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Movie Production Incentives: Blockbuster Support for Lackluster Policy

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Introduction

In the last decade, state governments have "gone Hollywood," or tried to, by enacting dozens of movie production incentives (MPIs), including tax credits for film production. Hollywood might be expected to wield influence in the California state legislature, but it is more surprising to see movie and TV executives throwing their weight around in Louisiana, Massachusetts, Michigan, New Mexico, and South Carolina. All these states and most others have enacted MPIs. Those who were quickest and most generous have landed productions. Other states are left empty-handed despite having offered embarrassingly generous tax abatements to attract filmmakers.

Based on fanciful estimates of economic activity and tax revenue, states are investing in movie production projects with small returns and taking unnecessary risks with taxpayer dollars. In return, they attract mostly temporary jobs that are often transplanted from other states. States claim to boost job training

Key Findings

- *Forty-four states now offer significant movie production incentives (MPIs), up from five states in 2002, and twenty-eight states offer film tax credits.*
- *In the face of state budget pressures and preposterously generous incentives in Louisiana and Michigan, states may curtail or even terminate their MPI programs. Kansas and Iowa have suspended theirs, Kansas for two years to save revenue and Iowa briefly to investigate corruption.*
- *MPIs have often escaped routine oversight about benefits, costs and activities.*
- *Spurious research is common in campaigns for film tax credits, often featuring dramatic job creation claims. A recent study concluded that Pennsylvania's film tax credit produces net benefits of $4.5 million by assuming that any business interacting with the film industry would not exist but for the credit. MPIs create mostly temporary positions with limited options for upward mobility.*
- *The MPI experience demonstrates that a politically connected industry can grow if the state greatly reduces its taxes, but states should have a tax system that operates as a welcome mat to all industries, not just those politicians have picked.*

William Luther wrote this study while a summer researcher at the Tax Foundation. He would like to acknowledge the assistance of Tax Foundation Tax Counsel Joseph Henchman, Frank Hefner for suggested references during the research stage, and the Institute for Humane Studies.

with MPIs, but these tax incentives often encourage individuals to gain skills that are only employable as long as politicians enact ever-larger subsidies for the film industry. Furthermore, the competition among states transfers a large portion of potential gains to the movie industry, not to local businesses or state coffers. It is unlikely that movie production incentives generate wealth in the long run. Most fail even in the short run. Yet they remain popular.

Florida Governor Charlie Crist (R), Michigan Governor Jennifer Granholm (D), New Mexico Governor Bill Richardson (D), Oregon Governor Ted Kulongoski (D), Ohio Governor Ted Strickland (D), and Texas Governor Rick Perry (R) in particular have strongly pushed for MPIs to encourage film production in their states. In California, a state that avoided offering credits until very recently, Governor Arnold Schwarzenegger hopes that they will lure back productions now moving to other states. In the rare case when the executive branch rejects the use of MPIs, as Indiana Governor Mitch Daniels (R) did in 2008, or strongly questions them as Iowa Governor Chet Culver (D) and Rhode Island Governor Don Carcieri (R) have done recently, their concerns are overridden with resounding support from the state legislature and incentive beneficiaries.[1]

Politicians are not alone. While the occasional letter to the editor warns otherwise, most citizens view state-funded film production in a positive light, a win-win for everyone. This report describes the various incentives that states have enacted, explains their undeserved popularity, and makes an argument for their immediate discontinuance.

How State Legislatures Try to Lure the Big Stars

Louisiana was the first state to adopt an MPI. In 1992, it enacted a tax credit for "investment losses in films with substantial Louisiana content."[2] By 2009, 44 states, the District of Columbia, and Puerto Rico offer movie production incentives. (See Maps 1 and 2.) Every state has at least a government film office dedicated to helping productions navigate red tape, many with snazzy websites and elaborate presentations.

Of the six states without movie production incentives, three lack at least one of the major taxes that the credits would be taken against: Nevada does not tax corporate or individual income, Delaware levies no sales tax, and New Hampshire has no tax on wages or general sales. Among the other three states with no MPIs—Nebraska, North Dakota, and Vermont—legislation has been considered to implement credits. Nebraska's LB 282, introduced in January 2009 for instance, would provide tax credits of up to 25 percent of qualifying expenditures. Alabama, Arkansas, California, Ohio, and Texas enacted film tax credit or rebate legislation for the first time in 2009.

Not all the legislative action during the next few years will be in states with no MPIs. States with MPIs are in a heated competition to match other states' increasingly generous incentive packages, and in some states, existing incentives are set to expire. Given that so many states are considering (or reconsidering) movie production incentives, it is important for legislators and taxpayers to know the different types of incentives, their relative strengths and weaknesses, and which states have adopted various versions of this counterproductive tax policy. (See Table 1 for a listing.)

