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# STATE FILM SUBSIDIES: NOT MUCH BANG FOR TOO MANY BUCKS

by Robert Tannenwald

Like a Hollywood fantasy, claims that tax subsidies for film and TV productions — which nearly every state has adopted in recent years — are cost-effective tools of job and income creation are more fiction than fact. In the harsh light of reality, film subsidies offer little bang for the buck.

- **State film subsidies are costly to states and generous to movie producers.** Today, 43 states offer them, compared to only a handful in 2002. Over the course of state fiscal year 2010 (FY2010), states committed about $1.5 billion to subsidizing film and TV production (see Appendix Table 1) — money that they otherwise could have spent on public services like education, health care, public safety, and infrastructure.

  The median state gives producers a subsidy worth 25 cents for every dollar of subsidized production expense. The most lucrative tax subsidies are Alaska's and Michigan's, 44 cents and 42 cents on the dollar, respectively. Moreover, special rules allow film companies to claim a very large credit even if they lose money— as many do.

- **Subsidies reward companies for production that they might have done anyway.** Some makers of movie and TV shows have close, long-standing relationships with particular states. Had those states not introduced or expanded film subsidies, most such producers would have continued to work in the state anyway. But there is no practical way for a state to limit subsidies only to productions that otherwise would not have happened.

- **The best jobs go to non-residents.** The work force at most sites outside of Los Angeles and New York City lacks the specialized skills producers need to shoot a film. Consequently, producers import scarce, highly paid talent from other states. Jobs for in-state residents tend to be spotty, part-time, and relatively low-paying work — hair dressing, security, carpentry, sanitation, moving, storage, and catering — that is unlikely to build the foundations of strong economic development in the long term.

- **Subsidies don't pay for themselves.** The revenue generated by economic activity induced by film subsidies falls far short of the subsidies' direct costs to the state. To balance its budget, the state must therefore cut spending or raise revenues elsewhere, dampening the subsidies' positive economic impact.

- **No state can "win" the film subsidy war.** Film subsidies are sometimes described as an "investment" that will pay off by creating a long-lasting industry. This strategy is dubious at best. Even Louisiana and New Mexico — the two states most often cited as exemplars of successful industry-building strategies — are finding it hard to hold on to the production that they have lured. The film industry is inherently risky and therefore dependent on subsidies. Consequently, the competition from other states is fierce, which suggests that states might better spend their money in other ways.

- **Supporters of subsidies rely on flawed studies.** The film industry and some state film offices have undertaken or commissioned biased studies concluding that film subsidies are highly cost-effective drivers of economic activity. The most careful, objective studies find just the opposite.

Given these problems, states would be better served by eliminating, or at least shrinking, film subsidies and using the freed-up revenue to maintain vital public services and pursue more cost-effective development strategies, such as investment in education, job training, and infrastructure. Effective public support of economic development may not be glamorous. However, at its best, it creates lasting benefits for residents from all walks of life.

State governments cannot afford to fritter away scarce public funds on film subsidies, or, for that matter, any other wasteful tax break. On the contrary, policymakers should broaden the base of their taxes to create a fairer and more neutral tax system.

## Film Subsidies Are Costly and Have Spread Rapidly

Film tax credits have become one of the most widespread ways that states subsidize private industry. Forty-three states offer tax subsidies to producers that shoot films within their borders.[1] Most of these subsidies take the form of credits against business taxes, especially taxes on corporate profits.

In the 2010 state fiscal year, states spent about $1.5 billion on film tax subsidies (Appendix Table 1). In 2009, that money would have paid for the salaries of 23,500 middle school teachers, 26,600 firefighters, and 22,800 police patrol officers.[2] In some states, such as Connecticut, Louisiana,

[1] These are subsidies that offset corporate or individual income taxes that producers would otherwise have to pay. The seven states without such film subsidies are Delaware, Nebraska, Nevada, New Hampshire, North Dakota, South Dakota, and Vermont. Kansas', Iowa's, and New Jersey's film tax credits have been suspended; they could be reinstated in the future. In August of this year, Iowa permitted taxpayers to claim film tax credits earned before the credit had been suspended. See http://www.njfilm.org/incentives.htm; Rod Boshart, "Film tax credits resume in Iowa," *Lee-Gazette Des Moines Bureau*, August 27, 2010, http://wcfcourier.com/news/local/govt-and-politics/article_f7621b60-b228-11df-b9ea-001cc4c002e0.html; "Entertainment, Media and Communications Tax Newsletter," PricewaterhouseCoopers, March 2010, http://www.publications.pwc.com/DisplayFile.aspx?Attachmentid=3166&Mailinstanceid=15588. Some other states offer film producers less lucrative subsidies, consisting of exemptions from sales taxes and/or taxes on lodging.

[2] Based on salaries reported in the U.S. Bureau of Labor Statistics' *May 2009 National Occupational Employment and Wage Estimates*, http://www.bls.gov/oes/current/oes_nat.htm#33-0000. The mean annual salary for each of these occupations was divided into $1.26 billion, which is 84 percent of $1.5 billion, on the assumption that states offering film subsidies get back 16 cents in tax revenues on the subsidy dollar. These tax revenues are generated by the economic activity stimulated by film tax credits. See page 5 of this report for further discussion.

