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Why Film Subsidies Fail: A Case Made for Texas by the States

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Key Points

- Film subsidies don't produce long-term jobs that are worth the cost.
- Choosing which film companies will succeed while others fail is not a functional role of government.
- The elimination of film incentives in Alaska, Michigan, Florida, West Virginia, Arizona, and Iowa should serve as an example for Texas.
- Texas should repeal the Moving Image Industry Incentive Program.

Introduction

Since 2009, when film incentives peaked in 44 states, 13 states have abandoned their programs (National Conference of State Legislatures). Wyoming and West Virginia are the latest to end their subsidies. Today, only 31 states provide some form of film incentive. Several of these states—including Texas—have cut their program amount, and many others have introduced caps on spending.

In 2007, the Texas Legislature established the Texas Moving Image Industry Incentive Program which allowed for the Texas Film Commission to finance media production within the state (Texas Film Commission, 2018a). Two years later, the program was enhanced from the $20 million originally offered to $62 million, with a peak of $95 million in 2013.

Texas offers rebates of between 5 and 20 percent of a project's qualifying Texas expenses to film producers (Texas Film Commission, 2018b). An additional 2.5 percent can be rebated if the filming takes place in an economically distressed or underutilized area. Seventy percent of hired help must be Texas residents, and 60 percent of production days must take place in Texas. While film is primarily the focus of the program, television, commercials, and video games can be subsidized as well.

The Texas Moving Image Industry Incentive Program has failed to deliver on its promises of jobs and economic growth. More importantly, corporate welfare programs like film subsidies take not only money but choice away from taxpayers and consumers who are much more efficient than government at deciding where their hard-earned money should go. Some may feel their money is better off elsewhere, while others could decide to fund entertainment through private investment. The program should be repealed so taxpayers can keep more of their hard-earned money.

Economics

A number of things about media incentives just don't add up economically. For one thing, these programs do not pay for themselves (Tannewald, 1). They have a significant cost. In Texas, $95 million of taxpayer money was appropriated for production companies in 2013. Despite cuts, the Texas Legislature still allotted $22 million for film production in 2017 (SB 1, I-60).

Comparative Advantage

Comparative advantage, a theory developed by economist David Ricardo, refers to the idea that some individuals or groups in certain geographical areas are more apt to produce certain goods than others. Agglomeration, or the concentration of certain industries in a geographic area, occurs when certain areas build up more industry-specific infrastructure than others. These theories can be applied to film as well (Swenson, 67), whether it be for location, crew availability, or other applicable reasons.

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Naturally, the vast majority of film production today would occur in states where this agglomeration, or clustering, has taken place. States decide to engage in subsidies for film when they believe that additional spending will increase their ability to compete. However, studies have shown that incentive spending does little to break up these clusters (Thom, 11).

This dilemma is exemplified by the way different states built up advantages in various fields of an industry. California, for instance, has increasingly remained the breeding ground for entertainment media employment, making it difficult for other states to host sufficient crews of their own (Christopherson and Rightor, 5). New York is far more concerned with supporting production facilities that are already operating within the state rather than attracting new companies (4).

Texas has unique contributions as well, even within entertainment. However, lawmakers shouldn't expect Texas to compete with states already vested in the business by throwing taxpayer dollars at the industry. Beyond a crew, film production is a niche field in that it requires other personnel such as lawyers, accountants, agents, casting companies, etc., who are experienced within this line of work. Most film companies hire a crew locally, but a bulk of the film's profits typically flows to the aforementioned specialists temporarily moved to the state (Tannewald). This leads to an overestimation of output and employment (Robyn and David, 7). When states engage in economic development by trying to form industries inorganically, inefficiencies form as a result.

A Zero-Sum Game

When states use public money in an effort to win production companies over, it manifests into a race to the bottom. Across the United States, media incentive spending was only $2 million in 1999. In 2010 spending reached $1.4 billion, a significant rise (Bishop-Henchman 2011). The idea that states should increase their subsidies is not sound, as other states will only counteract those decisions in turn. Typically, incentives are implemented under the assumption that companies will not want to produce in a state without subsidies. However, looking at an example like The History Channel's *Deadliest Catch*, it's likely that the television program would continue in absence of the subsidy, due to what the Alaskan landscape provides. Publications show that location scouting is an integral part of planning for a film, and location scouts are typically hired to find the best places to film based on a script's setting (Swenson, 67).