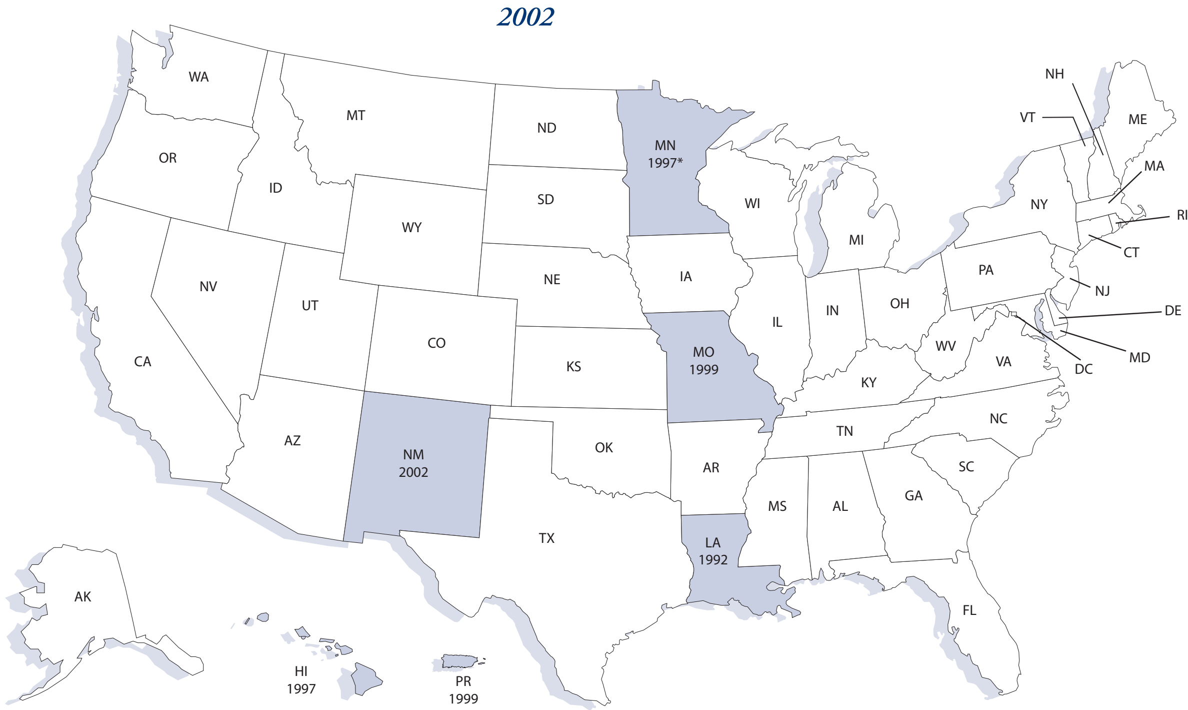
Tax Credits

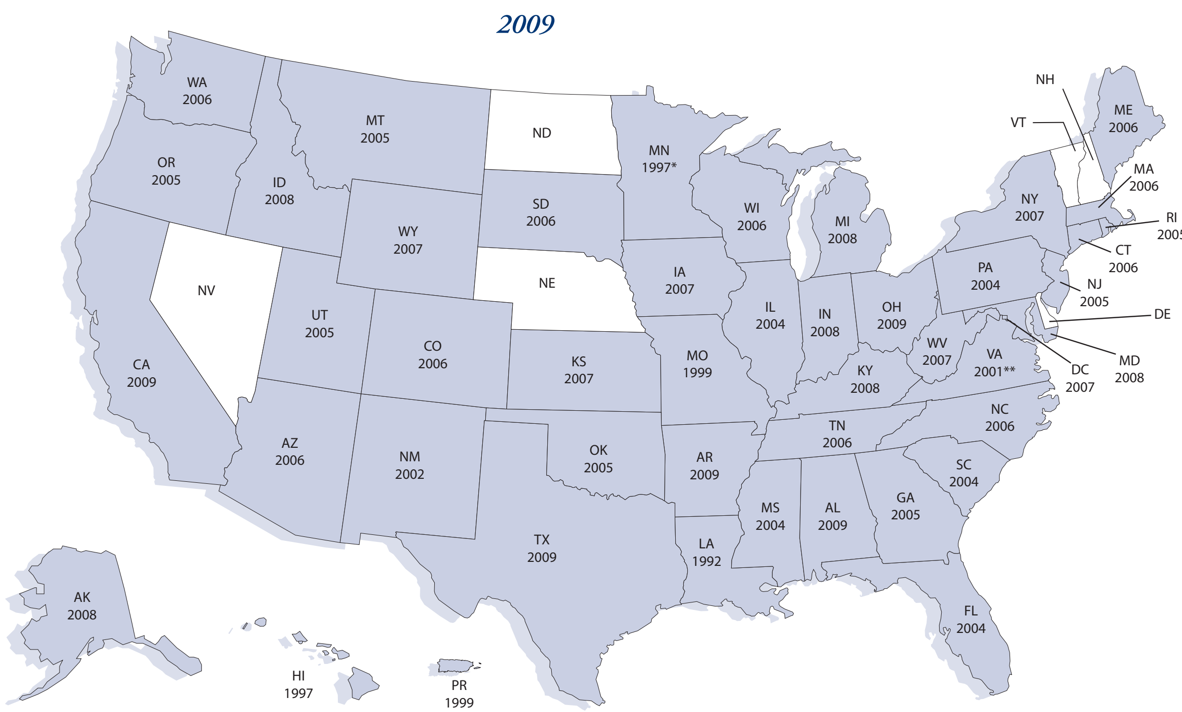
Twenty-eight states offer movie production incentives in the form of a tax credit that removes a portion of the companies' income tax. To qualify for a tax credit, a production company typically has to spend a certain amount of money in the state, employ a minimum number of local workers, or invest in local infrastructure. The value of the tax credit they get is often a percentage of those local expenditures, local wages or local investments.

1 Schneider, Mary Beth. "House votes to override veto of tax-incentive bill for films." *Indianapolis Star*, January 9, 2008; Crumb, Michael J. "Iowa AG: State lifting film tax credit suspension." *Associated Press*, November 25, 2009; Gregg, Katherine. "State tax officials want to limit film tax credits." *Providence Journal*, March 11, 2008.

2 Louisiana Act 894 (H.B. 252) (1992).

Figure 1
The Spread of State Tax Credits, Cash Rebates or Grants for Movie Production Between 2002 and 2009





* Minnesota's cash rebate program was repealed in 2002 but re-enacted in 2006.
** Virginia's film grant program was established in 2001 but not funded regularly until 2006.
Source: Tax Foundation

Table 1

States Offering Movie Production Incentives by Type as of December 2009

	MPIs	Tax Credit	Cash Rebate	Grant	Sales Tax Exemption	Lodging Exemption	Fee-Free Locations
Alabama	X	X			X	X	
Alaska	X	X			[No Tax]		
Arizona	X	X			X		
Arkansas	X		X				
California	X	X			X	X	X
Colorado	X		X			X	
Connecticut	X	X			X	X	
Delaware					[No Tax]		
Florida	X		X		X		
Georgia	X	X			X		
Hawaii	X	X					
Idaho	X		X		X	X	
Illinois	X	X				X	
Indiana	X	X				X	
Iowa *	X	X				X	X
Kansas	X	X				X	
Kentucky	X	X			X	X	
Louisiana	X	X					
Maine**	X		X		X	X	X
Maryland	X		X		X		
Massachusetts	X	X			X		
Michigan	X	X	X			X	
Minnesota	X		X		X	X	
Mississippi	X		X		X		
Missouri	X	X					
Montana	X	X			[No Tax]	X	
Nebraska						X	
Nevada		[No Tax]				X	
New Hampshire		[No Tax]			[No Tax]		
New Jersey	X	X			X	X	
New Mexico	X	X			X	X	
New York	X	X			X		
North Carolina	X	X			X	X	
North Dakota						X	
Ohio	X	X				X	
Oklahoma	X		X		X		
Oregon	X		X		[No Tax]	X	
Pennsylvania	X	X				X	X
Rhode Island	X	X					
South Carolina	X		X		X	X	X
South Dakota	X	[No Tax]	X		X	X	
Tennessee	X	X		X	X	X	
Texas	X	[No Tax]	X	X	X	X	
Utah	X	X	X		X	X	
Vermont					X	X	
Virginia	X			X	X	X	
Washington	X	[No Tax]	X		X	X	
West Virginia	X	X			X	X	X
Wisconsin	X	X			X		
Wyoming	X	[No Tax]	X			X	
District of Columbia	X			X			
Puerto Rico	X	X				X	X
TOTAL States	44	28	17	3	28	33	6

*As of November 24, 2009, Iowa has suspended new registration for incentives pending a criminal investigation into the handling of past film tax credits.
**Maine's wage rebate is effectively a cash rebate and is considered as such in this table.
Source: Tax Foundation, Entertainment Partners

Missouri, for example, offers a tax credit equal to 35 percent of eligible local production expenditures. To qualify, productions shorter than 30 minutes must spend $50,000; longer films must spend $100,000.