Massachusetts, Michigan, North Carolina, and Rhode Island, the value of film subsidies appropriated or awarded annually exceeds that of longstanding business tax incentives, such as tax credits for investment and research and development (Appendix Table 2).

The proliferation of film credits is a new phenomenon. Until 2002 state film subsidies were limited in scope. A few states offered film producers small credits against income taxes, deductions from taxable income for losses incurred in production, or loan guarantees. Other subsidies were confined to the provision of public services at no cost (for example, police details, ready access to public lands, assistance in identifying locations, and expedited permitting), or exemption from sales tax on purchases of goods from local vendors and from hotel and lodging taxes for employees working on an in-state movie shoot. These subsidies may or may not have been the best possible use of funds, but they were low-cost and therefore relatively harmless.

The new wave of film tax subsidies started in two states, New Mexico and Louisiana. Following the lead of Canadian provinces and the Canadian national government,[3] both states offered film producers generous income tax credits, equal to a percentage of the cost of shooting films incurred within their boundaries. Louisiana offered a credit equal to 25 percent of cost, with an extra 5 percentage points for purchases from in-state vendors and payroll for Louisiana residents. New Mexico introduced a 15 percent credit and then raised it in stages to 25 percent by 2007.

Since these two states first made a big pitch for film producers, similarly structured tax credits have spread rapidly across the nation in a classic "race to the bottom."[4] Louisiana's and New Mexico's film tax credits appeared to be highly successful: they induced a big jump in the number of feature films shot within the states' borders, and employment in film and TV production soared in both states. Lured by film producers' promises of similar (apparent) economic rewards, several states enacted comparable tax credits. Now, practically every state has a film tax credit.

States incorporate one of two rare features into their film tax credits — refundability or transferability— that makes them especially generous and therefore costly to sponsoring states.[5] If a producer lacks sufficient tax liability to use all of a *refundable* film tax credit, the state pays the producer the whole credit anyway, in effect giving the producer an outright cash grant. For example, suppose that a producer is awarded a film tax credit of $100,000 but has a pre-credit tax liability of only $50,000. A non-refundable credit would reduce the producer's tax liability to $0 but leave it with $50,000 in unusable credits. If the tax credit is refundable, the state pays the producer $100,000, including the $50,000 in credits it otherwise could not use.

*Transferable* tax credits are also lucrative deals for film producers and in the long run just as costly to the state. Producers can sell such credits to other companies that owe taxes to the state,

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[3] For an overview of Canadian federal and provincial film production subsidies, see the websites "Canada Film Capital," http://www.canadafilmcapital.com/taxcredit/index.html, and "Canadian Heritage," http://www.pch.gc.ca/pgm/em-cr/evaltn/2008/prt3-eng.cfm.

[4] Susan Christopherson and Ned Rightor, "The Creative Economy As 'Big Business': Evaluating State Strategies to Lure Filmmakers," *Journal of Planning Education and Research,* December 21, 2009, pp. 3-5, http://www.aap.cornell.edu/crp/upload/FilmBigBiz.pdf.

[5] Massachusetts is an exception; it offers film producers a choice of either transferability or a refund equal to 90 percent of film tax credits awarded. See http://www.mafilm.org/mass-film-tax-credit-law-in-a-nutshell.

regardless of their line of business. The sale is usually undertaken with the assistance of the state itself and/or a financial intermediary that packages purchased film tax credits from multiple states to make them more attractive to potential purchasers.

Often, those purchasers are financial services firms. Insurance companies find purchases of film tax credits especially profitable, since they can use them to reduce taxes on premiums. Through the end of fiscal year 2009, insurance companies had purchased about half of all transferred Massachusetts film tax credits, for example, and other financial institutions had purchased about a quarter of them.[6] In Connecticut, Bank of America and Wachovia — two large banking institutions that have recently benefited from federal financial assistance — purchased a combined $7 million in film tax credits in 2006 and 2007.[7]

Transferability has a particularly pernicious impact on state budgeting and accountability. It allows a film producer to gain a subsidy immediately (from the sale of the credit), but the costs may not show up on the state's books for several years because purchasers of film tax credits have several years to cash them in before they expire. (Under standard state accounting rules, tax credits are "booked" in the year in which they affect revenues.) A significant percentage of purchased tax credits are claimed in years after they were purchased. For example, of the $166.3 million in film tax credits awarded in Massachusetts through the end of FY2009, 89.5 percent had yet to be claimed by taxpayers.[8]

This accounting mismatch leads some analysts to overestimate the cost-effectiveness of film tax credits in creating jobs. For a given year, these analysts count the jobs created by film production and the amount of film tax credits paid out of the state treasury. They fail to count the film tax credits "accrued" in that year, sold in the secondary market, and not paid out until later years.

