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Financing rules of the activity of cultural institutions in the context of economic efficiency

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**Financing rules of the activity of cultural institutions
in the context of economic efficiency**

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Financing rules of the activity of cultural institutions in the context of economic efficiency

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Abstract

The aim of this article is the efficiency evaluation of statutory subsidies granted to cultural institutions in the context of subsidizing rules of these institutions. From the economic point of view, the financial analysis of cultural institutions shows economic inefficiency of all institutions. In the majority these are institutions that live on thanks to income from the organizer's subsidies, generating low own revenue in relation to incurred costs.

The authors make the argument that subsidized cultural institutions in Poland report heterogeneous financial results despite the fact that their financial management is based on the same financing rules.

The authors assume that similar amounts of transfers should provide a comparable range of performed tasks, and thus the access to goods and services supplied.

The subject of the study of measuring the economic efficiency of the expenditure of cultural institution are public theatres and music institutions in big cities. The object of the study was limited to cultural institutions whose core business include performing arts. In the paper, while fulfilling the set objective of the study and while verifying the hypothesis graphical method, descriptive statistics, as well as methods of statistical inference have been used.

It should be emphasized that despite homogenous principles of granting statutory subsidies, the economic efficiency of individual cultural institutions of culture is diverse. Lack of correlation between the level of financial results, the level of the statutory subsidies and of the total costs of a cultural institution leads to conclusion that more factors in this field should be investigated.

1. Introduction

The concept of “culture” is one of the toughest and most capacious concepts. The eighteenth-century philosopher J. G. Herder summarized already that: “there is nothing more indeterminate than the word culture” (Herder, 1964, p.4). The debate over the concept of culture (Strent, 2011, p. 133) does not fall within the abovementioned topic, however, the concept of economics of culture is appearing increasingly in the realm of finance (Ilczuk, 2011, p. 7).

There is a view in the literature, that the concept of culture is identified with “industries” of culture subsidized from public funds, such as theatre, opera, concert hall, etc., and this understanding of culture does not include so-called lucrative industries of culture, which could include among others media, cinema, recording industry, and especially products of new technologies (Głowacki et al., 2009, p.3). This view is controversial and will not be discussed below.

The aim of this article is the efficiency evaluation of statutory subsidies granted to cultural institutions in the context of subsidizing rules of these institutions. The authors make the argument that subsidized cultural institutions in Poland report heterogeneous financial results despite the fact that their financial management is based on the same financing rules.

2. Literature review.

The analysis of the public expenditure efficiency is not any new problem in the literature. Significance, amount and range of financing particular benefits from public funds is a persisting dilemma not only of scientists and of the circles interested themselves, but also of the socio-political debate. As already Samuelson (Samuelson, 1954, pp. 387-389) was the author of the theory of public goods, disposer of those is the collective consumer. Also the universal accessibility justifies government intervention regarding financing culture because culture, no matter what its demand is, is a socially acceptable good due to positive externalities (merit goods) (Baumol & Bowen, 1966, p.582). The importance of culture as a prerequisite for sustainable development has been emphasized many times, what also justifies the subsidizing of cultural institutions (Thorsby, 2000, p.31). P. Bendixen (Bendixen, 2001, p.13), looking for links and relations between market-driven economies and culture, concluded that modern

economies could not develop without the contribution of culture. At the same time he emphasized that, due to the specific nature of cultural institutions and their social mission, it was extremely difficult to determine the boundary between effective spending of money for cultural activities and wasting of them (Bendixen, 2001, p.11). Costs and thereby the financial result were also analysed in terms of technological progress, what differently from production influences creators of culture.

On the basis of century-old observation of such performances, a theory evolved called "cost disease" (Baumol & Bowen, 1966, p.542), which is the reason for permanent deficits affecting cultural production. The cost disease results also from the demand for cultural goods and thereby from the price that consumers are able to pay for the use of these goods. Due to that, in the literature, the subsidizing of cultural activities has long been justified, and J. M. Keynes himself got involved in building of public support for cultural institutions (Ilczuk, 2015, p.6). The theory of cost disease has often been positively verified, among others by the abovementioned Thorsby (Thorsby, 2000, p.23).

Although the literature generally considers the subsidizing of cultural activities justified, again and again a need for further development of tools and guidelines to evaluate activities of cultural institutions and thereby to determine the efficiency of public expenditure is arising (Thorsby, 2010, p. 44).

