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When should regions bid for artistic resources?

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Abstract Under a variety of assumptions, subsidized bidding for creative resources fails to spur economic growth. First, under many conditions, the resource would find an optimal location in any case. Second, the bid may be good for a winning city's economy, but bad for the arts more generally. The bid winner is not necessarily the most appropriate home for the resource. Third, bids based on publicly available information are unlikely to beat the market price for attracting those resources. The key to stimulating growth, and drawing successful creative resources, is to stimulate the underlying microconditions for entrepreneurship, whether in the private or public sectors. Furthermore, we should make arts subsidies less location-specific.

Keywords Arts · Culture · Subsidy · Entrepreneurship

1 Introduction

Should regions make special bids to attract growth-enhancing resources? And more specifically, might the *arts* serve as such a resource? If so, under what conditions?

Such questions have at least two motivations. First, we are interested in understanding economic growth more generally. We wish to know to what extent historical growth has been driven by the arts, or by bidding for productive resources more generally. Second, we face ongoing policy questions about how to generate economic growth, and how governments should support the arts.

For the purposes of exposition, I will refer to artistic resources. Particular examples of these resources may include a celebrity, a firm, a nonprofit, a stadium, or perhaps a whole artistic sector. The key assumption is that such resources produce economic (and presumably cultural) value for a region, but only if they are located or based in

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that region. Of course, this value can include option, existence, and bequest values but I will speak of economic value in the most general sense.

The second core notion is that of a "bid." By definition, a region bids for an artistic resource when the government of that region offers the resource some economic inducement to locate or relocate. Such bids may include tax breaks, free land, and favorable regulatory treatment, among other examples. Regions are hoping that the bulk of the benefits from the bid will accrue to that region itself.

The total cost of a bid, which includes the subsequent ramifications of current incentives, will be called the price of the resource. A region usually pays some price whether or not it wins the bidding, but it pays a higher price if the resource actually goes to that location. That is, it will cost something to prepare the offer of a tax bonus, but the bulk of the cost comes if the resource actually moves and the tax break must be granted. Here, I am referring to gross cost, as the benefits of the resource relocation may outweigh the costs over time. A simple example of such costs would refer to the infrastructure spending that might be required to accompany a new concert hall.[1]

The institutional context for these concepts is straightforward. Canadians offer tax breaks to induce Hollywood to shoot movies in Toronto. A local art museum may bid for a blockbuster exhibit. A local government may give away land to attract a new stadium or performing arts center. Regions bid for resources and projects at the national level as well. *Lord of the Rings* was shot in New Zealand, in part, because the filmmakers received tax breaks from the New Zealand government. More generally, nations often lure foreign capital by offering favorable tax and regulatory treatment.[2]

I consider bidding for resources within the context of interregional competition. That is, I ask what policies a particular region should adopt, knowing that other regions also will be trying to attract growth-enhancing resources. Such a regional bidding assumption provides the relevant context for most policy decisions. A region cannot evaluate its own attempts to nurture culture, and support economic growth, without considering the broader national and global environment.

To whatever extent some resource is valuable for growth, we can expect interregional competition to bid up the price of that factor. In the final bidding equilibrium, it is an open question whether that factor still brings net growth benefits, once we consider the explicit and implicit prices to be paid. Citing "growth synergies" does not, by itself, make this bidding a positive-sum game. If the synergies of some resource involve $1 million in value, we might expect that fact to add $1 million to the resource price.

[1] Bidding, of course, can be implicit rather than intentional. A region might lower taxes for some other reason, but the lower taxes will nonetheless operate as an implicit bid for resources, including artistic resources. The analysis does not require that we pin down a definite "intent" on the part of regional policymakers.

[2] Despite recent cutbacks, most government growth in the United States, over the last 20 years, has come at the state and local level. Arts policy reflects this fact, which illustrates the relevance of interregional bidding. State-level arts spending is now of more importance than the National Endowment for the Arts (NEA). When the NEA started in 1965, few states had official Arts Councils or any kind of official arts policy. In 1979, NEA funds were 80% greater than state legislative appropriations; by 1989, the state appropriations were 60% higher. The New York State Council on the Arts (NYSCA) alone is more than half the size of the NEA in real terms. Its 2003 state appropriation is $49.3 million, compared to the NEA's approximately $121 million, 40% of which is sent out to the states, leaving a real NEA budget of just over $72 million.

Starting with this framework, let us see when bidding for resources pays off. I will not assume that markets, and market prices, are in every case efficient. Instead, I will seek to determine when market prices, or implicit bidding prices, will fail to reflect the full value of resources, and what those results imply for public policy.