Some states cap the total value of film tax credits awarded within a given time period, but caps in several states are high (see Appendix Table 1, column 2). Moreover, not all caps hold under political pressure. New York raised the amount of its cap substantially in fiscal year 2009 after the cap, designed to limit total film tax credits awarded over a five-year period, was reached within one year.[9]

## Despite the Glitz, Film Subsidies Don't Work

6 Navjeet K. Bal, "A Report on the Massachusetts Film Tax Incentives," Commonwealth of Massachusetts, Department of Revenue, July 2009, http://www.mass.gov/Ador/docs/dor/News/2009FilmIncentiveReport.pdf, p. 21; Shelley Geballe, "Fiddling While Rome Burns: Connecticut's Multi-Mullion Dollar, Money Losing Subsidy to the Entertainment Industry," Connecticut Voices for Children, June 2009, Appendix B, http://www.ctkidslink.org/publications/bud09filmtax.pdf.

7 Geballe, Appendix B.

8 Bal, p. 20.

9 Nicole Gates Anderson, "A Cliffhanger for New York's Film Industry," *Gotham Gazette*, May 4, 2009, http://www.gothamgazette.com/article/fea/20090504/202/2902. States impose a variety of conditions on eligibility for film subsidies designed to limit their cost and/or steer production outlays to residents of the sponsoring state. As the next section of this paper shows, however, even with these conditions, film subsidies do not create jobs and income for residents of host states in a cost-effective manner.

If one judges film subsidies simply by the number of productions they attract, film subsidies have indeed "worked"— at least so far. For example, in 2002, the year that Louisiana enacted its film subsidy, one motion picture project ("Evil Remains"[10] or "Trespassing") was produced within its borders. Within five years, the number of such projects had jumped to 54.[11] In Massachusetts, five feature films were shot in 2006, the year that the Commonwealth introduced its film tax credit. By 2008, the number of such movies made in the Commonwealth had climbed to 17.[12]

Given the generosity of film incentives and the mobility of film production, the powerful influence of film incentives on site selection is not surprising. No wonder that in 2006, a director filming a movie in Rhode Island (a state that offers a 25 percent subsidy) exclaimed that film executives "would shoot a movie on Mars if they could get a 25 percent tax break!"[13]

However, even if states attract productions with lucrative subsidies, the merit of such subsidies as tools of long-run economic development — which is how the entertainment industry pitches them — rests not on the number of films they attract but rather on the extent to which they generate good, stable jobs and income for residents in a cost-effective manner.[14]

### Most Thorough Study Shows Cost Far Exceeds Benefit

The only independent, in-depth empirical study to date that properly evaluates a film subsidy according to this criterion was undertaken by the Massachusetts Department of Revenue. It found that in 2008:

- Massachusetts lost $88,000 in tax revenue for every new job created by the Commonwealth's film tax credit and filled by a Massachusetts resident.

- Every dollar of state tax revenue lost because of the film tax credit generated less than 69 cents in income for the Commonwealth's residents. The Commonwealth could have given its citizens a bigger financial boost at a lower cost by repealing its film tax credit, recouping the tax revenue, and sending them checks in the mail.

- For every dollar of film tax credits awarded to film producers, the Commonwealth gained only $0.16 in revenue, mostly in the form of income tax revenues withheld from film company employees. The remaining $0.84 had to be financed by higher taxes elsewhere or cuts in public

10 http://www.louisianaentertainment.gov/film/films_by_year.cfm; http://www.imdb.com/title/tt0350232.

11 "Louisiana Motion Picture, Sound Recording and Digital Media Industries, Prepared for State of Louisiana, Louisiana Economic Development, Baton Rouge, Louisiana," Economic Research Associates, February 2009, pp. 87-89, http://www.louisianaentertainment.gov/film/files/(ERA%20report)pdf..

12 Bal, p. 7.

13 Darcy Rollins Saas, "Hollywood East? Film Tax Credits in New England," New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006, pp. 2-3, http://www.bos.frb.org/economic/neppc/briefs/2006/briefs063.pdf.

14 Given the shaky state of today's economy, the temporary, part-time jobs created by film production might seem better than nothing. However, film tax credits are meant not to be a countercyclical tool but rather an instrument of economic development, improving residents' prospects for stable work and income.

services.[15] Independent studies of film subsidies in other states have estimated similar financial costs, ranging from $0.72 to $0.93 per awarded subsidy dollar.

Studies commissioned by film and tourism agencies or by the Motion Picture Association of America claim that film subsidies produce "win-win" outcomes for everyone, generating enough tax revenue so that states can expand services even as they offer film producers generous subsidies. In other words, film subsidies allegedly "pay for themselves." These studies are severely biased, as explained in the last section of this paper.

## Why Film Subsidies Don't Work

1. **They are very generous,** as noted above. They give movie makers an enormous amount of money for every full-time equivalent job or dollar of income they create for residents.

2. **A large portion of the jobs they create, especially those with the highest pay, are filled by non-residents.** Most locations in the United States (other than Los Angeles and New York City) lack "crew depth" — an ample supply of workers possessing the skills needed to make a feature-length movie. However, movie-making is so mobile that producers import their own scarce talent, such as principal actors, directors, cinematographers, and screen writers. As Cathy Greenhalgh observes in her study of cinematographers, "Film making is extremely expensive and employees are hierarchically organized. Most crew members are hired locally, while top personnel travel extensively from job to job."[16] These non-resident "top personnel" enjoy the best jobs and a large chunk of the income created by feature film production.

