprofits to demonstrate their effectiveness, if not even the efficiency of their operations. With profits as the basic bottom line of businesses missing, such demands have send the sector struggling to find

alternative effectiveness and efficiency measures and, more generally, to find new ways to address its accountability problems.

4. **The Legitimacy Crisis:** At last, with the growing commercialization and the increased questioning of its effectiveness and accountability, the nonprofit sector is on the verge of losing the public's trust and at least parts of its privileges. A number of highly publicized scandals, including the United Way scandal that broke in 1992, and growing critical coverage in the media further amplified the problem. In terms of privileges, the sector is facing challenges to its tax-exemption, especially property tax exemption (see below), at the local level and to its ability to advocate and thus influence the political process at the federal level.

At the bottom of this interrelated set of crises lies one central problem: the perceived growing commercialization of nonprofit organizations, which is brought about by increasingly insufficient donative revenue (whether public or private), but has the potential to shake the foundations the sector stands on: public trust and the justification for the privileges it enjoys. It is at this point—with respect to the assessment of earned income as a means of financing, however, that a significant difference in thinking between the arts and the larger nonprofit field emerges.

SELF-SUSTAINABILITY VS. COMMERCIALIZATION

One proposition in the arts field has been to close the “earnings gap” (Stevens, 1995) by finding ways to increase earned income to levels that give arts organizations financial independence or, in other words, that make them self-sustainable. To be sure, this is a very appealing and intriguing proposition for many stakeholders. For local governments, for instance, increasing the self-sustainability of local arts institutions would reduce subsidies and thus allow them to redirect scarce resources to other needy areas. One example is Baltimore, where the privatization of history museums with the self-sustainability goal in mind had, however, fatal or near-fatal consequences for those museums that were not prepared organizationally and strategically to recognize the implications (FitzSimmons, 1999). Insofar as arts institutions are able to appreciate the consequences and prepared to strategically leverage their assets (*ibid.*), the new mantra of self-sustainability should be equally, if not even more, appealing to the organizations themselves. Earning their own way can free the organization from the vagaries and volatility of, as well as the strings attached to, public subsidies as well as private donations. To paraphrase the old adage: if the piper can pay herself, she can also call the tune herself.

From the broader nonprofit perspective, the self-sustainability issue is less clear-cut. To be sure, the call for self-sustainability is increasingly heard throughout the nonprofit sector. In contrast to the arts, however, there is also a growing debate of the commercialization threat that increased reliance on earned income brings with it. Commercialization in this context means different things (Weisbrod, 1998):

Organizations charging fees and increasing fees for their core services (e.g., raising admissions), engaging in mission-related economic activities (e.g., museum stores) or engaging in completely unrelated business activities. Significantly, rising ticket prices and admissions (i.e. related income) is a large and very important part of the commercialization problem. In general, there are a number of consequences of the commercialization trend, including issues relating to (i) funding interdependencies; (ii) mission or goal displacement; and (iii) local tax exemption.

(i) *Revenue Interdependencies*

In aiming at increasing earned and commercial income (and thus reaping the benefits outlined above), organizations might not be fully aware that there are various revenue interdependencies in play, meaning that a stronger or lesser pursuit of one given form of revenue will have certain effects on the other revenue types (Weisbrod, 1998; Kingma, 1996). Generally, we differentiate between three broad categories of revenues: government support (including third-party payments, direct subsidies or contracts); private fees and charges; and private donations from individuals, foundations and corporations. Some of these interdependencies are

- The fairly well-known and thus prominent “crowding out” effect, which is usually taken to mean that increases in government support will lead to decreases in private donations (Steinberg 1989). The assumption here is that individual as well as private institutional donors will shift their philanthropic giving away from organizations that are beginning to receive substantial amounts of government support. Some of this behavior might have ideological roots based on the belief that government money taints the private character and independence of nonprofit organizations; in part, it can also be a function of the perception that an organization receiving public support is less in need of private support (Brooks 1999).
- Already referred to is an interdependence between fee income and public support, as local or state governments might decide to pull out of funding obligations if the organization appears to be able to take care of itself economically. While I am not aware whether this is already a problem in the arts, a visible case is higher education where state legislatures frequently reduce subsidy levels after universities and colleges have succeeded in raising earned income through tuition increases. Thus, attempts to close the earnings gap is likely to just open other revenue gaps, especially for arts institutions that have significant municipal support.
- Thirdly, rising fee income might also negatively affect private donations, as donors see either less need or do not feel that their donations are important to the organization. As private donations are still more important in the arts than in other areas of nonprofit activity, this is potentially a very significant problem.

