

# THE SCIENCE OF TAXING THE ARTS

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*Most OECD countries support the arts with a broad range of tax incentives. The primary incentives provided in New Zealand are direct subsidies to traditional art forms, such as the ballet and the symphony orchestra; tax credits for donations to certain not-for-profit organisations, which may include arts organisations; and tax incentives for New Zealand production of films, digital and visual effects.*

*This paper investigates the economic, philosophical and sociological arguments raised for, and against, the provision of tax incentives for 'the arts'. A variety of direct and indirect instruments are discussed. A trans-Tasman comparison of arts related funding and incentives is undertaken and the suggestion made that New Zealand must engage in more effective targeting of scarce resources in order to maximise outcomes from tax incentives and increase economic efficiency.*

## I INTRODUCTION

Countries throughout the OECD provide tax based support for the arts. This may take the form of tax credits, tax deductions for charitable donations, direct grants or targeted support. Incentives are provided to a range of industries that include, but are not limited to, the performing arts, film, publishing, music, digital media, literature and television.

Typically, government support of the arts is justified with the assumption that the market for the arts does not work, or that the arts generate a social benefit that validates state support. There are a number of issues in quantifying and justifying state support for the arts. Of particular relevance are the definitional issues around what qualifies as 'art'; the difficulties associated with measuring the potential economic contribution, if any, from the arts; and measuring the level of assistance provided to the arts community, particularly in relation to indirect assistance. As observed by Frey:

creativity is an elusive concept and most difficult to deal with in a way providing useful insights for the typical problems with which the economics of art is concerned. In particular, the effect of government intervention on artistic activity is complex, and does not lend itself to simple relationships and conclusions.<sup>1</sup>

In the current environment of constrained resources, it would appear timely to revisit the issue of tax incentives for the arts and ask the questions of who receives tax incentives, how

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<sup>1</sup> Bruno Frey, 'State Support and Creativity in the Arts: Some New Considerations' (1999) 23 *Journal of Cultural Economics* 71, 75.

much they get, who decides on the allocation, and the economic or social benefit gained from the subsidies provided. This paper explores the justification for tax incentives for the arts and offers some suggestions for their existence. In addition, it investigates the philosophical issues raised in providing tax incentives for the arts, including what qualifies as an ‘art’.

The funding of arts activities is not questioned. However, it is suggested that greater transparency is required in New Zealand in relation to arts funding decisions. Moreover, an expectation of demonstrated economic or social benefit should be a prerequisite for state assistance.

The paper commences with a discussion on what is art. An outline of the literature follows, incorporating the economic, philosophical and sociological arguments for the provision of tax incentives for the arts. The different forms of incentives, and advantages and disadvantages of the incentives, are summarised. The current direct and indirect funding approaches in New Zealand and Australia are examined, followed by a discussion on the debates around the provision of incentives for arts activities. Conclusions are drawn in the final section.

## II WHAT IS ART?

When exploring a topic such as this, perhaps the first issue to address is the question of ‘what is art’? Arts are typically ‘experience’ activities, providing economic value that is difficult to measure. Definitions of art range from the product of human creativity, to the popular Wikipedia definition: ‘the process or product of deliberately arranging elements in a way that appeals to the senses or emotions’.<sup>2</sup>

For the purposes of this paper, art is not confined to the traditional ‘high arts’. While the more conventional performing arts (eg, ballet, opera, and orchestral performances) are considered, other more modern arts, such as digital film production, are included in the discussion. Items that are cultural in nature and traditionally supported by the state, such as the provision of a national archive, national library or a national museum, are excluded from this discussion. Cultural activities tend to be broader in definition than the arts, including heritage items as well as more traditional forms of performing arts.<sup>3</sup> The primary reason for exclusion of cultural activities in this analysis is that arguments surrounding justification of funding for culturally significant activities differ considerably from the debates around activities of a more

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<sup>2</sup> Wikipedia, <<http://en.wikipedia.org/wiki/Art>>.

<sup>3</sup> Victor A Ginsburgh and David Throsby, *Handbook of the Economics of Art and Culture, Volume 1* (Elsevier, 2006) 5.

conventional artistic nature.<sup>4</sup> Instead, the focus is on those activities that have greater discretion for a country, are more likely to be supported by a small proportion of the population and are less likely to have cultural significance.

From a broader perspective, art may be included within the category of ‘creative industry’; a topic that has generated considerable research interest in recent times. A creative industry is defined by Barrowclough and Kozul-Wright as essentially dualistic, comprising an intangible and a tangible component and ‘underpinned by intangible creativity and ideas (symbolic cultural expressions, musical ideas, visual images, products of the intellect) as well as a tangible mode of delivery’.<sup>5</sup> For the purposes of completeness, creative industries are also included in this analysis.

Among the statements defending state support for the arts are those such as the following: ‘art is beyond calculation, and due to its uniqueness it may not be compared with anything else’;<sup>6</sup> ‘we have an interest in promoting beauty and excellence, which it is reasonable for us to fulfil in part through government activity’;<sup>7</sup> and ‘the arts are among the most desirable products of civilization – they are among the most worthy of the outputs of the economy’.<sup>8</sup> However, despite this apparent worthiness, in many cases there is a gap between supply and demand of arts activities, which results in the need for financial support from other sources, such as the state.

### III TAX AND THE ARTS

Tax incentives are typically provided to encourage or modify certain behaviours. These behaviours may be macro- or micro-economic in nature: for example, they may be provided to individuals to encourage saving for retirement, or they may be provided to large organisations to assist in maintaining competitiveness in a global environment. Typically, there is some economic benefit associated with their provision.

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4 For example, individuals have different perspectives on the funding of cultural activities and the funding of more traditional art forms. In addition, cultural goods and services are more likely to adhere to the ‘public good’ definition that is used to support government funding, whereas more conventional arts do not easily fit within this boundary.

5 Diana Barrowclough and Zeljka Kozul-Wright, *Voice, Choice and Diversity Through Creative Industries: Towards a New Development Agenda* (Routledge, 2008) 5.

6 Bruno S Frey and Werner W Pommerehne, *Muses and Markets: Explorations in the Economics of the Arts* (Oxford University Press, 1989) 8.

7 Harry Brighouse, ‘Neutrality, Publicity and State Funding of the Arts’ (1995) 24 *Philosophy and Public Affairs* 35, 35.

8 William J Baumol, ‘Applied Welfare Economics’ in Ruth Towse (ed), *A Handbook of Cultural Economics* (Edward Elgar Publishing Ltd, 2003) 21.

The behavioural effects resulting from tax incentives are well known, and include:

- increasing the attractiveness of the concessionally taxed activity;
- the need for increased tax revenue from other sources to supplement revenue foregone;
- the possible impact on economic activity, with the altered allocation of scarce resources.<sup>9</sup>

Economics and art are a relatively recent addition to the academic literature, with the origin of the discipline now known as contemporary cultural economics in the mid 1960s, following the seminal research of Baumol and Bowen.<sup>10</sup> Despite its recent addition to the academic community, tax incentives for the arts are not new; they have existed in some countries from the early twentieth century.<sup>11</sup>

A variety of economic and philosophical viewpoints have been raised for, and against, state involvement in funding the arts. The reasons outlined below from Towse,<sup>12</sup> and Throsby and Withers,<sup>13</sup> are used as a framework for investigation of the common arguments for government assistance to the arts.<sup>14</sup>

Towse<sup>15</sup> suggests that there are three primary benefits that flow from the arts to society, which provide an argument for state support:

- The economic spill over from the existence of the art (such as increased tourism);
- The creation of a legacy for future generations; and
- Their educational contribution.

Throsby and Withers<sup>16</sup> add the following:

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9 Commonwealth of Australia, *Tax Expenditures Statement 2008*, <<http://www.treasury.gov.au>> 23.

10 William J Baumol and William G Bowen, *Performing Arts — The Economic Dilemma: A Study of Problems Common to Theater, Opera, Music and Dance* (The Twentieth Century Fund, 1966).

11 Stephen E Weil, 'Tax Policy and Private Giving' in Stephen Benedict (ed), *Public Money and the Muse: Essays on Government Funding for the Arts* (W W Norton and Company, 1991) 168.