   The Massachusetts study noted above — the only in-depth study of a film subsidy that distinguishes new jobs filled by residents from those taken by non-residents — clearly shows that the Commonwealth's film tax subsidies have disproportionately benefited non-residents. It estimates that between calendar years 2006 and 2008, residents enjoyed only 16 percent of the compensation paid to employees working on Massachusetts-based major film productions.[17]

   The Massachusetts study also estimated employment generated by the ripple effects of film subsidies. For example, employees working on a film spend some of their pay at nearby restaurants and hotels; carpenters working on sets use part of their profits to purchase tools, which increases the income of nearby hardware stores. A much larger percentage of these indirectly created jobs (88 percent) went to residents. Taking into account the jobs created both directly and indirectly, the study estimated that in 2008, residents filled 59 percent of all subsidy-induced jobs. However, since non-residents enjoyed considerably higher average wages than residents, residents earned only 40 percent of the total payroll generated both directly and indirectly by the Commonwealth's film tax subsidies.

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[15] Bal, p. 17.

[16] Cathy Greenhalgh, "Traveling Images, Lives on Location: Cinematographers in the Film Industry," in Verid Amit, ed., *Going First Class? New Approaches to Privileged Travel and Movement,* Berghahn Books (New York: 2007), p. 74.

[17] During this three-year period, 41 percent of total payroll for all credit-eligible feature films went to just 36 non-resident employees, each of whom received more than $1 million in salary per production. Author's calculations and Bal, pp. 13, 17-19.

Information from other states also suggests that many of the economic benefits of film productions go out of state. In Connecticut, only 11 percent of spending eligible for the state's film tax credit in fiscal year 2009 was described in tax credit applications as "actual Connecticut expenditures."[18] According to the Arizona Department of Commerce, film producers subsidized by the state in calendar year 2008 spent 62 percent of their budgets outside of Arizona.[19] A study of Michigan's film tax subsidies by Michigan State University concluded that in fiscal year 2008, film producers spent 47.5 percent of their budgets out of state.[20] And in 2008, the *Providence Journal*, after threatening a lawsuit, obtained information from the Rhode Island Office of Film and Television concerning the production of the film "Hard Luck." Of the $11 million spent on this production in Rhode Island, only 17 percent went to Rhode Island residents or businesses.[21]

3. **Many of the jobs created by film tax credits are temporary and part-time.** Much of the work created by film shoots for nearby residents consists of short-term jobs. Examples include extra acting parts, the construction of sets, hair-dressing, catering, security, sanitation, trucking, and other transportation services. Sometimes, even in a serious recession, the unemployed and underemployed do not get this work, as some of these slots are filled by film company employees working overtime — especially since producers often want services without much advance notice.[22]

   The Massachusetts Department of Revenue, after analyzing applications for film subsidies, reported that "most employees on the projects [film productions in Massachusetts] lasted from a few days to at most a few months."[23] According to Michigan State University, jobs in film production in Michigan during calendar year 2008 lasted an average of 23 days.[24]

4. **The tax credits reward producers for projects they might have undertaken anyway.** Every company making a movie within a state qualifies for the state's film subsidies, even if the company would have filmed in the state without the subsidies. Every state with a film tax subsidy confers such windfalls.

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[18] Geballe, p. 2.

[19] "Motion Picture Production Tax Credit Program: Annual Report, Calendar Year 2008," Arizona Department of Commerce, March 18, 2009, p. 9, http://www.azcommerce.com/doclib/finance/mopic%20annual%20report%20cy%202008%20final.pdf.

[20] Author's calculations and Steven R. Miller and Abdul Abdulkadri, *The Economic Impact of Michigan's Motion Picture Production Industry and the Michigan Motion Picture Production Credit,* Center for Economic Analysis, Michigan State University, February 6, 2009, Table 2, p. 6, http://www.michigan.gov/documents/filmoffice/MSU_Economic_Impact_Study_269263_7.pdf.

[21] Katherine Gregg, "Hollywood is here, but is price too high For State?" *The Providence Journal*, March 3, 2008, http://www.projo.com/news/content/film_credits_02_03-02-08_LM957VT_v77.365ac0a.html.

[22] " '[Michigan's film tax credit] gave my boys some overtime that they were happy to get,' said Frank Rymill, co-owner of DeSantis trucking in Warren," in Tim Martin, "Film Tax Credit Draws Mixed Reviews", *Lansing State Journal*, April 7, 2010.

[23] Bal, p. 8.

[24] Michigan State University, Motion Picture Credit, p. 7.

The Massachusetts study concluded that about 7 percent of spending qualifying for the Commonwealth's film tax credits would have taken place even if these subsidies had never been enacted.[25] Moreover, the study likely underestimated the amount of windfalls conferred by these tax credits, such as by assuming that *no* feature films would be produced in Massachusetts if the film tax credits were repealed.

5. **Film subsidies don't pay for themselves, so state taxpayers bear the burden.** The economic activity induced by these subsidies generates insufficient tax revenue to offset their cost. As noted above, estimates of revenue gains range from $0.07 to $0.28 cents per dollar of awarded subsidy. The only studies claiming that a state film subsidy pays for itself were financed by the Motion Picture Association of America and/or a state office of film and tourism (Appendix Table 3).