Film incentive programs also face difficulty ensuring permanent industry. Louisiana is renowned as a success, revered as the poster child for subsidies, but reports still show that the state has failed to transform these incentives into permanent operations (Mathis, 2). No matter how many movies seemingly funnel in, the program is of no value if the supposed economic activity and jobs cannot be sustained absent of the subsidy (Tannewald). Moving picture incentives don't create permanent jobs or growth. They simply shift these products from state to state (Luther, 9). The Texas Comptroller of Public Accounts has found that most of these subsidized jobs leave the state following project completion (Combs, 64).

Even the Texas Comptroller admitted that the film industry is erratic and will constantly need more and more investment to persuade film companies to stay (Combs, 7). As a consequence, it would be wise and advantageous for Texas not to engage in such a race.

Concentration

The economic impact of film is often concentrated within the state. In Texas, most projects occur in Austin, Dallas, and San Antonio (Combs, 72). This is also evident through the Film Commission offering additional benefits to companies that choose to invest in areas that are underdeveloped by comparison.

This war among the states funnels more money into the film business than it does to nearby businesses or state revenues (Luther, 2). Even then, the program's funds are not being used most efficiently (Combs, 64). Within the program, there is a disproportionate amount of output. The video game industry receives considerably less money (only 19 percent), yet provides a substantial amount of spending (41 percent) and jobs (45 percent).

Taxpayer dollars are sourced from all over the state, in large part through the sales tax, to eventually be allocated to a few urban areas, due to the concentration mentioned above. Texans across the state are paying for others to reap the supposed economic benefits. A better option would be to lower business and other applicable tax rates, as this would not favor any particular institution. Rather, it could help decentralize economic activity in the state and would allow for free enterprise to flourish. The Mercatus Center reports that if Texas eliminated its corporate welfare, it could see a 24 percent reduction in corporate income taxes (Mitchell and Winter).

Return on Investment and Opportunity Cost

It is difficult to reconcile Texas' claims of profitability with reports from other states. While the apparent prosperity of the film industry may lead legislators to believe that their state can profit from film subsidies, the reported return on investment to a state's economy from subsidies has been dismal (Robyn and David, 4-5). The Texas Film Commission reports a 533 percent return on investment; however, looking at other states shows a great disparity. The cost-benefit analysis of film subsidies turns out negative more times than not. In past years, Louisiana has only been able to recover between 13.7 and 16 percent of tax credits granted (Mathis, 2). New Mexico recovered 43 cents for every dollar spent (MNP LLP, 2) and so did Florida (West Virginia Legislative Auditor, 17). Arizona calculated 28 cents. Connecticut found 7 cents (Robyn and David, 5). The Massachusetts Department of Revenue found 16 cents on the dollar (Tannenwald, 5). This means that the other numbers could be inflated. Most reports examining the cost-benefit analysis of film incentives ignore opportunity costs, a premise which is fundamentally flawed. One alternative would be to leave the money paid for subsidies in the hands of taxpayers so they can spend as they so choose. The Film Commission needs to stop guessing with taxpayer money.

Employment

Film subsidies don't produce jobs that last or are worth the cost. The Texas Comptroller's office found in 2010 that the program was systemically lacking in regards to job creation (Combs, 64), giving little transparency over what kind of jobs the program was creating and minimal assurance that job creation was occurring at all. The same phenomenon has been observed in other states. Texas' film incentives program creates jobs that disappear, benefits the economies of other states, and operates under several misguided assumptions about how a market economy operates.

Temporary in Nature

The purpose of the incentive program is to create jobs. Unfortunately, most of the jobs the industry generates are temporary and disappear when production ends. This has been observed in Texas, as well as in Maryland and other states (Kilmer, 9). In 2010, the office of the Texas Comptroller reported that 27,057 production jobs were funded, with only 3,790 of those jobs being full-time equivalent (Combs, 61). Five years later, in 2014, there were 126,132 jobs created but only 15,483 were full-time equivalent (House Select Committee on Economic Development Incentives). Many of these jobs disappear once a film project ends (Combs, 64). So while the Texas Film Commission reports that the program created more than 153,000 jobs in the 10 years it has existed (Texas Film Commission 2017), how many of these jobs were temporary or part-time?