Twenty-six of the 28 states and Puerto Rico make their tax credits transferable or refundable; three states do both. (See Table 2.)

Table 2

Type of Tax Credit Offered by State as of December 2009

	Tax Credits	
	Transferable	Refundable
Alabama		X
Alaska	X	
Arizona	X	
California*		
Connecticut	X	
Georgia	X	
Hawaii		X
Illinois	X	
Indiana		X
Iowa	X	
Kansas		
Kentucky		X
Louisiana**	X	X
Massachusetts**	X	X
Michigan***	X	X
Missouri	X	
Montana		X
New Jersey	X	
New Mexico		X
New York		X
North Carolina		X
Ohio		X
Pennsylvania	X	
Rhode Island	X	
Tennessee		X
Utah		X
West Virginia	X	
Wisconsin		X
Puerto Rico	X	
TOTAL States	14	15
(Both: 3, Neither: 2, Either: 26)		

*California allows transferable credits only for "independent films" and between affiliates

**Louisiana and Massachusetts allow production companies to choose between transferring credits and refunding them. Credits are only partially refundable in both states.

***Tax credits in Michigan are either refundable, transferable business tax credits or non-refundable, non-transferable income tax credits. The state charges a 0.5% application and redemption fee.

Source: Tax Foundation, Entertainment Partners

Because the credits are so generous, their value often exceeds the movie production company's tax liability to the state. California and Kansas are the only states that offer credits but do not pay film production companies more than their tax obligation. Puerto Rico offers to pay half of the eligible credit before shooting even begins.

Brokers facilitate the sale of tax credits by the production companies, taking a cut of between 25 and 30 percent. These brokers break the credits down into smaller amounts and resell them to companies that use them like coupons on their tax returns, leaving the original production company with between 70 and 75 percent of the face value. This reduces the per-dollar effectiveness of the film tax incentives.[3] Not all transferrable credits are transferred, but when they are, filmmakers receive only about three quarters of the value; the rest goes to brokers and their customers.[4]

Fifteen states have refundable tax credits, allowing film production companies to sell excess tax credits directly back to the state. Some states only refund a percentage of the credit's value in much the same manner as a broker. Others have let the companies get the full benefit of every credit, even though it means paying production companies with money from other taxpayers.

Louisiana, Massachusetts, and Michigan allow production companies to choose between transferring credits and cashing them in for a partial refund. Thus, the state performs the function of brokers in other states but takes a smaller cut. Companies compare the benefits and costs of transferring and refunding credits: if brokers can provide the service at a lower cost than the state, moviemakers transfer them; otherwise, they accept the partial refund.

Cash Rebates

Once states committed themselves to transferable or refundable tax credits, which pay a film production company more than its tax liability,

3 Grand, John. "Motion Picture Tax Incentives: There's No Business Like Show Business." *State Tax Notes*, March 13, 2006. 791-803.

4 This fact should not be misconstrued to suggest that brokers are not providing a valuable service. They are, in fact, making credit redemption cheaper for moviemakers. In their absence, moviemakers would use far more resources trying to locate end users in order to redeem credits. The point being made, rather, is that some portion of the credit must be used to offset the cost of redemption as opposed to encouraging production.

the obvious question arises: Why not just give them cash? Credits and cash are economically equivalent, but cash rebates avoid the transaction cost of credits. Every dollar spent by the state is a dollar received by the film production company, cutting out brokers and making the subsidy more efficient. Eighteen states have done just that.

Cash rebates for moviemakers work exactly as one would expect: production companies are reimbursed for a portion of their qualified expenses. Just as with tax credits, the value of a rebate is often a percentage of eligible expenditures.

For example, South Carolina currently offers cash rebates valued at 20 percent of all wages paid to local actors and stunt performers for projects with over $1 million in expenditures. Additionally, production companies can obtain rebates for 30 percent of qualifying local expenditures.

Grants

Another way to provide film production subsidies is the traditional grant. Texas, Tennessee and the District of Columbia offer grants to filmmakers. In D.C., eligible films can obtain a grant valued at the lesser of 10 percent of the qualified expenditures or 100 percent of the sales and use taxes paid to the District on qualified expenses. More generously, Texas gives grants for 5 to 15 percent of qualified expenditures or 8 to 25 percent of wages paid to local workers; an additional 2.5 to 4.25 percent is available if one quarter of filming days are spent in "underused areas." Grants in Tennessee range from 13 to 17 percent of qualifying local expenditures.

Miscellaneous Red Carpet Treatment

State governments can be creative when competing to host movie productions. It is not surprising that states have gone beyond credits, cash rebates and grants. States offer filmmakers a variety of targeted and exclusive freebies, such as miscellaneous tax exemptions, fee-free locations, free use of office furniture, and services like emergency response or traffic control at little or no cost.

Exemptions from General and Selective Sales Taxes

Thirty states offer exemption from sales tax as an incentive for filmmakers. Additionally, lodging taxes are exempt in 32 states if cast and crew members stay at hotels for a period of time greater than 30 days. Unlike sales tax exemptions, though, which are specifically targeted at film production companies, lodging exemptions are available to anyone staying in the state for more than 30 days. Nonetheless, many film office websites include the lodging exemption in the promotional material about their film production incentives.

Forgiven Fees and Even Free Whitewater

If a private organization or company wants a city or state government to stop traffic and provide police officers, they ordinarily pay fees and taxes. That is often not the case for film production companies that want to shoot on location. Almost every state has a film office that caters to the needs of moviemakers. As the Nevada Film Office boasts, tax dollars are spent to save "production hours, effort, manpower and guesswork" by scouting locations, defining and managing logistics, acting as an intergovernmental liaison, and gathering resources so that filmmakers "can stay on time and on budget."[5] With seven employees and more than 600 projects a year, this can be a pricey venture; the Nevada Film Office's budget in 2009 was more than $700,000.[6]

At least six states offer fee-free locations. The most unusual of these comes from West Virginia. River On Demand™ is "a complimentary service made possible by the drawdown of the Summersville Lake by the U.S. Army Corps of Engineers, Huntington District," that allows filmmakers "to choose between raging whitewater and calm water."[7]

While most states do not offer complex river control technology in their incentive packages, the more pedestrian fringe benefits

5 Nevada Film Office. <http://www.nevadafilm.com>. Accessed June 2, 2009.

6 Ryan, Cy. "1.4 million hole found in governor's budget." *Las Vegas Sun*, March 19, 2009.

7 "Incentives." West Virginia Film Office. <http://www.wvfilm.com/incentives.htm>. Accessed August 2, 2008.

that state governments have been throwing in to lure film production companies—police officers directing traffic and emergency crews on standby—unquestionably help the film's bottom line at the expense of state taxpayers. And they do so in a non-transparent manner, without the public attention that film tax credits get. Such incentives are often buried in the budgets of other departments. As a result, legislators often overlook them when debating bills. Policymakers and citizens should be aware that the final cost of movie production incentives is higher than those reported by state film offices.