   Given that 49 out of 50 states have a balanced budget requirement,[26] states offering film subsidies must therefore cut public services or increase taxes elsewhere to make ends meet. These measures stunt economic growth, offsetting the economic and revenue gains induced by film subsidies. A valid estimate of a subsidy's impact on a state's economy must take into account the negative effects of these offsetting measures.[27] Yet, only four of the ten independent studies listed in Appendix Table 3 do so.

6. **Given the economics of film production, states will have to give movie-makers generous subsidies *indefinitely* in order to "stay in the game."** Some supporters of film subsidies argue that exceedingly generous subsidies will become unnecessary once states create self-sufficient "media clusters." But the odds are against any state's creating a media cluster that is viable with small subsidies, or no subsidies at all.

   Among film subsidy enthusiasts, adherents to the "cluster" argument believe that the growth process jump-started by state film subsidies will become self-reinforcing. They argue that more and more producers will choose the state as a location in part because the local labor pool has the necessary training. The proximity of work opportunities will stimulate interest in joining the local filmmaking workforce. Related enterprises, like sound-recording and re-editing studios, will start up as their prospects improve. The supporting workforce will broaden as lawyers, accountants, engineers, electricians, and others gain film-related skills and certifications. Eventually, the state will be able present producers with all the facilities and talent they can find in Hollywood or New York, but at a much lower price, at which point the state's generous subsidies will become unnecessary.[28]

   However, two key impediments stand in the way of any state's establishing a third media cluster within the United States: pressure on film producers to minimize costs and producers' extreme geographic mobility.

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[25] Bal, pp. 9-10.

[26] Vermont is the only state lacking such a requirement.

[27] See Iris J. Lav and Robert Tannenwald, "The Zero-Sum Game: States Cannot Stimulate Their Economies by Cutting Taxes," Center on Budget and Policy Priorities, March 2, 2010, http://www.cbpp.org/cms/index.cfm?fa=view&id=3100.

[28] Christopherson and Rightor, pp. 10-11.

Film production is risky and costly. It has become especially expensive in recent years, primarily because of new technologies and the soaring pay of superstar actors. In order to continue to attract investors, producers need subsidies. Right now, the only reliable source of subsidization is government, so state subsidies are essential.[29]

The geographic mobility of film production has intensified in recent decades, for several reasons. Computerized equipment and the development of a sophisticated worldwide communications infrastructure have enabled producers to create, in effect, "moving production factories" that can operate at a wide array of locations.[30] Equipment has become smaller and lighter, and a large cadre of geographically mobile skilled film professionals has formed to adapt to these new realities. Consequently, producers can, and do, move to take advantage of the best financial deals available. While their responsiveness gives states the impression that they can capture "a piece of Hollywood" and gradually withdraw subsidies as film production takes root, mobility works both ways. If a state tries to wean producers from its lucrative financial support, they will leave for a state that continues to offer it. As *USA Today* has put it, movie production is a "gypsy-like … industry, which roams from place to place to find the best locations — and the best deals."[31] Therefore, states that have created large subsidies to lure film producers are caught in a perpetual fiscal bind.

If any states have made progress in establishing a media cluster, they are New Mexico and Louisiana, the two states that have been offering large-scale film subsidies the longest. Between 2002 and 2008 their employment in the film and video production industry increased six-fold. New Mexico has made a concerted effort to use its colleges and universities to train students in media-related skills, although experienced craftsmen and craftswomen are in scarcer supply. Louisiana has concentrated on promoting the construction of supporting infrastructure, like sound studios.

Yet, the ultimate success of New Mexico's and Louisiana's bold forays is still uncertain. In 2009, employment in film and video production fell sharply in both states — by 50 percent in Louisiana and 20 percent in New Mexico, compared to 10 percent in the nation as a whole. New Mexico's largest sound studio, Albuquerque Studios, Inc., which cost $91 million to construct, filed for bankruptcy in July of this year. (Now the state is offering loans to developers planning the construction of a new studio near Santa Fe.[32]) Louisiana has also seen one studio go bankrupt, while bribery and fraud have marred its subsidy program.[33]

Other states are beginning to question the wisdom of their film subsidies after several years of staggering budget shortfalls and the prospect of continued red ink for at least two more fiscal

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[29] Christopherson and Rightor, pp. 3-4.

[30] Kerry A. Chase, "Theater of Conflict: Commerce, Culture and Competition in the Global Entertainment Industry," http://people.brandeis.edu/~chase/research/theater.pdf.

[31] Sharon Silke Carty, "Michigan tax credit courts film industry to lure money, jobs," *USA Today,* August 17, 2009, http://www.usatoday.com/money/media/2009-08-16-michigan-movies_N.htm.

[32] David Romero, "Albuquerque Studios files Chapter 11 After many months of financial troubles," July 21, 2010, http://www.krqe.com/dpp/news/business/albuquerque-studios-files-chapter-11.

