



## Public provision vs. outsourcing of cultural services: Evidence from Italian cities



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### ARTICLE INFO

#### Article history:

Received 8 October 2013

Received in revised form 6 June 2014

Accepted 12 June 2014

Available online 18 June 2014

#### JEL classification:

L33

H76

Z11

#### Keywords:

Public cultural expenditure

Local government

Outsourcing

### ABSTRACT

Cultural policy often implies the transfer of public resources to cultural institutions. In this contribution we focus on the determinants of a government's choice between subsidies to external cultural organizations and in-house cultural production. We argue that the determinants of grants in the cultural field may be the same as those of outsourced services, and we make reference to the empirical literature on the drivers of public services outsourcing. We consider Italian cities' cultural policies in the 1998–2008 period, a time when overall cultural expenditure shrank while cultural transfers increased. Using dynamic panel data analysis and controlling for specific economic, fiscal, and political characteristics of each city, we find that transfers to cultural organizations are negatively affected by asset specificity and more likely to occur in cities subject to fiscal stress. The results also highlight that the timing of elections plays a role.

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### 1. Introduction

Cultural policy has traditionally been concerned with providing financial support for the arts, heritage institutions and cultural industries. Many economists and cultural policy scholars have discussed the benefits and costs of indirect vs. direct public support for cultural activities, with the former being generally devised as tax exemptions on donations, while the latter use public revenues to provide cultural services or to subsidise producers (Throsby, 2010). However, within the field of direct public support, less attention has been devoted to the choice between supplying in-house produced cultural services and supporting external cultural organisations. In this paper, we investigate the drivers of a government's choice between these two alternatives through an empirical analysis.

We concentrate our analysis on 106 Italian municipalities, namely, cities that are provincial administrative centres, over the period 1998–2008. Italian cities are interesting because they have substantial cultural expenditures: they pay for libraries, own museums and theatres, and many of them have organised very popular cultural festivals in recent years. Until 15–20 years ago, Italy's public cultural policy was, at all levels of government and in the vast majority of cases, to engage in in-house production of cultural services. However, in recent years, especially at the municipal level, substantial variability has emerged in the levels of in-house production relative to overall spending.

A number of empirical works have appeared over the last decade that analyse local government cultural policy using public spending data (Getzner, 2002; Noonan, 2007; Werck et al., 2008; Benito et al., 2013), but they all attempt to explain the level of spending, not the mode. We similarly employ public accounting data, but our focus is on the determinants affecting the choice between direct

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production and support for cultural institutions, which we argue may be considered a form of outsourcing. Consequently, we refer to the vast empirical literature on the outsourcing of public services (Domberger and Jensen, 1997; Bel and Fageda, 2007, 2009) and extend it to the cultural sector.

In particular, our variable of interest is the amount of municipal subsidies for private and hybrid cultural organisations as a share of total municipal cultural spending. Admittedly, using the relative size of what public accounting labels “transfers” as a proxy for outsourcing is an uncommon choice. Indeed, most contributions specifically focusing on the determinants of outsourcing have used dichotomous dependent variables (e.g., Lopez-de Silanes et al., 1997; Dijkgraaf et al., 2003) or categorical ones (e.g., Walls et al., 2005; Levin and Tadelis, 2010). The reason for this is that databases are often available that indicate whether local governments have contracted out services, particularly when considering a single public service, such as waste management. We lack information on Italian mayors' contracting behaviour in individual areas of cultural policy, such as libraries, museums or theatres, and therefore, public data aggregation does not allow for such a fine-grained analysis. However, even if we had such disaggregated information on the cultural sector, we argue that exclusively considering contracting would only tell part of the story. Cultural services may also be easily externalised by subsidising cultural institutions: in this sense, they are similar to schooling services. Elinder and Jordahl (2013) address ideology and school privatisation in Sweden, and they use subsidies as a share of total spending on schools as the dependent variable.<sup>1</sup> We believe that there are more advantages than disadvantages to such an approach when addressing cultural policy. It also allows us to exploit the time dimension of a panel dataset. Bel and Fageda (2007) identify the failure to consider dynamics as the main shortcoming of the available empirical evidence explaining outsourcing.

