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Introduction

Martin Feldstein

Museums are fundamentally different from other institutions in our economy and society. Like universities and symphony orchestras, they play a central role not only in the current cultural life of the nation but also as conveyors of our cultural heritage from one generation to the next. But unlike universities and orchestras, they are literally the preservers of the objects of culture themselves.

Although art museums are a vital part of our culture, financially they are relatively neglected stepchildren of our affluent economy. As nonprofit institutions, they lack both the ability to raise financial resources in the ways that profit-making businesses can and the substantial public funding of government activities. The largesse that can flow to universities from loyal alumni is not available to museums.

The sharp rise in the value of paintings and other forms of art during the past decade has made museums both remarkably rich and at the same time remarkably poor. They are rich if measured by the value of their collections at current market prices but poor because the sharp rise in the relative price of art severely limits their ability to acquire additional works of art.

Museums that are so rich in art are also poor when judged by the operating budgets available for the preservation, protection, restoration, display, and education associated with that art. There is a distressing contrast between the cultural importance and artistic treasures of our nation's leading museums and their very modest operating budgets. The 150 largest art museums have a combined annual operating budget of less than $1 billion, not even one percent of national spending on higher education and only about as much as Americans spend each year on fishing tackle or golf equipment.

The federal government's annual support through the National Endowment for the Arts is less than $15 million. The total direct support to nongovern-

mental art museums from all levels of government totals only about $70 million a year, about the federal government's daily spending on farm subsidies.

The budget stringency of museums reflects not only their status as private nonprofit organizations but also their mission to preserve art and to display it to a broad public. The mission of displaying art to the public restricts revenue by limiting the appropriate admission charges. Although a for-profit organization with a collection of Rembrandts or Renoirs might be able to earn substantial income by charging very high admission fees, a nonprofit museum would not follow such a policy because the resulting substantial decline in attendance would be contrary to the museum's basic mission.

The character of museums restricts their financial ability in another important way. Additions to a museum's collection, as well as the restoration and preservation of the existing collection, are analogous to the investment in plant and equipment by a manufacturing business. But unlike a for-profit business, a museum cannot finance these investment activities by issuing equity. And while the art collections themselves are very valuable assets, the purpose of the museum as a curator and public displayer of art means that the collections cannot be treated like financial assets or like the assets of an ordinary business that can be sold whenever funds are needed.

This introductory essay, as well as several of the background papers and personal statements, discusses some of the practical issues that museums face in dealing with the inherent conflict of being rich in art and poor in operating budgets. I came to the subject of this volume as someone without any specialized knowledge about the economics of art museums but with an interest in nonprofit organizations more generally and in the effects of government policies, particularly tax policies, on the private sector. I learned a good deal from the economic background papers and from the comments of the museum experts at the conference reported in this volume. My comments here are an attempt to summarize some of the key conclusions that I believe emerged from the research and the discussions as well as some personal ideas about the economic problems facing our leading museums.

It is convenient to organize these comments in three parts dealing with the uses of funds, the sources of funds, and the necessary trade-offs among conflicting goals that museums must face.

Uses of Funds

Consider first the three major uses of museum funds: operating costs, art acquisitions, and the construction of new facilities.

Operating costs are primarily personnel costs, including the professional staff of curators and conservationists and the support staff of office employees, maintenance workers, guards, and so on. Because of the nature of museum activities, there is little or no scope for the type of technical progress that reduces labor inputs in manufacturing businesses, financial enterprises, and

the like. Operating costs are therefore likely to rise indefinitely at about the same rate as wages and therefore at a rate that is about two percentage points greater than the rate of increase of the general price level. This has important implications for endowment management to which I return below.