12 Ruth Towse, *Baumol's Cost Disease: The Arts and Other Victims* (Edward Elgar Publishing Ltd, 1997).

13 David Throsby and Glen Withers, *The Economics of the Performing Arts* (Edward Arnold (Australia) Pty Ltd, 1979).

14 This section focuses on the primary arguments for state support for the arts. It is acknowledged that other arguments exist, such as supporting infant industries, or increasing access to the population of a particular art form. For further discussion on justification of these forms of concession, refer to Brett Freudenberg, 'Tax: Contributing to a Sustainable Arts Sector in Australia — Lessons from Overseas' (2010) 15(2) *Media and Arts Law Review*, 169, 174.

15 Towse, above n 12, 256.

16 Throsby and Withers, above n 13, 170.

- Support for the arts ‘provides work for artists in their chosen profession, prevents loss of talent to other professions or to other countries and also attracts key non-artistic personnel to the country who require a cultured environment’;
- The option value associated with the arts that is held by individuals that do not attend arts performances;<sup>17</sup>
- The high risks and uncertainties of artistic activity;
- The range of community benefits generated by the existence of the performing arts, as well as for those who do not attend the performances, including ‘the provision of public creative ideas and aesthetic standards; the development of national feeling, pride and identity; the provision of social comment and criticism; and the social improvement of the participants in the arts’.

Each of the points raised by Towse, and Throsby and Withers, is discussed in more detail in this section.

### ***A National identity and national prestige***

As observed by O’Hagan, ‘one of the arguments used most frequently in relation to subsidies to the arts relates to national identity’.<sup>18</sup> Throsby and Withers<sup>19</sup> define ‘national identity’ as ‘those elements of national life which characterise a country and distinguish its attitudes, institutions, behaviour and way of life from those of other countries’. Further suggestions are that the existence of arts institutions leads to an enhanced concept of society, which leads to greater social cohesion<sup>20</sup> and that individuals benefit from national or international recognition of achievement.<sup>21</sup> There is also the suggestion that art is a reflection of society; in which case it is reasonable that society as a whole supports it.

The ‘national pride’ argument is often used to justify the potential for inequity inherent in arts based funding; that is, ‘low income nonusers are compelled to pay taxes to finance the

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<sup>17</sup> An option value exists when individuals do not attend arts activities themselves; instead, they place value on their presence so that others may attend, or for possible self-attendance in the future.

<sup>18</sup> John W O’Hagan, *The State and the Arts: An Analysis of Key Economic Policy Issues in Europe and the United States* (Edward Elgar Publishing Ltd, 1988) 23.

<sup>19</sup> Throsby and Withers, above n 13, 177.

<sup>20</sup> Steven Globberman, *Culture, Governments and Markets: Public Policy and the Culture Industries* (The Fraser Institute, 1987) 30.

<sup>21</sup> Throsby and Withers, above n 13, 177.

entertainment of high income and well educated theatre-goers'.<sup>22</sup> The opposing views can be seen in the following two claims: 'screen productions are particularly significant for their impact on how New Zealanders see themselves'<sup>23</sup> and national identity arguments as support for the arts are 'very dubious grounds on which to base a public subsidy argument'.<sup>24</sup>

The issue of increased national identity or national pride relating to arts activities remains far from settled, with few recent empirical studies undertaken testing the claim. Research by Throsby and Withers finds that 66% of questionnaire respondents indicated that the community benefited from a publicly supported symphony orchestra, while only 19% of those respondents had attended a symphony performance in the last two to three years.<sup>25</sup> However, the data supporting this claim is now 35 years old, thus it is an area that warrants further research attention.

### ***B Externalities***

One of the most common arguments for state support for the arts is that they provide externalities or spill over benefits. An externality exists when the benefits (or costs) of a good or service have a spill over effect to those not involved in the transaction.<sup>26</sup> In relation to the arts, positive externalities may exist for society in both production and consumption. For example, individuals travelling to experience an arts performance will potentially consume other goods and services, such as accommodation, meals and transport. This expenditure assists in job creation in a variety of industries in the location of the art provided. Thus, the externality argument is that if 'benefits exist to non-consumers as well as to consumers, society as a whole should be willing to pay more for a product than would the direct consumers of that product'.<sup>27</sup> However, it is also argued that most economic activities create some form of externality, thus the existence of an externality in isolation is unlikely to provide sufficient grounds to justify financial support from the state.

### ***C Legacy for future generations/option value***

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22 William G Morrison and Edwin G West, 'Subsidies for the Performing Arts: Evidence on Voter Preference' (1986) 15 *Journal of Behavioral Economics*, 57.

23 Ministry for Culture and Heritage, *Review of Government Screen Funding Arrangements Discussion Paper*, <<http://www.mch.govt.nz>> (2004).

24 O'Hagan, above n 18, 25.

25 Throsby and Withers, above n 13, 183.

26 Globerman, above n 20, 16.

27 Globerman, above n 20, 16.

Towse suggests the creation of a legacy for future generations as justification for state support.<sup>28</sup> This is perhaps more frequently recognised in the literature as the option value associated with the arts, as suggested by Throsby and Withers.<sup>29</sup> The literature suggests that some individuals who do not attend the performing arts nonetheless attach a value to their existence. For example, Throsby observes that:

the arts are socially beneficial when held by people who do not themselves consume the arts directly, or an acceptance by some individuals of the desirability of others' consumption, can be accounted for in this way. In such cases what appears at first sight to be "imposed choice" turns out to be ultimately consistent with the principle of consumer sovereignty.<sup>30</sup>

In the economic literature this has been explored as the 'willingness-to-pay' approach, which examines the value of a particular art to the population. Bille Hansen<sup>31</sup> finds that in a situation of payment for the Royal Theatre in Copenhagen, the population was willing to pay an amount at least equal to the government subsidy. While visitor numbers to the theatre were around 7% of the total population, willingness to pay by non-users was also substantial. This effect is described by Throsby and Withers<sup>32</sup> as an option value on the presence of the arts for non-users. The option value is not reflected in the market, as no demand is exerted.<sup>33</sup> The value exists from the opportunity to attend performances, despite non-attendance in practice, together with a value that they can be utilised by others. The option value argument, to some extent, addresses the question of why it is that if benefit is generated by arts, those obtaining that direct benefit may not incur the full costs of it. Thus, state support may be warranted to allow this option demand to be met.

### **D Education**

The educational potential from the arts may flow to both the producer and the consumer. Existence of arts organisations provides employment and skill enhancement opportunities for those engaged in all elements of the production. Similarly, it is argued those attending the arts also benefit from a component of learning from the experience. However, traditional forms of art are often charged with being the domain of the elite. While this is outside the scope of this paper,

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28 Towse, above n 12.

29 Throsby and Withers, above n 13.

30 David Throsby, 'The Production and Consumption of the Arts: A View of Cultural Economics' (1994) 32(1) *Journal of Economic Literature*, 23.

31 Trine Bille Hansen, 'The Willingness-To-Pay for the Royal Theatre in Copenhagen as a Public Good' (1997) 21(1) *Journal of Cultural Economics*.

32 Throsby and Withers, above n 13.

33 Frey and Pommerehne, above n 6, 10.

there is considerable support among the literature linking factors such as income and education to 'high arts' attendance. As observed by Baumol,<sup>34</sup> 'the difficulties of those who advocate public support for the arts is compounded by the well-documented fact that their audience is typically composed of individuals whose incomes, wealth and education are well above those of the population as a whole'.<sup>35</sup>

The relationship between attendance at arts performances, higher levels of education and higher consumer income is well established.<sup>36</sup> Blaug captures this point succinctly, stating that 'audiences for the arts are skewed to the right in income, age, occupation, and levels of education and indeed differ more markedly in years of schooling achieved than in any other personal characteristic'.<sup>37</sup> Thus, the argument in support of increased education may be valid as a spill over benefit, but is tempered by the over-utilisation of some arts activities by the wealthier, more educated proportion of society.

### ***E Arts and economic growth***

In recent years, considerable attention has been paid to the links between arts based industries and economic growth. This economic growth can be viewed as an externality from state support for the arts industries. There is some indication that the arts, as an industry, is growing at a faster pace than average and providing a greater contribution to society than many other industries. The United Kingdom publishes an annual *Creative Industries Economic Estimates*,<sup>38</sup> outlining estimates of economic contribution provided by the creative industries.<sup>39</sup> As at January 2009, the gross value added by creative industries was estimated at 6.4%. In addition, creative industries in the United Kingdom are demonstrating higher growth than the

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34 Baumol, above n 8, 21.