Most of the literature on (nonartistic) regional development offers a different focus. For instance, it is often debated whether reasonable incentives in fact attract valuable resources at the margin. Another line of critique claims that interregional competition leads to a "race to the bottom" with regard to tax and regulatory policies. Bidding wars can create negative externalities through induced changes in policy, which may imply a case for cross-regional case for collusion. These points are well-taken, but I wish to focus the analysis on some relatively neglected factors.[3]

The remainder of this article is structured as follows. Sections 2–4 will consider three critical factors—whether location is a cooperative game, public choice issues, and the publicness of the information about resource value—for evaluating bidding for creative resources. Section 5 will summarize some conclusions.

2 Is location a cooperative game?

Let us start with the question of whether resource location is a coordination game. Sometimes, the relevant resources will locate in the proper region without government-subsidized bids. The location decision may have an efficient voluntary solution.

Assume that one municipality, call it Santa Fe, benefits from a new opera company more than other municipalities would benefit. To pursue this scenario, we must break it down further. Either the opera company receives special benefits from being in Santa Fe, relative to other locales, or it does not. Let us consider each possibility in turn.

2.1 The opera company receives special benefits from locating in Santa Fe

If the opera company will fare best in Santa Fe, we can expect the Company to locate in Santa Fe, even in lieu of a subsidy. Think of Santa Fe and the opera company as resembling a happy marriage. A husband benefits greatly from the proper choice of wife. But, a governmental subsidy generally is not required for the marriage to take place. The wife also benefits from the choice of this husband and will marry him in any case. Both parties will be better off if they can mesh their plans, and good information suffices to bring about the felicitous outcome.

Arts advocates frequently talk in terms of synergies, by which they refer to interlocking benefits for the city and the relevant artistic resource. Sometimes, this is called "agglomeration externalities." Whether or not such benefits are significant, their presence would not imply an argument for location-specific subsidies in this context. To the extent that synergies are present, we have a coordination game which likely can be solved without subsidizing location. Agglomeration externalities do provide a potential case for subsidizing the *creation* of new artistic resources, or for creating

[3] Colgan (1995), Thomas (2000) and Bartik (2005) survey these literatures.

whichever resources contribute to the positive externalities. But, the “creation” and “location” aspects of a subsidy program are conceptually distinct. If those resources go elsewhere, agglomeration externalities still will be produced.

To pursue the marriage analogy just a bit further, we might think that subsidies to marriage benefit society. After all, marriages produce children, contribute to social stability, and serve as social insurance. So, there may well be a case for a public subsidy to marriage. But, this provides no case for subsidizing particular marriages of one individual person to another. We should subsidize marriage as a general institution, rather than offering Tom benefits if he marries Sally but not if he marries Mary. The latter set of incentives will work only under the unlikely condition that some planner knows the beneficial sets of marriages. In other words, we can separate out the idea of a general subsidy from the idea of a subsidy to a particular match.

2.2 The opera company is hurt by locating in Santa Fe, relative to other possibilities

Counterintuitively, bidding for artistic resources can make the most economic sense when only one party benefits from the location decision. Consider the case when the city benefits from the resource, but the resource does not benefit from the city, relative to alternative locations. We might imagine that Santa Fe benefits by $10 million in value but the opera company loses $2 million in value, relative to alternatives. Intuitively, think of the opera company as accepting a smaller potential audience in Santa Fe. That being said, an opera company in Santa Fe might draw more tourism than would an opera house in the less exciting but more populous Jacksonville, Florida. So, Santa Fe restaurants and hotels receive additional profit from the opera company; hotels and restaurants in Jacksonville would not earn equivalent value from a comparable locational subsidy.

In this case, an appropriate subsidy greater than $2 million will bring the opera company to Santa Fe, the value-maximizing location. Note that this subsidy will be good for growth but arguably it is bad for the arts. The opera company, by construction of the example, would attract more interest in some other locale. So, we are sacrificing the arts to the exigencies of economic development. By coming to Santa Fe, the opera company becomes less effective in promoting its musical mission. The external benefits from the locational decision will be economic benefits, but they need not be musical or artistic benefits.[4]

We may be willing to make this tradeoff for utilitarian reasons, but rarely is it advertised as such. It is not what most arts lovers have in mind when they argue for subsidies. Furthermore, this scenario requires us to move away from the standard rhetoric about the synergies of location. The stream of net uninternalized benefits runs one way only, namely to the city. In a full accounting of the policy, the net loss to the opera company should be subtracted from whatever economic benefits are reaped by

[4] Of course, some of these external benefits might be musical in nature. The opera company location, for instance, might benefit a voice school in Santa Fe, but not in Jacksonville. Nonetheless, the point remains that the economic benefits in the example do not necessarily measure the cultural benefits or the resulting boost to the fortunes of music.

