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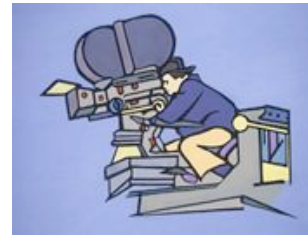
Roll the credits ... and the tax incentives

Cities, states and even countries spar for film production business, but at what cost?

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Contributing Writer

Call it a movie trailer for economic development: A film production company comes to town with its director and stars, spends a lot of money on lodging and food, hires locals as crew and extras. Residents run into their favorite stars at the local coffee shop, and the location is seen by millions of viewers on the big screen—a great boost for tourism.



All it costs you (the taxpayer) is a piddling tax incentive and a few other freebies.

That's the economic pitch, and it's a box-office hit with policymakers nationwide as states—including all but one in the district—have been beating a path to hand out tax and other incentives to the film industry in hopes of luring a little tinsel to one of their towns.

The film industry purports to be the second largest high-tech, high-profit, nonpolluting industry in the world (right behind computer technology), generating over \$40 billion in economic activity annually. But over the past half-dozen or so years, the film industry has moved and expanded out of its locus in Hollywood, and California in general, because of high costs on the West Coast and lower costs and other financial incentives offered by countries hoping to become the next entertainment hub. Canada (and British Columbia in particular), Ireland and New Zealand, among others, have been aggressively building film industries in part by drawing production away from Hollywood.

This so-called runaway production has since set off a chain reaction competition among U.S. states, with each giving the economic red-carpet treatment to the film industry with the goal of creating good-paying jobs, increased local consumption and some free wide-screen publicity about the landscape or urban milieu that might encourage more tourism.

But is it worth the price of admission? Do film incentives make economic sense in the short and long term, or are the alleged benefits an illusion? As the sheer breadth of incentives suggests, you won't find many opponents to this economic development strategy. But neither will you find much evidence that, as a strategy, incentives do any better than break even at the public box office.

Lassoing runaway production

Like eager suitors pushing and shoving, the players in this incentive game are jockeying to be first in line with the sweetest box of chocolates. According to a state official, Minnesota offered the first state film production incentives in 1997. Since then, the practice has grown to mammoth proportions.

Axiom, a payroll services and financial technology provider to the entertainment business, regularly publishes a directory of state incentives, which seem to be in constant flux. As of the spring 2006 publication, only nine states were without incentive programs in place or in the works. Louisiana, which arguably has had the most generous incentive package in the United States, offers a 25 percent investment tax credit, with some qualifications, along with other prerequisites. New Mexico and South Carolina are said to follow closely in their largesse. California has even entered the incentive game to win back industry business by offering a 5 percent sales tax exemption on certain equipment purchases and waiving permit fees and the state hotel tax on occupancy, among other perks.

All Ninth District states but North Dakota have joined the parade. In an attempt to recapture the positive fallout from "Dances with Wolves," filmed in South Dakota in 1989, that state's Legislature passed a film production incentive law this past spring that gives a 100 percent refund on contractors' excise, sales and use taxes on applicable taxable project costs in excess of \$250,000. The law took effect July 1 and runs until June 30, 2011.

Lodged in the state Senate in late July, Michigan's incentive bill, which passed the state House unanimously, offers a tax exemption on single business, corporate, sales and use taxes if a production spends \$250,000 or more on a film or TV project in the state, as well as a waiver on the occupancy tax after 30 days.

Montana's Big Sky on the Big Screen Act, signed into law in May 2005, gives production companies a 12 percent rebate on hired Montana labor, applied to the first \$50,000 worth of wages for each Montana resident employed, and an 8 percent rebate based on qualified expenditures, such as hotel and lodging, production equipment rental, fuel costs, and lumber and construction costs. The act is in effect until 2009.

Minnesota's original incentive program, dubbed Snowbate, was abandoned by then-Gov. Jesse Ventura in 2003, after five years of offering from 5 percent to 10 percent rebates on qualified film production expenditures. But this spring, the state Legislature reinstated Snowbate with a new \$1.7 million incentive package that translates to about a 15 percent rebate on production costs for companies filming in the state over the next year.

