The Economics of Entertainment: Succeeding at the State Level

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Abstract

Runaway production is the Hollywood term for films and television shows that are filmed outside Los Angeles. Once the entertainment capital of the world, Hollywood is facing stiff competition for production from other countries and states in the form of film incentives: tax credits or cash rebates for selecting a specific state, country, or locale to shoot a television show or film. This paper will examine the current state of film incentives in the United States, specifically presenting a case study of three states that have emerged as leaders and evaluating their strategic moves that impacted the entire process.

Keywords: Incentives, film, entertainment.

It is called "runaway production:" films and television shows that are filmed outside Los Angeles. For decades, Hollywood was *the* location for film and television production. Some production was also done in New York City, but Hollywood was the entertainment capital of the world. As California developed stricter rules, however, other countries and states began offering competition in the form of film incentives: tax credits or cash rebates for selecting a specific state, country, or locale to shoot a television show or film. This paper will examine the current state of film incentives in the United States, specifically looking at three states that have emerged as leaders and evaluating their strategic moves that impacted the entire process.

1. The Business of Incentives

Incentives are defined as "all measures that provide explicitly for a more favorable tax treatment of certain activities or sectors compared to what is granted to general industry" (Klemm, 2010, p. 315). This can come in many forms, from tax rebates to cash grants to tax credits, etc. In the United States, incentives are as varied as the number of states themselves; incentives are most often used to lure companies or businesses from another state or location. Internationally, most countries use some incentives, but they are especially popular in developing countries (Klemm, 2010, p. 316). Klemm argues that this "is probably not surprising, given their perception as a development tool, and given that developing economies are often hampered by structural weaknesses, for which they may wish to compensate by offering incentives. Some incentives, such as tax holidays, are almost exclusively a developing economy phenomenon" (p. 316).

However, there is little evidence to suggest that business tax incentives, in general, are as effective as politicians want to believe. A study by Peters and Fisher (2004) argues that the basic expectations of tax incentives – to create jobs for targeted people in targeted areas – is an unsubstantiated claim (p. 35). Their metareview of business incentive literature suggests that economic development is not substantially aided by incentives. Rather, although incentives can be somewhat revenue positive at the local level, they are generally revenue negative at the state level – in fact, "states will often end up paying the costs" for what one locale achieved (p. 35). Peters and Fisher call instead for a radical departure from current policy ideas; acknowledging, at the same time, that public officials are over-committed to the status quo (p. 35). Needed change cannot take place when the leadership believes in the old ideas.

A more recent study concurs. Klemm states that "In many cases, previous skepticism about tax incentives seems warranted, and advice against their rampant use appears appropriate" (2010, p. 333).

He adds that incentives seem rational in principle, but "In practice, however, it may be difficult to achieve such an outcome, because of the many disadvantages of existing tax incentives and difficulties in their administration" (2010, p. 333). He agrees that competition may drive the incentive structure, but also argues that this is only effective "if there is an increase in aggregate investment and activity, there may be revenue gains from this, such as from additional employment taxes or taxes on input" (2010, p. 323).

In summary, then, there is little research to recommend tax incentives as solid economic strategy. Although incentives may bring in a business, they do little to stimulate economic development or create targeted jobs. Yet incentives continue to be used because public officials believe in their effectiveness, albeit without proof that the effectiveness is there.

2. The Entertainment Industry

For the entertainment industry, however, incentives have become a part of the business. Production manager and author Eve Honthaner calls incentives "one of the hottest buzzwords in our industry" (2010, p. 89) and necessary for film or television production budgeting in today's economy. While noting that there are a number of reasons to select a shooting location, she maintains that "very high on the list of determining factors are the various incentive programs being offered throughout the U.S. and internationally" (p. 89).

Many experts credit Canada, specifically British Columbia, with beginning the trend of "runaway" production (see Gasher, 2002). By courting Hollywood with incentives and a present work crew, British Columbia went from a total of 4 productions in 1978 to 192 by 2000; direct spending grew from $12 million to $1.18 billion (Gasher, 2003, p. 21).