Acquisitions of new works of art will depend primarily on gifts and bequests of those works of art. The current tax rules (particularly the rules subjecting the appreciation in the value of gifts of appreciated property to the alternative minimum tax) are clearly a major barrier to the museums' ability to attract gifts of important works of art. Unless the tax rules are modified, expensive works of art are likely to lie beyond the reach of all but a very few American museums.[1] Although museums will continue to purchase some works of art, the heavy burden of operating expenses will absorb most of the unrestricted funds and the high prices of major works of art will make purchases very difficult. The most likely source of funds for the purchase of art will be from "deaccessioning" (to use the term that museum officials prefer to "selling" in the same way that politicians prefer "revenue enhancements" to taxes) some items from the collection in order to strengthen or diversify the collection in other ways. The subject of deaccessioning is also one to which I return below.

Finally there is spending on the construction of new buildings or the expansion of old ones. Because museums generally have much more art than they have the space to exhibit, there is always pressure to expand the size of the museum itself. As in other nonprofit organizations, it is often far easier to raise funds for a major building than for operating expenses. But as Neil Rudenstine warns in his comments in this volume, buildings are not only expensive per se but also lead to increases in the overall level of operating budgets. Limitations on operating budgets as well as on construction funds mean that museums that are eager to display more of their total collection will have to develop creative ways of showing a larger portion of their collection in a limited amount of space, even if that means a less-than-ideal presentation of some of the material.

Sources of Funds

Except for the Washington, D.C. museums that are supported by the federal government and those museums that are supported primarily by state and local governments (as discussed in the background papers by Richard N. Rosett and Charles T. Clotfelter), most of our major art museums are private nonprofit organizations that must depend for their funds on admission charges, charitable gifts, the limited profits that are generated by museum shops and restau-

1. After the completion of this project, Congress passed legislation excluding gifts of art to museums in 1991 only from the alternative minimum tax with an understanding that an extension of that new rule might be enacted during 1991.

rants, a relatively small amount of endowment income, and an even smaller amount of funds from the government.

In practice, revenues from admissions provide only about 5 percent of the total income of the largest 150 art museums. Traditional economic analysis provides a reason for concluding that an art museum should in principle not be funded through admission charges. Although the analysis is familiar to economists, it is worth reviewing here for the noneconomist readers of the volume. A fundamental idea in economics is that a nation's resources are used in the best way when each economic activity is expanded to the point where the benefit to consumers of any further expansion is just balanced by the cost of providing one more unit of that activity. Thus the production of bread should be increased until the value of the last loaf (as measured by a consumer's willingness to pay for it) is equal to the cost of producing it. If there is another consumer who would value an additional loaf of bread more than the cost of producing it, it would be good to produce the extra bread. But if the last loaf cannot be sold for what it costs to produce, too much bread is being made.

When applied to art museums, this implies that as long as an extra visitor to the museum imposes no additional costs on the museum or on other visitors, the ideal admission policy is to have no charge at all. Even a modest admission charge might deny someone who wished to see the collection the opportunity to do so even though his or her seeing it would impose no cost. It would be wrong to restrict attendance in this way just as it would be wrong not to produce a loaf of bread when there is a buyer willing to pay more than the incremental cost of production.[2]

Some charge could be justified for visitors to particularly popular exhibitions or whenever the galleries are crowded, because the existence of crowds reduces the enjoyment of other visitors and thereby imposes a kind of nonmonetary cost on them. But these "congestion-based" admission charges would not be able to cover the total cost of the museum's activities (including conservation) at the appropriate level of intensity.[3]

The conservation activities of the museum do not benefit only those who currently visit the museum. Future generations of visitors will benefit from the collection as well. Moreover, the reproduction of works of art in books

2. In the language of economics, it is appropriate to have no admission charge because museum attendance is a "public good," that is, the museum's collection can be enjoyed by an additional person without increasing the total cost of production. In contrast, it is appropriate to charge for bread because bread is a "private good," that is, the total cost of bread production must rise if an additional loaf of bread is to be consumed.

3. The appropriate level of intensity of museum activities is easier to define conceptually than to assess in practice. The appropriate level of spending by the museum is the highest level of spending at which any increase in spending does not produce current and future benefits to the museum's audience that are as large as the additional cost. Any reduction in the level of spending would reduce the benefits to the museum's audience by more than the reduction in costs.

and videotapes extends the group that benefits from the museum's collection beyond those who can actually visit the museum. Although it is obviously appropriate to charge for the cost of producing such books or videotapes, adding a royalty charge to the price would discourage some people from seeing the art even though they could do so without imposing any additional cost on the museum.