Benefits Out-of-State Residents

The West Virginia Legislature found that out-of-state companies spent a considerable amount of wages for out-of-state residents—approximately $21 million. Out-of-state resident wages represented nearly $6 million of tax credits out of a total of $15 million in tax credits issued, while $13 million in tax credits went to out-of-state companies (West Virginia Legislative Auditor, 19). Most of these wages will primarily benefit the home states of these workers, not West Virginia. Between 2006 and 2008, Massachusetts residents "only received 40 percent of the total payroll generated both directly and indirectly" by the subsidies (Kilmer, 9; Tannenwald).

Assumptions

It was found recently that Texas did not experience any post-incentive relative employment increases following the advent of subsidies (Swenson, 67). The states with notable increases were California and New York, which is not a surprise considering the film agglomeration occurring in those areas. According to Christopherson and Rightor (3), "Advocates of film incentives find big job gains and strong multipliers, while analysts such as those working for the U.S. Federal Reserve Bank or for state revenue departments and legislative committees find only modest job creation."

Those who calculate the economic and employment impact do so on a number of assumptions, such as which jobs are created and for how long, what earning payouts are, where the workforce lives and spends its money, and how that economic activity is multiplied (Christopherson and Rightor, 3). In addition, those positively evaluating the program sometimes include jobs that were present in the field before the incentives were even introduced (West Virginia Legislative Auditor, 38). Statistics are affected if jobs shift from somewhere else in the marketplace (Luther, 8). Even then, the Texas Film Commission doesn't standardize its data regarding components such as job creation, full-time equivalent jobs, spending, etc. This inhibits the ability to accurately determine job creation (Combs, 64).

While some will point to the success of the initiatives by explaining how the number of films and other projects has improved over time, this is simply immaterial unless additional job creation happens.

Corporate and State Accountability

It's not the role of a limited government to use taxpayer money to pick winners and losers in various industries. Subsidies distort markets by attempting to artificially increase the amount of film productions within a state. Doing so leaves taxpayers in a worse position, with less money to spend (Bundrick). Were taxpayers allowed to spend their own money as they pleased, we would see more economic benefits with a widespread effect across the entire economy.

Winners and Losers

Picking certain companies to receive subsidies has significant unintended yet harmful effects for other companies. Companies not receiving grants will have to pay higher taxes to make up for the money competitors are being provided. Since taxpayers have less money, other businesses lose out on potential profits, which then constrains input and output (Robyn and David, 7). Unsubsidized businesses will also face unfair competition from those companies that receive the subsidies.

Businesses that the film industry utilizes would be frequented and taxed, regardless of any subsidy (Robyn and David, 5). Additionally, businesses in proximity to the film site may suffer from lost patronage, due to closed roads and other factors.

Governments require specialized knowledge to create such plans, but this knowledge is impossible for a governmental entity to attain. Governments lack the ability to both know and dictate the demands of the market (Robyn and David, 3). In a 2018 report, the Beacon Center of Tennessee looked at box office data and found that "over 40 percent of films that receive grants made less at the box office than they received in incentives" (Shultis, 4). As the author points out, "We should let the free market determine which film projects are worthy of taxpayer money through ticket sales, not government handouts" (4).

Louisiana invested in an additional 17 sound stages than what was required because they wrongfully predicted the needs of their own economy (Luther, 10). While governments often want to support infant industries by subsidizing them until average costs fall, there has been extremely limited success with creating a cluster artificially where it did not exist already (Robyn and David, 4).

When governments skew the economy in pursuit of economic development, smaller companies lose out on the riches. Three out-of-state companies received 69 percent of West Virginia's funding (West Virginia Legislative Auditor, 7, 18). A minimum of two-thirds of economic development spending in Florida, Missouri, and New Mexico benefited large business (Tarczynska and Cafcas, 6). Larger groups typically have more political buy-in power and find it easier, compared to smaller firms, to influence the legislature and film offices for preferential treatment (Thom, 12). Also, politicians are often dissuaded to stop such policies by businesses who threaten to go elsewhere. Since the Moving Image Industry Incentive Program can also be used to fund commercials, several corporations have been promoted with this money, including Whataburger, Dick's Sporting Goods, Wal-Mart, and AT&T (Combs, 70-71).

Not only is Texas being fickle with what production companies it approves, it is also participating in randomized investment strategy. However, instead of this, Texas has better options. Ending film subsidies to implement broad tax relief and reforms will provide more economic development through the formation of a business climate that is receptive to numerous groups across Texas. In addition, it can simply allow taxpayers to use their own money as they see fit (Christopherson and Rightor, 5).