While the Wisconsin Legislature passed the Film Wisconsin bill in May, it won't go into effect until July 1, 2007. The Film Wisconsin law offers

a refundable tax credit of 25 percent of direct production expenditures; sales and use tax exemptions for machinery, equipment and services; a 15 percent state income tax credit to Wisconsin-based artists; a 25 percent tax credit to investors in a Wisconsin-based production; and use of state-owned buildings and locations free of charge, as available. This is easily the most generous of Ninth District incentive packages and is geared to compete with Illinois, and Chicago in particular.

Conversely, Mark Zimmerman handles outdoor promotions for North Dakota's Department of Tourism. He also handles his state's film business, which according to him doesn't amount to much. "The state Legislature has not seen the benefits of offering incentives," he said. "I field occasional calls," he said. "The first one is usually 'Do you have snow?' and the second is 'Do you have an incentive program?'" Zimmerman said that while some states see incentives as a standard economic development tool, "entertainment is not high on the list of investments" in North Dakota.

If you offer, they will come (maybe)

Just how much have these incentives put Ninth District states in the running for big productions? It's impossible to say what their ultimate impact will be because most of the incentive packages have been enacted recently—or are pending. But for several productions filmed lately in the Ninth District, incentives didn't play a part in location decisions.

This past July, actor-director Sean Penn and crew came to the small South Dakota towns of Carthage, Hot Springs and Winner to shoot scenes for the film "Into the Wild," based on Jon Krakauer's best-selling, real-life book about a young, meandering Chris McCandless, whose life takes him through Carthage and elsewhere in South Dakota before a fatal trip into the Alaskan bush. The production likely spent more than the \$250,000 eligible for refunds, but the deadline to file an application and the July 1 enactment of the law conflicted, so the company could not take advantage of the incentives.

Minnesota hosted two feature films in 2005: "North Country," shot on the northern Iron Range, and "A Prairie Home Companion," set in downtown St. Paul. These productions spent \$5 million and \$2.5 million in their respective locations, and "Prairie Home" did so without the benefit of incentives because the location played a starring role. ("North Country" received a regionally based incentive of \$200,000.) Lucinda Winter, executive director of the Minnesota Film and TV Board, said that this doesn't generally happen in the film world.

Montana, for example, upped the usual ante by offering additional perks like free locations and reduced office rent to avoid losing out to South Carolina and six other states for a film called "Plumm Summer." The script, originally written with a Montana location, had already been rewritten to fit South Carolina, but Montana's offer managed to lure the production to Bozeman for 35 days this summer. About 60 local cast and crew were hired, and the production was expected to pump about \$2.5 million into the local economy.

An offer they can't refuse

Those who tout incentives assert that they bring jobs and new dollars to the location. Maybe ironically, big films aren't seen as major,

long-term employers. Small productions, commercials, TV films and other work tend to keep production talent employed. But it's the major film productions that put a state's industry on the map and showcase the local production talent, which helps build the industry further in something of a self-reinforcing cycle. According to a 2005 report by the Montana Film Office and ArtsMarket Inc., a Bozeman economic and research firm, incentives help build "the intellectual capital that comes from having a year-round creative industry working within the state."

Having an established, year-round industry allows Montana's university film programs to place graduates at in-state jobs. "It's the truest form of economic development when you can put people to work," said Montana's Film Office manager, Sten Iversen.

In South Dakota, Carolyn Linn, administrator/producer of Linn Productions in Rapid City and a member of the Black Hills Film Council, said that her company and the council are continually building the film production industry in her region. Linn said that the "support crew is growing all the time," and the council is working with local colleges to provide education and training in the field. She said that in addition to crew people being trained, sound stages and other support infrastructure are being built.

Andrew Chamberlain, staff economist at the Tax Foundation, a Washington, D.C., think tank, said, "It's true that if you encourage more film work, you'll develop an advantage over time. It's learning by doing in economics." But under such an argument, virtually all industries would qualify for incentives, and if every industry is receiving a taxpayer subsidy, nobody is left to pay for necessary government services. Another unanswered question is whether an advantage in film is worth the investment given the fickle, footloose nature of an industry that can move easily to the next-in-line suitor with a bigger box of candy.