Santa Fe. An economic impact study, as is usually done, will fail to take these costs into account.[5]

The case for subsidy is most rhetorically appealing when the following conditions are realized. First, both parties benefit from the location decision, due to synergies. Second, the location decision could not have happened without the subsidy. The problem is that these two assumptions cannot always be squared.

One surviving argument for subsidy refers back to the distinction between externalities from creation and externalities from location. We might believe that opera companies produce uninternalized social benefits for the country or the world as a whole. In principle, the federal government could subsidize opera in very general terms, and then allow opera companies to move where they wish.

To the extent this scenario works, it suggests subsidies should be as general and as nonlocation-specific as possible, given the constraint of political feasibility. This will militate against subsidies to immobile infrastructure and favor subsidies to relatively mobile resources. In particular, this will favor subsidies to arts training and education, in addition to portable cash grants. It also may favor some artistic forms over others. Most paintings are more portable than large site-specific sculptures, so the relative advantage of subsidizing painting should be upped. If film is to be subsidized, it may be preferable to target script development, rather than shooting in a particular locale, and so on. Political feasibility will limit flexibility in these regards, but at the margin we can alter the content of subsidies—whether national or local—to take this analysis into account.

3 Public choice considerations

So far, I have been treating bids as reflecting the value of courted resources to the relevant region. But, sometimes, bids will reflect the interests of politicians rather than interests of voters. These cases generate some additional results.

Often, the general citizenry will benefit from an industry more than will the decision-making politicians. Arts resources, for instance, might bring more opera performances, a more active social life, and a revitalized downtown, in addition to increased tax revenue. Politicians, however, might care mostly about the increased tax revenue.[6] Their lack of concern for the full benefits can lead to underbidding. Alternatively, perhaps, the regional government is benevolent, but political obstacles limit its ability to bid at full value.

The bidding for the resource then will reflect only the benefits as perceived by politicians, or as reflected by the constraints. So, take an example where politicians benefit by $500 million, but the general public benefits by another $500 million, for

[5] The regional development literature, of course, stresses different external costs. The bids of one region may induce other regions to adopt "race to the bottom" tax or regulatory policies. To whatever extent this better-known effect holds, it strengthens the point at hand. For a collection of views on economic impact studies, see *Economic impact of the arts: A sourcebook* (1987). Seaman (1987, 2000) and Cwi (1987) offer the most forceful critiques. See also Madden (2001). Radich (n.d.) and Reeves (n.d.) offer overviews. Seaman (2002) argues for contingent valuation studies as a superior alternative.

[6] Electoral pressures will to some extent narrow the gap between politician and voter benefits, but it is plausible that some differential will remain (Kalt and Zupan, 1984).

a $1 billion total. Political bidding will price the resource at or below $500 million, which is below true total social value.

The case for subsidized bidding in this scenario remains murky. Presumably, other regions will be underbidding for the resource as well, and for similar reasons. Of course, generalized underbidding implies that the winning city can get a desirable resource on the cheap. But, generalized underbidding also means that a particular region can attract a resource without being the best home for that resource. The winning region is not the one that values the resource the most, but rather the region that maintains the highest absolute bid after underbidding kicks in. If a particular region remedies its underbidding problem, it does not necessarily lead to a more efficient allocation. In terms of real value created—for citizenries—winning the bid might simply reshuffle resources to the higher-bidding governments.

Under some conditions, the government most able to up its bid will also correspond to the region able to receive the greatest net benefits from winning the resource. But, this scenario is less intuitive than it might at first sound. It does not specify a positive relationship between total value for the citizenry and total value for the politicians. (If such a plausible relationship holds, universal underbidding still can lead to a satisfactory outcome; all regions will underbid, but the region that values the resource the most will underbid the least.) Instead, the scenario requires a more convoluted condition. There must be a correlation between value for the citizenry and the *ability to increase* political willingness to bid at the relevant margin. Whether this relationship will hold is not obvious or intuitive; if the citizenry cares a lot, we might expect the initial bid to be high and thus hard to increase. Again, we return to the conclusion that the willingness of a single region to bid more can either increase or decrease net social value.