35 An example of this is provided by Towse who notes that in the United Kingdom, opera receives five times the amount of subsidy per attendance when compared to other Arts Council supported performing arts organisations, despite only being attended by 7% of the population. Ruth Towse, 'Opera' in R Towse (ed), *A Handbook of Cultural Economics* (Edward Elgar Publishing Ltd, 2003).

36 For example, Throsby, above n 30; Ginsburgh and Throsby, above n 3; J Mark Davidson Schuster, 'Tax Incentives in Cultural Policy' in V Ginsburgh and D Throsby (eds), *Handbook of the Economics of Arts and Culture, Volume 1* (Elsevier, 2006) 1275.

37 Mark Blaug, 'Where Are We Now on Cultural Economics?' (2001) 15 *Journal of Economic Surveys* 123, 125.

38 Department for Culture, Media and Sports, *Creative Industries Economic Estimates*, 2009, <<http://www.culture.gov.uk>>.

39 The estimates include the following industries: advertising; architecture; art and antiques; designer fashion; video, film and photography; music and the visual and performing arts; publishing; software, computer games and electronic publishing; and radio and television.



wider economy (at 4% over the 10 years from 1997 to 2006 compared to 3% for the economy as a whole).

Peacock observes that state support for the arts can provide a spill over benefit to other producer organisations.<sup>40</sup> This is similar to Florida's argument of the existence of a 'creative class'.<sup>41</sup> Florida's primary argument is that the presence of 'creative' individuals among a population can result in improved economic growth. Florida calls these people the 'creative class', explaining 'the distinguishing characteristic of the Creative Class is that its members engage in work whose function is to create meaningful new forms'.<sup>42</sup> Florida suggests that approximately 30% of the United States' population may qualify as comprising part of the creative class.<sup>43</sup>

Florida's research indicates that 'places that succeed in attracting and retaining creative class people prosper; those that fail don't'.<sup>44</sup> This may perhaps be viewed as a multiplier effect where initial spending (ie, state funding) results in increased consumption (ie, spending), which results in increased national income. The question that is difficult to answer is whether the consumption would have existed in the absence of the state funding; in other words, is there a causal relationship between the state funding and increased national income. An alternative explanation may arise from the established link between education and arts attendance, whereby cities with highly educated populations create the demand for arts activities, rather than responding to a supply-driven service.

Florida is not the first to highlight the potential economic benefits from a thriving arts community. Throsby observes that 'the arts can be seen as a potentially leading sector in central city renewal and in urban economic development'<sup>45</sup> and Globerman suggests that 'government intervention and support in the culture area has been increasingly justified on the basis that

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40 Alan Peacock, 'The Arts and Economic Policy' in V Ginsburgh and D Throsby (eds), *Handbook of the Economics of Arts and Culture, Volume 1* (Elsevier, 2006) 1134.

41 Richard Florida, *The Rise of the Creative Class and How It's Transforming Work, Leisure, Community and Everyday Life* (2002); Richard Florida, *Cities and the Creative Class* (2005).

42 Richard Florida, *Cities and the Creative Class* (2005) 34.

43 Florida defines a 'creative class' as 'a fast growing, highly educated, and well-paid segment of the workforce on whose efforts corporate profits and economic growth increasingly depend. Members of the creative class do a wide variety of work in a wide variety of industries — from technology to entertainment, journalism to finance, high-end manufacturing to the arts. They do not consciously think of themselves as a class. Yet they share a common ethos that values creativity, individuality, difference, and merit'. Richard Florida, *The Rise of the Creative Class and How It's Transforming Work, Leisure, Community and Everyday Life* (Basic Books, 2002) 3.

44 Ibid 4.

45 Throsby, above n 30, 25.

culture is “big business” that makes an important economic contribution to the entire community’.<sup>46</sup> Thus, the argument that state funding support may result in increased economic growth has some merit. However, the arts need to demonstrate that their funding assists in achieving this outcome and, in addition, that the benefit of the activity exceeds the cost of its provision.

### ***F Risk, uncertainty and market failure***

The argument described by Throsby and Withers<sup>47</sup> as the risk and uncertainty of artistic activity is perhaps more readily recognised as the potential for market failure. Market failure is a common argument raised in support of state assistance to the arts and is the condition where ‘the market is “incapable” of producing the “socially efficient” output rate for a particular product’.<sup>48</sup> The position is captured by Towse<sup>49</sup> who suggests that:

failure to pass the market test does not necessarily mean that the goods in question are unwanted; it merely reflects the fact that they are not amenable to ordinary commercial standards of valuation. In these conditions public support may be entirely justified as the only available means to make demand effective.

The market failure argument appears warranted for many arts based activities. However, it is not applicable for all arts. As observed by Frey and Pommerehne, markets for the arts may work effectively.<sup>50</sup> Frey and Pommerehne use the example of fine art to demonstrate this principle, noting that works by Lichtenstein and Warhol were commercially recognised and traded at high prices long before museums of modern art considered them suitable for display. This raises the question of whether the market for arts does not work effectively, or whether it has not been appropriately tested.

Historically, various art forms have benefited from individual or corporate benefactors that have assisted in funding the activity. While this continues today, it is often the ‘high profile’ arts that receive corporate sponsorship which also receive state funding.

### ***G Community benefits and the merit good argument***

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46 Globerman, above n 20, 21.

47 Throsby and Withers, above n 13.

48 Globerman, above n 20, 13.

49 Towse, above n 12, 256.

50 Frey and Pommerehne, above n 6, 16.

Throsby and Withers<sup>51</sup> suggest that society benefits from the provision of the arts. This is aligned with the economic perspective of the arts as a merit good. A merit good is one that, ideally, is maximised as it is deemed to be socially desirable. Education and health services can be examples of merit goods: where they are provided on the basis of need, rather than ability to pay.

Netzer suggests that:

the meritorious nature of the arts is the most general and perhaps the most widely espoused argument for public subsidy. It is a valid point of view but an inadequate guide for public policy; it tells us nothing except that more of what is good is better. It does not, for example, help fund-granting agencies to decide which activities and organizations are most deserving of additional subsidy.<sup>52</sup>

Thus, merit may be one deciding factor in where funding is distributed, but in isolation, the merit good argument is insufficient for funding allocation decision-making in an environment of scarce resources.

## **H Summary**

What may be seen from the perspectives outlined above is that a number of arguments exist for why state support for the arts is desirable. However, the issue is not assisted by the complexity of demand and supply associated with the arts, combined with the elements of private goods providing public externalities. Perhaps the issue is best captured by Barrowclough and Kozul-Wright who suggest that creative enterprises ‘come with high risk, uncertainty, transaction costs, network externalities, spillovers and public good effects that imply that markets alone will not be sufficient to create an adequate resource base’.<sup>53</sup>

## **IV STATE SUPPORT FOR THE ARTS**

Throughout the OECD, various forms of tax support for the arts exist, including exemptions from capital gains, estate or gift taxes; deductions for individual and company donations to art organisations; direct grants or subsidies; state provided support for arts based education and

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51 Throsby and Withers, above n 13.

52 Dick Netzer, *The Subsidised Muse: Public Support for the Arts in the United States* (Cambridge University Press, 1978) 16.

53 Barrowclough and Kozul-Wright, above n 6, 3.

training; and a variety of additional tax exemptions for arts institutions.<sup>54</sup> A further way of subsidising the arts via the tax system is through reduced Value Added Taxes, such as those provided in the Netherlands.<sup>55</sup> Additional state support mechanisms are suggested by Schuster: ‘tax policies, copyright laws, zoning, unemployment and employment programs, urban redevelopment programs, and social security legislation are among the ways that governments can affect the flow of money to the arts and the mix of artistic activities ultimately available to the public’.<sup>56</sup> Moreover, state support may take the form of assistance in relation to arts infrastructure. These are all important funding mechanisms, but the limitations associated with measuring the components of these various expenditures that may have an impact on the arts will be evident. Thus, the research limits itself to those subsidies that can be clearly linked to arts activities: both direct and indirect tax incentives.<sup>57</sup>

Subsidies reduce the ability of the market to provide an optimal price and quantity from the traditional supply and demand mechanism. However, as found by Schuster, ‘many countries are experimenting with a wide variety of tax-based incentives that go well beyond the realm of private individual or corporate philanthropy’.<sup>58</sup>

Historically, the provision of direct grants, which may be either public or private in nature, has been one of the most common methods of providing financial assistance to the arts.<sup>59</sup> In addition to direct subsidies, governments frequently encourage taxpayer contributions to arts institutions, for example, through tax credits. In New Zealand a tax credit is available at 33.33 cents for each dollar donated to an approved organisation.<sup>60</sup> The benefit from the tax credit is in the form of an overall reduction in the individual’s tax liability.