The case against charging admission fees and publication royalties is fully persuasive only when there is enough support from private contributions and government funds to maintain the appropriate level of museum activities. When these other sources of funds are inadequate, higher admission fees may be better than lower levels of spending. The possibility that admission charges could appropriately be a more important source of funds than they are today is discussed in the last section of this chapter.

Cash gifts from individuals and corporations account for about one-third of the annual operating budgets of the major 150 museums, with about four-fifths of those funds coming from individuals. As Don Fullerton's background paper indicates, the tax deductibility of charitable gifts significantly increases the total dollar amount of such giving, and the increase in giving induced in this way is substantially more important than all direct government support for art museums.

The 1986 reduction in individual marginal tax rates and the unfavorable treatment of gifts of securities under the alternative minimum tax rules have substantially reduced the value of gifts of cash and securities to museums (as well as the gifts of art). Although such financial gifts will undoubtedly increase in the future as incomes rise, the relative size of such giving will be depressed unless there is a change in tax rules with respect to charitable giving.

Although charitable contributions are an important source of museum finance, the voluntary nature of charitable giving means that these funds are likely to be less than enough to support the appropriate level of museum activities. The key reason is that any individual can enjoy the museum's services without being a contributor. Although each contributor also enjoys the satisfaction of giving, as well as the benefits of enhanced museum services, most of the benefit of an extra dollar in the museum's treasury goes to the large number of other museum visitors. Even with the reduction in the cost of giving implied by the tax rules, individuals will not be motivated to contribute enough to support the appropriate level of museum activities. Even individuals with the highest marginal tax rate must forego roughly 65 cents of alternative spending to give a dollar to a museum, while that dollar will benefit literally hundreds or thousands of museum visitors.

Because our museums are such a great national treasure, it is tempting to hope that Washington will provide greater support in the future. But whatever the merits of the case for increased federal funding—and the traditional "pub-

lic goods" analysis indicates that they are considerable—direct federal support now accounts for less than 2 percent of the total operating budgets of the nation's private art museums, and the remarks of Andrew Oliver of the National Endowment for the Arts in this volume confirm that there seems little prospect of a significant increase. Our political tradition makes additional support from local governments and through the federal tax system more likely than increased direct funding from Washington, but the financial pressures on states and localities at the present time make significant increases in funding for the arts unlikely.

Income from endowments now contributes about one-sixth of the museums' total operating budgets. Richard N. Rosett's background paper reports that museums have used an average payout rate of 6.4 percent in calculating the amount of their endowment that they spend. About three-fourths of this income is spent on current operations and the rest on acquisitions.

Some simple calculations show that this current practice represents an unsustainably high rate of spending of endowment funds in most museums. If the endowment income is not to decline over time as a fraction of total spending, the size of the total endowment must increase over time at the same rate as the operating budget. Since operating expenses rise with the level of wages, which have increased over the long term at about 2 percent a year more than prices, the growth of the endowment must exceed the rise in the general price level by about 2 percent a year. Major universities with well-managed endowments invested in a combination of debt and equity securities calculate that over long periods of time the real inflation-adjusted return on endowments averages only about 4 percent. Even if a museum's endowment is judged to be large enough in relation to current expenditures that the endowment need only grow at 2 percent a year in real terms, the spending financed by the endowment should be limited to 2 percent plus the value of gifts and bequests to the endowment. Very few museums have the flow of endowment gifts and bequests that would justify spending as much as the 6.4 percent average payout rate that museums as a whole are now taking.

As I listened to the discussion at the meeting and talked with museum officials, I concluded that while museums are doing a great deal to expand annual operating gifts from individuals and corporations, they are doing less to increase major bequests and gifts to the endowment fund. By contrast, universities appear to do much more to attract very large gifts and bequests to be added to endowment capital. One reason for the difference is that major universities are financially much larger than major museums and can justify the specialized professional staff needed to solicit major gifts and bequests. The only way for museums to know if they could be successful in seeking such capital funds is to regard such a fund-raising project as an investment with an uncertain payoff, devoting funds to the project for several years to see if it repays the effort and expenditure.