The authors also point out the possibility of implementation in cultural institutions *controlling* tools used in companies (Wnuczak, 2014, p. 6). Budgeting as an element of managing cultural institutions appears also in Byrnes' publications, who emphasizes the great importance of creating budgets for cultural institutions (Byrnes, 2008, pp. 284-297). The authors carrying out this study will focus exactly on economic efficiency, ignoring other aspects of efficiency.

3. Research methods.

The subject of the study of measuring the economic efficiency of the expenditure of cultural institution are public theatres and music institutions in cities belonging to the category of large cities, i.e. with the population of one hundred thousand to a million. The object of the study was limited to cultural institutions whose core business include musical activities consisting in satisfying the needs and cultural inspirations of the society by creating theatre performances and by

dissemination of performing arts in the form of operetta performances, shows and musical events, ballet, etc., in other wordstheatre, concert hall and ballet. However, only those institutions whose organizer is a municipality. For the study, only statutory subsidies provided by the organizer will be taken into account.

The conducted studywas to approve or reject the hypothesis according to which the subsidized cultural institutions in Poland have heterogeneous financial results although their financial management are based on the same financing rules.

For the sake of better transparency of data, when the study was conducted, a distribution of features into four compartments, in which the results will be classified, was introduced. These compartments, called quartiles, correspond to the distribution of the data included in the boxplot. In order to determine the level of variation of costs of particular cultural institutions the coefficient of variationwas used.

In order to measure the efficiency of management, in the financial analysis an indicator determining the ratio of the financial result to certain quantity that influences the result was used.

In turn, the Pearson correlation coefficient allowed to determine whether there is a relationship between the level of statutory subsidy in overall revenue and the financial result expressed in overall costs.

4. Rules of financing cultural institutions.

According to the art. 27 § 1*Act on organizing*¹a cultural institution manages independently the given and acquired part of assets and it runs its ownindependent economy within the possessed resources, it has a legal personality and is independently responsible for its liabilities.Under the art. 4 § 1 section 8 of *Ustawa o finansach publicznych [Public Finance Act]* of 30 June 2005*Act on organizing...*state and local cultural institutions are counted as entities of the public finance sector, which by their activity perform the constitutional role of the state, consisting in providing access to culture for all citizens (Lewandowski, 2006, p. 3).

¹*Ustawa o organizowaniu i prowadzeniu działalności kulturalnej* z dnia 25 października 1991 r Dz.U. 1991 Nr 114 poz. 493

Regarding local cultural institutions, based on the Constitution, the principle of subsidiarity, resulting from a series of acts, and above all from the municipality's catalogue of own tasks, can be articulated.²

A lack of homogenous rules for obtaining ministerial subsidies as well as statutory ones by local cultural institutions casts a shadow on the constitutional principle of adequacy, which should be applied to all local cultural institutions. The multidimensionality of obtaining subsidies is at odds with the principle of financial self-management³.

This principle allows self-managing assigned assets and the self-management as regards given resources. The main limitation of the principle of self-management, apart from subsidies, is the principle of efficiency, which will be pointed out by the authors during the course of the elaboration.

On the basis of *Public Finance Act* the principle of direct budget financing cultural activities of the institutions whose statutes include objectives or tasks related to cultural activities can be articulated. An addition to this principle is the principle of indirect financing cultural activities through a system of earmarked subsidies and specific grants Art 9 [Act on organizing...]. The main difference between statutory subsidies and specific grants is the procedure of concluding an agreement regarding specific grants. It is worth mentioning that *Public Finance Act* is mainly dedicated to specific grants, what corresponds to the abovementioned inconsistency in the existing of the principle of adequacy, and at the same time of the idea of self-governance and decentralization (Szlendak et al., 2012, p. 35). This principle is often articulated as financing of cultural institutions by the organizer in the form of various types of subsidies.

In conclusion, cultural institutions, according to the art. 27 § 1 [Act on organizing...], run their own independent economy within the possessed resources, bearing in mind the principles of efficiency of their use. The basis for the financial management is a financial plan established by the director, with reference to the unchanged amount of the organizer's subsidies. The consequence of this principle is the principle of direct financing of cultural institutions from the budget. A cultural institution covers the costs of current operations and liabilities from own revenue - Art. 28 § 1 [Act on organizing...]. Public expenditure

² *Strategia Rozwoju Kapitału Społecznego 2020* Warszawa 2013, p. 22, annex to resolution No. 61 of the Council of Ministers of 26 March 2013 item 378

³ art. 27 [Act on organizing...], art. 51 [Local Government Act] of 8 March 1990, *Dz.U.* 1990 No. 16 item 95

should be done in a purposeful and cost-effective way, with bearing in mind the principles of: obtaining the best results from the investment, optimal choice of ways and methods of achieving set objectives- Art 44 §3 *Public Finance Act*.