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54 It is acknowledged that support may also be regulatory in nature, such as the requirement in New Zealand for locally generated programming to be broadcast for at least one-third of the hours between 6.00am and 10.00pm, in order to qualify for a Local FM Radio Broadcasting Licence. In many countries, program content is unregulated.

55 Value Added Tax incentives are the principal form of tax incentives for the arts in the Netherlands. Sigrid J C Hemels, ‘Tax Incentives for the Arts: The Case of the Netherlands’ (2006) 5(1) *Journal of Cultural Economics* 2.

56 J Mark Davidson Schuster, ‘Tax Incentives as Arts Policy in Western Europe’ in Paul J DiMaggio (ed), *NonProfit Enterprise in the Arts: Studies in Mission and Constraint* (Oxford University Press, 1986) 320.

57 For a comprehensive discussion on a range of international approaches to funding the arts, refer to Clare McAndrew, ‘Artists, Taxes and Benefits: An International Review’ (2002) *Arts Council England Research Report* 28; and Freudenberg, above n 14.

58 Above n 36, 1286.

59 Throsby and Withers, above n 13, 230.

60 It is acknowledged that some of the terminology may have a different interpretation in different jurisdictions. In New Zealand, tax rebates have been recently replaced by tax credits. In Australia this is now referred to as a tax offset.

Another form of indirect subsidy is a tax deduction for contributions to the arts (more commonly framed as a tax deduction to a not-for-profit organisation). Under a tax deduction, an amount is deducted from taxable income, which reduces the taxable amount. Tax deductions favour high income earners who pay tax at a high marginal tax rate. This point is illustrated in Table 1, which outlines the different tax outcomes under different tax conditions. The simple example assumes an individual with an income of \$10 000 making a \$1000 charitable donation, with two possible tax rates (45% and 20%) and two possible tax treatments: a tax credit at 33.33 cents per dollar donated or a tax deduction. Table 1 shows the greater tax benefit from a tax deduction for a higher rate taxpayer, with the greater tax benefit from a tax credit accruing to a lower rate taxpayer.

**Table 1: Comparison of tax treatments: tax deductions and tax credits**

Tax deduction			Tax credit at 33.33c/\$		
Tax rate	45% tax (\$)	20% tax (\$)		45% tax (\$)	20% tax (\$)
Income	10 000	10 000	Income	10 000	10 000
Donation (deduction)	1000	1000	Tax	4500	2000
Taxable income	9000	9000	Donation	1000	1000
Tax payable	4050	1800	Tax credit	330	330
Tax 'saving'	450	200	Tax payable (tax — tax credit)	4170	1670
Cost of donation to taxpayer	<b>550</b>	<b>800</b>	Tax 'saving'	330	330
			Cost of donation to taxpayer	<b>670</b>	<b>670</b>

While there has been some investigation as to which methods are preferable insofar as eliciting higher levels of donation, the issue remains unclear. Of further relevance is that there appears to be little evidence that an individual's primary motivation for giving is for tax benefit.<sup>61</sup> However, tax benefits may encourage higher levels of donation by the wealthy.

In countries that provide tax deductions for private contributions to arts organisations, Brooks suggests that this provides a significantly larger contribution than direct government

<sup>61</sup> Kym Madden and Cameron Newton, 'Is the Tide Turning? Professional Advisers' Willingness to Advise about Philanthropy' (Working Paper No CPNS 30, Centre of Philanthropy and Nonprofit Studies, Queensland University of Technology, 2006). Madden and Newton highlight a number of reasons, other than tax benefits, that motivate philanthropic giving (31–32).

subsidies.<sup>62</sup> Brooks finds that in the United States, around \$14 in indirect contributions is made for every \$1 in direct subsidy.<sup>63</sup>

Another issue with tax deductions for any activity is their relative decline in recent years as marginal tax rates have reduced. This general decline in marginal tax rates has seen the balance of the contribution move from the state to the taxpayer. Thus, a donor wanting to make a contribution at a certain level has seen the government co-contribution reduce. As observed by Weil, ‘in theory at least ... the value of the charitable deduction as an incentive for private giving has been substantially eroded simply by the ongoing reduction in the maximum marginal tax rate’.<sup>64</sup>

As a tax credit provides a higher benefit to lower income earners, an argument has been made that a tax credit system is preferable on improved equity grounds. However, as captured by Throsby and Withers:

since the rates struck under a tax credit system would probably be such as to reduce the financial incentive to rich donors as compared to a system involving deductibility of donations, and since this group is likely to be the major source of private finance, the overall flow of private funds to the performing arts could be expected to be lower under the more “equitable” tax credit arrangement than with a more discriminating scheme.<sup>65</sup>

From the perspective of an individual, a tax incentive decreases the marginal cost of making a donation to an arts organisation. A question that has been explored in the literature is whether the existence of such an incentive increases the amount that is donated, as the cost of giving reduces. The literature is undecided on this effect. Early research found that the organisation receiving the donation receives more than the government reduction in tax revenue.<sup>66</sup> However, more recent research challenges this finding and indicates that donors will take advantage of the tax expenditure to reduce the private contribution.<sup>67</sup>

## **V NEW ZEALAND AND AUSTRALIA**

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62 Arthur C Brooks, ‘In Search of True Public Arts Support’ (2004) *Public Budgeting and Finance* 88, 89.

63 This may be compared to the Royal New Zealand Ballet, which received NZ\$3.5 million in state support (in the 2008/09 financial year), additional revenues of NZ\$2.5 million from other grants and sponsorship, and NZ\$2.7 million from all other income; indicating around 40% of revenue was in the form of a direct state subsidy.

64 Weil, above n 11, 169.

65 Throsby and Withers, above n 13, 240.

66 Schuster, above n 36, 1273.

67 *Ibid* 1274.

This section outlines the tax incentives provided in New Zealand and Australia for the arts. New Zealand funding includes sources from both national and local governments, while Australian funding is obtained from both the national and the state governments.

### *A New Zealand*

In 1963, the establishment of the Queen Elizabeth II Arts Council resulted in the provision of a number of objectives for the Arts Council; these are outlined below:

- (a) 'to encourage, foster and promote the practice and appreciation of the arts in New Zealand;
- (b) to make accessible to the public of New Zealand all forms of artistic or cultural work;
- (c) to improve standards of execution of the arts;
- (d) to foster and maintain public interest in the arts and culture in New Zealand; ...'.<sup>68</sup>

The aim of providing funding at the present time is outlined in the appropriations for the 'Vote Arts, Culture and Heritage' and is to 'help ensure that culture is visible and accessible, and deliver cultural products and services to New Zealanders and international audiences'.<sup>69</sup> The focus on culture, rather than arts, is apparent in this statement.

New Zealand's current position on funding for the arts is perhaps best seen in a recent announcement by Chris Finlayson, New Zealand Minister for Arts, Culture and Heritage, that the government intends to investigate overseas funding models to encourage a 'culture of philanthropy' in New Zealand, with the arts as a focus. A taskforce 'consisting of several of New Zealand's most high-profile supporters of the arts' will investigate ways to improve charitable giving in New Zealand.<sup>70</sup> However, Mr Finlayson comments that the state has an ongoing responsibility for funding the arts. For many years in New Zealand there have been few generous tax incentives for this endeavour, with the exception of the film industry.

The film industry has benefited from government support in recent years, with the provision of a tax exempt Large Budget Screen Production Grant for New Zealand based production of films, digital, and visual effects.<sup>71</sup> The objective of this grant is to increase economic growth by

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<sup>68</sup> Throsby and Withers, above n 13, 209.

<sup>69</sup> New Zealand Treasury, 2009, *Performance Information for Appropriations — Vote Arts, Culture and Heritage*, <<http://www.treasury.govt.nz>>.

<sup>70</sup> New Zealand Government, 2009, *Review to Improve Arts Philanthropy*, Press Release, <<http://www.beehive.govt.nz>>.