Quantifying Trade-Offs

Museums quite rightly have a multiplicity of missions including not only the display of the collection but the preservation and restoration of the works of art, scholarly research, and public education. Understandably, the staff and trustees of the museums might generally believe that more of these activities would be better than less.

The desire to expand services is characteristic of those who are responsible for all types of nonprofit organizations, including education, health-care, welfare services, and religious organizations as well as museums. From society's perspective, however, the expansion of each type of activity must be balanced against the real costs. If we step away from the nonprofit sector for a moment, for most of the vast array of ordinary goods and services produced in our economy, the basic forces of supply and demand do a very good job of balancing the values of various products and services with their costs of production.

But in the nonprofit sector, the market cannot be counted on to achieve the correct level of spending on different types of activities. The mechanisms that society has created to supplement the market in support of nonprofit organizations are also far from perfect in balancing the costs and benefits of different activities. In some activities, too few resources are available (in the sense that additional spending would create benefits that exceed their costs), while in other areas, the method of financing causes the volume of resources to be excessive. Because of the "public good" character of museums, the total level of spending is almost certainly less than optimal, while the financing of hospital care through tax-subsidized private and public insurance probably causes the level of spending on hospital care to be excessive.

Those who are responsible for the governance and management of museums must therefore recognize that they are unlikely ever to have enough funds to operate their institutions at the level of activity that could be justified in an ideal world. Instead they must make difficult choices of what to do with the limited funds available.

As J. Carter Brown, Director of the National Gallery of Art, correctly notes in his comments, economists emphasize the need to recognize trade-offs in every type of activity. A museum cannot do more of everything, but faces trade-offs: it can do more of one thing that it wants only by doing less of another. The key to good decision making is to see those trade-offs explicitly.

In many cases it would help to quantify the trade-offs facing a museum. What will an extra, say, $50,000 a year buy? How many extra hours would it allow the museum to be kept open? Or, alternatively, how many students could be brought to the museum for a single visit or a series of visits using that money? Or how many teachers could be brought to the museum for a series of classes that would permit them to teach about art more effectively in the city's schools? Or how many members of a minority group that does not normally

come to the museum could be brought in by a variety of outreach programs? Only by quantifying the choices and assessing what the explicit trade-offs are within the given budget can the museum officials feel that they have made a well-reasoned choice.

In some cases, of course, quantification is easier than others. It may not be clear what a $50,000 program of advertising, transportation, and free admissions would do to minority attendance. But a quantitative guess refined as experience accumulates is better than just a feeling about what should be done.

It is even more difficult to quantify the effects of increased spending on preservation and conservation. And yet, without at least some crude quantification, how can the responsible museum officials know whether funds are being well spent?

Because museum budgets are severely constrained, it is desirable to revisit two issues about the sources of funds for museums in this spirit of facing difficult trade-offs: the deaccessioning of items from the collection and the charging of admission.

Museum officials have a natural reluctance to sell (deaccession) works of art from their collections. In addition to the loss of the work from the museum's own collection, there is the concern that the painting or other object might no longer be available to the public in any museum or might even leave the country. Moreover, a work of art that goes from the expert hands of a museum curator to a private individual might not be cared for as well. These are legitimate concerns of anyone who feels responsible for the care and public display of the works in the museum's collection.

Although museum storerooms have many works of art that cannot currently be displayed because of inadequate space, and that may not have been displayed for decades, curators argue that works that are currently unfashionable may be of greater interest in the future. There is a concern, moreover, that selling objects from the collection may deter future gifts of works of art or may even deter cash contributions by prospective donors who come to regard the sale of the museum's art as an alternative source of cash for operating purposes.