[33] Jack Egan, "Louisiana film biz hit with Controversy," *Variety*, September 10, 2009, http://www.variety.com/article/VR1118008413?refCatId=3722.

years.[34] Kansas suspended its film tax credits during 2009 and 2010[35] as one of several measures to balance its budget. Iowa suspended its film tax credit after allegations of fraud surfaced in 2008. In October of this year, Iowa's auditor reported that between $26 million and $32 million in film tax credits awarded by the state — 80 percent of the credits awarded before Iowa suspended its credit — were issued improperly.[36] New Jersey suspended its film tax credit in July. Arizona is letting its film tax credit expire in December. Rhode Island has imposed a cap on its film subsidy.[37]

## Supporters of Film Subsidies Rely on Flawed Studies

One strategy that proponents have used to convince policymakers and the public that film subsidies are a boon to state economies is to commission consultants to prepare state-specific studies. The conclusions of these studies— at least those that are published— always validate the proponents' position. Ernst & Young's (E&Y's) study of New Mexico's film tax subsidies is a prominent example.[38]

Conducted at the request of the New Mexico State Film Office and State Investment Council, the study[39] concluded that in fiscal year 2008, New Mexico's film tax credits generated $1.50 in state and local revenue ($0.94 in state revenue and $0.56 in local revenue) for every dollar in tax credit paid.[40] Thus, according to this report, the tax credit more than paid for itself. This conclusion, however, differs dramatically from a study conducted by Anthony Popp and James Peach of New Mexico State University, which found that the credits generated just $0.14 in state revenues per tax subsidy dollar.[41]

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34 See Elizabeth McNichol, Phil Oliff and Nicholas Johnson, "States Continue to Feel Recession's Impact," Center on Budget and Policy Priorities, October 7, 2010, http://www.cbpp.org/cms/index.cfm?fa=view&id=711.

35 Kansas Department of Revenue, http://www.ksrevenue.org/taxcredits-film.htm. Also see footnote 2.

36 Lee Rood, "80% of Iowa film program tax credits were flawed, audit finds," *Des Moines Register,* October 27, www.desmoinesregister.com.

37 "State Film Incentives," Screen Actors Guild, http://www.sag.org/state-film-incentives.

38 Ernst & Young also did a study for New York State on the impact of its film tax credits (reported in Table 3). The study was commissioned by the New York State Governor's Office of Motion Picture and Television Development and the Motion Picture Association of America. See "Estimated Impacts of the New York State Film Credit: Prepared for the New York State Governors Office of Motion Picture and Television Development and the Motion Picture Association of America," Ernst & Young, February 2009, http://www.southwindsor.org/pages/swindsorct_IT/New%20York%20Ernst%20%26%20Young%20State%20Film%20Credit%20Study.pdf.

39 "Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit: Prepared for the New Mexico State Film Office and State Investment Council," Ernst & Young, January 2009, http://www.nmfilm.com/locals/downloads/nmfilmCreditImpactAnalysis.pdf.

40 "Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit: Prepared for the New Mexico State Film Office and State Investment Council," p. i, .

41 Anthony V. Popp and James Peach, "The Film Industry in New Mexico and The Provision of Tax Incentives: A Report Submitted to the Legislative Finance Committee of the State of New Mexico," Arrowhead Center, August 26, 2008, http://www.nmlegis.gov/lcs/lfc/lfcdocs/film%20credit%20study%20TP&JP_08.pdf.

The E&Y New Mexico study suffers from several flaws. Three of the most troublesome are:

- **Exaggeration of the impact on tourism.** Ernst & Young estimates that in 2007, 32 percent of the new economic activity and over 36 percent of the new revenue generated by New Mexico's film tax credit came from subsidy-induced tourism. The consulting firm based its estimate on a survey conducted by the New Mexico Department of Tourism, based in turn on a questionnaire that the department emailed to people who stopped at one of its visitor centers or asked for maps and guidebooks by regular mail.[42] The chief economist of New Mexico's Legislative Finance Committee in 2009, Norton Francis, strongly criticized the survey and E&Y's interpretation of its results.[43] Moreover, only four out of every 100 households given the questionnaire returned it; it is hard to draw even tentative conclusions from a survey ignored by such a large percentage of those polled.

- **Double counting.** After examining budget information supplied by film producers, E&Y estimated that the producers spent 21 percent of their budgets on payroll, goods, and support services that did not qualify for the New Mexico film tax subsidy. E&Y concluded that each dollar of these "non-qualified" outlays stimulated the state's economy to the same extent as a dollar of spending that qualified for the tax subsidy.

  Yet, it is highly likely that these "non-qualified outlays" went largely to *non-residents*.[44] E&Y reported that almost two-thirds of this non-qualified spending was for "producer and director compensation." As discussed above, such highly skilled talent tends to be imported from other states, especially California and New York. Consequently, these individuals likely spent a much smaller percentage of their compensation in New Mexico than resident employees did. While non-resident employees do spend money on food, housing, meals, and other items while working in New Mexico, those expenses are covered by allowances, which *did* qualify for the film subsidy and, therefore, whose economic impact had already been taken into account. E&Y's apparent assumption that highly paid non-resident employees spent most of their salaries in New Mexico, *on top of* their living allowances, amounts to double counting. Most of the independent studies listed in Appendix Table 2 assume that none, or a small fraction, of salaries paid to highly skilled employees are spent in state.