<sup>71</sup> *Income Tax Act 2007*, ss DS 1, DS 2, EJ 4, EJ 5, EJ 7 and EJ 8.

providing a financial incentive to attract large budget film and television productions to New Zealand. In addition, the grant has a secondary objective to accelerate skill development and technology transfer within the local screen production industry and to provide additional benefits for the economy via increased tourism and the promotion of New Zealand.<sup>72</sup>

The value of the Large Budget Screen Production Grant is 15% of qualifying production expenditures. The grant applies to screen productions in various formats (including feature films and television drama series). For these formats ‘qualifying New Zealand production expenditure’<sup>73</sup> must be NZ\$15 million. The grant is also available for post, digital and visual effects, in which case the qualifying New Zealand production expenditure may be between NZ\$3 million and NZ\$15 million. The grant is available to New Zealand resident companies or foreign organisations operating with a fixed establishment in New Zealand for the purposes of lodging an income tax return. Audited information must be presented to the Inland Revenue Department for verification prior to grant payment.

Another key incentive is the Screen Production Incentive Fund (SPIF), announced in 2008.<sup>74</sup> The SPIF provides a grant of 40% of New Zealand qualifying production expenditure for New Zealand feature films and 20% for television and other screen production expenditure. Funds allocated for this endeavour were NZ\$27.8 million over four years<sup>75</sup> plus a further NZ\$26 million from existing funding to the New Zealand Film Commission (NZ\$53.8 million in total).<sup>76</sup> To qualify for these funds, the productions are required to have significant New Zealand content<sup>77</sup> and meet an eligibility threshold (eg, NZ\$5 million for feature films; NZ\$250 000 per

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<sup>72</sup> Office of the Minister for Economic Development, Cabinet Policy Committee Business Committee, *Large Budget Screen Production Grant Review of Bundling* (Cabinet Paper, 2007).

<sup>73</sup> This is ‘the production expenditure incurred for, or attributable to: goods and services provided in New Zealand; the use of land located in New Zealand; and the use of a good that is located in New Zealand at the time that good is used in the making of the screen production’. Film New Zealand, *Production Guide*, 2007, <<http://www.filmnz.com/production-guide>>.

<sup>74</sup> *Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009*, s DF5.

<sup>75</sup> That is, NZ\$3 million in the 2008/09 year, and NZ\$8.250 million in each of the following four years.

<sup>76</sup> Ministry for Culture and Heritage, *New Zealand Screen Production Incentive Fund*, 2008, <<http://www.mch.govt.nz>>.

<sup>77</sup> A ‘New Zealand Content Test’ exists for this purpose, which has been designed to ‘reflect the importance of on-screen New Zealand content — in terms of New Zealand characters, locations, stories, and historical and cultural elements’. However, the criteria also state that it is possible for a production to meet the content test ‘while having no identifiable New Zealand setting, characters or other cultural elements. It is not the intention of the Test to restrict New Zealand film-makers’ creativity by limiting them solely to New Zealand settings and situations.’ Thus, high levels of New Zealand production activity could also assist in meeting the test. *Ibid.*



hour of documentary production). The upper limit is NZ\$15 million for any individual production, resulting in a maximum grant of NZ\$6 million (at 40%) to any one project.

In New Zealand, government funding is provided to a number of sectors that fall within the broad definition of the arts. The government department that receives this funding is the Ministry of Arts, Culture and Heritage. Funding is provided in the following categories:<sup>78</sup>

- Music Industry Commission;
- New Zealand Film Archive;
- New Zealand Symphony Orchestra;
- Royal New Zealand Ballet;
- Film Production Fund;
- Christchurch Art Gallery;
- Te Papa Tongarewa;
- New Zealand Music Commission; and,
- Creative New Zealand.<sup>79</sup>

Expenditure in the 2009/10 budget (along with the previous year actual spend) is outlined in Table 2. Table 2 highlights the percentage of annual income that is provided by the state to a range of arts institutes in New Zealand. Funding appears to be primarily based on historic provision, with no additional justification provided in government budgets on how funding decisions are made.

**Table 2: New Zealand expenditure on the arts: 2009/10<sup>80</sup>**

	2008/09 actual (\$'000)	2009/10 budget (\$'000)	Per cent of annual income
Museum services	24 644	24 644	50%
<i>Performing arts services</i>			
New Zealand Symphony Orchestra	13 446	13 446	78%
Royal New Zealand Ballet	3534	4384	42%
New Zealand Music Commission	1378	1378	88%

<sup>78</sup> A number of categories of funding, eg, management of historic places, public broadcasting (New Zealand on Air, TVNZ, Radio New Zealand International, Broadcasting Standards Authority) have been excluded from discussion in this paper.

<sup>79</sup> This is the Arts Council of New Zealand. It is responsible for schemes such as the Creative Communities Scheme, which aims to increase participation in the arts at a local level, and increase the range and diversity of arts available to communities, <<http://www.creativenz.govt.nz>>.

<sup>80</sup> New Zealand Treasury, *The Estimates of Appropriations 2009/10 — Vote Arts, Culture and Heritage*, B.5, <<http://www.treasury.govt.nz>>.

Te Matatini <sup>81</sup>	1248	1248	80%
<i>Promotion and support of the arts and film</i>			
Creative New Zealand	15 937	15 689	45%
New Zealand Film Commission	3611	3611	22%

These figures exclude capital expenditure. For example, Te Papa Tongarewa (the national museum) is allocated NZ\$9 million per annum for ongoing capital expenditure, exhibition research and development, and acquisition of items for the collection. In relation to economic factors, the primary output performance measures and standards are outlined in Table 3. What can be seen from Table 3 is that the performance measures provide for minimal accountability for funding provided. Reporting measures such as audience numbers, or performances provided, do little to increase efficiency or quality of provision.

**Table 3: Primary performance measures in New Zealand**

Museum services	Visitor numbers, new exhibitions
Performing arts services	Audiences, performances
Promotion and support of the arts and film	Arts development, access to arts experiences, projects funded, films financed

In addition to central government funding, in many New Zealand regions arts funding is supported by local government. For example, in Wellington (a city which considers itself to be the cultural capital of New Zealand), the Wellington City Annual Report discloses expenditure on the arts under the category of ‘Cultural Wellbeing’, as outlined in Table 4.<sup>82</sup>

**Table 4: Expenditure on ‘Cultural Wellbeing’ in Wellington (2008/09)**

	Total cost (\$'000)	Cost per resident
Arts partnerships	\$2620	\$13.61
Community arts and cultural support	\$3741	\$19.43
Galleries and museums	\$6376	\$33.12
Heritage	\$1226	\$6.37
Total ‘Cultural Wellbeing’	\$13 963	\$72.53

By way of comparison, expenditure on other environmental items that are typically considered as important to New Zealanders is outlined in Table 5:

<sup>81</sup> The national body for Maori Performing Arts for Aotearoa.

<sup>82</sup> Wellington City Council, *Summary Annual Report 08/09*, 2009, <<http://www.wcc.govt.nz>>.

**Table 5: Selected environmental expenditure in Wellington (2008/09)**

	Total cost (\$'000)	Cost per resident
Environmental conservation attractions	\$4260	\$22.13
Gardens and beaches	\$12 075	\$62.73
Green open spaces	\$14 014	\$72.80
Total selected environmental expenditure	\$30 349	\$157.66

Tables 4 and 5 highlight the different values appointed to each of these activities. Total expenditure (excluding finance expenses) for the Wellington City Council in the 2008/09 financial year was NZ\$331 million, indicating that 4.2% of expenditure was related to 'Cultural Wellbeing'. On the selected environmental issues, expenditure was 9.1%. As with spending at the national level, no justification for funding allocations to either of these activities is provided.

In 2007, the previous maximum limit on the tax credit available for donations made by individuals was removed and the amount became claimable at the value of one-third of the gifted amount.<sup>83</sup> In addition, maximum deduction limits for corporate donations were removed. These tax concessions are available for donations made to 'registered charities'. To meet the requirements under the *Charities Act 2005* (NZ), a registered charity must have a charitable purpose; broadly providing services of benefit to the community. A number of arts organisations, including the Royal New Zealand Ballet, are listed as registered charities by the Charities Commission.

### **B Australia<sup>84</sup>**

The equivalent portfolio to New Zealand's Ministry of Culture and Heritage is the Australian Department of the Environment, Water, Heritage and the Arts. Under 'arts' portfolios, funding allocations for 2009/10 are:

- The Australia Council for the Arts<sup>85</sup> — A\$181.9M
- Australian Film, Television and Radio School — A\$23.7M
- Australian National Maritime Museum — A\$23.2M

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<sup>83</sup> *Income Tax Act 2007*, ss DB 41, DV 12, LD.

<sup>84</sup> For further discussion on Australia's tax treatment of the arts, refer to Freudenberg, above n 14.