Individual states in the U.S. saw the immense potential in bringing the industry home. In addition to in-state spending, Entertainment Partners notes that "Production of filmed entertainment is especially amenable to incentives because it is highly mobile, environmentally 'clean,' capital- and labor-intensive, and effective in promoting tourism" (2011, p. 9). Job training was of special interest in a downward-spiraling economy: an out-of-work carpenter could learn how to build sets; an out-of-work electrician could learn lighting; local hairstylists and make-up artists could learn how to adapt to the camera. With unemployment rates rising, the entertainment industry offered many different employment possibilities.

As more and more states adopted entertainment incentives, some with mixed results, Hollywood was given more and more options for relocating their productions. "In order to boost local film industries, create jobs, stimulate local economies and promote tourism, they (the states) appear to be tripping over each other to see which can offer the most desirable incentive package and attract the most film dollars" (Honthaner, 2010, p. 90).

In 2002, only two states offered production incentives; by 2005, the number was up to 15, and by 2010, 43 states had enacted incentives (McDonald, 2011). As incentives grew more wide-spread, production managers began running incentives in their early budgets for a production in order to select the location. The entertainment industry, though often misunderstood by politicians as "Hollywood," is, in fact, a business – and a prosperous business at that, when approached correctly. As an incentive-driven industry, the entertainment industry succeeds where other industries have failed.

The impact on Hollywood cannot be overlooked. FilmL.A., a non-profit operation researching runaway production, notes that "The loss of just one television drama series can amount to thousands of lost jobs and tens of millions of dollars of lost production spending over several viewing seasons" (2012, p. 4). Yet Hollywood is losing television drama faster than other production, with less than 50 per cent of the fall 2012 drama pilots being produced in Los Angeles (FilmL.A., 2012). In 2010, more than 58 per cent of all television drama pilots were shot in Los Angeles; by 2011, that number dropped to 57.1 and, by fall 2012, had dropped to 43.9 (FilmL.A., 2012). Television production companies are looking for less expensive places to film.

3. Current Study

Three states are consistently listed as being the most competitive in using incentives to lure runaway production in film and television: Georgia, Louisiana, and North Carolina (FilmL.A., 2012; McDonald, 2011). All three are unlikely suspects: far from Los Angeles, originally lacking in film production, yet all have managed to thrive and create an industry within their own state. This paper presents a case study of these three states, including what other states can do to emulate them.

3.1 Louisiana

In 2002, Louisiana had 3.5 million spent on production (McDonald, 2011). Later that year, Louisiana became one of the first two states to adopt film incentives (New Mexico was the other) (Katz, 2006). By 2010, production spending in Louisiana reached 674.1 million, with 118 projects shot (McDonald, 2011). Currently, Louisiana is considered the third most productive film/television state in the United States; only California and New York produce more. In fact, Louisiana is nicknamed "Hollywood South" (FBT 2011).

Louisiana provides a partially refunded tax credit at 30 per cent of the local spend. "Local spend" refers to qualified expenditures made by the production company inside the state. The minimum spend to receive the incentive is $300,000; Louisiana accepts all productions except news and sports (Chianese, 2011). Additionally, Louisiana is a right-to-work state, and has a very deep crew base, approximately 9 deep in each position. That means that they have enough crew to cover 9 different productions at one time. Louisiana charges an application fee for each production, ranging from $200 to $5,000 per production when the company applies for the incentive. A temperate, year-round easy climate is also a consideration for production companies.