(ii) *Mission or Goal Displacement*

Perhaps the greatest threat underlying the commercialization phenomenon is the danger of mission or goal displacement (Weisbrod, 1998). In the nonprofit context, it is typically assumed that nonprofit managers do not engage in commercial activity for

purely economic goals (as the for-profit firm does), but as a means to generate additional revenues to cross-subsidize their under-funded core charitable, educational or artistic goals and missions. Goal or mission displacement refers to the possibility that increasing emphases on, as well as the lure of success with, commercial activities will tempt nonprofit managers to lose track of what the organization originally set out to accomplish. At the same time, the traditional balance of power in organizations may shift from the service professionals who traditionally used to run nonprofit organizations (i.e., social workers or curators) to more recently hired and financially-savvy business staff with MBA or MPA degrees (Alexander 1996).

In the cultural arena, the one institution where the threat of mission displacement is perhaps playing out most publicly is the Public Broadcasting System. Over the past few years, the seemingly increased use of commercials in the form of corporate underwriter messages has sparked substantial criticism of the growing commercialization of “commercial-free” television, which is seen as the final departure from the ideal blueprint as laid out by the Carnegie Commission and that helped establish the public television system (LaMay and Weisbrod 1998). When Tom and Ray Magliozzi, or “Click and Clack The Tappet Brothers” of NPR’s *Car Talk* show, make their plucks for the “Shameless Commerce” division on their website (which is, however, linked, but not part of NPR’s site), it is probably as much indication as ironical self-reflection on what is happening on the public air waves.

While this by itself is seen as undermining the public broadcasting’s original mission, it also seems only to be the short end of the problem. In a recent article in the *American Prospect*, two child psychiatrists charged that, with the decision to air the hugely successful *Teletubbies* show, PBS aimed at creating a new market of the previously un-tapped audience of one-year olds for purely commercial reasons, including benefiting from the merchandising potential of the show. The problems with the show, however, lie in its apparent void of any educational content, the lack of research on how television in general may affect less than two-year olds and the resulting strong recommendation of the American Academy of Pediatrics not to let infants and toddlers under two watch any television (Linn and Poussaint, 1999). Thus, the question does arise whether PBS, in trying to claim educational benefits of the show despite the lack of research to back up such claims, is placing commercial goals over educational goals, thus displacing the latter.

While PBS might be the most prominent example, it is not the only one. Similar issues are at play in the museum field (Anheier and Toepler, 1998). While commercialization can take many forms in this field, the most visible development is the emphasis that is put on merchandising. Museum shops are expanding and get more space within the museum. Off-site stores are mushrooming and some of the larger museums have entered the mail order business with professional catalogues that are virtually indistinguishable from similar commercial catalogues, except for the merchandise descriptions that carefully note that the product is derived from objects in the museum’s collection, which in turn shields the merchandising operation from taxation. While it can

be argued that catalogues and merchandising help increase the visibility of the museum and thus further the educational mission, the core incentive is the revenue potential. Unfortunately, however, the usefulness and viability of stores and catalogues as income generators are not fully studied and there remain some questions.

As an example, net proceeds from merchandising as a percentage of adjusted total revenue dropped from 10 percent in 1991 to 6 percent in 1993 to 1 percent in 1995 in the case of the Museum of Fine Arts Boston. Similarly, for the Metropolitan Museum of Art they dropped from 11 percent in 1987 to 2 percent in 1991 to 1 percent in 1995 (Anheier and Toepler 1997). To be sure, there are many possible reasons that these limited data may not represent a long-term trend¹ and further study is in order. Nevertheless, these examples should serve as a cautionary tale that going down this commercial route might not always have the expected pay-offs for museums thinking of re-directing resources towards enlarging their stores. Perhaps even more significant is a closer look at the actual financial extent of merchandising. Indeed, mail order and merchandising operations can account for substantially more than half of all revenues (as well as expenditures) of the museum. If thus the largest part of the art institution's finances is bound in commercial activities, situations might indeed arise where economic goals will take priority over educational goals and the threat of mission displacement becomes real.

(iii) *Local Tax-Exemption*

Of all the various taxes nonprofit organizations are exempt from, the local property tax is perhaps the most valuable exemption. Again, the more a nonprofit begins to resemble a commercial operation, the louder become questions as to why it should be exempted from property tax, which is of course the most critical source of local government finance. So far, the main thrust of the local tax exemption challenge has hit the "usual suspects," namely hospitals and also colleges and universities (Salamon, 1997). But many other nonprofits are affected as well, including museums and other cultural organizations (Leland, 1997). As one example, the exemption of Longwood Gardens, an operating foundation created by industrialist Pierre S. du Pont, was challenged in a suit brought by the local school district (Pamela Leland, Seton Hall University, private communication).