<sup>85</sup> The Australia Council is responsible for 'creation, presentation and appreciation of distinctive cultural works by providing assistance to Australian artists and making their works accessible to the public' *Budget: Portfolio Budget Statements 2009–2010* (Budget Related Paper No 1.6 Environment, Water, Heritage and the Arts Portfolio, 13).

- National Film and Sound Archives — A\$25.2M
- National Gallery of Australia — A\$69.9M
- National Library of Australia — A\$69.8M
- National Museum of Australia — A\$46.2M
- Screen Australia — A\$102.1M

Of further, and perhaps greater, relevance is the *Tax Expenditures Statement*, which ‘provides details of concessions, benefits, incentives and charges provided through the tax system ... to taxpayers by the Australian Government’.<sup>86</sup> A tax expenditure is ‘a tax concession that provides a benefit to a specified activity or class of taxpayer’.<sup>87</sup> There are approximately 340 tax expenditures, which may be in the form of a tax deduction, tax offset, tax exemption, or a concessional tax rate. The *Tax Expenditures Statement* provides an outline of the financial revenue foregone due to the provision of the tax benefit. As noted in the *Tax Expenditures Statement*: ‘tax expenditures are often an alternative to direct expenditures as a method of delivering government assistance or meeting government objectives’.<sup>88</sup>

In Australia, tax expenditures are significant. By way of example, superannuation tax concessions are one of the key components of the tax expenditures in Australia, attracting A\$22.3 billion in the 2009/10 tax expenditure statement.<sup>89</sup> Recreation and culture concessions are A\$240 million for 2009/10. Examples of tax concessions provided for the arts at the Commonwealth level are:

- The exemption of certain prizes (such as literary awards) from taxation;
- Income averaging for certain occupations, including authors, inventors, performing artists and production associates;
- Film Tax Offset payments (where film production companies incur expenses in relation to Australian productions, they may be eligible for tax offsets, including a location offset, a producer offset, and a post, digital and visual effects offset). These tax offsets are typically a 15% rebate;
- An exemption from income tax for the Australian Film Finance Corporation;

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<sup>86</sup> Commonwealth of Australia, *Tax Expenditures Statement 2008*, <<http://www.treasury.gov.au>>.

<sup>87</sup> Ibid 6.

<sup>88</sup> Ibid.

<sup>89</sup> This figure is costs less offsets. The Treasury, *Tax Expenditures Statement 2009*, Appendix D, Aggregated Superannuation Tax Expenditure (2009) 240.

- Capital gains tax exemption for assets disposed of under the Cultural Gifts Program;<sup>90</sup> and,
- Tax incentives for film investment (this is accelerated depreciation of capital expenditure incurred in purchasing an interest in the copyright of a new Australian film). The write-off may be either fully deducted in the year of acquisition or spread over two years.<sup>91</sup>

Similarly to New Zealand's Charities Register, Australia operates a Register of Cultural Organisations. Donors contributing to organisations on this register will attract a tax deduction for their donation. The purpose of the scheme is to strengthen public support for the arts.<sup>92</sup> A number of conventional arts organisations are on the register, including state ballet companies and the Australian Ballet. In 2001, 'prescribed private funds' were implemented, which allowed individuals to form charitable trusts which benefited from attracting tax deductions for donations made. In 2009, these were replaced with 'private ancillary funds'. When certain conditions are met, private ancillary funds allow donors to claim tax deductions for charitable giving to that entity.<sup>93</sup>

Screen Australia provides direct funding for the film and television industry.<sup>94</sup> For example, an Enterprise Program provides funding up to A\$500 000 per year for three years to support film production companies to develop their businesses. In addition, single-project development programs exist for individual projects of value up to A\$50 000. Targeted 'Talent Escalator Programs' exist to support skill development, expansion of market knowledge and production expertise, with funding up to A\$20 000. Furthermore, an Innovation Program funds up to A\$30 000 for digital media development purposes and A\$250 000 for production.

Over the period from 1994/95 to 2007/08 in Australia, more than three-quarters of film agency income was from the government. Over this period, A\$1.85 billion in appropriations was

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90 The Taxation Incentives for the Arts Scheme commenced operation in 1978. The purpose of the scheme was to encourage donations of gifts in kind to cultural institutions in Australia. Today, an indirect tax incentive remains under this scheme (now the Cultural Gifts Program), providing for a tax deduction and capital gains tax exemption for a gift of property that has cultural significance to a public art gallery, museum, library or archive.

91 The Treasury, 2010, *Tax Expenditures Statement 2009*, A50, A51, B29, B32, B72 and E7 respectively. This list is not intended to be exhaustive; a number of additional tax concessions for arts activities are provided.

92 Australian Government, Department of the Environment, Water, Heritage and the Arts, <<http://www.arts.gov.au>>.

93 The Treasury, above n 91, A66.

94 Screen Australia commenced in 2008 and brings together the functions of the Australian Film Commission, the Film Finance Corporation Australia and Film Australia Limited. Screen Australia is also responsible for the aforementioned producer offset.

provided to federal film agencies and A\$481 million to the state film agencies.<sup>95</sup> Funding is also provided through the Australia Council for the Arts. This organisation provides contestable funding of around A\$160 million per annum to arts organisations and individuals.

Funding to the arts is also provided by the states. For the purposes of comparison, the state of New South Wales is used for analysis. The New South Wales government provides support for the arts through Arts New South Wales. As well as fellowships, scholarships and awards, it also provides direct funding. The funding is provided with the aim of increasing access to arts and cultural activities across New South Wales. In addition, the New South Wales Film and Television Office provides financial and other forms of assistance to the film and television industry.

Adopting the state of New South Wales for comparison purposes permits inclusion of a unique Australian icon in this discussion: the Sydney Opera House. In 2009, the Sydney Opera House received A\$14.4 million in the form of a government endowment, together with A\$30.4 million in the form of a maintenance grant. Operating revenues from the sale of goods and services were A\$50 million, with an overall reported loss of A\$8.7 million. The operating revenue and expenses provided in the financial statements for the organisation indicate that under the current arrangements, it is not possible to achieve an effective market based outcome. However, the significance of the Sydney Opera House is evident in the number of visitors it attracts (over 7 million per annum) and performances it holds (1600 per annum).<sup>96</sup> Moreover, the Sydney Opera House is generally considered important for Australian national identity.<sup>97</sup>

## VI DISCUSSION

This discussion starts from the position that arts funding is necessary, and desirable, for a number of reasons. These reasons include economic benefit, together with more intangible benefits like contributing to national identity. The primary issue is the form that this funding should take, and how it should be allocated.

The fundamental economic argument is that we exist in a world of scarce resources and, accordingly, choices must be made in relation to how these resources are allocated. In an environment of limited resources, it would appear reasonable to suggest that funds are allocated

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95 Screen Australia, <<http://www.screenaustralia.gov.au/gtp/govtfundsummary.html>>.

96 Source: Sydney Opera House public relations material, <<http://www.sydneyoperahouse.com>>.

97 For example, the Chairman of the Sydney Opera House Trust is quoted as saying that the Sydney Opera House is 'core to our national cultural identity and a source of great pride to all Australians' (reported by the BBC News, 29 November 2008, *Sydney Opera House Architect Dies*).

to where they will provide the greatest return, or at the very least, an established return, either from a demonstrated social or positive economic benefit. Some of the issues discussed earlier are revisited in this section, together with some additional issues raised from the previous section on arts funding in New Zealand and Australia.

### ***A National identity***

While the national identity argument may have validity in certain countries, traditionally, in New Zealand, it has been sporting achievements that have created identification with the New Zealand national identity and raised the country's national prestige, rather than accomplishments in the performing arts. There are few, if any, instances of traditional performing arts where New Zealand has raised its international profile due to the existence of a particular activity. However, the Sport and Recreation New Zealand budget for 2009/2010 to promote and encourage sport and recreation in New Zealand was NZ\$22 million,<sup>98</sup> which is only slightly higher than the funding provided to the Royal New Zealand Ballet and the New Zealand Symphony Orchestra combined.

Conversely, while more of a cultural symbol than an arts institution, an important cultural reference point for Australia is the Sydney Opera House. This organisation appears to be unable to break even, even with the support of the state, thereby perhaps justifying state support for its continued existence. Thus, the national identity argument appears most relevant when assessed on a country specific case-by-case basis.