In an ideal world in which museums were adequately funded, these arguments might well be fully persuasive. But in the actual second-best world in which museums are woefully underfunded, museum professionals have generally come to accept the sale of works of art from their collections, as long as the receipts from those sales are restricted to purchasing new works of art for the collection.

Perhaps surprisingly, when works are sold, they are not sold subject to restrictions that they may not be exported or that they must remain in the collection of a public museum. Imposing such legal restrictions would reduce the sale price for any object sold but would allay some of the concerns that museum officials have about their stewardship responsibilities.

Such restrictions that protected the care and public availability of deaccessioned works of art might also make museum officials willing to use the funds from such sales for certain types of operating expenses. Expenditures on the restoration or preservation of works of art in the collection may be seen as close substitutes for the acquisition of new works of art. Indeed, the restoration or preservation of a work that is already in the museum's collection may be a socially more productive way of adding to the museum's usable collection because it represents a virtual net addition to the world's stock of art rather than just a shift of ownership.

Funds spent on improving the security of the museum's collection (guards, electronic surveillance, etc.) or the internal climate of the museum (air conditioning, humidification, etc.) are similar in their effect to more technical museum work to restore and preserve works of art. Museum officials who see themselves as the stewards of the world's art might even find expenditures on restoration, preservation, and protection more worthwhile than expenditures on acquisitions.

I come finally to the problem of admission charges. I have already explained why economists would say that in an ideal world it would be appropriate to have no admission charge at all. Even when a charge is justified by the detrimental effect of additional visitors on the enjoyment of the museum by others, the level of the charge would ideally be set to reflect only this "congestion" effect and not with a view to raising revenue.

Museums must, however, live in a second-best world in which the lack of funding means that all of the museum's missions are served less well than would be ideal. There is too little restoration and preservation, open hours are too restricted, too little is done to attract members of the public who normally do not come to the museum, too little is done to educate those who do come, and too few specialized exhibitions are presented for relatively well-informed museum visitors.

Although an increase in admission charges would discourage some attendance, it would, at a minimum, permit the museum to serve its other missions more adequately. Museum charges are now quite low relative to what an individual would expect to pay for a similar amount of time spent at a concert or theater or sporting event. Although museums have been reluctant to increase general admission charges, they do impose extra fees for major travelling exhibitions with wide popular appeal, and the resulting revenue is seen as a significant contributor to annual budgets. Nevertheless, receipts from admission charges still finance only some 5 percent of museum operating budgets.

The decision of whether or not to raise admission charges should be based on a quantitative assessment of the likely results. How much would an extra dollar of admission charge reduce total attendance? How much additional revenue would be produced, taking into account the higher revenue from those who continue to come and the revenue lost from those who stop coming? What could the museum do with the extra revenue? What types of individuals

would choose not to come if the admission charge were increased? Could special discounts for particular groups (e.g., students, senior citizens) or particular times during the week eliminate most of the adverse effect on attendance while still producing extra revenue from those visitors who are less sensitive to the price of admission (e.g., higher income groups and visitors from out of town)? Could some of the extra revenue be used to encourage attendance through public information programs designed to attract visitors or through activities at the museum that bring in additional visitors? In this way it might even be possible to increase total attendance while raising charges and net revenue. But even if that is not possible, the museum should face explicitly the trade-offs made possible by considering higher admission fees.

A Concluding Thought

Although museums are a small part of our economy, they are a vital part of our national life. Those who are responsible for museums rightly see themselves as the protectors of the treasures that our generation has inherited from the past, as the collectors of the creative activity of the current time, and as teachers who help the broad public to know and appreciate these works of art.

Ordinary market forces cannot support an appropriate level of museum activities. This is recognized by the public's willingness to support museums through contributions of money and art and by the government's support through grants and through the special tax treatment of charitable gifts.

But unless there is a dramatic change in our nation's priorities, museums will continue to have budgets that are too small to pursue their many missions at socially appropriate levels. Museum administrators and trustees will therefore be forced to confront difficult trade-offs among competing objectives. I hope that this volume can contribute to improving the quality of those choices.

I Panel Discussions