- **Lack of transparency.** E&Y's explanation of its methodology is incomplete, and the explanation the firm does provide leaves the impression that its estimates of the tax credits' economic impacts are upwardly biased even further. For example, based on surveys of film industry employees and analysis of budget data supplied by film producers, E&Y estimated that the average salary of film production workers in New Mexico was $82,400 in 2007. E&Y stated that, in light of this information, it "adjusted" the model of New Mexico's economy that it used to estimate the tax credit's statewide economic impacts; yet it did not explain what that

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[42] "Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit: Prepared for the New Mexico State Film Office and State Investment Council," pp. 9-11.

[43] Chief Economist Francis also expressed concern that the respondents to the survey were unrepresentative, much more likely than New Mexico tourists as a whole to have traveled to the state to visit sites they saw in a film. Memo from Norton Francis, Chief Economist, State of New Mexico Legislative Finance Committee, to Senator John Arthur Smith, Chair, SFC and Representative, Luciano "Lucky" Variella, Vice Chair, HAFC, "RE: Ernst and Young Film Study: REVISED," March 7, 2009, pp. 5-6.

[44] Ernst & Young did not indicate *why* this spending, over one-fifth of the total, failed to qualify for the subsidy.

adjustment was or why it was necessary. Moreover, according to the Bureau of Labor Statistics, the average salary in New Mexico's film and video production industry was $35,000 in 2007. E&Y's $82,400 estimate is 2.4 times larger than BLS's, yet E&Y apparently made no attempt to reconcile the two figures. Without an explanation, the reader is left without crucial details needed to evaluate E&Y's estimates.[45]

In light of these upward biases and ambiguities, and the conclusions of the more transparent study of New Mexico's film subsidies undertaken by Popp and Peach, noted above, it is highly unlikely that New Mexico's film subsidies "paid for themselves" in 2007. Consequently, to finance these subsidies, New Mexico probably had to cut state services, offsetting at least part of the subsidies' boost to jobs, income, and tax revenues for New Mexicans.

## Conclusion

State film subsidies are a wasteful, ineffective, and unfair instrument of economic development. While they appear to be a "quick fix" that provides jobs and business to state residents with only a short lag, in reality they benefit mostly non-residents, especially well-paid non-resident film and TV professionals. Some residents benefit from these subsidies, but most end up paying for them in the form of fewer services — such as education, healthcare, and police and fire protection — or higher taxes elsewhere. The benefits to the few are highly visible; the costs to the majority are hidden because they are spread so widely and detached from the subsidies.

State governments cannot afford to fritter away scarce public funds on film subsidies, or, for that matter, any other wasteful tax break. Instead, policymakers should broaden the base of their taxes to create a fairer and more neutral tax system. Economic development funds should be targeted on programs that are much more likely to be effective in the long run, such as support of education and training, enhancement of public safety, and maintenance and improvement of public infrastructure. Effective public support of economic development may not be glamorous, but at its best, it creates lasting benefits for residents from all walks of life.

[45] Chief Economist Francis made a similar point in his memo to the New Mexico Legislative Finance Committee of March 7, 2009. See Francis Memo, p. 4.

## APPENDIX TABLE 1

### Financial Commitments to Film Incentives, by State (FY2010 unless otherwise noted)

| State | Dollars Appropriated or Claimed($millions) | Remarks |
|---|---|---|
| Alabama | 7.5 | $10 million appropriated per year in FY2011 and beyond. |
| Alaska | 20 | The state has appropriated $100 million for FY10 through FY14. The $20 million is one-fifth of this five year total. In theory, all $100 million could be awarded by FY2011. |
| Arizona | 70 | The state is terminating its film incentive on December 31, 2010. |
| Arkansas | 0 | The state currently has no funds appropriated for its film incentive program. |
| California | 100 | $100 million appropriated per year from FY2010 through FY2014. However, recipients cannot begin to claim credits until taxable year 2011. |
| Colorado | 0.3 | $1.5 million appropriated in prior years; remainder has been rolled over. |
| Connecticut | 116 | FY2009. The state offers an "open-ended" subsidy, that is, it has no appropriated cap. State awards incentive to any producer meeting requirements. |
| Florida | 53.5 | Appropriated for FY2011. |
| Georgia | 33.5 | Amount claimed in calendar year 2008, latest year for which data are available. An open-ended subsidy. |
| Hawaii | 16.2 | An open-ended subsidy. |
| Idaho | 0 | One million dollars authorized but funds have never been appropriated. |
| Illinois | 20.5 | Film tax credits claimed for calendar year 2008, the latest year which data are available. An open-ended subsidy. |
| Indiana | 2.5 | Appropriated. |
| Iowa | 12.9 | Awarding of film tax credits suspended in 2008 after allegations of fraud. Figure represents film tax credits awarded in prior years yet to be claimed as of FY2010, as estimated by the Iowa Department of Economic Development. State auditor reported in October 2010 that $26 to $32 million in film tax credits were awarded improperly prior to suspension of program. An open-ended subsidy. |
| Kansas | 0 | Program suspended in 2008 because of state's fiscal difficulties |
| Kentucky | 15 | Appropriated. |
| Louisiana | 139 | An open-ended subsidy. |
| Maine | 0 | No funds appropriated in FY2010. |
| Maryland | 2 | Appropriated. |
| Massachusetts | 100 | An open-ended subsidy. |
| Michigan | 110 | An open-ended subsidy. |
| Minnesota | 2.5 | Appropriated. |
| Mississippi | 20 | Appropriated. |
| Missouri | 4.5 | Appropriated. |
| Montana | 0 | Expanded subsidy recently enacted. Only about $25,000 claimed in calendar year 2009. |
| New Jersey | 15 | New Jersey suspended its subsidy for FY2011, but is still paying out tax credits earned in prior years. |