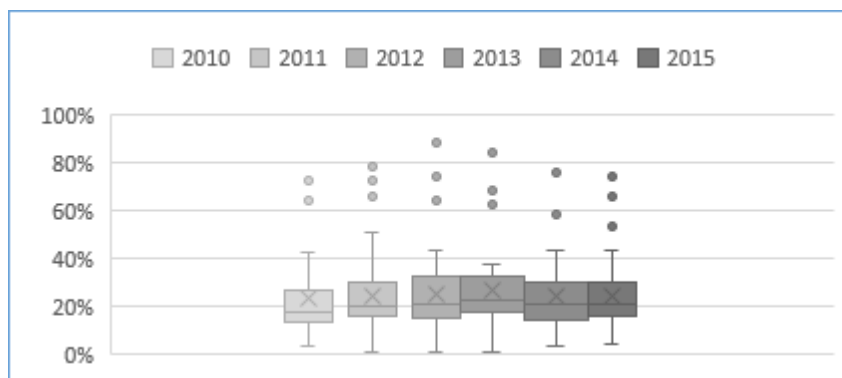
5. Results of the study.

From a purely economic point of view, the analysis of finances indicates the inefficiency of all institutions. In the majority these are institutions that live on thanks to income from organizer's subsidies, generating low own revenue in relation to the incurred costs.

In order to maintain continuity and development of activities, own revenue, independently generated by a cultural institution, is particularly important. Particularly the share of own revenue in the total revenue (self-financing) should be considered. This potential for self-financing is a way to preserve the autonomy in the scope of activities performed (Kowalik et al., 2013, p. 76). Moreover, cultural institutions should run its own economy within the possessed resources, bearing in mind the principle of efficiency of their use. Therefore, it is important to maintain a balance between generating of revenue and providing of public services by cultural institutions, and the level of subsidies.

The conducted study showed that the substantial majority of cultural institutions is characterized by almost negligible or low share of own revenue in the total revenue. In the majority of the examined cultural institutions - in 54 cases, which represents more than 90% - the share of own revenue in total revenue did not exceed the 51%. Therefore, the economic efficiency of these institutions can be described as very low.

Figure 1. The share of own revenue in the total revenue of cultural institutions

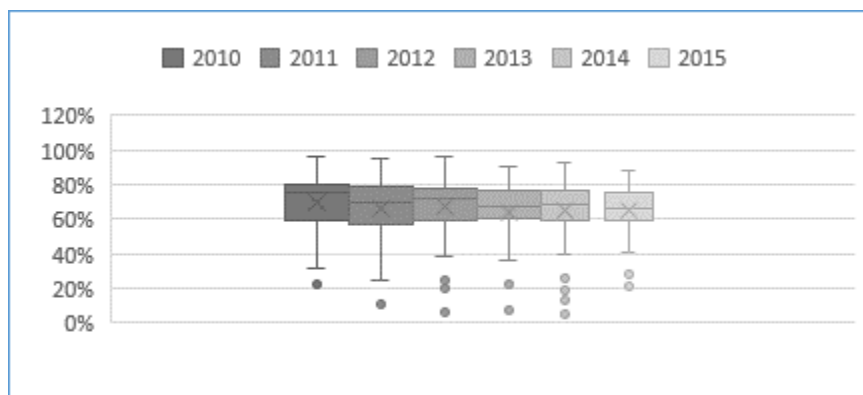


Source: Own elaboration based on reports on the implementation of financial plans of municipal cultural institutions between 2010 and 2015

The performed analysis indicates that in particular cultural institutions the indicator of self-financing was at the similar level throughout the whole study period. Small increases and decreases occurring in particular years affect only slightly the ability of cultural institutions to self-finance (Fig. 1). The level of own revenue in the majority of cultural institutions did not allow of self-financing.

The conducted studies proved that statutory subsidies are an important factor of the revenue of cultural institutions. While these institutions generated relatively low own revenue in relation to the total revenue, the share of subsidies in the total revenue is significant. Subsidies accounted for 25% (in 2011) up to almost 100% of the total revenue (Fig. 2).