In the light of the growing number of problems that cities face, it is quite likely that cash-strapped local tax collectors will indeed pay greater attention in the future to the many well-endowed urban arts institutions that occupy prime, and thus valuable, city space in hopes of extracting some financial contribution for their municipalities in form of taxes or an alternative scheme known as payments-in-lieu-of-taxes (PILOTS). Having arts organizations that appear to be economically viable and autonomous by virtue of large endowments and/or a highly commercialized income structure is thus bound to raise questions about what exactly the benefit for the locality is and why such organizations do not contribute in more concrete ways to their communities.

¹ E.g., the drop in the early 1990s might have been recession related. Lower net proceeds could also be a function of higher costs associated with investments in new additional off-site stores.

So far, the nonprofit sector has been fairly successful in fighting these local challenges, but even if municipalities do not succeed in revoking property tax exemptions on a large scale, there will be greater resistance to accommodating nonprofits and the nonprofit arts in the future. Perhaps an indication of this is Washington, D.C.'s initial reluctance to re-zone the former downtown flagship store of the bankrupt Woodward & Lothrop department store chain for use by the Washington Opera. Obviously, the revitalization potential of a new opera house was not perceived by the city as a sufficient recompense for the loss of property tax income derived from the commercial use of the building.

IN SEARCH OF RATIONALES FOR SUPPORTING THE ARTS: ECONOMIC CAPITAL OR SOCIAL CAPITAL?

In sum, the central thrust of the argument here is that there might be challenges out there for the arts that we are perhaps ill-equipped fully to take into account at this time. It is, of course, also possible that the arts are so different from the rest of the nonprofit sector that none of these larger challenges will ever materialize. However, can we take the risk of not investigating this further? And what are the reasons that these issues are not on our radar screens quite yet?

While the first question cannot be answered without further empirical inquiry, the answer to the second question lies in the prevailing arts policy paradigms, so to speak. Perhaps generalizing a bit too broadly, the arts policy debate in the past has focused primarily on developing legitimizing frameworks for supporting the arts and the key focus has been on the issue of funding.

However, my argument here would be that the rationales and justifications put forward over the past couple of decades to legitimize public involvement and support are beginning to outlive their usefulness and might prove insufficient to help guide us through the emerging new realities of the arts. Most of the legitimizing arguments have traditionally been economic in nature. It was essentially economic arguments—various forms of market failure with Baumol and Bowen's (1966) cost disease the most important—that prepared the ground for government involvement in the arts in the United States in the 1950s and 1960s. The 1970s then saw the rise of the economic impact study—still the tool of choice for arts advocates otherwise lacking any arguments to convince skeptical local authorities to support the arts for anything other than the arts' sake. In a way, there is thus a long tradition of arguing the value of the arts, and thinking of the arts, economically, at least as far as support rationales are concerned. From this perspective, it is perhaps not too surprising that the latest trend of self-sufficiency is again economic in nature, only this time it plays out at the organizational rather than the market or industry level.

The primary advantage of thinking economically has been that it did allow the argument of support for the 'professional artist as professional artist' or the professional

arts as professional arts. As long as impact studies could show that there are economic benefits that the community derives from the arts, it does not really matter what the arts do in the community. In a way, the “fringe benefits” of artistic and cultural activity were sufficient.

By the same token, there was little discussion of how the arts can change to become more integral parts of the community or, in other words, how the arts can best benefit communities with their *traditional* accomplishments (i.e., professional artistic output) as a fringe benefit. Without that, however, a true new legitimacy might not be easily attainable.

At this point, it is perhaps worthwhile to put the preoccupation with the economic side of things to rest for a while and begin to explore alternative avenues that might help us place the arts more firmly on the political and social maps of society. But one such avenue is the debate about civil society and social capital that has gained some currency both in the U.S. and abroad (Salamon and Anheier, 1997; 1999). Civil society is often conceptualized as the space between the state and the market, the realm of civic activity, voluntary associations, informal networks, clans and families, which keeps both the state and the market in check and provides the bonds that hold communities and society together. Alas, the relationships between civil society and arts and culture have not yet been explored or even flagged. Among the few exceptions is political theorist Benjamin Barber who wrote that the “arts are civil society’s driving engine, the key to its creativity, its diversity, its imagination, and hence its spontaneity and liberty. As democracy depends on civil society for its liberal spirit, so civil society depends on the arts; thus democracy needs the arts’ commitment to free creativity, liberal diversity, and unfettered imagination” (Barber 1998, p. 109). And he goes on to say that “[i]magination is the link to civil society that arts and democracy share. When imagination flourishes in the arts, democracy benefits. When it flourishes in a democracy, the arts and the civil society the arts help to ground also benefit. Imagination is the key to diversity, to civic compassion, and to commonalty” (p.111).²