Why Movie Production Incentives Don't Work But Are Still Popular

When measuring the effectiveness of their tax incentive programs, most states measure job creation. When deciding how much to pay a company to move in or expand, state officials usually base their decision on how many people the company plans to hire, how high the salaries will be, how permanent the jobs are likely to be, and what product the company produces.

But a growing economy is more than just new jobs. Improving standards of living and increased wealth is achieved by increasing productivity and developing and employing new technologies, and this can occur even with a stable workforce. If fewer individuals can be more productive and achieve the same results with less labor, displaced labor then finds a new end, such as developing a product yet to be produced or discovering cost-saving technology. Merely counting added jobs, therefore, does not prove that tax incentives make a state and its residents better off.

Of course, some jobs are more glamorous than others. Hollywood epitomizes glamour. From politicians' point of view, bringing Hollywood to town is the best of all possible photo opportunities—not just a ribbon-cutting to announce new job creation but a ribbon-cutting with a movie or TV star.

Boosting Economic Development

Every state has one or more government departments devoted to economic development. Their mission is to market the state's advantages to multi-state businesses, hoping those firms will expand or build new operations in state.

Many state economic development offices go beyond mere marketing and red-tape cutting to offering specialized incentive packages. When a company shows interest, the negotiation begins. The economic development office works with state and local officials to craft a package of incentives to reward the firm, which may include free road construction and other infrastructure, exclusive and expedited permitting and zoning, and of course, tax incentives. The firms play coy, solicit bids from other states, and eventually pick a "winner" where they will locate or relocate a facility. Economic development officials boast that they helped their state secure the new jobs.

Politicians correctly note that the motion picture industry is a lucrative one. According to Job Bank USA, a typical camera operator earns between $22,640 and $56,400 a year. Film and video editors average a little more: their median annual earnings in 2004 were $44,711.[8] To be sure, film productions require a large staff: hair and makeup artists, production assistants, grips, gaffers, audio technicians, boom operators, and extras—just to name a few. Many of these positions pay quite well. And politicians can gain favor with voters if they appear to be bringing good jobs to their state.

Creating Jobs, Shifting Jobs

The scenario, as politicians describe it, is rosy for individuals and businesses. Newly employed film production workers will spend their wages at the local supermarket, restaurant and gas station. These businesses will then be able to expand their production, meeting the new demand. In the end, the wealth generated by job growth is expected to multiply throughout the community. Also, film production

8 "Salary, Wages, Pay: Television, Video, and Motion Picture Camera Operators and Editors." *Job Bank USA*. <http://www.jobbankusa.com>. Accessed August 1, 2008.

companies will buy locally to qualify for tax credits, helping existing in-state firms grow their business and expand employment.

While the imagery associated with putting the unemployed to work is quite compelling, the reality of the situation is somewhat different. Most film production jobs are filled by out-of-state residents specializing in particular areas of audio or visual production.[9] Additionally, producing a film is a relatively short-term venture in comparison to other investment projects. Since most of these positions are not permanent, "workers are left unemployed" after the production ends unless a steady stream of films is present.[10]

In many cases, therefore, state officials are creating temporary positions with limited options for upward mobility. Of course, those visitors pay for lodging, spend their wages, and generally contribute to the economy, but that isn't the sort of economic benefit that ordinarily makes a compelling case for a massive tax subsidy.

When evaluating job creation, legislators should acknowledge that some jobs might be destroyed in the creation of film production jobs. A hairstylist might go from serving the public to crimping and curling on film sets. Earnings might be higher on the film set, and that's a plus, but it's one job shifted, not one just created. If some of the jobs "created" by film tax incentives are offset by jobs lost elsewhere in the state—that is, if some are just shifts in production to the movie industry from another sector—job creation estimates will be skewed. If tax incentives merely allow those already employed to upgrade to a better job, the real gains from job creation are much lower than boosters suggest.[11]

Empty Rhetoric on Economic Benefits

When it comes to evaluating whether MPIs increase wealth in state, studies are often lacking.[12] Even when studies are available, though, estimates are typically fanciful.

Consider the 11 "facts" offered by the Alabama Film Office in support of MPI legislation.[13] Five of the facts point to the supposed successes in Louisiana. Two note that Alabama has less generous incentives and a smaller film industry than other states. Two suggest the film industry is growing. And two make unsupported claims such as, "With the right incentives, Alabama's Entertainment industry will create high-quality, high paying jobs and the fiscal impact can be beneficial to the State economy." Key phrases like "high-paying" and "high-quality" are vague and subjective, as is what constitutes the "right incentives." The only "supporting facts" backed up by policy studies—or any source for that matter—are those documenting the Louisiana experience.[14]

If the heart of the argument for film credits in states like Alabama is the perceived success of Louisiana, it is a weak argument indeed. For one, Alabama is not Louisiana; known and unknown factors contributing to success in Louisiana may be lacking in other states. Second, late adopters overestimate results by using figures from early-adopting states, as if the 30th state to do something will reap as many benefits as the first. The policy environment has changed substantially since Louisiana enacted MPI legislation, and states now face intense incentive-driven competition from other states. Asserting that Alabama will experience similar results without controlling for the new policy environment is irresponsible. Third, and most damaging to the case for

9 Some states require a specific percentage of those employed in the production of the film to be residents of the state granting the credit. To our knowledge, there is no information available on how this affects where moviemakers and production crewmembers choose to live.

10 Grand (2006).

11 Bartik, Timothy J. 1994. "Jobs, Productivity, and local development: What implications does economic research have for the role of government?" *National Tax Journal* 47 (4): 847-861.

12 Hinkley, Sarah and Fiona Hsu with Greg LeRoy and Katie Tallman. 2000. *"Minding the Candy Store: State Audits of Economic Development" Good Jobs First.* Institute on Taxation and Economic Policy.

13 "Alabama Entertainment Industry Incentive Act of 2009 Highlights." *Alabama Development Office*. <http://www.ado.alabama.gov/content/media/publications/filmoffice/AEIIA%2008%20Highlights%20V3%20PDF%20031308.pdf>. Accessed October 1, 2009.

14 "Supporting Points for Film Legislation." *Alabama Film Office*. <http://www.alabamafilm.org/AEIIA%202008%20Highlights%20V5%20031908.pdf>. Accessed August 5, 2008.

Iowa Film Tax Credit Scandal: A Warning for Other States

By Joe Kristan, CPA, Des Moines, Iowa

In 2007, Iowa began offering a 25% credit for film investors and a 25% credit for production companies—both transferable, both uncapped—for money spent in Iowa to make movies. In addition, service providers were exempted from income taxes and sales taxes on qualified film production. This unlimited subsidy to the film industry was amazingly uncontroversial; only 3 out of 150 legislators voted "no."