Even when the correct city wins the bidding process, traditional cost—benefit analysis can be misleading. The relevant benefits are not the gross value brought into a city, but rather the difference in value between the number 1 and the number 2 bidding cities. This value differential will be smaller, sometimes much smaller, than the traditional measure of gross benefits expressed by standard cost—benefit studies. So, if we are comparing gains to the costs of taxation and rent-seeking, the investment might not make the hurdle. The net gain from subsidy still can be zero or negative.[7]

The arguments for subsidies are weak in many of these scenarios. As economists and social scientists, it is not our job to teach regions how to benefit at the expense of other locales. It is part of the economist's brief to help distinguish between the regional and general returns to a location decision. Even if one region can bid for a resource at a profit, the location decision need not maximize total value for the world as a whole. We would instead prefer a solution that increases available social benefits on the aggregate.

To be sure, a higher bid will increase the incentive to create more resources for the future. In this regard, remedying the underbidding phenomenon can bring more general benefits across a longer run. But again, public policy advice should outline the relevant benefits and costs clearly. Bidding more today will not, in general, improve

[7] In yet other cases, remedying underbidding will benefit the artistic resources, but at the expense of the bidding regions. Bidding at a higher level, of course, raises prices in the long-run and makes it more expensive for the region to acquire talent.

the allocation of the resource under bid. And, we should restructure our subsidy programs to make them less location-specific, as discussed earlier.

We could make the more abstract argument that higher bids will improve the general efficiency of the bidding process.[8] Nonetheless, most of these future benefits may well go to other regions. A policy advisor could recommend a bid on the grounds of general long-run altruism; it is harder to argue that this particular bid will improve the allocation of the resource under question.

Recognition of these realities would place many arts advocates in an awkward position. On one hand, they wish to argue that the world as a whole does not offer sufficient appreciation for the arts. This suggests that many regions are underbidding for resources. On the other hand, they wish to induce their own region to offer a higher bid for creative resources. Yet, these two positions do not fit together very well. Bidding at the appropriate level, when everyone else is underbidding, will not in general improve the allocation of artistic resources.

Now consider the opposing case of generalized overbidding for creative resources. For instance, bringing in a creative resource might increase opportunities for graft and corruption, while benefiting the citizenry to a minimal degree. Or politicians might enjoy "trophy acquisitions," leaving the costs to be borne by the taxpayers. Such mechanisms are sometimes alleged to be true for stadium bids. More generally, there is a moderate amount of evidence for a "winner's curse" (Thaler, 1994). Winner's curse can operate because the winning bidder is the one that most overestimates the value of the resource or the item under bid more generally.

Under the overbidding assumption, a selfish city or region should not try to enter the bidding process at all. The resource can be won only by overpaying for it. An altruistic region might have reason to enter the bidding process, but only to stop its neighbors from overpaying. The altruistic region could not itself come out ahead by winning the bid, although it could prevent a greater mistake from occurring elsewhere.

Once again, these results diverge from the scenarios postulated by arts advocates. It is not a winning political strategy to suggest: "Let us win this bid and take some losses to protect our neighbors from their costly overoptimism." So, again we do see circumstances where a subsidized bid could improve welfare, but the scenario differs from the usual rhetoric.

4 Secrecy

Creative and economic resources have their biggest net impacts on regional growth when their virtues are not commonly understood. The logic here is evident once we consider cross-regional bidding.

Suppose it is known generally that importing arts activities boosts urban growth. Numerous cities will then bid for the arts. To the extent that the bidding is competitive, the price of getting a resource will rise to meet the (risk-adjusted) benefits of having that resource.

[8] We can imagine more bids as "thickening" the market. Note that this runs counter to the usual regional development story of competitive bids imposing negative externalities on other regions.

To consider the converse case, assume that an insightful entrepreneur suddenly discovers that, say, the *Lord of the Rings* movies will be a huge hit and stimulate tourism in New Zealand. That entrepreneur then woos the relevant artistic resource, just as the New Zealand government courted the director Peter Jackson. In this context, we can think of the entrepreneur as either a politician or as working through the private sector.

In either case, a resource with secret value can be bought "on the cheap" and it will yield significant net benefits. Furthermore, those benefits, when they come, will be a surprise to most observers. An artistic product, event, or movement will appear to have "come from nowhere." The rise of rock and roll in Memphis, the rise of grunge in Seattle, the rise of Silicon Valley, and the early rise of Hollywood all fit this general pattern. Similarly, the original studio investment in *Lord of the Rings* was considered extremely risky rather than a commercial sure thing. Most observers worried that Jackson had never made a major studio action picture before and they feared that the features would bomb in the marketplace.