Regarding the drivers of the decision to supply public cultural services in-house or externally, our analysis is in line with the empirical research on the determinants of outsourcing. The first explanation commonly found in the literature (Kodrzycki, 1998; Dijkgraaf et al., 2003; Levin and Tadelis, 2010) identifies the effect of fiscal stress, whereby a critical fiscal stance of a local government is expected to be positively related to outsourcing provision. Furthermore, following economic efficiency arguments, private production is often expected to be less costly than public production, as the latter may be affected by government failures. The presence of an inefficient scale of production or a large number of potential service providers (triggering competition in the industry if policy makers decide to outsource) are then relevant (Savas and Schubert, 1987; Donahue, 1989). However, transaction costs due to asset specificity concerns make outsourcing a less likely choice (Hart et al., 1997; Brown and Potoski, 2003). There may also be political explanations underlying the decision of whether to outsource the provision of cultural services. In particular, the literature has considered political patronage, interest group pressure, electoral cycles and ideological attitudes as possible drivers of public service delivery choices.

We consider all of these determinants and use dynamic panel data analysis in our investigation. Our results reveal that the main drivers of Italian cities' decisions to outsource cultural services are two measures of fiscal stress and the share of current municipal spending on cultural facilities exhibiting high asset specificity. There is also evidence of a peculiar electoral cycle, in line with the findings of Dalle Nogare and Galizzi (2011), whereby incumbent mayors spend less on cultural subsidies in an election year. Apparently, mayors reduce spending on outsourced cultural activities to a greater extent than on those provided in-house.

The paper is organised as follows: Section 2 surveys the relevant literature; Section 3 briefly outlines the focus of our investigation; Section 4 describes the increasing role of municipal governments in shaping cultural policy in Italy; Section 5 discusses our dependent variable and illustrates the independent ones; Section 6 describes the estimation strategy; Section 7 reports our results; Section 8 presents the robustness checks, while Section 9 concludes.

## 2. Related literature

The paper relates to two strands of the literature: the literature on the drivers of outsourcing and the cultural economics literature.

First, by focusing on the mode of provision of cultural services, we contribute to the literature analysing the factors affecting the outsourcing and contracting out of local public services. This body of work uses local government data to reveal the determinants affecting the decision of whether to supply public services in-house or externally. These contributions assess the impacts of both economic (comprising both strictly economic and fiscal drivers) and political factors, with reference to the public choice approach, the transaction cost literature and political economy models. The empirical evidence is generally obtained from cross-sectional studies across local jurisdictions of specific countries (Bel and Fageda, 2007) and varies with respect to whether they analyse several services (e.g., Brown and Potoski, 2003; Levin and Tadelis, 2010) or exclusively focus on one (e.g., Dijkgraaf et al., 2003; Walls et al., 2005).

Among the most common determinants, various measures of local governments' fiscal positions and economic efficiency have been generally considered to have a positive relationship with the likelihood of privatising or contracting out local public services (Kodrzycki, 1998; Dijkgraaf et al., 2003). Other studies have provided empirical findings showing how the level of transaction costs and contractual incompleteness (such as asset specificity or the difficulty of performance monitoring) are central in determining when a local service may be outsourced (Brown and Potoski, 2003; Levin and Tadelis, 2010). The efficiency gain obtained through cost reduction incentives may also be offset by the decline in the quality of outputs if the latter are difficult to measure or fully specify (Jensen and Stonecash, 2005), but quality does not necessarily decline when contracting out services (Hart et al., 1997).

Regarding the political factors, interest group pressure and ideological attitudes have been considered possible drivers of public service delivery choices. The interest group influence hypothesis has typically been supported when a broad range of services is analysed. For instance, Lopez-de Silanes et al. (1997) find that state laws that impose accountability requirements in personnel

<sup>1</sup> Understanding subsidies as a form of privatisation of local public services is also present in Merzyn and Ursprung (2005), who investigate the role of voters' attitudes towards privatisation using data from two Swiss referenda.

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