The state film office—really one guy, Thomas Wheeler—promoted this as "half-price filmmaking." As one of the most generous state film subsidies, it attracted lots of interest. The eagerness of the film people to take free money prompted the state officials to declare the program a success. Newspaper articles and stories talked about all the stars visiting, all of the wonderful parties and fabulous restaurant meals crews were buying, and the wonderful business hipster t-shirt shops were doing.

But just as the parties were getting good, Iowa's tax revenues collapsed. In April 2009 the legislature enacted a cap on certain tax credits, including the film credit, effective for the fiscal year beginning July 1; the Department of Economic Development (DED) limited the film credits to $50 million. This led to a rush of applications, with films potentially generating $363 million in credits getting them in under the wire. This would be about 6% of Iowa's $6 billion annual budget.

Over the summer of 2009, state officials quietly began to look closely at "half-price filmmaking," using an outside auditor (the administration and the state auditor are from different parties, so the administration didn't want him involved). At 4:56 p.m. on a Friday in September, Governor Culver announced the resignation of the DED director and made the first public disclosure of a scandal:

- A Mercedes and a Range Rover were purchased for producers to keep with film credit funds.
- Not a single film's expenses were adequately documented. Only two of 18 even submitted receipts.
- Contracts were amended to increase credits after approval.
- Large payments were made to relatives of filmmakers with credit funds.
- Payments were made outside of Iowa, when only payments in Iowa qualified.

Wheeler was fired and a criminal investigation opened. The AG's office said the credits were being granted based on a misreading of Iowa law. The credit was suspended, leaving productions in limbo. After the state lost a lawsuit, though, the credit program was re-opened on a limited basis.

The outside auditor's report described a film office in chaos, with fragmentary records, no support staff, and almost no documentation to support the giveaway that could amount to $121 per Iowan. Credits were claimed for non-cash expenses such as "consideration" for having your name in the credits, and even for the costs of brokering the credits. They were also issued in advance of expenses. Strawman Iowa LLCs were used to claim credits for non-Iowa expenses.

The scandal has led to the appointment of a committee to review Iowa's 30-odd economic development tax credits and public demands to increase oversight of the film tax credit program in particular. Officials and citizens in other states should also consider such steps, since the problems with Iowa's tax credit program could easily be found in other states.

MPIs, several in-depth studies of Louisiana's film credits show them to have failed the state's economy.[15]

MPIs are certainly generating wealth for one group of citizens: the movie industry. According to Ellis and Rogers, "The nature of competition forces [the locality] to give the firm, in the form of incentives, *all* of the benefit of the firm being in the locality."[16] While further empirical research is necessary to solidify a claim this strong, it is reasonable to assume most of the benefits that states compete for and claim as trophies are actually captured by the movie industry.

To some extent, evaluating the wealth generated by MPIs depends on which level of government one is observing. From a national perspective, even boosters would probably admit that little if any wealth is created by these programs. Jobs created in New Mexico are offset by those destroyed in California. Rather than creating wealth, MPIs just shift production from one state to another.

Short-sighted state officials may not be expected to worry too much about neighboring states' job counts, but what goes around comes around. By committing tax dollars and state effort into securing film jobs, state officials miss the chance to use those resources instead for lowering tax burdens for all industries. Because MPIs are a field crowded with state competitors, committing huge resources may have little payoff.

Officials should acknowledge that moving 100 jobs from one state to another does nothing for the nation's economy except enrich the film industry at the expense of other state taxpayers.

Misusing the Multiplier

How can one industry's economic development be compared to another's? Economists use multipliers to measure the differing economic impact of growth in various industries. The

15 Albrecht, Greg. March, 2005. "Film and Video Tax Incentives: Estimated Economic and Fiscal Impacts." *Louisiana Legislative Fiscal Office*; and Perilloux, Gary. June, 2009. "Some want to up production credit to compete with other states." 2theadvocate.com. <http://www.2theadvocate.com/news/business/47113387.html>. Accessed October 1, 2009.

16 Ellis, Stephen and Cynthia Rogers. 2000. "Local economic development as a prisoners' dilemma: The role of business climate." *Review of Regional Studies* 30 (3):315-330.

basic idea is that a dollar of spending generates additional demand within a region or locality. Industries whose purchases cycle back through the local economy have a higher multiplier. On the other hand, expenditures made outside the locality are considered a "leakage" and do not contribute to the multiplier effect. If a government gives $1 million to a company whose activity results in $2 million in output during a given time period, the multiplier is 2.0.

Admittedly, the multiplier gives no thought to any activity outside of the local economy. Despite this limitation, the multiplier of each industry is an important measure for state and local governments as they determine the most effective ways they can spend the taxes they have already collected.

By this measure, movie production offers little economic bang for the taxpayer's buck when compared to other industries. Film production has an economic impact multiplier of 1.92. This is only slightly larger than a new hotel, 1.91, and much less than automotive manufacturing, 2.25, and nuclear power plants, 2.51. So while South Carolina officials boast that their incentives program generated $2.38 in economic activity for every dollar spent in 2006 and 2007, this is less impressive when one realizes that many other industries achieve larger multipliers with invested funds.[17]

It is undisputed that some states have built a large movie industry by offering MPIs. Louisiana had only two film productions before ramping up incentives in 2002, but now 60 projects are underway.[18] However, there is also evidence that MPIs encourage entrepreneurs to act haphazardly. A recent study conducted for Louisiana Economic Development by Chicago-based Economic Research Associates states, "An additional 15 sound stages in Louisiana could be supported over the next 10 years."[19] The economic incentives offered by the state have prompted developers to overinvest in sound stages relative to other things. Seven new developments underway when the study was released would add 32 more sound stages to the state. Assuming development proceeds as planned, the tax system will subsidize the creation of 17 sound stages beyond that which the state will need or be able to support.

The flood of dollars from MPIs can induce spending on what would otherwise be considered a poor investment. At an estimated $150 million, *The Curious Case of Benjamin Button* was deemed "too risky" by industry giants Paramount and Warner Bros. Nonetheless, lobbying efforts and film incentives eventually landed the film in Louisiana.[20] This might be chalked up as a success if one assumes government officials possess sufficient knowledge to pick winners and losers. But they don't. Even though this particular film turned out to be profitable, that may not be the case next time. Capitalism operates with risk and reward, of course, but here much of the risk is borne by the taxpayer.

State Pride, Tourism, and Censorship

State pride is no doubt a big motivator for the adoption of MPIs by legislators. Seeing the picturesque Rocky Mountains on the silver screen pleases Colorado residents, and bustling city streets in full-color, high definition reinforces the Big Apple culture. And it can be disenchanting to see a movie that is set in your state but shot elsewhere. In signing a bill boosting his state's film tax incentives in 2004, then-Governor of Illinois Rod Blagojevich noted that the 2002 musical film *Chicago* was shot in Toronto.[21] A major reason for the reenactment of Minnesota's film cash rebate program was the out-of-state filming of *Leatherheads*, *Juno*, and *Gran Torino*, all set or originally set in Minnesota. Louisiana's first-in-the-nation film tax credit was explicitly to support films highlighting Louisiana.