Moving away from the more traditional arts, New Zealand and Australia have both recently benefited from the national prestige, or increased national awareness, associated with a successful film industry.<sup>99</sup> The considerable positive economic benefits and externalities from the *Lord of the Rings* trilogy, filmed in New Zealand, are outlined later in this section.

### ***B Calculating economic benefit***

One of the issues with tax incentives is their lack of transparency. New Zealand is one of few OECD countries to not produce a tax expenditures statement. The concept of tax expenditures was raised by Stanley Surrey in 1973, in the seminal work *Pathways to Tax Reform: The Concept of Tax Expenditures*.<sup>100</sup> Surrey claimed that governments should account for tax expenditures in the same manner as other government expenditures. Since Surrey raised the

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98 New Zealand Treasury, *Estimates of Appropriations 2009/10 — Vote Sport and Recreation*, B.5, 315.

99 For example, in Australia: *Jindabyne*, *Samson and Delilah*, and *Rabbit Proof Fence*.

100 Stanley Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Harvard University Press, 1973).

issue, most countries have made some attempt to measure this foregone revenue and have published tax expenditure statements to report these amounts. Typically the production of a tax expenditure statement is to ensure transparency of policy and to facilitate debate and input into development of the tax system. The explanation provided for this non-disclosure in New Zealand is that the levels of revenue foregone are small. However, the impact of this non-disclosure is that it becomes difficult to analyse the effectiveness and potential contribution to the economy of the tax based incentives. Moreover, this lack of visibility of state expenditure removes accountability for the funds invested. At the present time in New Zealand, the primary performance measures for arts activities are outputs such as performances and audiences (as outlined in Table 3), rather than demonstration of economic or social benefit.

### *C Who decides?*

A criticism frequently attached to the provision of any tax incentive is the tendency to privilege one group above another. In a democratic environment, direct taxpayer funded subsidies may be accused of lacking transparency. Furthermore, when the state funds certain art forms and not others, it is influencing the arts activities that are likely to be provided. As captured by Feld, ‘centralized government grant-making creates the risk that a small number of decision makers will determine the kind and quality of art worthy of support, based on their particular judgments and tastes’.<sup>101</sup>

By way of comparison, the provision of a tax deduction, tax credit, or government matching co-contribution for a charitable donation, provides for individual preference to influence the organisations that receive state support. However, the use of deductions does not resolve the issue. Weil claims that ‘the bulk of giving to cultural organizations comes from a relatively small handful of affluent taxpayers’.<sup>102</sup> When tax support is provided in the form of a tax deduction, Weil suggests that ‘this handful of taxpayers is in essence able to spend the public’s money without any of the administrative safeguards or democratic participation that would normally accompany such a public expenditure’. This view is shared by Schuster<sup>103</sup> who claims that tax deductions ‘may exacerbate the tastes of relatively wealthy donors who use the tax incentive to leverage and help finance large donations to certain charitable sectors’. In addition, Schuster

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101 Alan L Feld, ‘Revisiting Tax Subsidies for Cultural Institutions’ (2008) 32 *Journal of Cultural Economics* 275, 276.

102 Weil, above n 11, 173.

103 J Mark Davidson Schuster, ‘Issues in Supporting the Arts through Tax Incentives’ (1987) 16 *Management and Law* 31, 45.



claims ‘not only do tax incentives affect the relative cost of artistic goods and services, they also affect the relative mix of artistic activities that public and private arts institutions, artists, and entrepreneurs ultimately choose to provide’.<sup>104</sup> What is apparent is that the privileged arts that receive government funding are likely to be those provided to the public.

As outlined in the previous section, vehicles such as ‘prescribed ancillary funds’ in Australia, allow individuals to create trusts to which tax deductible donations can be made, with the objective of future distributions to ‘deductible gift recipients’. These instruments have proved popular, with 769 vehicles approved as at 2008, with a combined value of A\$2.1 billion in donations received.<sup>105</sup> Approximately 20% of these donations (A\$447 million) has been distributed; A\$62 million, or 14%, of which was donated to ‘cultural organisations’.<sup>106</sup> The issue of whether these vehicles have increased overall levels of giving to arts organisations has yet to be established.

#### **D Costs**

There are a number of financial issues associated with arts funding, particularly in New Zealand. The process for allocation of funds to the arts in New Zealand is unclear, appearing to be based primarily on historical practice, with little evaluation and analysis over time in relation to its continued provision. By way of illustration, arguably New Zealand’s most well-known performer among the more traditional arts is the opera singer, Kiri Te Kanawa. However, opera in New Zealand receives no direct government support.<sup>107</sup> Conversely, and again arguably, New Zealand has not produced any internationally recognised ballet dancers, but this activity attracts significant government funding.

Schuster suggests that the problems associated with appropriately targeting tax incentives, and the difficulty with assessing the cost of the tax incentive, are that these incentives may ‘prove to be particularly costly ways to support the arts’.<sup>108</sup> There are well-established issues in

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104 Schuster, above n 56, 321.

105 Australian Tax Office, 2010, *Prescribed Private Funds Statistics*, <<http://www.ato.gov.au/nonprofit>>.

106 Ibid.

107 However, New Zealand Opera does receive a grant of NZ\$2.3 million per annum from Creative New Zealand. This is a recurrent grant, despite coming from a contestable fund. In addition, New Zealand Opera receives funding from the local Auckland City Council. However, its primary funding source is from corporate donations.

108 Schuster, above n 56, 354.

measuring tax expenditures, both in terms of their cost and their effectiveness. Zee, Stotsky and Ley<sup>109</sup> suggest that there are four costs associated with the provision of tax incentives:

- i. distortions between activities that receive incentives and those that do not;
- ii. foregone revenue;
- iii. administrative resources; and
- iv. the social costs of rent-seeking activities associated with the abuse of tax incentives.

All these points are relevant, and their existence supports an argument that state funding of any enterprise should require justification of social or economic benefit. As observed by Globerman:

conceptually, the cost to the public treasury is the foregone tax revenue associated with the tax write-off ... appropriately discounted to a present value. In fact the more relevant notion of social costs to employ when evaluating any public policy is the value of the resources used to produce the output in question, presuming the resource would not have otherwise been unemployed.<sup>110</sup>

This concept of the opportunity cost associated with arts funding is important, and one that is not frequently seen in the literature. In particular, opportunity cost applied to industries that have demonstrated an ability to contribute to economic growth would appear to be a valid, if perhaps contentious, measure.

When compared with expenditure on the arts in Australia, and in particular on the Australian film industry, New Zealand's tax incentives are meagre. There is an awareness of the importance of remaining internationally competitive in the film industry, as demonstrated in the Ministry of Economic Development Cabinet Paper in 2007, which outlines changes to the Large Budget Screen Production Grant, and observes that 'the proliferation of production subsidies around the globe has been one of the most significant factors affecting the choice of production venues for a significant volume of production. Therefore, in order to remain a preferred destination, New Zealand must ensure that our incentive is globally competitive'.<sup>111</sup> Despite this awareness, New Zealand does not provide incentives at a comparable level to many other OECD countries.

### ***E Maximising economic benefit***

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109 Howell H Zee, Janet G Stotsky and Eduardo Ley, 'Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries' (2002) 30 *World Development* 1497, 1501.

110 Globerman, above n 20, 11.

111 Office of the Minister for Economic Development, above n 72.

The argument that a strong arts community can assist in job creation and other economic benefits is not without merit. However, this argument may be extended to almost every industry: most have the potential for economic growth, job creation and skill development.<sup>112</sup> The issue is in deciding which of the arts are more equal than others when funding decisions are made. There may be the potential for the arts sector to be, or become, a high-growth market but, nonetheless, it would seem prudent to fund those activities that are most likely to produce this outcome.

There are some who consider that New Zealand is performing well in its support of the arts. For example, Barrowclough and Kozul-Wright suggest that New Zealand has ‘a sophisticated menu of policy tools and regulations promoting production’ in creative industries, and ‘[in New Zealand as well as in other] countries, the debate has moved on from whether the sector is a valuable one or not, to which policy tools are best adapted to participating in it or which are most acceptable given international policy commitments’.<sup>113</sup> Furthermore, Florida<sup>114</sup> suggests that New Zealand will be among a number of smaller countries ‘that have built dynamic creative climates and are turning out creative products ranking from Nokia cell phones to the Lord of the Rings movies’. However, it is suggested that New Zealand has not capitalised on the success of the *Lord of the Rings* films and subsequently lost an opportunity to benefit from further economic gain as a result of expansion of this niche industry. By way of comparison, in 2009 Australia launched an A\$17 million Creative Industries Innovation Centre to provide emerging creative organisations with access to business advisory and development networks.<sup>115</sup>

There are numerous opportunities to provide arts funding. New Zealand, as a small country, needs to be particularly strategic about the provision of funding for enterprises that may or may not contribute to economic growth. In 2002, the New Zealand Institute of Economic Research produced a report on the economic impacts of the *Lord of the Rings*.<sup>116</sup> While the film trilogy was not yet complete at the time of the report, it provides some indication of the transitory and lasting benefits gained from its New Zealand production. The primary benefits are outlined below:

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112 The World Bank suggests that creative industries can add up to 7% to GDP, with associated growth rates of 10–20% per annum. Barrowclough and Kozul-Wright, above n 5, 6.