Still, advocates argue that the state's payback is much greater than any tax forgiveness or direct rebates. In a plea to the Minnesota Legislature to reinstate Snowbate, Winter said that during the five-year period of the original Snowbate program from 1997 to 2002, \$58 million was spent on productions in the state while just over \$2 million was rebated to the film companies. A small price, she said, to bring those dollars in direct production costs and another \$8 million in related spending to the state.

Scott Robbe, a film producer in Madison, Wis., and part of the Film Wisconsin task force that pushed for an incentive package in that state, said that his state's tax rebate incentives look something like this: "25 percent incentive money and 75 percent new money that the state had never seen before."

The 2005 Montana report projected film production in the state for 2006, along with the costs of a proposed incentive plan. Based on an estimate of 85 productions statewide, the report said \$25 million would be generated in direct expenditures, creating tax revenue of \$2.22 million. Meanwhile, total incentive costs would be \$1.62 million, netting the state \$600,000, along with another \$60,000 for state administrative fees.

But such assertions fail to consider the full costs and benefits of these incentives, and as such fall well short of offering anything close to the

real return on this public investment. For example, there's no telling how many Montana productions are the sole result of incentives, and how many would have occurred with no such handout.

In fact, just how much film incentives cost and how much is gained remain a mystery in most programs. The Tax Foundation's Chamberlain noted that there are no studies by economists that determine the financial benefits or costs of film incentives because very few governments track their costs and tax benefits.

It may be a compelling argument from state and local officials about getting more than you had before, Chamberlain said. "But it's really a wash or loss." He added, however, that "you'll never convince [politicians] that it's not a good idea—the payoff is too big." Chamberlain said he once heard another economist describe the incentive issue this way: Incentives were not designed to create jobs but to create job announcements. This may be a little harsh, but "the literature speaks with one voice," Chamberlain said. "At the national level, this does nothing to spur more activity."

From an economist's viewpoint, these are terrible policies, Chamberlain said. In the long run, incentives will erode the tax base because they favor certain (often new) businesses over others, and the tax burden falls disproportionately on existing businesses. The notion of incentives as an investment leaves something to be desired as well. To be considered an investment, incentives should return the original capital plus some profit—in other words, after all the adding and subtracting, incentives should lead to higher total tax revenue.

When Wisconsin's incentive bill was proposed, a state Department of Revenue report suggested the net fiscal impact was ultimately "indeterminate." But it calculated a hypothetical example of a production with \$10 million in expenditures, wages of \$50,000 for 100 employees and 50 percent of expenditures subject to sales and use taxes (and thus rebates) and concluded that the state would likely see a net loss in revenue.

Given current incentive levels, it's not hard to see why. With rebates on production costs running 15 percent in Minnesota and 25 percent in Wisconsin and elsewhere (and among sundry other incentives), these subsidies will be difficult to recoup by states when taxes—sales, income, corporate—on relevant business activities are typically in the single digits in terms of percentage.

And the debate also misses the fundamental economic question of opportunity costs: What public good or service went unfunded because lawmakers decided to use finite tax dollars for film incentives, and what would be the return on this alternative investment?

This picture needs a wider lens

Of course, Ninth District states aren't alone in this competition. Chamberlain, from the Tax Foundation, acknowledged that states face a classic prisoner's dilemma. Here, two crime suspects interviewed separately are offered reduced sentences if each rats the other out; if both stay mum, they'll go free. But because they are separated, neither trusts the other to keep quiet—so each rats on the other in order to secure a lesser sentence, and ultimately both are worse off.

Incentives work the same way, Chamberlain said. If all states

eliminated incentives, they would all be better off; films would still get made, and they would go to the most optimal locations, while states could focus scarce tax dollars on traditional public goods rather than on film incentives. But they're unable to do so because they can't trust other states to do the same, and doing nothing is even worse, because states lose economic activity to others offering incentives.

Michigan's Lockwood believes the incentive game has gotten out of hand, with each state upping the ante a little more. Chamberlain and others suggest that federal legislation may offer the only resolution, essentially legislating a cease-fire to the incentive arms race.

In the meantime, however, those involved in perpetuating the rising costs of the incentive game say they have to play or they'll surely lose. Said Minnesota's Winter, "We're not even at the table without incentives."

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