17 Hefner, Frank. "Impact Analysis for Film Production in South Carolina." *S.C. Coordinating Council for Economic Development*, April 29, 2008.

18 Hamilton, Gaye. "Business Incentives: Attracting Arts and Entertainment Industries." *National Conference of State Legislatures 34th Annual Legislative Summit*, New Orleans. July 22, 2008.

19 "Trends in Film, Music, and Digital Media." 2006. *Economic Research Associates*. Louisiana Economic Development. <http://www.louisianaforward.com/uploads/pdf/ERA%20Trends%20Paper.pdf>.

20 Perilloux, Gary. "State film industry growing." *The Advocate*. March 7, 2007.

21 Chase, John. "Illinois Governor Approves 25 Percent Tax Credit for Filmmakers." *Chicago Tribune*, August 19, 2003.

Travel and tourism departments view movies as a type of "free advertisement" which help "shape perceptions about the state."[22] Increased tourism, of course, can lead to increased tax revenue from sales and hotel taxes and provide a boost to local economic activity. But while tourism is expected to be positively correlated with movie productions, there is no reason—or evidence—that this correlation is very large or powerful. Consider State Senator LeRoy Louden's observation of *About Schmidt's* role in Nebraska tourism as recorded by Leslie Reed:

> "That one with that old guy touring across the United States in his RV… it showed the archway over Interstate 80 at Kearney," Louden said. "That was national, worldwide recognition for that archway and it didn't make a nickel's worth of difference." [23]

Although Louden's remarks are not a substitute for future research, it does suggest the burden of proof falls on those making claims that movie productions lead to a booming tourism industry. While some tourism might result, one should certainly ask, "How much?" and "At what cost?"

State pride is commendable but it is wishful thinking that places like Lansing, Michigan will become the next Hollywood. However, that's what a series of TV spots pushed by Governor Jennifer Granholm (and starring actor Jeff Daniels) describe as happening if the struggling state keeps its film tax incentive program. Lured by film production credits, the argument goes, the rich and famous will flock to Michigan, boosting the state's economy and image in a single effort. The probability of such a transformation actually occurring is extremely small, but the dreams of Tinsel Town can die hard for citizens and statesmen.

In addition to the dollar value of tax credits and other giveaways, there is a hidden cost to providing movie production incentives. States using MPIs to generate "free advertisement" for travel and tourism departments often include a stipulation in their production incentives package: filmmakers must portray the state in a positive light.

In Hawaii, for example, films using "Hawaiian terminology in the title" and promoting "Hawaiian scenery, culture, or products" are eligible for 33 percent more funding than similar films that do not.[24] Along the same lines, Nebraska State Senator Chris Langemeier expressed concern in debate that, as one reporter recalls, "Unscrupulous out-of-state filmmakers might collect Nebraska tax incentives and then give a poor portrait of the state."[25]

New Mexico takes it one step further. Films receiving the MPAA's "R" rating are only eligible for credits if deemed "acceptable" by the Private Equity Investment Advisory Committee—a reviewing board composed of the State Investment Officer and four members appointed by the Governor. Films must also not be "harmful to children" or "likely to outrage any of New Mexico's various cultural communities."[26] In Canada, only films deemed to be "sufficiently Canadian" are eligible for public funding, which has opened the door for the Ministry of Heritage to push for further restrictions on violent or suggestive films.[27]

Requiring films to pass a sensitivity test before being granted a credit subsidizes government-approved opinion with taxpayer dollars. Insisting that films portray a state positively is tantamount to discouraging films that expose corruption or advocate for change in a state. The cost, then, of so-called "free advertisement" for travel and tourism departments is some degree of censorship.

22 Grand (2006).

23 Reed, Leslie. "Tax Incentives for Films Get Mixed Reviews." *Omaha World-Herald*, January 31, 2008.

24 Grand (2006).

25 Reed (2008).

26 Propp, Wren. "State Council Keeps Movie Money Clean." *Albuquerque Journal*, May 25, 2003.

27 Henchman, Joseph. "Canada Proposes Expanding Censorship for Film Tax Credit Recipients," *Tax Foundation Tax Policy Blog*, June 6, 2008, <http://www.taxfoundation.org/blog/show/23263.html>.

Raising Tax Revenue and "Paying for Itself"

Champions of MPIs and other tax incentives are often not content to claim that the economic activity of an incoming firm will create jobs or benefit the economy in general. They also claim that despite exceedingly generous tax subsidies, MPIs will raise tax revenue. State lawmakers reason that when the film production company sees the incentive package and agrees to operate in that state, any tax revenue generated by their activity only occurs because of the incentives.

Therefore, even if the entire corporate tax liability of a film production company is zeroed out by tax credits, ancillary taxes might save the day. Those would include state income taxes paid by employees, property taxes paid on in-state production and post-production facilities, local and state sales and use taxes, and any other means of generating revenue not covered by tax credits.

For example, assume the motion picture industry in a state spends $10 million a year, with that money multiplying into economic activity worth $20 million, and taxes on that activity generate $4 million a year in tax revenue. If the state then offers $5 million in film tax incentives, it might see ancillary activity boosted to $30 million and tax revenue on that activity rise to $6 million. States facing that result will typically report that $5 million in credits "created" $30 million in economic activity and $6 million in tax revenue, making it sound like a no-brainer. But much of that activity and revenue pre-existed the credits.

Unpleasantly surprising to lawmakers, studies find that states lose money by offering tax credits for film production. A 2008 study prepared by Dr. Frank Hefner, Director of the Office of Economic Analysis at the College of Charleston, for the South Carolina Coordinating Council for Economic Development, found that film incentives returned 19 cents in taxes for each dollar paid out in rebates.[28] Therefore, the South Carolina film credits scheme generated a net loss in revenues equal to 81 percent of expenditures on rebates.

This confirms the 2005 findings of Greg Albrecht, Chief Economist at the Louisiana Legislative Fiscal Office. Albrecht claims, "The State may expect to recoup 16-18 percent of the tax revenue it obligates to the [movie production incentives] program."[29] His estimate suggests Louisiana, like South Carolina, is losing around 83 cents of each dollar it shells out in incentives.

It should be noted that Louisiana and South Carolina have been two of the most ambitious states offering MPIs. That these states were unable to generate sufficient economic activity to break even with generous incentive packages should raise serious doubts for other states.