3.2 North Carolina

North Carolina actually began film production in the 1980s, long before incentives were in vogue. After a film shoot in 1983, producer Dino De Laurentiis built several studios there; the lower cost of everything, combined with a moderate temperature, made North Carolina a natural draw for independent filmmakers. This well established film community was threatened with extinction, however, when Louisiana – and other states – began offering incentives. North Carolina started offering incentives – very competitive incentives – in 2007 to off-set the draw of other states (Washburn, 2012). Due to a deep crew base (approximately 2,000 crew members) and studio infrastructure, North Carolina was able to attract an enormous amount of production; an impact study on Charlotte, NC, showed that the effect was actually revenue positive. Using an IMPLAN model, . . . in 2008 the direct impact of the film and video production and distribution industry on the Charlotte Region was to: (1) increase output by over 271 million dollars, (2) support 1,398 full-time equivalent jobs, (3). Increase employee and freelancer compensation by over 66 million dollars with average compensations of $4,678 per job, and (4) to increase the value added produced in the region by over 84 million dollars (Connaughton and Madsen, 2011, p. 24). North Carolina offers a refundable tax credit of 25 per cent of the local spend. The minimum local spend is $250,000. There is no application process; productions simply fill out an "intent to film" (Chianese, 2011). North Carolina is a right-to-work state.

3.3 Georgia

Georgia is considered the fourth largest film production state, outranked only by California, New York, and Louisiana. Georgia passed its first film incentive in 2002, then updated the incentive in 2005 and again in 2008. Each pass made the film incentive more competitive; Georgia offers a 20 per cent incentive on the base spend, then offers an additional 10 per cent if a Georgia promotional icon is placed in the film credits. Georgia's is a transferable tax credit, meaning it can be sold to a third party. The minimum spend is $500,000, and an application must be filled out 90 days before commencing principle photography. Georgia has a moderate climate, a deep crew of approximately 5,440, and is a right-to-work state (Chianese, 2011).

In order to understand the studio side of production, an interview with Mary Ann Hughes, Vice President of Production for ABC/Disney, illuminated the requirements for a state to be successful. First, the entertainment industry can only flourish where there is infrastructure already in place, a deep job force already trained, and incentives that are legal and clearly understood by all involved. Second, the state has to have an honest understanding of what they are promising – and the funds to back up the agreement. Third, the industry insisted that the states need to hire liaisons who have worked in the entertainment industry at some point in their career (Hughes, 2011).

4. Discussion

In analyzing the most successful states, then, the deep crew base is evident in each case. This crew base is vital to the bottom line; a production loses all the incentive money if they are forced to bring in crew from another state. While most productions will bring in a few key crew members, the majority will be hired in the location state. This provides one of the key benefits back to the state, in the form of taxes paid by locally employed people. An incentive return of 20 – 30 per cent also shows up in each of these most successful states.

The incentive must be large enough to entice the production, but not so large that it breaks the state. The smaller percentages noted here create a better win/win situation. A larger return has been offered by other states – but most of them saw no real return on the investment, and several had to delete film incentives altogether due to their losses.

It is also extremely important to have a minimum spend, and each of these states does. Without the minimum spend, productions can float from state to state, taking advantage of numerous incentive programs, but not staying long enough to provide any jobs or spending benefit. The minimum spend also keeps the incentive money from being devoured by smaller productions who hire very few people. Once the incentive money is gone, there is no chance to lure the larger productions who hire more, and spend more.

For incentives to be of benefit, both to the state and to the production, there must be a deep crew base, a minimum spend, and a tax return of 20-30 per cent. These considerations put a state in the best position to create a self-sustaining industry within its borders. It is worth noting that, although Hollywood is a strongly union-based industry, the most competitive states outside of California are all right-to-work states. This indicates that being a non-union state is not a hindrance to success in this industry.

5. Limitations

It should be noted that film incentives, and the country or state offering them, experience changes on an almost daily basis. While this information was correct at the time this paper was written, the industry changes almost as rapidly as the technology needed to generate it. Every effort was made to procure up-to-date information.

6. Conclusion

As long as there is competition for the business of entertainment, incentives will remain a vital part of the industry. Research analyzing the requirements and determining the effectiveness of film incentives will help states better attract the business of entertainment in the global marketplace.

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