Rent-Seeking

These development programs have incentivized politicians to funnel money into private pockets and claim that they have created jobs and economic growth (Luther, 13). These legislators often respond to "action bias," feeling pressure to create policy despite knowing that the costs far outweigh the benefits (Thom, 13).

Some programs have been wracked with political corruption and pay-to-play attitudes. Tom Wheeler, previous director of the Iowa Film Office, was charged with misconduct in 2010 (Bishop-Henchman 2010) for accepting in-kind expenditures as program expenses (Robyn), as well as purchasing a Range Rover for personal use with state funds (Luther, 9). West Virginia found itself in a similar situation where indirect expenditures that do not normally qualify to fulfill the requirements of the film tax credit program were routinely being included (West Virginia Legislative Auditor). Previous California state Sen. Ronald Calderon was charged for accepting bribes from a film studio, while Louisiana lawyers were sentenced for constructing false expenditure reports (Luther, 5). Cases such as these represent one more reason why government should not be involved in the film business.

"Cash Back"

In Texas, film incentives operate as a direct subsidy. Companies report their expenditures, and the state cuts them a check for the respective percentage. Essentially, this is just like receiving "cash back," an option not typically available in any other form of economic development.

Texas also offers additional benefits to these productions, such as sales and use and fuel tax exemptions (Texas Film Commission, 2018c). These incentives function as corporate welfare, and should not be allocated either. Moreover, it has been found that benefits such as the sales tax exemption don't even influence wage or employment growth (Thom, 9).

Waste & Market Distortions

When claiming the program is a success, individuals fail to realize that some of this spending would have occurred absent of the subsidy. Tax windfalls also occur when more financial incentives are allocated than needed to successfully attract someone to a specific location (Saas, 2). Much like coupons, you would not refuse a discount on something you are already planning to purchase.

Film subsidies foster market distortions, especially through diminishing risk for producers. Due to the immense specialization and short-term nature of the industry, risk is imminent. Is it right for the state to gamble with public money and participate in risky investments (Christopherson and Rightor, 5)? The distortions occur through the unsanctioned expansion of the entertainment market (Robyn and David, 6). By artificially increasing return for investors, these behaviors diminish risk for the producers, thereby transferring it onto taxpayers.

These subsidies promote distortion among job markets as well. A state must have an efficient balance of talent available, or problems can arise. Enough crew must be consistently employed within the state to engender sustainable industry (Christopherson and Rightor, 4). At the same time, it is imperative that enough talent be available for out-of-state production companies seeking potential employees. In Alaska, oil and fishing industries suffer as residents train to work in film, leaving spots for needed trades vacant (Robyn and David, 5).

Also, even more inefficiencies have arrived as companies become less incentivized to curtail spending (Kilmer, 6). When something is subsidized, it is both increasingly convenient and cheaper to consume. Similar to visiting a buffet, subsidies promote overconsumption (i.e., spending in excess).

Recommendations

Eliminate Funding and Repeal the Program

Considering the outcomes in other states and its own, Texas should take a hard look at its film program. While the Texas Film Commission boasts that it has created over 153,000 jobs in 10 years, a large part were probably not full-time equivalent or sustained. While the commission reports a return on investment of 533 percent (using the sum of actual spending for projects paid and as-applied estimates from applications not yet submitted for payment at the time), it is unclear whether the calculations took into account additional considerations such as pre-existing development, how the market operates, and results in other states. These outcomes diminish the viability of an already flawed concept—a corporate welfare program that picks winners and losers—and the Texas Legislature would be acting responsibly in repealing this program.

Alternatives

The Texas Legislature may decide not to completely eliminate the program at this time. If that is the case, the following are some options for reform.

Interstate Compact

Since the first line of defense of most states regarding film subsidies and other tax incentive programs consists of pointing the finger at other states to argue that since other states are doing it, "our" state cannot afford *not* to do it, one solution would be an interstate compact to ban such subsidies and tax preferences. Interstate compacts are "agreement[s] between two or more states of the United States that [are] approved by those states' respective legislatures, and, if required based on the subject matter of the compact[s], consented to by the US Congress" (Library of Congress). For example, the states of Texas, New Mexico, Oklahoma, Arkansas, and Louisiana could agree together not to offer any incentives for movie productions trying to set states against each other to obtain preferential tax treatments or subsidies.