Successful resource bids, by their nature, involve initial values that are hard to evaluate and are especially hard to verify. High returns come when resources are undervalued in the eyes of competing entrepreneurs. So, it will not be possible to generate commonly accepted economic impact studies on the resource. It will appear that the relevant entrepreneur is taking a big chance on the untried, rather than delivering a benefit of obvious importance. Think of the examples discussed earlier. What kind of economic impact study could have been produced for "grunge" music, working right before Nirvana and subsequent bands hit it big? Even the music companies had no idea that Nirvana would sell millions of CDs and start the next big musical trend.

The policy implications are evident. If we, as outside academics, are producing studies and public arguments in favor of investing in particular artistic resources, the time for investing in those resources probably has passed. Similarly, if a resource passes a publicly-available cost—benefit test, its price probably already reflects its full value.

Entrepreneurs, acting on their hunches (rather than on publicly available information), represent the best means of attracting a growth-enhancing resource. If an entrepreneur can spot an undervalued resource, and lure it to a region, or fertilize an already-present resource, those investments can boost regional growth.

Note also that the secrecy scenario avoids some of the well-known problems with regional competition. It is commonly alleged that regional competition for resources leads to a fiscal or regulatory "race to the bottom." This is far less likely to happen when the value of the key resource is private rather than public information. If other parties or regions are clueless about the value of the resource, a destructive bidding war is less likely.

The benefits from finding a secretly undervalued resource relate to Kirzner's (1973) work on entrepreneurial alertness, and Polanyi's (1974, 1980) work on polycentric orders and inarticulable knowledge. Kirzner explains how entrepreneurs become alert to opportunities and understandings that no one previously had seen. His notion of alertness refers to a sudden but rapidly-vanishing epiphany of insight. Polanyi stressed how value creation springs from decentralized polycentric orders that encourage experimentation. He also emphasizes that much of the relevant knowledge is "inarticulable" rather than publicly available. In his view, entrepreneurial knowledge is like knowing how to ride a bike, rather than like a series of easy-to-transcribe instructions.

In these cases, a successful investment will appear, to outsiders, like a stab in the dark. The entrepreneur may somehow “know,” “see,” or “feel” success right before him, but the very nature of undervaluation suggests this hunch is not publicly verifiable.

Furthermore, we should not be surprised to find an absence of clear positive evidence linking the arts and economic growth. Successful bids occur precisely when the value of the resource is difficult to measure and verify *ex ante*. We, therefore, should not expect to find systematic statistical measures to prove the *ex ante* value of bidding. We will find *ex post* case study successes, but otherwise be left in the dark by the empirics. *Ex ante* successes, by their nature, resist publicly verifiable quantification.

Local governments will stand the greatest chance of attracting successful resources when they can act on entrepreneurial hunches. That being said, the reality of political entrepreneurship is often problematic. Political entrepreneurship is most likely when we remove governments from the constraints of accountability and political checks and balances. In other words, we would have to allow local governments to act more like private entrepreneurs. Political entrepreneurs would be free to invest significant resources based on their subjective, nonverifiable judgments of what is likely to succeed.

Note that the older European model of aristocratic arts support in some way resembled this scenario. A king, duke, or noble would support the artists that he or she preferred, with only a minimum of responsibility to taxpayers and with only a minimum of outside scrutiny. This system not only supported many hack court artists but also many geniuses, such as Titian and Velazquez. I am not suggesting that we move to an aristocratic model, given its political costs. Nonetheless, the history of aristocracy provides a useful foil for understanding government funding of the arts. In either the private or public sectors, the idea of entrepreneurship remains central to an understanding of our successes.

5 Concluding remarks

Subsidized bidding for creative resources is more problematic than is commonly believed. Under a variety of assumptions, both realistic and minimal, we have seen that subsidized bidding for creative resources fails to spur economic growth.

That being said, subsidized bidding can sometimes bring economic value. Those cases are the following:

1. The bid is good for a city’s economy, but bad for the arts.
2. The subsidies draw more resources into growth-enhancing activities, and are not so location-specific.
3. The subsidy remedies previous generalized underbidding, thus making the price system more effective in the longer run.
4. The bid is made by a perceptive entrepreneur, who ignores or “sees through” the publicly verifiable understanding of the relevant values.

Of these four scenarios, the second and fourth provide the most positive way forward. The first is unattractive from an arts point of view, and the cross-regional altruism behind the third probably is not politically sustainable in the long run. In terms of policy recommendations, a region should (a) strengthen the decentralized microconditions for successful artistic entrepreneurship, and (b) consider subsidies and bids which are less location-specific.

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