Figure 2. The share of the statutory subsidies in the total revenue of the respective cultural institutions



Source: Own elaboration based on reports on the implementation of financial plans of municipal cultural institutions between 2010 and 2015

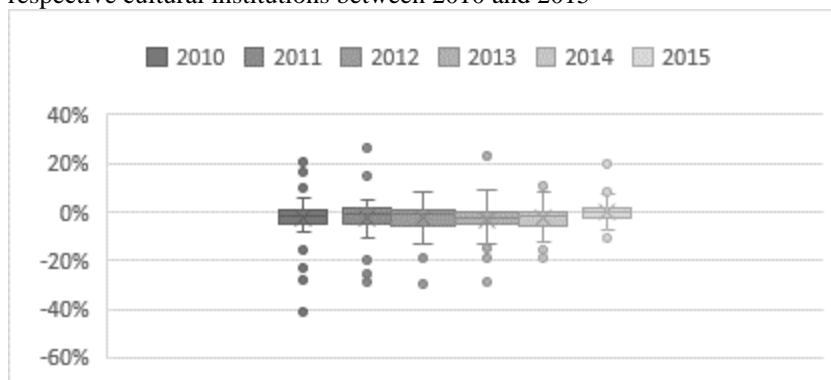
The conducted study indicates a relatively stable level of statutory subsidies granted to the respective cultural institutions in the whole study period. The management of a cultural institutions without any motivation of acquiring resources, does not want, or rather does not need to take any additional action.

The authors measured the share of the statutory subsidies provided by the organizer in the costs incurred by these institutions, should be indicated. The value of the resulting indicator will determine, firstly what amount of the cost is financed by public resources. Secondly, whether the level of subsidies varies depending on the incurred total costs.

Between 2010 and 2015, the share of statutory subsidies in the operating costs of the respective cultural institutions fluctuated from 27% to 111%. For three quarters of the cultural institutions it was higher than 54%. This means that for only 25% of cultural institutions the subsidy did not exceed almost a half of the cost. Significant changes occurred in Q4. This indicates to a high share of subsidies in total costs for at least 50% of the examined cultural institutions, thus making these institutions dependent on public sources of financing. However, it is important, whether the level is caused by a fast pace of decrease in subsidies or by a decrease of total costs in relation to the previous year. The studies conducted in this direction indicate a slight or just noticeable statistical variation of the costs of most of the examined cultural institutions (Vs at the level below 30%). The conducted studies show that a significant growth of the share of the minimum subsidy in relation to the cost was due to the relatively faster growth of subsidies in relation to changes in the costs.

The conducted studies allow to formulate some basic conclusions. The level distribution of financial result in the institutions is similar. Throughout the whole study period, the financial result of the cultural institutions was at the level corresponding to a minimum of 13% and a maximum of 8% of their total costs. A small improvement is visible in the last year of the study, particularly in relation to the minimum value and the lower quartile. The analysis of the data indicates that there are so-called outliers that are extremely small.

Figure 3. Distribution of the financial result as % of the total costs of the respective cultural institutions between 2010 and 2015



Source: Own elaboration based on reports on the implementation of financial plans of municipal cultural institutions between 2010 and 2015

A negative indicator of the financial result to the costs indicates a lack of economic stability of the respective theaters in relation to the homogenous rules of their financing. It should be pointed out that, compared to the costs, the level of the losses was relatively low, fluctuating around a few percent.

There is no relationship between the amount of the statutory subsidies expressed in the total revenue and the financial results expressed in the total costs. The Pearson correlation coefficient for the studied features was 0.0042.

6. Summary.

The analysis of the data indicates that there is a very small group of cultural institutions characterized by a high indicator of financing. Although statutory subsidies significantly improve the financial situation of cultural institutions, cultural institutions using subsidies to a lesser degree, and those whose important source of financing their

activities were their own revenues, are characterized by higher efficiency. This proves the authors' thesis on heterogeneous financial results although all institutions were based on the same financial rules. Financial independence of cultural institutions, based on sustainability of their financing sources is an essential condition for their harmonious development.

From an economic point of view, this situation might be caused by a lack of adequate incentives to increase own revenue due to the organizer's subsidies ensuring at least theoretically, coverage of costs of facility maintenance and, as it results from the analysis, the costs of the activity of theatres. The differences between the relationship of the costs and the revenue showed that for only 25% of cultural institutions the subsidy did not exceed almost a half of the cost, what indicates that the level of implementation of the principle of efficiency and thriftiness is not applied to the same extent.

In conclusion, it should be emphasized that despite homogenous principles of granting statutory subsidies, the economic efficiency of individual cultural institutions of culture is diverse.

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