A 2009 report by the Pennsylvania Legislative Budget and Finance Committee looking at that state's $75 million film tax credit and grant program estimated that the state loses $58.2 million on the program.[30] If one assumes, however, that all film activity and related industries in Pennsylvania (some $500 million worth) would disappear if the credit were repealed, there is a "net fiscal gain" of a modest $4.5 million. The authors of the study strongly suggest, therefore, that the credit "pays for itself" even though the amount is modest even under generous assumptions, and even though much of the $500 million worth of "film-related activity" would exist without the credit.

There are two main reasons for this disappointing revenue picture, and why targeted film tax credits fail to expand economic activity the way general tax reductions do. For some film productions, states are paying companies to do what they would have done anyway. There is a roughly finite number of big studio productions in the United States each year, and movies would have to be shot somewhere even if there were no movie production incentives.

28 Hefner, Frank. (2008).

29 Albrecht, Greg. "Film and Video Tax Incentives: Estimated Economic and Fiscal Analysis." *Legislative Fiscal Office*, March 2005.

30 <http://lbfc.legis.state.pa.us/reports/2009/35.PDF>

Unfortunately, it is impossible to determine in advance which ventures will depend on incentives and to what degree. So in some cases, legislators are offering unnecessary incentives. When state legislatures produce tax revenue estimates of film production activity, however, they necessarily assume that no films would be made in the absence of incentives.

Second, ancillary taxes are insufficient to cover the cost of incentives because film productions are exempt from many of them. For example, a major ancillary tax is the general sales tax. As long as a film production company is on location, much of what it will buy is from local vendors. However, only 11 of the 44 states offering tax credits, grants or cash rebates collect sales and use taxes for film production expenses.[31] That leaves 29 states without an important way to recoup revenue lost to the corporate credit. With few remaining sources of revenue, states end up in the red.

The Political Approach to Local Economy

Boosting the economy is a top priority to many politicians, and one might wonder why such "boosting" is always needed. Stephen Walters and Louis Miserendino claim that economic development projects—from building sports stadiums to handing out incentives packages—are typically an attempt to "make up for absent private investment flows." Ironically, they find that poor policy is the primary reason for capital flight.[32]

Politicians in states with poor tax climates—excessive taxes on sales, income and property—and burdensome business regulations face declining tax revenues and economic activity as private investment flees. In response, they dole out incentives packages that exempt select projects from the unattractive policies and encourage development for specific firms.

Of course, funding these new efforts requires further tax increases, which, in turn, discourage further investment. This accelerated decline is then used to justify further incentives and tax increases to fund them.

Rather than addressing the underlying problem and encouraging growth and development primarily by reducing tax burdens across the board and removing cumbersome regulations, which is politically challenging, politicians focus on what's easy: industry-specific incentives. In fact, Calcagno and Hefner conclude, "[I]t is rational for politicians to target firms with [direct financial incentives] regardless of economic benefit."[33] This implies that from a political perspective, economic development is secondary at best and confirms Ellis and Rogers in their conclusion that political motivations can negatively affect local economic development.[34]

Economic development by targeted tax incentives rather than by a low and neutral tax system allows politicians to direct resources to special interest groups and take credit for development, even though it is less than what might have occurred otherwise. The alternative, which is to correct poor tax policies that deter economic activity, decentralizes the process and leaves development decisions to entrepreneurs.

Walters and Miserendino describe what is lost when officials choose to keep a broken tax system and pursue targeted incentives:

> Imagine the creative energy that would have been unleashed if, for the last half–century, entrepreneurs knew that the city tax collector would not confiscate the value they would create in turning around a decaying neighborhood with new shops or condos. Imagine the infusions of capital that would have occurred if every

31 Other potential ancillary taxes are similarly negated by particular incentives packages.

32 Walters, Stephen J.K. and Louis Miserendino. "Baltimore's Flawed Renaissance: The Failure of Plan-Control-Subsidize Redevelopment." *Perspectives on Eminent Domain Abuse*, Volume 3. Institute for Justice. June 2008.

33 Hefner, Frank and Peter T. Calcagno. 2007. "State Targeting of Business Investment: Does Targeting Increase Corporate Tax Revenue?" *Regional Analysis and Policy*, 37 (2): 90-102.

34 Ellis and Rogers (2000).

> investor… got the same incentives extended to well-connected players involved in planners' chosen redevelopment areas.[35]

Film Industry's Rent-Seeking

While many politicians support film incentives, moviemakers are often the ones leading the charge. By his own account, Mike Binder, a prominent member of the film industry for over 30 years, "personally advocated for [Michigan's new tax credit bill] with Gov. Jennifer Granholm and the Legislature."[36]

Economists label as "political rent seeking" any attempt by the private sector to obtain extraordinary profits beyond what the market would provide, by controlling the legal environment. Unlike trade, which is mutually beneficial, "[p]olitical rent seeking tends to be a negative sum game."[37] That is, while trade expands the economy in total, rent seeking shrinks it.

The film industry has been successful in seeking these "economic rents." Per-production tax credits mean money in the pockets of moviemakers and studio owners. Since the benefits are concentrated on a relatively small industry with the same business practices, beneficiaries can organize easily to demand political favoritism under tax law.[38]

For example, Shreveport Mayor Cedric Glover and film industry advocates met with Louisiana legislators in June of 2008 requesting a special legislative session focused specifically on film industry tax credits.[39] Considering how small the film industry is compared to other employers in Louisiana, this is a demonstration of the film industry's power in Louisiana. With so much to gain, production companies are willing to spend significant resources to solicit politicians and gain political favor.

In Iowa in 2009, the state became mired in litigation as tax credit beneficiaries sued the state after Governor Chet Culver suspended the film tax credit program (see sidebar on page 9). The suspension occurred after allegations of little or no vetting of recipient projects, missing invoices for 20 out of 22 recipient projects, credits provided for ineligible broker fees and product placement deals, and improper administration that led to credits being provided for out-of-state expenses. Culver has convened a panel to provide information as to whether the tax credit program should continue.

While the benefits of MPIs are concentrated, the costs are dispersed among a much larger group: taxpayers statewide. That makes organizing against film credits difficult. Action is often forgone entirely because gains from policy change to individual taxpayers are so small. New York, for example, allotted $65 million for film credits in 2008. But with a population over 18 million, the giveaway amounts to only $3.43 a person—not even enough to cover a Nathan's Famous hot dog meal. Since the harm to each individual taxpayer is very small, film industry interests have been able to get politicians to pander to their wants at the expense of the many.

An Arms Race of Incentives

In 2002, Louisiana passed legislation to ramp up its movie production incentives.[40] Dubbed by *Variety* as "the other LA," the Bayou State offered three specific programs: a sales tax exemption, a labor tax rebate of up to 20 percent, and an investment tax credit of up to 15 percent.[41]

Film companies immediately flocked to the state. *Runaway Jury* starring Dustin Hoffman, Gene Hackman and John Cusack

35 Walters and Miserendino (2008).

36 Binder, Mike. "Give film industry tax credit a chance to grow state jobs." *Detroit Free Press*, June 18, 2008.

37 Ross, Kelley L. "Rent-seeking, Public Choice, and the Prisoner's Dilemma." *The Proceedings of the Friesian School*, Fourth Series, 2008.