113 Barrowclough and Kozul-Wright, above n 5, 20.

114 Above n 44, xxiv.

115 Australian Government, Department of the Environment, Water, Heritage and the Arts, <<http://www.arts.gov.au>>.

116 New Zealand Institute of Economic Research, 2002, *Scoping the Lasting Effects of the Lord of the Rings* (Report to the New Zealand Film Commission, 6), <<http://www.nzier.org.nz>>.

- Financial benefits of New Zealand expenditure, including NZ\$353 million expenditure (to March 2002) and labour costs of \$188 million;
- Peak period employment of around 1500 people per week;
- The use of around 5000 vendors, primarily in New Zealand;
- Broadening of production skill base and capacity;
- Enhancing New Zealand's creative reputation, talent development and production capacity; and
- Lifting industry capability and ability to new levels.

The differences in approaches between funding the arts and encouraging business in the arts are vast. State provided funding for the arts implies that it should be both transparent and accountable: discretionary taxpayer funded support should come with strings attached. As noted by Bille Hansen, 'it is not enough to show that the arts generate income, employment and tax revenues, for all economic activity does that. Of course, the arts are not the only sector that contributes directly and indirectly to value growth and employment in society'.<sup>117</sup> Thus, it may not be sufficient to consider certain forms of arts as necessary for society, particularly when they are not available to all for consumption.

### ***F Externalities***

One of the potential greatest outcomes from expenditure on the arts is the potential for spill over benefits. The *Lord of the Rings* production in New Zealand provided significant externalities for the country, many of which are long-term in nature. Those estimated by the New Zealand Institute of Economic Research<sup>118</sup> include:

- Increased international profile of the New Zealand film industry;
- Increased skill base in the New Zealand screen production industry;
- Establishing a foundation for New Zealand creative entrepreneurship, centred on the film industry;
- Broadening film infrastructure;
- Enhancing Brand New Zealand; and
- The creation of spin off industries, such as merchandising.<sup>119</sup>

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<sup>117</sup> Bille Hansen, above n 32, 310.

<sup>118</sup> New Zealand Institute of Economic Research, above n 116.

<sup>119</sup> It is acknowledged that the report highlighted some negative externalities from the production of *Lord of the Rings* in New Zealand, including increased labour costs in some industries, the potential for adverse environmental

When these benefits are compared to those of the more traditional art forms, such as ballet and the symphony orchestra in New Zealand, the traditional arts activities have not demonstrated the same capacity to generate positive externalities.

### ***G Merit good argument***

Following the economic argument of market failure and the potential demise of some areas of art, the associated question becomes whether this is likely to have a significant impact on society. It is well established<sup>120</sup> that the traditional arts are frequented to a greater extent by those with greater education and higher incomes, thus it may not be unreasonable to suggest that the majority of the population would not suffer a declining quality of life if art forms such as the ballet or symphony orchestra were no longer state funded. The question is succinctly captured by Peacock, who claims ‘the interesting question is why such support, coupled with regulatory measures to control the provision and sale of historical artefacts, is found in the arts, whereas in other forms of productive activity, such support is increasingly reduced, as instanced in privatisation measures’.<sup>121</sup> This can be seen in New Zealand, with the removal of tax credits for research and development in November 2008. However, funding for traditional arts has either remained the same or, in some instances, increased.

Peacock<sup>122</sup> suggests that there is scepticism by governments about the ability of consumers to appropriately value the choice of arts that they wish to enjoy, thereby resulting in producer interest groups with the ability to influence the policy approach in this regard. However, there is an equally compelling argument that if these arts institutions were ‘good enough’ then they would not need state funding because they would attract sufficient private audiences to permit self-funding.

### ***H Summary***

Perhaps the two primary potential benefits from arts organisations are the potential for improved national identity and economic growth. Elements of the ‘high arts’ in New Zealand, such as the ballet and national orchestra, have shown they are unlikely to generate considerable economic activity or add significantly to New Zealand’s national identity. These national arts in

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effects in some filming locations, and increased house prices in the Wellington suburbs where much of the work was undertaken. However, these effects are mostly short-term in nature. Ibid.

120 For example, Globerman, above n 20, 40.

121 Peacock, above n 40, 1124.

122 Peacock, above n 40.

New Zealand are unable to compete with the standards of their more well-known counterparts in larger countries (eg, England's Royal Ballet and Royal Opera House) and thus are unlikely to attract the international audiences required to generate increased economic benefit. Conversely, New Zealand cultural activities, such as Te Papa Tongarewa, the national museum, have a demonstrated ability to attract a wider audience.<sup>123</sup>

The Ministry for Culture and Heritage *Review of Government Screen Funding Arrangements Discussion Paper* in 2004<sup>124</sup> emphasises that government support should be based on 'the screen sector's ability to contribute to the government's broad cultural and economic objectives; [and] the identification of gaps in the sector where government intervention is appropriate and effective and will be complementary to activities in the private sector'. While there appeared to be an attempt to take advantage of the immediate post-*Lord of the Rings* positive impact on the New Zealand film industry (eg, the large budget productions such as the *Chronicles of Narnia* and the *Hercules* mini-series filming in New Zealand<sup>125</sup>), this position appears to have been ineffectively capitalised, with few producers choosing New Zealand as a location in more recent times.<sup>126</sup>

In a highly competitive, global marketplace, the need for all publicly funded organisations to be held accountable for the use of state funds, and provide a demonstrated return on investment, appears defensible. As a small country, New Zealand has to be strategic in all expenditure. Appropriate targeting of specific, highly skilled endeavours and providing incentives to encourage these activities in New Zealand, appears to be more likely to generate a positive return than continuing the funding of traditional art forms that appear less likely to do so.

In New Zealand, the art form that has demonstrated the greatest potential to make both an economic and social contribution is film production. New Zealand does not have the population

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123 For example, an exhibition held at Te Papa Tongarewa in Wellington in early 2009 (Monet and the Impressionists) was estimated to bring NZ\$34.5 million in additional spending into the Wellington region. The total net economic benefit from the exhibition was estimated at NZ\$14.8 million. Of the 150 000 people attending the exhibition, 52% were from outside the Wellington region.

124 Ministry for Culture and Heritage *Review of Government Screen Funding Arrangements Discussion Paper*, <<http://www.mch.govt.nz>>.

125 Suggested by Trevor Mallard, as Economic Development Minister in 2006, as providing a NZ\$363 million direct cash injection into the New Zealand economy, additional economic activity of NZ\$119–227 million and indirect benefits of between NZ\$10 and NZ\$34 million. *Government Support for Films to Continue, Minister of Economic Development Media Statement*, 6 March 2006, <<http://www.med.govt.nz>>.

126 It is acknowledged that potential tax benefits will not be the sole factor for decisions relating to the location of film production. New Zealand's landscape also provides a wide range of opportunities for promotion as a niche production location.

base to attract the audiences demanded of an international standard ballet or opera company, or orchestra. However, the film industry has an established ability to compete at an international level, while providing significant social and economic benefits.

## **VII CONCLUSION**

One's view on the provision of tax incentives is likely to be influenced as much by one's perspective of the place of the arts in society, as much as by potential economic analysis. However, where economic analysis may assist is in the allocation of scarce resources. While there is an argument to be made that funding is best allocated on efficiency grounds, this must be tempered by the intangible, and desirable, benefits that the arts contribute to society.

Arts funding is necessary but, as with any scarce resource, must be allocated to the activity that will generate the greatest return. This return may be in the form of a contribution to national identity, generation of externalities, increased economic growth, improved educational opportunities or any of the other established potential benefits of the arts. Criteria such as these should be used in funding allocation decisions to ensure that the greatest benefit is gained from the limited funds available.