To be sure, re-invigorating civil society holds the potential to help address a broad range of societal dysfunctions and halt the vanishing of the community. Locating the arts in this context will thus provide a strong and powerful legitimization. Unfortunately, the civil society idea remains somewhat abstract and even Barber’s arguments for the relationship between the arts and civil society are well-intentioned, but lack nevertheless concreteness.

More useful in this respect is the related concept of social capital, which—somewhat simplified—refers to the bonds of trust and norms of reciprocity that individuals develop by interacting with another, primarily through participating in associations, networks and so on. The social capital idea figured prominently in Political Scientist Robert Putnam’s (1993) work on Italy, in which he showed that participation in

² I owe this quote to James Allen Smith.

voluntary associations was positively correlated with the degree of economic development and good governance. In the U.S., it was further popularized with his fabled “Bowling Alone” article about the alleged decline of social capital in the United States (Putnam, 1995). Looking at the arts from a social capital angle would entail a greater focus on those parts of the cultural universe that actually provide venues for citizens to participate and interact, which in turn fosters social bonds and raises the level of trust in communities with the concomitant spill-over effects. This of course is a very different kind of participation than the one we have concentrated on in the past: Participation in terms of passively attending an arts event is neither sufficient nor interesting from this perspective.

CONCLUSION

In sum, if we accept that the nonprofit arts will sooner or later be fully subject to the same challenges as the nonprofit sector at large, then we need to develop different conceptual frameworks and a new base for legitimizing support and the extension of privileges (e.g. preferential tax treatment) beyond market failure and economic impact. The social capital route may be but one way—particularly useful to explore more fully the ways in which the arts contribute to their communities. However, it is also a limited one, as it is unlikely to provide much cover for the high arts that we all have traditionally been so preoccupied with: teasing social capital contributions out of the work of traditional arts institutions that produce traditional professional art outputs for traditional passive audiences will be a major challenge.

In a way, we will thus still have to go back to the drawing board and try to develop yet another take on what impacts the arts might have in the broader civil society. Here again, we could seek council in the larger nonprofit debate and begin to look for measures that help us understand what special functions or roles the nonprofit arts perform vis-à-vis the non-nonprofit arts. This would mean that we change the focus slightly. We would stop arguing why the arts *per se* should be supported and we would begin arguing why nonprofit organizations should be supported that produce arts. In a way, this means that we would be looking for comparative advantages or efficiencies of organizational form (nonprofit versus for-profit or public auspices)—taking for granted that the arts should be there in the first place, a proposition that even those who believe that the arts should be left to the market place do not call into question.

The issue then becomes whether it matters who is actually providing the services. Indeed, the search for ways to demonstrate the broader impact of nonprofits this way is gaining momentum. While there is a growing body of empirical studies that attempt to compare performance in industries where two or even three sectors are present at the same time (hospitals, child care, nursing homes, etc.), the available evidence is still inconclusive, however, and this line of inquiry is generally hampered by measurement issues. However, a number of special functions commonly ascribed to nonprofits can be hypothesized that could be used to establish a broad and multi-dimensional argument of

what the impact might be (for a closer discussion, see Salamon, Hems, and Toepler 1999). These special functions include:

- *Service Function*. Nonprofits provide services that are not typically provided by either government or the market, or if they do, they provide these services differently, that is, *inter alia*, at lesser cost, greater equity, or higher quality;
- *Innovation Function*. Nonprofits perform an innovation function in pioneering new approaches or solutions that may be taken over by government or the market at a later stage;
- *Advocacy/Social Change Function*. Nonprofits serve as agents of social change;
- *Expressive Function*. Nonprofits provide an outlet for expressing diverse values or interests; and
- *Community Building Function*. Nonprofits help build communities and strengthen democracy. (This equals the social capital dimension).

To be sure, these hypothesized roles and functions are in need of empirical validation and this process has just begun (*ibid.*). Moreover, some of them might not actually apply to the nonprofit arts, and to some we think we already know the answer (e.g., the service function). However, it is time to dig a bit deeper, to draw together what evidence is already out there and present it in a larger frame. At least I believe, this would be a welcome addition to our current preoccupation with arts economics and funding.

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