38 Gwartney, James D., Richard L. Stroup, Russell S. Sobel, and David Macpherson. "Economics: Private and Public Choice." *Thomson South-Western*. 11th ed. 134-137.

39 Kent, Alexandyr. "Mayor, movie industry talk tax credits," *Shreveport Times*, June 10, 2008.

40 Grand (2006).

41 "Louisiana. (U.S.)." *Variety*, October 28, 2002.

was shot entirely in Louisiana. Disney's *The Haunted Mansion* was shot partly in Louisiana. Both films were released in 2003. Television production boomed as well. The Academy of Television Arts and Science nominated Louisiana-based projects for 11 Emmys in 2005.[42]

But a booming production industry was not the only thing Louisiana managed to encourage. State legislatures across the nation saw the apparent success and followed suit. Seeking to outbid Louisiana, states began to offer bigger and better MPI packages.[43]

The next six years saw an explosion of movie production credits nationwide. While several states offered modest incentives before 2002, more and more have begun to exempt filmmaking purchases from sales tax and offer tax credits or cash rebates. The number of states offering tax credits, cash rebates, or grants grew to 44 by 2009, up from 5 in 2002. More than a dozen states added movie production expenses to their list of sales tax exemptions in the same period. California even entered the fray in 2009 with a 20 percent credit for large productions and a 25 percent credit for small ones; coupled with proximity to Hollywood infrastructure, it is likely to overwhelm what other states can reasonably offer in the near future.

It is not only the quantity of MPIs offered that increased; they have also grown in magnitude. States entering the game late were behind and they knew it. Early adopters had developed infrastructure and economies of scale that made production cheaper. To catch up, late adopters have sought to overcome this disadvantage by offering even larger incentives.

Michigan, for example, now offers credits worth 30 to 50 percent of personnel expenditures and up to 42 percent of production expenditures, besting even Puerto Rico's 40 percent credit. As a relative latecomer to the film tax credit game, Michigan needed a very generous incentive to draw in productions, so generous in fact that it will cost an estimated $150 million in the current fiscal year. As part of it, the state grants credits for 25 percent of infrastructure investments in an explicit effort to catch up with states like Louisiana and New Mexico. But what are they really "catching up" to? The academic research suggests they're merely outdoing each other in a contest of who can funnel the taxpayers' money into the film industry fastest. Michigan, realizing this, is considering scaling back or even eliminating its incentives as part of addressing its budget shortfall.

Each year, legislators have gone back to the drawing board to outdo the incentives of neighboring states and give their home state an edge in attracting movie production. But this just encourages other states to increase their incentives in response. As a result, the cost of encouraging film production goes up each year. Incentives that would have lured filmmakers less than a decade ago now fall short and taxpayers are left facing bigger and bigger bills to support the production incentives "arms race."[44]

Potential Solutions

If MPIs are as ineffective as this study suggests, what can be done to stop them?

Unilateral Moratorium

Since states are losing money at present—in the form of lower tax revenues and stifled economic growth—some might very well decide to stop subsidizing the movie industry regardless of what other states do. The competition between states at this point is so intense that states can understandably conclude that trying to outdo Louisiana and Michigan in generosity isn't worth it.

States that offer few natural economic advantages to the film industry would certainly lose their tax-induced movie production jobs if they repealed their MPIs, but they would free up resources for other, more long-lasting

42 Randolph, Ned. "LA works up for 11 Emmys." *The Advocate*, July 16, 2005.

43 For an observation of actual bidding between states, see Suzanne Robitaille's *BusinessWeek Online* piece, "Lights, Camera — Tax Breaks!"

44 Ellis and Rogers (2000).

economic activity. Each state that takes this step will take pressure off other states to offer ever more generous incentives.

In the past year, tough economic times have led states to re-evaluate programs and tighten their budgets. As a result, some states are being more realistic about the purported effects of movie production incentives. Pennsylvania required its MPIs to be renewed by the legislature, which ultimately did so in 2009 after a bitter debate on the benefits and costs of the program. Rhode Island officials placed curbs on its MPIs in 2008 after criticism of the $52 million cost threatened outright repeal. Connecticut's program was strongly challenged by critics, and barely avoided a low cap being placed on the size of the credits. Kansas suspended its MPIs for 2009 and 2010 and Iowa is considering repeal after a brief suspension.

Of course, the peculiar nature of the film industry makes MPIs popular despite their failings, and overturning the present system will prove to be a difficult task.

Multilateral Moratorium

One possible solution is for all states currently offering incentives to cooperate in doing away with MPIs, through some sort of multi-state compact. By agreeing to compete exclusively with broad-based tax cuts, for example, states can continue to encourage growth and development without all of the shortcomings associated with industry-specific incentives.

If states are not experiencing gains—and academic studies of film credits suggest this is the case—there is reason to believe such an effort could work. As with any cartel, of course, there is the danger that voluntary action is unlikely to last if one state can benefit by cheating. Once one state breaks the pact, competitive forces drive the others to follow suit. Any such compact must take this into account.

Federal Action

Melvin Burstein and Arthur Rolnick of the Federal Reserve Bank of Minneapolis have suggested that Congress use its Commerce Clause power to end "the economic war among the states" and prevent states from "using financial incentives to induce companies to locate, stay, or expand in the state."[45] The Commerce Clause is originally in the Constitution precisely for the purpose of empowering the federal government to prevent states from harming the free flow of goods in a national market. Such action must not deter "good" competition based on broad-based lower tax burdens or better services, since that is at the heart of our system of federalism.

Federal action would overcome the credible commitment problem that plagues a voluntary multilateral moratorium. State officials could request Congress to enforce a multilateral pact or Congress could impose a moratorium on the states. Either would effectively end MPIs. Or course, a federal solution would be unprecedented and may well usher in additional problems not considered here.

Conclusion

While broad-based tax competition often benefits consumers and spurs economic growth and development, industry-specific tax competition transfers wealth from the many to the few.

Movie production incentives are costly and fail to live up to their promises. Nonetheless, they remain popular with state officials and many of their constituents. Some of the MPIs' negative results may eventually cause this support to wither, particularly in tough economic times. Among these failures, the two most important are their failure to encourage economic growth overall and their failure to raise tax revenue.

From the movie industry's perspective, the increasing censorship that accompanies many incentives may eventually drive a wedge between film producers and state officials. Until then, filmmakers will continue to enjoy the bounty while taxpayers are left with the bill.

45 Burstein, Melvin L. and Arthur J. Rolnick. 1995. "Congress Should End the Economic War Among the States." *Federal Reserve Bank of Minneapolis 1994 Annual Report 9 (1):3-19.*

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