| TABLE 1 (continued) | | |
|---|---|---|
| **Financial Commitments to Film Incentives, by State (FY2010 unless otherwise noted)** | | |
| **State** | **Dollars Appropriated or Claimed($millions)** | **Remarks** |
| New Mexico | 66.7 | An open-ended subsidy. |
| New York | 350 | $420 million per year available starting in FY2011 through FY2015, a total of $2.1 billion. |
| North Carolina | 22.5 | An open-ended subsidy. |
| Ohio | 10 | Appropriated. |
| Oklahoma | 5 | Appropriated. |
| Oregon | 5 | Appropriated. |
| Pennsylvania | 74 | An open-ended subsidy. |
| Rhode Island | 15 | Appropriated. |
| South Carolina | 10 | Appropriated. |
| Tennessee | 20 | Appropriated. |
| Texas | 11 | Appropriated. |
| Utah | 7.5 | Appropriated. |
| Virginia | 1.25 | Appropriated. |
| Washington | 3.5 | Appropriated. |
| West Virginia | 10 | Appropriated. |
| Wisconsin | 0.9 | Appropriated. |
| Wyoming | 2 | Appropriated. |
| TOTAL | 1475.25 | |

Sources: Documents of state revenue departments, state budget bureaus, reports of state legislative fiscal reports, and other documents. Available from author on request.

APPENDIX TABLE 2

**Film Tax Credits Cost as Much as Longstanding State Business Tax Credits In Some States, Like Investment Tax Credits and Credits for R&D**

Tax credits claimed in millions FY2010, unless otherwise noted

| State | Film Tax Credits | Investment Tax Credits | R&D Tax Credits |
|---|---|---|---|
| Connecticut | $41 | $47 | $15 |
| Louisiana | $139 | N/A | $19 |
| Massachusetts | $100 | $59 | $91 |
| Michigan (FY09) | $117 | $127 | $63 |
| North Carolina | $23 | N/A | $20 |
| Pennsylvania | $74 | N/A | $40 |
| Rhode Island | $14 | $12 | $5 |

N/A not applicable or not available

Sources: Numerous documents from state departments of revenue and taxation, state budget bureaus, state legislative fiscal agencies, and other state fiscal studies. Available from author on request.

APPENDIX TABLE 3

## Selected Results of Studies of Film Subsidies in U.S. States

| State (1) | Author(s) (year)( 2) | Sponsor (3) | Net Revenue Foregone per Net Job Created by Film Tax Credit (4) | Net Revenue Foregone per Net Job Created for Residents or for Residents and Non-Resident Alike? (5) | Revenue Gained from Feedback Effects per Dollar of Film Subsidy Claimed($) (6) | Does the study take into account economic costs of financing subsidy with service cuts or tax increases? (7) | Does the study recognize that some film production would take place in-state even without the subsidy? (8) |
|---|---|---|---|---|---|---|---|
| Massachusetts | MA DOR (2009) | MA Legislature | $88,000 | Only for residents | $0.16 | Yes | Yes |
| Connecticut | McMillen, et al. (2008) | CT DCED* | $33,400 | Residents and Nonresidents | $0.07 | Yes | No |
| Louisiana | Economic Research Associates (2009) | LA Legislature | $16,100 | Residents and Nonresidents | $0.13 | No | No |
| Louisiana | Legislative Finance Office (2005) | LA Legislature | $14,100 | Residents and Nonresidents | $0.18 | Yes | No |
| Michigan | Michigan Senate Fiscal Agency (2010) | MI Legislature | $44,561 | Residents and Nonresidents | $0.11 | Yes | No |
| New Mexico | Popp and Peach (2008) | NM Leg Finance Office | $13,400 | Residents and Nonresidents | $0.14 | No | No |
| New Mexico | Ernst and Young LLP (2009) | NM Film and Tourist Office | ($400) | Residents and Nonresidents | $1.50 | Not applicable, as subsidy allegedly pays for itself | No |
| Pennsylvania | ERA (2009) | PA Legislature | $13,000 | Residents and Nonresidents | $0.24 | No | No |
| New York | Ernst and Young LLP (2009) | NY Film Office | ($2,000) | Residents and Nonresidents | $1.90 | Not applicable, as subsidy allegedly pays for itself | No |
| Arizona | Arizona Department of Commerce (2009) | and MPAA** | $23,676 | Residents and Nonresidents | $0.28 | No | No |

*CT DECD— Connecticut Department of Community and Economic Development
**Motion Picture Association of America

## TABLE 3 (Sources)


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