In fact, the idea of an interstate compact to ban state subsidies is not new and has been offered for other forms of subsidies than movie production subsidies, such as for stadiums (The Bridge), and appears to generate broader interest with the recent, well-publicized race for subsidies run by Amazon (Farmer; Salazar).

Were the state to find it more feasible to eliminate the Moving Image Industry Incentive Program over time, there are several recommendations for reform.

Caps on Spending

Texas' first step, if not to eliminate the program entirely, should be a commitment to place a spending cap on the program and phase out the program over time. Without spending caps, states encourage frivolous spending. Several states have introduced program caps, most notably California, Louisiana, New Mexico, and New York—places where the film industries are most prominent (National Conference of State Legislatures). Other states like Colorado, Maryland, and even Texas have reduced their amount of available financial offerings.

Transparency

Requiring that the film expenditures undergo an independent audit or accounting procedure can help to ensure that compliance with the commission's rules is taking place. While it used to be required that any project totaling $300,000 or more undergo an independent audit, this is no longer the case. As of March

27, 2017, programs are no longer required to attend to these audits (Texas Film Commission, 2018d). Without an independent accounting, it is easy for film offices to evaluate the data through faulty methods and disguise the true economic impact of incentive programs (Christopherson and Rightor, 4). Without full disclosure of a movie's budget, expenditures, and assumptions underlying the Film Commission's claims, it is impossible to have an unbiased view of subsidies (6). A majority of states with film programs require an audit, including New York, New Mexico, Louisiana, and Nevada.

The 84th Legislature required the Texas Comptroller to certify that businesses were generating significant revenue that would offset the initial investment by the state (HB 1, I59). This requirement was no longer present as of 2017 (SB 1, I-60). Instead, it is simply required that the Comptroller verify that there are sufficient funds within Texas' economic development programs to offset the costs of appropriation. If these programs truly are profitable, as the Film Commission claims they are, then there should be no issue with this certification process. For the sake of transparency, it would be wise for Texas to reinstate this requirement as well.

The Texas Comptroller has recommended that the Film Commission standardize its data and issue regular reports (Combs, 6). Little data are collected in regards to the outcome of these programs. Payroll data, collected by state employment tax authorities, are typically all that there is available (Swenson, 67).

It can also be beneficial to have these economic development plans reviewed and audited. Washington and Oklahoma have introduced citizen commissions that evaluate incentives (Pew Charitable Trusts, 21). Were Texas to do this, the Film Commission would be evaluated and formal reports could be received from a body such as the Legislative Budget Board, Office of the Governor, Sunset Advisory Commission, or the Comptroller's office. Texas recently, as of 2016, did implement an Economic Oversight Board which has the potential to be a promising step in the right direction.

Conclusion

Texas is a beautiful and prosperous state that would still attract numerous film projects, regardless of whether subsidies are available. The state has a generous business climate and few regulations surrounding entertainment projects. Also, there is no hotel occupancy tax on stays exceeding thirty days and no personal income taxes (Texas Film Commission, 2018c). In comparison, Arkansas, a state bordering Texas with a similar film program, has the second highest state-local sales tax nationally and third highest corporate income tax of its nine neighboring states (Bundrick, 25).

If a government picks winners and losers by pledging its financial support to some films and not others, it is ignoring ideals consistent with the free market. In the end, those extraneous costs to produce are inflicted upon the companies not chosen as well as taxpayers (Kilmer, 11). While some would argue that this government-generated competition is integral to a growing economy, this is simply not competition. This is government run amok, artificially endorsing companies over others, perpetuating market distortion and less economic prosperity.

The outcomes for the aforementioned states—Alaska, Michigan, Florida, West Virginia, Arizona, and Iowa, which eventually relinquished their film programs—should act as a foreboding example for Texas (National Conference of State Legislatures). While entertainment incentive programs may appear lucrative on the surface, there is much more to them than meets the untrained eye. Understanding the latent effects of such policies can help Texas lawmakers make informed decisions regarding the Movie Image Industry Incentive Program in the future.

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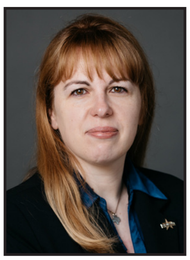

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